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Audience Participation: Crowdfunding Large Scale Theatrical Productions Through Regulation A+

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AUDIENCE PARTICIPATION: CROWDFUNDING LARGE SCALE THEATRICAL PRODUCTIONS THROUGH REGULATION A+

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Theatrical financing has been conducted in much the same way for the better part of a century. This method, however, has consistently provided only the shows with access to the deepest of pockets a path to Broadway. The advent of Internet-based crowdfunding provides producers access to a potential source of capital that was previously unavailable. Prior to the promulgation of the SEC regulations regarding Title IV of the JOBS Act, this capital could only be accessed through donation or reward based financing campaigns, but with the introduction of Regulation A+, there is finally a practical method for the widespread solicitation of investors for theatrical productions.

This comment explores the realities of theatrical financing as well as the associated regulations regarding the sale of these sorts of securities. Part I will describe the background of theatrical financing and the governing regulations, and will highlight the restrictions faced by theatrical producers under the current framework. Part II will set forth the specifics of Regulation A+ and asserts that this framework for equity crowdfunding is particularly well suited to the unique aspects of theatrical financing. Part III will address potential shortcomings and objections to this assertion.

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Introduction

On July 16, 2012, *Dogfight* opened at Second Stage Theatre, an Off-Broadway theatre in New York City.[1] *Dogfight* was written by Benj Pasek and Justin Paul (music and lyrics), and Peter Duchan (book), based on the screenplay for the 1991 movie by the same name.[2] The Second Stage Theatre, which seats 296 audience members, is a stage dedicated to showcasing the works of contemporary American playwrights.[3] The show closed on August 19, after approximately 40 performances.[4] *Dogfight* will likely never see the inside of a Broadway theatre. Despite favorable reviews and a star-studded cast and creative team,[5] this Off-Broadway production may be the highest profile production that *Dogfight* will ever mount.

Pasek and Paul are members of a generation of musical theatre creators that have acquired a vocal and supportive fan base on the Internet. In the ten years that they have worked together, they have put together five full-length musical theatrical works, and while only one of them has made it to Broadway (with a second set to open in November 2016),[6] their combined works have garnered more than 30,000 individual performances uploaded to YouTube alone.[7] This sort of fan base evolved along with the Internet, but up until this point there was no effective way to capitalize on

1. Ben Brantley, *Cruel, Tuneful Jerk in Love*, NYTimes (July 16, 2012), http://www.nytimes.com/2012/07/17/theater/reviews/dogfight-at-second-stage-theater.html?_r=0.

2. *Id.*

3. *Id.*; About Us, 2st.com, http://2st.com/about-us (last visited Nov. 25, 2015).

4. Brantley, *supra* note 1.

5. *Id*.

6. *See A Christmas Story, The Musical On Broadway*, PASEKandPAUL.com (2013), http://pasekandpaul.com/projects/a-christmas-story-2/ (last visited Nov. 25, 2015); Olivia Clement, *Dear Evan Hansen Finds a New Broadway Home*, Playbill (Sep 12, 2016), http://www.playbill.com/article/dear-evan-hansen-finds-a-new-home-on-broadway

7. *Pasek and Paul*, YouTube.com (2015), https://www.youtube.com/results?search_query=pasek+and+paul&filters=video&page=1 (last visited Nov. 25, 2015).

the wide reach the Internet provides to raise amounts of capital sufficient to mount a large-scale theatrical production. There is an enormous capital barrier to a production of this kind.[8] This barrier is typically overcome with the help of producers, who solicit capital through traditional means on behalf of the creative team as a whole.[9] The process is tried and true, but favors the cultivation of a handful of very wealthy "angel" investors and fails to capitalize on the theatrical community that has developed all across the country.[10]

This comment proposes the utilization of equity crowdfunding, enabled by the promulgation of Regulation A+ by the Securities and Exchange Commission (SEC), as a useful method of raising capital to fund musical theatrical productions. The proposal attempts to expand the typically narrow field of theatrical investment to allow for investments by everyday consumers of the theatre and provide opportunities for different writers and composers to produce shows that might otherwise prove unable to obtain the necessary funding. While the rules and their implementation have yet to be demonstrated in practice in this context, they provide the potential for the first significant evolution in theatrical funding since the inception of the large-scale musical theatrical production.

Part I of the comment provides an overview of the financing frameworks provided by private security offerings and the history of internet-based crowdfunding. It describes the legal and practical background of investing in theatre and the previous relevant forms of equity financing, and donation and pre-sell based crowdfunding. Part II of the comment lays out the specifics of the two tiers of Regulation A+ and the aspects of the regulation that make it ideal for large-scale theatrical financing. It delves into the rationales for theatrical investing as differentiated from the rationales for other forms of investing. Part III acknowledges weaknesses of the equity crowdfunding regulations and attempts to further showcase the ways in which Regulation A+ could be particularly useful for theatrical financing.

I. Usual Methods of Investment for Large-Scale Theatrical Productions

In order to understand why Regulation A+ may provide a useful method for theatrical financing, it is important to understand the basic framework by which these productions are typically financed. In recent history, theatrical financing typically involved utilizing various regulatory

8. Patrick Healy, *The Staggering Cost of Broadway*, NYTimes: Arts Beat (July 21, 2011, 11:15 AM), http://artsbeat.blogs.nytimes.com/2011/07/21/the-staggering-cost-of-broadway/.

9. *See* Elliot H. Brown & Daniel M. Wasser, *A Practical Guide to Theatrical Financing*, 16 Ent. & Sports Law 6, 9 (Fall 1998)

10. *Id*. at 7.

exemptions and exceptions promulgated by the SEC in order to organize private securities offerings.to generate the necessary funding.[11]

A. *Securities Offerings in General*

In a manner similar to the financing of many closely-held businesses, most large scale theatrical productions are financed by selling shares in an overarching business entity through a private securities offering. The law governing these kinds of transactions has evolved significantly since the early 20th century, and the associated rules and regulations provide important restrictions that have shaped the tried and true methodology of theatrical financing.

1. What is a Security?

In some cases it can be difficult to determine whether or not a certain form of indebtedness or obligation is a security. The question of whether a form of investment is a security is a statutory matter first and foremost. Both the Securities Act of 1933[12] (the 1933 Act) and the Securities Exchange Act of 1934[13] (the 1934 Act) provide definitions of the term "security".[14] While not exactly the same, they are substantively equivalent.[15]

A financial interest is a security if it is included in the list of financial instruments detailed in the statutes.[16] This list includes well-known forms of securities, including stock, notes, bonds, debentures and options, as well as imprecisely defined categories, including "participation in any profit-sharing agreement" and an "investment contract."[17] In addition, both the 1933 and 1934 Acts employ catchall clauses that include "in general, any interest or instrument commonly known as a 'security' " in the definition.[18] These different terms are all used to characterize shares and methods of investment in order to better determine their treatment by the courts.

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11. *See, e.g.,* Brooke Sopelsa, *The Risks, Rewards and Realities of Investing in Theatre*, CNBC, (Oct. 18, 2010), http://www.cnbc.com/id/39342313.

12. 15 U.S.C. §77b (2012).

13. 15 U.S.C. §78b (2012).

14. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

15. *See, e.g.,* Marine Bank v. Weaver, 455 U.S. 551, 555 n.3 (1982) ("We have consistently held that the definition of 'security' in the 1934 Act is essentially the same as the definition of 'security' in § 2(1) of the Securities Act of 1933 . . . ."); United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 847 n.12 (1975) ("The definition of a security in § 3(a)(10) of the 1934 Act . . . is virtually identical [to the definition in the Securities Act of 1933] and, for present purposes, the coverage of the two Acts may be considered the same." (citations omitted)); Tcherepnin v. Knight, 389 U.S. 332, 342 (1967) ("The same Congress which passed the Securities Act in 1933 approved the Securities Exchange Act in 1934, and the definition of security contained in the 1934 Act is virtually identical to that in the earlier enactment.").

16. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

17. *Id.*

18. *Id.*

Due to the nebulous nature of several of the categories of security, room for judicial interpretation in their definition has been found. In this context, perhaps the most significant and difficult cases involve determining whether particular financial interests qualify as investment contracts. Indeed, the Supreme Court defined this form of security in the seminal case of *SEC v. Howey*.[19]

> [A]n investment contract . . . means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[20]

This definition has not only become the touchstone for determining whether or not a financial interest is an investment contract, but the Supreme Court later pointed out that, for definitional purposes, the investment contract of the *Howey* test is the equivalent of an "interest or instrument commonly known as a 'security' "[21] and lower courts have noted that the *Howey* test can also help identify "participation in any profit-sharing agreement".[22]

In the present context, investment in theatrical productions certainly qualifies as a security under the *Howey* test, as it represents an investment in "a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[23] This basic breakdown fits perfectly with the structure of a typical theatrical investment, as there is a financial investment in a venture undertaken by a group that is intended to garner profits based on the business and creative efforts of the producing and creative teams.

2. What is an Offering?

Offerings, put simply, are the process by which securities are sold. The securities laws restrict public and private offerings in order to protect the interests of investors and issuers effectively. Unless they qualify for an exemption under the 1933 Act, issuers of securities wishing to make a public offering of those securities must register their offering with state securities regulators and the SEC.[24] Registering offerings is typically burdensome and expensive due to comprehensive disclosure requirements and other restrictions, including. restrictions on the use of advertising prior to the

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19. *SEC v. W. J. Howey Co*., 328 U.S. 293 (1946).

20. *Id.* at 298-99.

21. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1975).

22. *See, e.g.,* Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 102 (7th Cir. 1977) ("[C]ourts have made no real distinction between investment contracts and profit-sharing plans."); Trostle v. Nimer, 510 F. Supp. 568, 572 (S.D. Ohio 1981) (noting that "[i]n most contexts," the two are synonymous).

23. *Forman*, 421 U.S. at 852.

24. *See* 15 U.S.C. § 77r (2012); *see, e.g.,* Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 348 (1991).

offering,[25] and on the appropriate methods of advertising available securities.[26] The disclosure requirements err on the side of more disclosure in order to protect investors.

Companies that qualify for statutory exemptions, however, can bypass the burdensome requirements associated with the ordinary public offerings described above and instead make private offerings.[27] Congress first provided these exemptions after it determined that, in some instances, registration would be impractical, the benefits associated would be too remote, or the limited size and reach of the offering would not implicate the need to protect investors.[28]

3. Private Offerings Under Regulation D

Three important such statutory exemptions may be found in Regulation D, as promulgated under the 1933 Act. These exemptions take the form of three different types of private offering, described in Rules 504, 505, and 506. The vast majority of recent theatrical financings have been organized under one of these exemptions.[29]

Rule 504 permits issuers to offer and sell up to $1 million in securities during any 12-month period.[30] These securities may be sold to any number and type of investor, and the issuer is not subject to specific disclosure requirements.[31] In a Rule 504 offering, restricted securities are typically sold, meaning that there is no easy or quick way to resell the securities.[32]

In a Rule 505 offering, the amount of securities that can be offered and sold in a 12-month period is increased to $5 million, but the rule introduces a restriction that, to be eligible, investors must be an "accredited investor" as defined in Regulation D.[33] In order to qualify as an accredited investor, an investor must either have an have an earned income that exceeded $200,000 ($300,000 together with a spouse) in each of the prior two years and must reasonably expect the same for the current year, or a net worth of over $1 million, either alone or together with a spouse.[34]

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25. *See* 15 U.S.C. §§ 77e(a) (2012)

26. *See* 15 U.S.C. § 77e(b)(1) (2012) (describing activities prohibited by an issuer during the waiting period)

27. Lisa A. Mondschein, *The Solicitation and Marketing of Securities Offerings Through the Internet*, 65 Brook. L. Rev. 185, 192 (1999).

28. *Id*. *See* House Comm. on Interstate and Foreign Commerce, Fed. Supervision of Traffic in Inv. Sec. in Interstate Commerce, H.R. Rep. No. 73-85, pt. 2, at 5 (1933) (describing conditions under which an issuer can offer its securities without registration); see also, 15 U.S.C. § 77c(b) (2012) (providing the SEC with the authority to add classes of securities to those exempt from registration if "enforcement . . . is not necessary in the public interest.").

29. *See* 17 C.F.R. § 230.500-506 (2016); Brown & Wasser, *supra* note 9

30. See 17 C.F.R. § 230.504 (2016).

31. *Id*.

32. *See* U.S. Sec. & Exch. Comm'n, Rule 144: Selling Restricted and Control Securities (Jan. 16, 2013), http://www.sec.gov/investor/pubs/rule144.htm.

33. *See* 17 C.F.R. §§ 230.505 (2016).

34. 17 C.F.R. § 230.501 (2016).

Under Rule 505, an issuer may sell to an unlimited number of these accredited investors, but may not sell to more than 35 non-accredited investors without disclosing additional financial information.[35]

Although the accredited investor requirements from Rule 505 are still present in Rule 506, under Rule 506 there is no restriction regarding the amount of money that may be raised.[36] Due to the fact that most Broadway productions require a budget greater than the $5 million authorized under Rule 505,[37] it is unsurprising that most large-scale productions receive their financing through offerings under Rule 506.[38] While the potential investing pool is limited to the particularly well-off, this Rule provides a way for shows to raise a significant budget with relatively few substantial regulatory burdens.

B. *Crowdfunding Prior to Regulation A+*

The concept of selling securities and financing a business venture through the Internet has been around since the late 1990s.[39] It was constrained, however, by the regulations that were in place at the time,[40] so the opportunities presented by the Internet for true crowdfunding were not seen until the advent of rewards-based crowdfunding services, such as Kickstarter and Indiegogo.

1. Reward Based Crowdfunding

Reward-based crowdfunding entered the spotlight in the late 2000s.[41] Since then, the users of the most famous of these sites, Kickstarter, have pledged over $2.1 billion in support of more than 95,000 successfully funded projects.[42] A Kickstarter page hosts projects, defined as "finite work[s] with a clear goal that you'd like to bring to life,"[43] for a limited amount of time.[44] If the fundraising goal is not met during the specified period, the donors who pledge will not be charged, and the project will not

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35. 17 C.F.R. § 230.505 (2016).

36. 17 C.F.R. § 230.506 (2016).

37. Healy, *supra* note 8.

38. Brown & Wasser, *supra* note 9, at 8.

39. *See, e.g.,* Mondschein, *supra* note 27, at 185. .

40. Regulation D allowed for limited offerings over the internet, but the value restrictions and accredited investor requirements limited the possibility of true crowdfunding, as did the even more significant value restrictions under Regulation A, the precursor to Regulation A+. *See id* 194-199.

41. *See About*, KICKSTARTER, https://www.kickstarter.com/about; *About Us*, INDIEGOGO, https://www.indiegogo.com/about/our-story.

42. *Stats*, KICKSTARTER, https://www.kickstarter.com/help/stats.

43. *Kickstarter Basics: Kickstarter 101*, KICKSTARTER, https:// www.kickstarter.com/help/faq/kickstarter£asics?ref=faq_subcategory#Kick (last visited Nov. 28, 2015).

44. *Creator Handbook: Funding,* KICKSTARTER.com, https:// www.kickstarter.com/help/handbook/funding (last visited Nov. 28, 2015).

be funded,[45] so in order to encourage pledges, creators offer different rewards for different levels of donation.[46] The site specifically prohibits projects from offering "equity or financial incentives (ownership, share of profits, repayment/loans, cash-value equivalents, etc.)," effectively prohibiting the offering of securities.[47] Kickstarter's rules are very careful to make this point abundantly clear. This is critical because the site solicits users of all kinds, from all over the world,[48] and prior to the implementation of Regulation A+, the securities regulations prohibited the public offering of securities on this scale.

2. JOBS Act (2012)

President Barack Obama signed the Jumpstart Our Business Startups Act (the JOBS Act) into law in the spring of 2012.[49] The JOBS Act was intended, in part, to facilitate the raising of capital for small companies.[50] The relevant provisions include Title II, which creates an exception from the Regulation D general prohibition against advertising and solicitation in the case of Rule 506 offerings,[51] Title III, which creates a new exemption to Regulation D that provides a framework for Internet based equity crowdfunding,[52] and Title IV, which, in its original form, was drafted to raise the fundraising limit for "mini-registrations" under a revamped Regulation A, allowing small companies to raise greater amounts of capital without going through the full registration requirements.[53]

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45. *Id.*

46. Fred Benenson & Yancey Strickler, *Trends in Pricing and Duration*, KICKSTARTER (Sept. 21, 2010), https://www.kickstarter.com/blog/trends-in-pricing-and-duration.

47. *Our Rules*, KICKSTARTER, https://www.kickstarter.com/help/guidelines?ref♂lp_nav. (last visited Nov. 28, 2015)

48. *Creator Questions: Getting Started*, KICKSTARTER, https:// www.kickstarter.com/help/faq/creator+questions#faq_41823 (last visited Nov. 28, 2015).

49. Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504 ; Mary Bruce, *Obama Signs JOBS Act into Law*, ABC NEWS (Apr. 5, 2012), http://abcnews.go.com/blogs/politics/2012/04/obama-signs-jobs-act-into-law/

50. Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504; *see also* Bruce, *supra* note 49.

51. Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2553 (2010); *see also* Matthew Savare & Richard Jaycobs, *Crowded Marketplace: How the JOBS Act Will Transform Film Financing*, FILMMAKER (Apr. 17, 2012), http://filmmakermagazine.com/44000-how-the-jobs-act-will-transform-independent-film-financing/.

52. Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2568 (2010).

53. Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2582 (2010); *see also* Chris Brummer & Daniel Gorfine, *The JOBS Act Isn't All 'Crowdfunding'*, FORBES (Oct. 8, 2013), http://www.forbes.com/sites/realspin/2013/10/08/the-jobs-act-isnt-all-crowdfunding/.

C. *Difficulties Associated with Funding Theatrical Productions*

Despite the rich cultural heritage of the American theatre, raising capital to put up a large-scale theatrical production is notoriously difficult.[54] The immense capital requirement aside, the limited pool of potential investors combined with the risk associated with the investment severely limits the fundraising potential for aspiring Broadway productions. While the difficulty level is certainly higher than many other fundraising ventures, some theatrical producers have always managed to find sources of capital.

1. Typical Sources of Funding are Limited

Two general sources of funding for theatrical production exist. The first, and probably the most well-known, is known as the "angel" investor. Referred to as "angels" because they "may well be in heaven before they see a return on their investment,"[55] these investors are typically very wealthy and invest based on a personal belief in the potential of the show.[56] Their motivation for investing may stem from a relationship with the producers, faith in the actors associated with the production, or simply from a desire to be a part of the process, regardless of the financial risk.[57]

The second common source of capital is the "flinty-eyed investor".[58] These investors are motivated by a financial interest beyond the possibility in that the original Broadway run might turn a profit. Flinty-eyed investors may be theater owners who will profit from the production renting their theater, road producers who will profit from a later national tour of the production, merchandising companies who will profit from the sale of production-themed merchandise at any and every performance, or even film or television companies who see the potential for profit from a later adaptation of the work.[59] These investors' businesses succeed when a show succeeds, so it is almost always in their interest to help productions in any way they can. However, due to the fact that so few productions provide a return on these investments, producers are always looking for new sources of capital.

2. Theatre is a Risky Investment

In addition to the extremely limited pool of potential investors, theatrical fundraising is hampered by the fact that financing theatre is an uncer-

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54. *See* Healy, *supra* note 8.

55. Ed Ewing, *The Sound of Money*, THEGUARDIAN (May 8, 2007), http://www.theguardian.com/money/2007/may/08/alternativeinvestment.

56. Brown & Wasser, *supra* note 9, at 6.

57. *Id*.

58. *Id*.

59. *Id*.

tain investment.[60] The majority of shows fail,[61] and investors can very easily lose their entire investment—it actually happens 75% of the time.[62] Today, a Broadway musical will often cost between $6 and $12 million, and recoupment of that budget within one year would be considered miraculous.[63] Individual investments under Regulation D, the typical method of fundraising in these cases as discussed above, average between $20,000 and $25,000,[64] but can reach up to nearly $1 million.[65] As a result, under the current framework, investors must be financially, psychologically, and emotionally prepared to take a substantial loss.

II. Regulation A+ Equity Crowdfunding as a Potential Funding Option for Theatrical Productions

The current framework in theatrical financing has two main problems as discussed in Part I, Section C above: a limited pool of potential investors and enormous financial risk. These problems are inherent in the framework's structure. The accredited investor requirements of Rule 506 of Regulation D limit who may be an investor and, therefore, encourage reasonably large individual investments from the subset of eligible investors in a market in which a majority of business ventures fail, contributing significantly to the risk factor. Regulation A+ has the potential to ameliorate the practical framework of the market and provide a less risky and perhaps even more efficient way to finance large-scale theatrical productions.

A. *Regulation A+*

The SEC regulations regarding Regulation A+ were initially promulgated during the spring of 2015. Like most regulatory frameworks early in their lifespans, Regulation A+ is hardly perfect, but this Part demonstrates how its unique strengths and weaknesses provide a viable method of instituting equity crowdfunding as a model for financing large-scale theatrical productions.

Despite the fact that Title III of the JOBS Act was the Title intended to facilitate equity crowdfunding,[66] the implementation of Title IV by the

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60. Sopelsa, *supra* note 11.

61. *Id*.

62. Patrick Healy, *So You'd Like to Invest in Broadway? Rules for Ivesting in a Broadway Production*, NYTimes (Aug. 15, 2014), http://www.nytimes.com/2014/08/17/theater/rules-for-investing-in-a-broadway-production.html.

63. Brown & Wasser, *supra* note 9, at 6.

64. Sopelsa, *supra* note 11.

65. Healy, *supra* note 62.

66. *See generally* Savare & Jaycobs, *supra* note 51; Amy Wan, *Title III Crowdfunding Became Legal on May 16: What It Does & What's Still Lacking*, Crowdfund Insider (May 17, 2016). It should also be noted that while Title III went live in May 2016, there is an absolute limit of $1 million in a 12 month period, so the implementation of Title IV discussed herein is still the most applicable update to the crowdfunding regime.

SEC under Regulation A+ provided an intriguing alternative.[67] Regulation A+ allows for the sale of equity securities as well as debt securities and allows for the distribution of these securities through general solicitation and advertisement. As Title II of the JOBS Act allows Rule 506 offerings under Regulation D to be promoted through general solicitation and advertisement,[68] the provision that makes Regulation A+ unique is the lack of an accredited investor requirement.[69] The regulation does have a set of disclosure requirements, but according to the SEC, the "offering circular" format required is meant to "simplify the process by which an issuer prepares its narrative disclosure by limiting the need for issuers to look outside the form for disclosure guidance."[70]

Form 1-A, the offering statement that provides the disclosure format for Regulation A+, is just under 30 pages long and offers fairly straightforward instructions regarding its completion.[71] It begins with the basic issuer information, including financial details, and basic information regarding the securities and the jurisdictions in which they will be offered.[72] The substantive portion of the statement must begin with a summary of the information contained in the section, and then, disclose the risk factors, explain dilution, describe the plan of distribution, disclose the planned use of proceeds, describe the business and property, disclose the management's discussion of financial condition, provide information regarding the directors, executive officers, and significant employees including compensation details and security ownership, and describe the security to be offered.[73]

Regulation A+ has two tiers: Tier I, which allows for offerings of up to $20 million in a 12-month period, and Tier II, which allows for offerings up to $50 million in a 12-month period.[74] While both tiers provide for the raising of more than enough capital for the average Broadway production, some of the specific rules could make one or the other more appropriate in certain situations.

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67. Commissioner Luis A. Aguilar, U.S. Sec. & Exch. Comm'n, Helping Small Businesses and Protecting Investors, (Mar. 25, 2015), http://www.sec.gov/news/statement/helping-small-businesses-and-protecting-investors.html.

68. Savare & Jaycobs, *supra* note 51.

69. Tanya Prive, *Regulation A+: Now Everyone Can Invest In Your Startup*, Forbes (June 19, 2015), http://www.forbes.com/sites/tanyaprive/2015/06/19/regulation-a-now-everyone-can-invest-in-your-startup/.

70. U.S. Sec. & Exch. Comm'n, Amendments to Regulation A: A Small Entity Compliance Guide (June 18, 2015), http://www.sec.gov/info/smallbus/secg/regulation-a-amendments-secg.shtml#3.

71. U.S. Sec. & Exch. Comm'n, Form 1-A, Part II, Part F/S (2014), https://www.sec.gov/about/forms/form1-a.pdf (last visited Dec. 18, 2015)

72. *Id*. at 3-5.

73. Amendments to Regulation A: A Small Entity Compliance Guide, *supra* note 72.

74. *Id*.

1. Tier I

The first level of Regulation A+ funding, Tier I, allows offerings of up to $20 million, cumulatively, in a 12-month period.[75] As the average Broadway musical costs between $6 million and $12 million,[76] this fundraising level allows for more than enough capital to fund all but the most expensive theatrical productions. In addition, Tier I imposes no limitations regarding the amount of capital an individual investor can contribute.

In Tier I, the offering statement must disclose balance sheets and other required financial statements regarding the two most recently completed fiscal years, or, if the issuer has not been in business for two years, the full time period during which they have been in existence.[77] This tier does not require audited statements unless the issuer already obtained an audit for another purpose and it was performed in accordance with the relevant standards.[78]

The potential difficulty with Tier I comes with the requirement of registration in each state in which an offer or sale is made. Because most crowdfunding is premised on selling via the Internet, requiring registration in every state in which an offer is made could cripple the process. Fortunately, Tier I of Regulation A+ is subject to the North American Securities Administrators Association (NASAA) Coordinated Review program.[79] The program is designed to facilitate the filing of Regulation A+ offerings in multiple jurisdictions. A Regulation A+ issuer files with the NASAA program coordinator, and the NASAA examiners check the application for deficiencies.[80] The examiners then clear the application or return it to the issuer for correction. Every state has agreed to approve the filing once it is cleared by the NASAA examiners, a process designed to take less than a month.[81] Therefore, this potentially crippling requirement actually has a reasonably efficient solution built-in.

Tier I seems like the obvious choice for theatrical fundraising. The fundraising cap is more than enough to finance most stage productions and the lack of individual investment restrictions allows for the issuer to continue soliciting investments from angel and flinty-eyed investors in addition to the community at large. It greatly widens the pool of potential investors without alienating any of those who have been financing theatrical productions previously. In addition, as the offering statements need

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75. *See Id.*

76. Healy, *supra* note 8.

77. *Id*.

78. *Id*.

79. North American Securities Administrators Ass'n, Coordinated Review, http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/.

80. North American Securities Administrators Ass'n, NASAA Multi-state Coordinated Review Program, http://www.nasaa.org/wp-content/uploads/2015/03/Coordinated-Review-Chart.pdf.

81. *Id*.

not include audited financial statements, the cost of disclosure is kept reasonably low. The potential weakness of Tier I is the state registration requirement. Regulation A+ will be a proving ground for NASAA Coordinated Review,[82] but it is so far unclear exactly how successful the program will be in this context.

2. Tier II

Tier II allows offerings of up to $50 million, cumulatively, in a 12-month period.[83] Since a typical Broadway production would have no problem with the $20 million limit of Tier I, there is no question that $50 million would be more than enough, even for more extravagant productions. Unlike Tier I, however, Tier II limits the amount of capital an individual investor can contribute.[84] While investors under Tier II are not unconditionally required to qualify as accredited, if they do not, they cannot invest more than 10% of the greater of their annual income or net worth.[85] That is not a particularly restrictive limitation, as those who do not qualify as accredited are not likely to be those considering investing such a great proportion of their capital in a venture as risky as theatre.[86]

As in Tier I, the offering statement in Tier II must include balance sheets and other required financial statements regarding the two most recently completed fiscal years, or, if the issuer has not been in business for two years, the time that they have been in existence.[87] In Tier II, however, these statements must be audited according to Generally Accepted Accounting Principles (GAAP) or Public Company Accounting Oversight Board (PCAOB) standards.[88]

The true strength of Tier II is the treatment of state securities registration. Unlike Tier I, in which securities must be registered in every state they are offered, securities sold under Tier II are considered covered securities, which pre-empt the state securities laws, and issuers of such securities are thus not required to register or qualify their offerings with state

82. Kiran Lingam, *The Reg A+ Bombshell: $50M Unaccredited Equity Crowdfunding Title IV takes Center Stage,* CROWDFUND INSIDER (March 25, 2015), http://www.crowdfundinsider.com/2015/03/65007-the-reg-a-bombshell-50m-unaccredited-equity-crowdfunding-title-iv-takes-center-stage/.

83. AMENDMENTS TO REGULATION A, *supra* note 72.

84. *Id*.

85. *Id*.

86. Conventional wisdom on saving and investing suggests that one should attempt to invest a total of around 10% of their annual income. *See e.g.* Ryan Barnes, *Top 5Budgeting Questions Answered*, INVESTOPEDIA, http://www.investopedia.com/articles/pf/07/budget-qs.asp (last visited Nov. 7, 2016). The Tier II restriction is unlikely to prove particularly limiting, therefore, as it is unlikely that investors that are not wealthy enough to meet the accreditation requirements would invest that entire 10% in a venture as uncertain as theatrical production.

87. *Id*.

88. *Id*.

securities regulators, or rely on the NASAA Coordinated Review Program.[89]

Tier II does not require issuers to raise more than $20 million, so a company that wishes to sell up to $20 million in securities may offer under either Tier I or Tier II. As a result, provided that the company can obtain audited financial statements, it might make sense for a company with a goal of under $20 million to offer under Tier II. While the NASAA Coordinated Review program seems well-organized and efficient, there is no guarantee that such a process will not run into problems, and the covered securities offered under Tier II have the potential to save an issuer a significant amount of trouble.

B. *Psychology of Theatrical Investment*

In light of the substantial risk of theatrical investment, it is not inappropriate to question the rationales for backing a new and untested production. Part of the appeal is certainly the fact that a huge success on Broadway can make back the initial investment many, many times over.[90] There are also the perks—invitations to performances, complimentary cast albums, posters, and other souvenirs,[91]—that often accompany this type of investment,[92] but there is a much less tangible appeal as well.

1. "Angels" and the Appeal of Contribution

For many investors with the capital to invest in theatre under the current framework, investment is an outlet for passion.[93] Theatrical productions, in general, are the product of the combined efforts of a group of people. Some of those people get involved because of the call of the stage, some get involved because they like figuring out how to make a theatrical effect work, and some get involved because there is nothing quite like gathering a large congregation of people for a night of live theatre. But the end goal for each person involved is the show. The same goes for investors—it is a "labor of love", not purely a financial decision.[94]

2. The Theatrical Community

While up until this point there was no efficient method for soliciting investments from the theatergoing public at large, the nature of the theatrical community makes it an ideal pool of potential investors, especially in a crowdfunding context.

According to the American Association of Community Theatre (AACT), there are more than 7,000 community theatre organizations

89. *Id*. *See also* 15 U.S.C. § 77r (2012) (regarding covered securities in general).

90. Sopelsa, *supra* note 11.

91. *Id*.

92. *Id*.

93. *Id*.

94. *Id*.

across the United States, and, through the efforts of 1.5 million participants, these theatre organizations produce more than 46,000 theatrical productions every year.[95] This is a modest estimate, as not all theatrical organizations are registered members of the AACT.[96]

The theatrical community also includes the people who make up large portions of the audience of the shows that play on Broadway's brightest stages, the customers who buy cast recordings of new and beloved musicals alike, and the casts and crews of the professional storefront and amateur productions that generate licensing fees for decades after the shows close on Broadway. These are the people that have pursued a field outside of the arts in their professional lives, only to dedicate their undoubtedly sparse free time to the production of theatre. Regulation A+ provides an opportunity for these people to support the art form they care so deeply for to an even greater degree, all added to the possibility of reaping some of the profits.

Imagine if even half of these community theatre participants were able to individually invest in $50 worth of securities in Broadway productions via Regulation A+. Those small individual investments would amount to nearly $40 million in financing for Broadway productions.[97] Assuming an average of 40 new theatrical productions on Broadway per year,[98] this would come out to approximately $1 million in funding for each new production. For many plays, this would amount to just under half of the fundraising goal.[99] For most musicals, this would amount to closer to 10% to 17% of the fundraising goal–still a sizable contribution.

There are a substantial number of potential investors that the current theatrical fundraising framework has so far been unable to reach. Equity crowdfunding of this kind could open the door to people who would make $50-$100 contributions, and allow them to join in the potential return. Such a practice would prove far too costly under Regulation D, and the other forms of crowdfunding would only be able to accept these amounts as donations. Regulation A+, therefore, provides a viable framework by which theatrical producers could tap into this substantial source of capital.

III. Potential Issues Regarding Regulation A+ Equity Crowdfunding for the Theatre

Regulation A+ is barely a year and a half old, so the actual effects of the new rules will likely not be fully understood for some time, though it

95. Howard Sherman, *Theater the Theater Community Disdains*, Huffington Post (Sept. 27, 2012), http://www.huffingtonpost.com/howard-sherman/theatre-the-theatre-commu_b_1914300.html.

96. *Id*.

97. One half of 1.5 million is 750,000. When multiplied by $50 per participant, it amounts to $37,500,000.

98. *Broadway Season Statistics*, The Broadway League, https://www.broadwayleague.com/index.php?url_identifier=season-by-season-stats-1.

99. *See* Healy, *supra* note 8.

seems as though the process itself has operated as expected so far.[100] The application of these regulations to the financing of theatrical productions is not without flaws, as is the case with any newly implemented set of regulations. That said, some of the biggest and most obvious weaknesses of the new crowdfunding framework will be felt less powerfully when used for theatrical financing.

A. *Illiquidity*

A major concern with the sale of securities of any kind is the issue of liquidity. In most markets, the power of an investor to easily sell the securities they have acquired is an important aspect of the investment process.[101] While investing via Regulation A+ in general would be no different, the unique nature of theatrical financing limits the ill effects generally associated with illiquidity.

Securities sold via Regulation A+ will suffer from illiquidity for the foreseeable future.[102] Although there is no resale restriction regarding securities offered via Regulation A+, unless they are going to be listed on an exchange that allows for them to be easily bought and sold, an investor would have to seek out an interested buyer independently in order to resell the security.[103] Due to the fairly low value of many crowdfunded securities, it is unlikely that such exchanges will come into being in the near future. While cheaper securities might intuitively suggest that there would be more interested buyers, the costs in setting up an efficient exchange would likely exceed the value of liquidity at this level.

This will not likely prove to be damning in the theatrical investment context because of the unique nature of theatrical investing discussed above. Notably, theatrical investing is not a market in which investors plan to dispose of their investment in the short term. Investors support theatrical productions in order to put on a show, and are typically aware of the reasonably high possibility of losing the initial investment.

Even under the current methods under Regulation D, theatrical investments are not the kind of securities that are easily bought and sold after the initial offering.[104] Regulation A+ will not cause a change to this status quo. As a result, even though Regulation A+ securities may not be partic-

100. Amy Wan, *Progress Report: Looking at Regulation A+ One Year Later*, Crowdfund Insider (July 11, 2016), http://www.crowdfundinsider.com/2016/07/87745-looking-regulation-one-year-later/

101. *See, e.g.,* Jim Mueller, *Understanding Financial Liquidity*, Investopedia, http://www.investopedia.com/articles/basics/07/liquidity.asp.

102. U.S. Sec. & Exch. Comm'n, Investor Bulletin: Regulation A+, http://investor.gov/news-alerts/investor-bulletins/investor-bulletin-regulation; *see also* Ryan Feit, *The Reg A+ Bombshell: $50M Equity Crowdfunding Under Regulation A*, SeedInvest, http://www.seedinvest.com/blog/regulation-a-equity-crowdfunding-rules/ (last visited Nov. 30, 2015).

103. Investor Bulletin, *supra* note 103.

104. *See* Healy, *supra* note 57.

ularly liquid, this has a limited effect on the draw or structure of theatrical investment.

B. *Offering Circular vs. Prospectus*

The other major weakness of a Regulation A+ offering is that the offering circular format for narrative disclosure may be as burdensome as the prospectus required in a registered security offering. Part of the reason issuers often attempt to avoid registered offerings is due to the complicated disclosure requirements. If the offering circular format is practically as burdensome as the traditional prospectus, it will likely dissuade issuers from considering an offering under Regulation A+.

The offering circular has been described many times as a stripped- or scaled-down version of a prospectus.[105] The offering circular, as guided by Form 1-A, must include a number of disclosure items. It must begin with a cover page that includes the basic identifying information regarding the offering as well as a summary of the offering circular as a whole, designed to make the case for why an investor should back the issuing company.[106] It must also include a "short", "concise", and "carefully organized" description of risk factors,[107] and must disclose and describe the dilution to be experienced by investors and the plan of distribution regarding the securities being offered.[108] Additionally, it must explain the plans for use of proceeds, a description of the business, its property, and a discussion of the company's operations through the eyes of the management,[109] provide a list of the issuing company's directors, officers, and other important employees, including biographical and compensation information and ownership of the voting securities.[110] Finally, and perhaps most obviously, the offering circular must provide a description of the securities being offered.[111]

At first glance, the disclosure requirements regarding the offering circular seem daunting: most of the required information runs parallel to the disclosure requirements of a prospectus for a registered offering. However, Form 1-A provides more guidance regarding the specific information, rather than simply pointing towards the statutory requirements. There are also several items that are specifically required in a prospectus, as laid out in Form S-1, but not mentioned in Form 1-A. These include a description of the selling security holders, disclosure of legal proceedings,

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105. Amendments to Regulation A, *supra* note 72; Charles Kaufman & Jor Law, *What's In a Regulation A Plus Offering Circular, Anyway?*, Crowdfund Insider (Sept. 4, 2015), http://www.crowdfundinsider.com/2015/09/73859-whats-in-a-regulation-a-plus-offering-circular-anyway/.

106. *Id.*

107. *Id*.

108. *Id*.

109. *Id*.

110. *Id*.

111. *Id*.

disclosure of disagreements with accountants, as well as disclosure of material changes in the issuer's business in the last fiscal year.[112] The basic difference seems to be that Form S-1 provides much less instruction, as it requires that issuers go beyond the registration form, whereas the offering circular format simplifies the Process by streamlining the listed requirements, therefore making it less burdensome to complete.[113]

Conclusion

The use of Regulation A+ offerings, under either Tier I or Tier II, to finance theatrical productions could provide an effective alternative to the current system that restricts theatrical investment mainly to the wealthy. The current method has been tried and true, but the Regulation D accredited investor requirements have forced producers to completely ignore the capital and potential investors in the theatrical community but outside of the typical channels. Online crowdfunding has been around for less than ten years, but has provided for an interesting alternative to traditional funding methods. The equity crowdfunding opportunities of Regulation A+ offerings combine the reach of the Internet with the profit sharing opportunities of traditional equity funding, all the while keeping the field open to those who have always invested in the theatre. For an industry that forever bemoans the difficulties of fundraising, this previously unexploited source of financing could provide opportunities for writers, composers, and producers that might not otherwise find them.

112. U.S. Sec. & Exch. Comm'n, Form S-1: Registration Statement under the Securities Act of 1933, http://www.sec.gov/about/forms/forms-1.pdf.

113. Amendments to Regulation A, *supra* note 66.