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Stephen Manuel Wolfson

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The Thesis Committee for Stephen Manuel Wolfson
Certifies that this is the approved version of the following thesis:

Crowdsourcing and the Law

APPROVED BY
SUPERVISING COMMITTEE:

Supervisor: _____
Matthew Lease

_____
James Howison

Crowdsourcing and the Law

by

Stephen Manuel Wolfson, BA, JD, Esq.

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Abstract

Crowdsourcing and the Law

Stephen Manuel Wolfson, MSInfoStds

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Supervisor: Matthew Lease

With the development and proliferation of new social and connective technologies, crowdsourcing is becoming a viable method for conducting many types of work. At the same time, however, these developments are progressing more quickly than the law and raising new legal questions that often do not have definite answers yet. This thesis address some of these legal issues that crowdsourcing raises.

In this thesis, we begin by addressing four areas that might lead to legal problems in the near future. First, we look at the labor and employment law issues that might arise from online crowdlabor markets like Amazon Mechanical Turk (www.mturk.com) and oDesk (www.odesk.com). Then we discuss inventorship issues under patent law that services like InnoCentive might experience. Next, we consider how data security laws could be problematic for open innovation projects like the Netflix challenge. Finally, we explore potential intellectual property ownership problems under copyright law.

After discussing these topics, this thesis then turns to examine in detail the area of *crowdfunding*. As the name suggests, crowdfunding refers to process of raising money through crowdsourcing. Until recently, one type of crowdfunding known as *crowdfinance* was largely illegal under federal securities laws. However, the law in this area is starting to change. In this chapter, we look at four different models for crowdfunding: donation, lending, reward/prepurchase, and equity investment. Following that, we consider how federal securities regulation might apply to crowdfunding, particularly the equity investment model. Finally we conduct a content analysis of three legislative proposals to create a limited exemption for crowdfunding in securities law that the U.S. Congress recently considered.

Finally, we assess how crowdsourcing platforms use private contracts to bind their users to certain terms and conditions. This chapter begins with a primer on contract law. Then we examine the enforceability of standardized online agreements. Following that, we review several provisions that are common to nearly all crowdsourcing platforms. Finally, we conduct a content analysis of the specific Terms of Use contracts of several crowdsourcing platforms.

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Introduction

In the summer of 1994, when the internet was only starting to become what it is today, Dave Ring hatched a plan to use this fledgling technology to do what was probably on the minds of many students at the time – beat FreeCell. As a graduate student at Texas A&M University, he enjoyed playing this card game that was included on his Windows operating system. But, he was troubled by the possibility that some of FreeCell's 32,000 possible hands might be unbeatable. Was he wasting his time trying to beat an impossible game? This thought bothered Ring, so he turned to the internet for help (Plante, 2012).

Instead of trying to solve all of the hands himself, Ring went to the Newsgroup sci.math to find volunteers. Through a series of posts, he rallied players around the globe to join together to try to beat FreeCell. Since each hand in the game was individually numbered, and the numbering was consistent across all games, Ring could distribute different hands to different players without unintentional overlap.

So, he divided the hands into blocks and gave different blocks to anyone who wanted to join in. The players then reported whether they could beat the hands. Ring took any unbeaten hands, packaged them together, and redistributed them to other players. Eventually, Ring realized that no matter how hard they tried, no one could beat hand #11,982. Even with the combined knowledge, skill, and efforts of players across the world, no one could figure out this hand. FreeCell had won.

Though it happened over a decade before Jeff Howe (2006) coined the term, Ring's project is an early example of what today we know as "crowdsourcing." While

technology and crowdsourcing techniques have changed dramatically since 1994, Ring's project shares the core of what makes crowdsourcing a unique and powerful method for problem solving. Through the connective and collaborative power of the internet, Ring was able to accomplish a task that otherwise would be impossible.

Today, crowdsourcing operates very similarly to this example. It uses the modern communication technologies to find workers, distribute tasks, and solve any number of problems. Indeed, in just a short time, it has developed to become a viable option for businesses to accomplish many different tasks. For example, Netflix, recently sought help from the crowd to improve their movie recommendation algorithm; Google uses its reCaptcha tool to help train its text digitization system; and Kickstarter helps people ever day to raise money from the crowd to fun various projects.

As more amazing examples like these develop, however, it becomes increasingly likely that crowdsourcing methods will run into legal problems. Currently, only a few laws directly address crowdsourcing. Nevertheless, as crowdsourcing continues to grow, we will see either old laws being used to deal with the issues that it raises, entirely new laws being drawn to regulate crowdsourcing activities directly, or both. Indeed, this is already happening, with the U.S. government recently passing a law that specifically affects one type of crowdsourcing. It is important to begin studying this intersection of crowdsourcing and the law so we can start to understand what the legal landscape is, and how it might develop.

In this thesis, we address several of the legal issues that crowdsourcing raises. In the first section, we provide a brief introduction to crowdsourcing then discus four areas

where crowdsourcing might run into legal regulation in the near future. Here, we begin by looking at labor and employment law and the Fair Labor Standards Act (FLSA). As the pool of crowdworkers grows, laws like the FLSA might be available to protect workers from unfair labor practices. We then turn to consider patent law. Though crowdsourcing might be an effective way to solve complex problems and develop patentable inventions, having many geographically and temporally dispersed people working together could cause problems with inventorship. After that, we look at problems that could arise with data security and the Federal Trade Commission's protection of consumer private information. Finally, we consider intellectual property ownership issues under copyright law. A person who crowdsources the development of creative works could lose control over those works if he does not pay attention to copyright law.

Following this, we delve more deeply into one method of crowdsourcing that has recently received attention from the law: the process of raising money through crowdsourcing known as crowdfunding. In just the past few years, crowdsourcing has developed as a popular way to raise money for many kinds of projects. Currently, there does not seem to be a problem under the law with soliciting donations from the crowd. However, until recently, offering equity investment deals through crowdsourcing has been largely illegal. In this section, we begin by reviewing the different methods of crowdfunding. Then we discuss federal securities regulation and how equity investment deals could run into legal problems. Finally, we conduct a content analysis on several

legislative proposals that Congress considered to add an exemption to securities law to permit certain some equity investment using crowdfunding.

In the final section, we examine online agreements and how crowdsourcing platforms use them to bind their users to certain terms and conditions. Today private contracts regulate online behavior online more than enacted laws, agency rules, or judicial decisions. Indeed, even anecdotal evidence reveals the near-ubiquity of online contracts: anytime you click "I agree" or something similar online, you are potentially binding yourself to a terms of a use agreement. In this section, we begin with a brief primer on contract law and contract formation. We then look at the forms that these contacts often take and whether they are commonly enforceable. After that, we examine several common provisions to standardized online contracts. Finally, we take a closer look at a number of actual Terms of Use agreements from crowdsourcing platforms, comparing what terms they include, and how they use these agreements.

BACKGROUND ON THE LEGAL ANALYSIS METHOD

Before beginning our discussion of crowdsourcing and the law, it will be helpful to briefly review the basics of legal analysis. It is important to realize that there are many sources of law in the United States that create what we know as "the law." First there is the U.S. Constitution. The Constitution establishes the structure, limits, and form of our government. After the Constitution, there are federal statutes that are passed by Congress and signed by the President. Third, Congress can pass statutes that create agencies, which can issue regulations. Following that, judicial decisions interpret statutes or apply common law rules and act as another source of law. Finally, each state has its own

constitution, legislatures, agencies, and court systems that can act in concert with or separate from their federal counterparts.

The second step to understanding legal analysis is to realize the difference between mandatory and persuasive authority. Because of the divided legal system in the U.S., Federal and state courts and laws have different jurisdictional reaches and not all laws or judicial decisions affect all people. Accordingly, some laws are binding whereas others are merely persuasive.

Bintliff (2001) writes that the general rule for judicial decisions is a case will be binding on any court that is hierarchically lower than it. At the federal level, the court system is divided into 13 judicial circuits (uscourts.gov). Within each circuit, the lowest trial court level is District Court. For any circuit, there may be several district courts. For instance, the 2nd Circuit has courts in Connecticut, New York, and Vermont. Decisions at the district court level are only binding on the court that made them, but are persuasive to other districts and potentially to the circuit court (Bintliff, 2001). The next level in the federal court system is called the Court of Appeals. Decisions from a Court of Appeals are binding on the district courts in that circuit, and persuasive to the sister circuits and any other courts in the country. Finally, the highest court in the federal system is the U.S. Supreme Court. The Supreme Court is mandatory authority to any federal court, and, potentially, to any state court (depending on the issue). Like the federal system, each state has its own court system that operates analogously to the federal system, with the trial level courts at the bottom and a court of last resort at the top (often, but not always called the Supreme Court).

Bintliff (2001) notes that the degree of persuasiveness varies depending on court and decision. For instance, federal Courts of Appeals decisions on federal law will normally be given great deference by state courts in the same circuit. Furthermore, cases with similar fact patterns will often be highly persuasive on subsequent cases. Bintliff writes that "factual similarity is key in choosing among persuasive decisions."

As should be obvious, secondary sources like scholarly articles, treatises, Restatements of the Law, or legal casebooks are not actually law and are not mandatory authority on any legal body. Even so, Bintliff (2001) writes that decisions makers often accept guidance from sources outside of legal proscriptions. The Restatements of the Law, for instance, are generally considered to be authoritative statements of many different areas of the law. In particular, the Restatements of Torts and Contracts are extremely well respected (Harvard Law School Library, 2011).

Considering this discussion of sources of law and the relative weight of legal authority, part of the trick to legal analysis is to assess and combine the myriad materials, and then make a judgment of how they apply – or should apply – to a given situation. Edwards (2010) writes that people often mistakenly think that understanding the law is like playing a game. Games have clearly defined rules that precisely regulate what you can and cannot do; the, however, law does not. Instead, legal analysis requires a balance of numerous sources, interests, and potential consequences. So, lawyers seek for clues about the meaning of statues and how they might be applied from the language of many sources, evaluate the significance of them, and combine them to reach a conclusion.

Edwards (2010) writes that lawyers most frequently use four basic types of reasoning. First, there is rules-based reasoning that reaches a decision by establishing and applying a law. Second, there is analogical/counter-analogical reasoning, which shows similarities and differences between old cases and a given situation. Third, there is policy based reasoning, which advocates for a result because it benefits society at large. Finally, there is narrative based reasoning which uses stories to suggest particular answers.

Considering these types of reasoning, and the different legal authorities, legal analysis strives to develop ideas for how laws might apply in given situations (Edwards, 2010). Notably, Bintliff writes (2001) that analogizing from cases with similar fact patterns is a particularly powerful method for legal reasoning. Still, all these methods of reasoning are available and used. Accordingly, legal analysis consists of making the best argument for how the law might apply to a given situation while keeping in mind the different legal authorities and their relative degrees of persuasiveness.

Look Before You Leap: Legal Pitfalls of Crowdsourcing

INTRODUCTION

In 2006, Jeff Howe (2006) identified a trend: companies were shifting jobs that had formerly been assigned to an employee or a contracted worker, and instead distributing them to large groups of people. As James Surowiecki recognized in *The Wisdom of the Crowds* (2005), large groups can effectively and accurately solve some tasks better than individuals, and businesses were beginning to apply such thinking. Howe called this "crowdsourcing."

Even before Howe coined the term, crowdsourcing has been changing the way people think about conducting work. New platforms seem to develop daily, allowing businesses to connect with and distribute various tasks to multitudes of prospective workers. Amazon Mechanical Turk (www.mturk.com), oDesk (www.odesk.com), Crowdspring (www.crowdspring.com), Kickstarter (www.kickstarter.com), and many others all help people use the power of the crowd in various ways. As the crowdsourcing industry grows and diversifies, however, it seems increasingly likely that it will experience legal regulation. This paper discusses several areas of the law that will likely impact crowdsourcing in the future.

We begin with employment law. Both federal and state laws stipulate how "employers" must treat "employees." We especially discuss the federal Fair Labor Standards Act, which guarantees anyone who qualifies as an "employee" things like a minimum wage and overtime regulation.

Next, we consider inventorship issues under patent law. One way to use crowdsourcing is for the research and development of patentable inventions. However, joint inventorship issues naturally arise where multiple people work on an invention. Under the law, all inventors must be included on a patent application and if they are not, the patent might be rendered unenforceable. Thus, anyone who wants use the crowd for research and development must consider joint inventorship issues and act accordingly.

Regarding innovation, more companies are now beginning to tap into "wisdom of crowds" based innovation by sharing more customer data in new ways, e.g. for academic research or with open-innovation providers like InnoCentive (www.innocentive.com). Unfortunately, developing effective methods for protecting customer privacy remains an open research problem (Narayanan and Shmatikov, 2008) with some highly visible recent failures (Barbaro & Zeller Jr., 2006; Ohm, 2010). The Federal Trade Commission (FTC) has recently begun aggressively acting to protect consumers from such data breeches caused by commercial entities. Companies should be mindful of this.

Finally, Crowdsourcing can also be an effective way to source and/or develop creative works. Yet because of copyright's works made for hire and joint works doctrines, crowdsourcers can easily lose control over crowd-developed creative works if they do not pay attention to these doctrines. Thus, anyone interested in crowdsourcing creative design must carefully consider copyright laws.

While we cannot hope to provide a complete survey of legal questions faced by crowdsourcing, we do introduce several legal issues and offer some insights into how lawyers and/or courts may (soon) think about the concerns that crowdsourcing raises.

Ultimately we offer three practical suggestions: be mindful of the law, define relationships in advance, and be open and honest with crowdworkers.

BACKGROUND

As Howe (2006) saw it, crowdsourcing takes the ideals of open sourcing and applies them outside of software development. However, crowdwork today includes many more labor models than Howe's definition seems to imply. Bent Frei (2009) divides paid crowdwork into four categories, moving from the simplest to the most complex. At the simple-work end of the spectrum, there are Micro Tasks, which are small, easy, and tend to be distributed in high volume for very little compensation. These jobs are often as basic as image tagging. Next there are Macro Tasks, which also tend to be high volume and low pay, but require more skill and effort, like writing simple product reviews. In the first two categories, employers generally do not need to direct or communicate with their workers much if at all. Moving to more substantial work, Frei identifies Simple Projects, which are lower volume, higher pay, and require more skill and time commitment. These jobs are often tasks like basic website design or creating outlines for presentations. Finally, Complex Tasks are the most difficult form of crowdwork. These jobs require specialized skills and significant time commitments from the workers. Moreover, they are usually high paying, single project jobs, like designing software modules. These latter two categories typically require employers to communicate with and direct their workers more than with the simpler tasks.

Crowdsourcing systems like Amazon Mechanical Turk (Mturk) fall on the Micro Tasks end of this spectrum (Frei, 2009). Mturk is a bulletin board like website that allows

“Requesters” (employers) to post “Human Intelligence Tasks” (HITs) (jobs) which “Providers” (workers) can accept and accomplish. Generally, HITs require little time to complete and return very little pay – each can be as low as $0.01 (Felstiner, 2009). Indeed, Ross et al. (2010) found in a study of Mturk worker demographics that Providers earn an average of less than $2.00 per hour. Furthermore, Requesters tend to be relatively hands-off with their workers. Dow and Kelmmer (2011) write that Requesters and Providers are normally anonymous to each other; there is little direct interaction between them. Employers often treat workers as merely “interchangeable replacements for computational processes” (p. 1). Workers have been termed “human processing units” (HPUs), a new functional component of computer architecture to complement the central processing unit (CPU) (Davis et al., 2010).

Moving to the more complex end of the spectrum of crowdwork, systems like oDesk allow employers to connect with highly skilled workers to complete much more substantial types of jobs. In a survey of oDesk workers, Brett Caraway (2010) found that oDesk more closely resembles a traditional work environment than the anonymous workforce on Mturk. First, oDesk allows employers to distribute work for hourly pay rather than as fixed price, single task contracts. Second, the platform encourages employers to communicate with, direct, and supervise their workers more. Through oDesk’s “Team Application” software, employers can monitor their workers’ keystrokes and mouse clicks, and even take screen shots and webcam pictures while they are working. Caraway (2010) writes that oDesk workers feel that they are held accountable for their work. Meanwhile, they earn substantially more money on oDesk than Providers

can on Mturk. oDesk reports that its workers commonly make between $10-$25 per hour on its platform ("oDesk").

Importantly, crowdwork is more than a niche labor market. Mturk, oDesk, and other types crowdwork represent a significant and growing amount of workers and money. In 2009, Mturk and oDesk had 200,000 and 331,000 registered users respectively (Frei, 2009). Further, from 1999-2009, workers across ten crowdsourcing companies earned a gross of $750,000,000 (Frei, 2009). Looking at Mturk specifically, Ipeirotis (2010) found that, from January 2009 through April 2010, 9436 requesters posted a total of 6,701,406 HITs, for a total value of at least $529,259. Since this study did not capture redundant HITs and may have missed many short-lived HITs, the actual sum of money which changed hands could be far greater. oDesk reports that employers spent more than $15,000,000 on online work in April 2011 and over 2000 people join its workforce daily ("oDesk").

With advantages for both, the crowdwork market might be attractive to workers and employers alike. For employers, crowdwork offers a highly scalable workforce of on-demand labor that they can easily tap into with little transaction costs. Meanwhile, workers can profit from their "spare cycles", or, in the case of platforms like oDesk, use their specialized skills (Felstiner, 2010). Moreover, with unemployment at 9% (Bureau of Labor Statistics, 2011), and very high underemployment (Newport and Muller, 2011), it is likely that more people will consider crowdwork in the future when looking for supplementary or primary incomes. As the crowdlabor market grows in profile and

importance, however, it seems increasingly possible that we should expect legal regulation.

LABOR AND EMPLOYMENT LAW

One area where crowdsourcing could clearly intersect with the law is in Labor and Employment law. With a substantial labor market, and numerous platforms enabling various types of work, the crowdsourcing industry could face federal and/or state regulation over employment practices in the near future. While crowdlabor has many benefits, anyone considering it must be aware of the potential consequences of having crowdworkers as "employees."

In the United States, both state and federal laws put restrictions on employers to protect against harm to employees. Since a complete survey of employment and labor law is outside of the scope of this paper, we focus on the federal Fair Labor Standards Act (FLSA). Not only is this law very important itself, but it will also help elucidate how other similar regulations may work.

The Fair Labor Standards Act

In 1938, Congress passed the Fair Labor Standards Act in response to declining wages caused by the Great Depression. "Low wages perpetuated a downward economic spiral," and the federal government decided to step in rather than let the market fix its own problems (Cherry, 2009). So, with the FLSA it established things like the federal minimum wage (currently $7.25 per hour), overtime protection, and special rules for children workers.

Before the FLSA can apply, however, the parties in a potential employment situations must be “employers” and “employees” within the meaning of the statute. Generally, employers fall under the FLSA if they conduct interstate business, or generate more than $500,000 in yearly gross revenue (United States Department of Labor, 2009).

Unfortunately, the act is unclear about who qualifies as an "employee." Struggling with this uncertainty, courts have developed several tests to determine whether someone is an employee under the FLSA. For example, the Common Law test looks at how much control the employer has over the worker’s work. Meanwhile, the Economic Reality Test focuses on the economic relationship between the worker and the employer and the degree of financial dependency between them (Smith, Hodges, Stabile, & Gely, 2009).

Courts applying the FLSA most commonly consider seven factors to determine employment status (Felstiner, 2010). No single factor is determinative, but all must be weighed:

> How integral the work is to the employer’s business;
> The duration of relationship between worker and employer;
> If the worker had to invest in equipment or material himself to do the work;
> How much control the employer has over the worker;
> The worker’s opportunity for profit and loss;
> How much skill and competition there is in the market for this type of work;
> If the worker is an independent business organization.

Importantly, FLSA employment status depends on the actual relationship between the employer and employee, not their subjective opinions of their relationship. Felstiner (2010) writes that even though both Mturk and oDesk classify their workers as independent contractors, this does not determine their status. The U.S. Supreme Court has

held that workers may be employees under the FLSA even if both the employer and employee agree that they are independent contractors (Felstiner, 2010). Moreover, Cherry (2009) notes that courts are more likely to find someone is an employee where employers are able to exert greater control over workers and can direct their work. Conversely, courts often classify workers as non-employees where they use their own equipment, set their own schedules, and are paid per project instead of hourly or via salary.

Applying the FLSA to crowdwork, Felstiner (2010) and Cherry (2009) argue Mturk workers could possibly be "employees" under the FLSA. For example, Felstiner (2010) writes that Providers who repeatedly conduct HITs for the same Requesters may be more like FLSA employees, even though they can complete individual HITs quickly. Still, it seems unlikely that a court would classify them as such. Requesters cannot exert much control over Providers, Providers use their own equipment, their employment is ordinarily for a very short time, and they are paid per-job. Even if some factors weigh toward Providers being employees, the others strongly weigh against them being classified as such under the FLSA.

Of course, this analysis may be different across the various types of crowdwork. oDesk is a prime example because its workers seem closer to "employees" under the FLSA than Mturk's Providers. First, employers on oDesk have more power and opportunity to control their workers. The "Team Application" software allows employers to monitor their workers in ways that are impossible even in conventional workplaces. Caraway (2010) writes that one survey respondent said that this software is like "being in an office environment where you have a boss or coworkers looking over your shoulder"

(p. 117). Second, many oDesk workers are paid hourly, like traditional employees. Indeed, oDesk encourages this. Finally, oDesk proclaims that workers can build reputations so employers can choose whom they know and like to work with ("oDesk"). Accordingly, employment relationships may exist longer than single projects.

Ultimately it is not clear if any crowdworker would be classified as an employee under the FLSA. This uncertainty, however, means that potential employers must be aware of the possibility of regulation. Indeed, as crowdlabor grows, this seems to become more likely.

PATENT LAW

Another area where crowdsourcing may intersect with legal regulation is in Patent Law. As crowdsourcing methods become more sophisticated, and more skilled labor enters the workforce, the number of complex projects that use crowdlabor for some or all of their production is likely to grow. One area that will probably experience this is the research and development of patentable inventions. However, having multiple people working on an invention raises important questions of joint inventorship. Anyone considering using the crowd's inventiveness and specialized skills to develop patentable design ought to consider such issues which could jeopardize their patents.

As previously discussed, crowdwork can help effectively solve complex problems. Schenk and Guittard (2009) profile InnoCentive as an example. Pharmaceutical giant Eli Lilly created InnoCentive in 2001 as a way to help develop novel solutions to various problems. Today, over 225,000 of "the world's brightest problem solvers" are part of this community that works on problems across many

disciplines, from Business to Engineering to Computer Science. The purchase cost for one of these solutions can range from $10,000 to $1,000,000 ("InnoCentive"). Like Mturk and oDesk, problem seekers and solvers alike have many incentives for using platforms like InnoCentive. However, with multiple workers helping to develop useful items, these systems implicate problems with inventorship.

U.S. Patent law grants creators of new, non-obvious, useful inventions limited duration monopolies over the exploitation of their works. Patents last maximally 20 years and give inventors the negative right to prevent others from practicing their inventions (Mueller, 2006). In exchange, inventors must disclose certain information about their inventions by disclosing it on the application, including the design, the purpose, and all the inventors contributing to the inception of the invention (Seymore, 2006).

Joint Inventorship

Under 35 U.S.C. § 116 (2011), multiple people making an invention must apply for the patent together. Interestingly for crowdsourcing, the law specifically holds that people can be joint inventors even if they work at different times, in different places, or contribute to different degrees. Moreover, a patent could be rendered unenforceable if an inventor is not on the application (Seymore, 2006).

As Seymore (2006) writes, determining inventorship is especially difficult where multiple parties work on different parts of the same project. Writing about academic research settings similar to crowdsourcing, he notes that inventions may derive from many institutions, research groups, outside contractors, and graduate students all working

together, but not necessarily aware of each other. Figuring out who deserves inventor status, who does not, and even who worked on an invention can be difficult.

Of course, not everyone who works on an invention must be on the application. An "inventor" must contribute to the conception of the invention; merely working under the direction of an inventor is insufficient. Conception is the "touchstone of inventorship" (Burroughs Wellcome Co v. Barr Laboratories, Inc., 1994, p. 1227). Each inventor "must contribute in some significant manner to the conception" (BJ Services Company v. Halliburton Energy Services Inc., 2003, p. 1373). Accordingly, an inventor must add to the invention's core ideas.

Unfortunately, the line between co-inventor and worker is often unclear. As the Court of Appeals for the Federal Circuit wrote in *Burroughs Wellcome Co*. (1994), "inventorship cases tend to be highly fact-specific and seldom provide firm guidance on resolving future disputes" (p. 1227). Still, one can make several observations about potential crowdsourced inventions. If, for example, a crowdsourcer offers a reward for a solution to a problem without further direction, similar to InnoCentive, the person/team that answers that problem successfully would likely be inventors. Conversely, if a crowdsourcer directs the crowd to perform research tasks that help develop the concept for a patentable design, the workers likely would not be inventors. Finally, if multiple teams work to solve multiple problems that are then combined as claims on one patent, everyone who contributes to the conception of a claim would be an inventor who must be included on the application (Seymore, 2004; Sibley, 2008).

Crowdsourcing may be an attractive and effective way for companies to develop novel solutions to any number of problems. Crowdsourcers, however, must be aware of patent law before conducting such work or they risk losing control over their intellectual property.

DATA SECURITY

A third area where crowdsourcing and the law will likely intersect is in data security. Businesses today are increasingly sharing information about themselves with the crowd in order to strengthen research and development. Realizing crowdsourcing's potential for innovation, these companies may be tempted to disclose data about their customers/users to researchers to facilitate and stimulate these efforts and help drive the crowd's ingenuity. Indeed, both America Online (AOL) and Netflix attempted to do so (Barbaro & Zeller Jr., 2006; Ohm, 2010). However, as both found out, doing so risks violating data security regulations.

The FTC is the federal agency charged with protecting consumers from adverse acts committed by commercial entities. 15 U.S.C. § 45 (2011) gives the FTC power to prevent businesses from engaging in "unfair or deceptive acts or practices" that affect commerce. Recently, this agency has been aggressively protecting consumers from data breaches by commercial entities, even scrutinizing the release of supposedly "anonymous" data. While crowdsourcing offers new opportunities for better analyzing and processing user data, businesses considering engaging in such crowdsourcing should tread carefully and stay informed to minimize risk of FTC data security regulations.

Even though this authority may not initially seem to include data security, since the 1990s the FTC has extended its power to scrutinize commercial entities that put their users' privacy at risk. Michael Scott (2008) details this development. The FTC first acted to protect online privacy was in 1999. In that case, the web hosting service Geocities disclosed its users' personal data to third parties who then turned and used that information for purposes that the users had not agreed to. The FTC found that Geocities acted improperly and needed to inform its users about data it collected, for what purpose, and to whom it would be disclosed.

Since the Geocities case, the FTC has further developed its power over data security. First, in 2005, the agency found that BJ's Wholesale Club violated the "unfair or deceptive practices" standard by failing to adequately protect its customer records from thieves. Shortly thereafter, the FTC filed a similar complaint against DSW when hackers broke into the company's database. The agency found that DSW failed to protect its customer's private data and thus violated the deceptive acts prohibition. Then, in 2006, the FTC extended its reach even further in a complaint against CardSystems Solutions (CSS). CSS provided businesses with products that authorized credit card transactions. The FTC found that CSS violated privacy regulations by failing to protect the personal information it collected by storing data in an unsecure format, failing to assess the vulnerability of its system, and not implementing strong protections against hackers (Scott, 2008).

What is more, the FTC also regulates how businesses treat supposedly anonymous user data. Recently, some companies have found that they can source innovative business

ideas by sharing user information to the crowd. In 2006 AOL released data from 650,000 users and 20 million search queries to the information retrieval community for research. Before doing so, the company attempted to anonymize the data. A New York Times article, however, showed that one could still find the identities of individual users (Barbaro & Zeller Jr., 2006). In response, the Electronic Frontier Foundation (EFF) filed a complaint with the FTC, requesting that it act against AOL (EFF, 2006). AOL ultimately fired the individual responsible and effectively shut down its research division (Ohm, 2010).

Later that year, Netflix released one hundred million anonymized user records as part of its "Netflix Prize" Contest. In this, the company offered one million dollars to the first team to significantly improve Netflix's recommendation algorithm. This contest was so successful the company decided to hold another one. However, two researchers discovered it was "surprisingly easy" for a malicious party to use Netflix's data, combined with a little other information, to find the identities of the users in the dataset (Narayanan and Shmatikov, 2008). Soon thereafter, a class action suit was filed against the company and the FTC entered the picture. Fearing legal troubles and agency pressure, Netflix cancelled its second contest (Ohm, 2010).

Maureen Ohlhausen (2011) writes that the FTC's views on data security have evolved from a "notice and choice" approach, where an online business would remain safe by adhering to its stated privacy promises, through a harms-based model, to today's hybrid approach. In 2010, the agency proposed a new framework for protecting consumer privacy, broadening its scope even further. Now it applies to all commercial entities that

collect information from consumers, online or offline, whether they interact directly or indirectly with consumers (Ohlhausen, 2011). This includes "any data that can reasonably be linked to a specific consumer, computer, or other device" (Ohlhausen, 2011, p. 44). Instead of focusing on privacy promises, this model looks at company actions likely to cause physical or economic harm or intrude into the lives of their customers.

With such actions, the FTC has shown it is moving toward a broad approach on consumer data security. This may impact the crowdsourcing industry in at least two ways. First, online businesses that collect user data must both protect them and only use them in ways that their users consent to. Second, as the AOL and Netflix examples show, while there may be benefits to using crowdsourcing to analyze user data, such disclosure can create new data security problems, even if an honest attempt is made to anonymize customer records. Businesses interested in using the crowd in this manner should understand the FTC's stance on data security and weigh their actions carefully.

COPYRIGHT

Another legal area at issue is intellectual property ownership under copyright. Anyone considering crowdsourcing creative works should be aware of copyright implications bearing on control over rights to those works.

Crowdwork can support creative designs in several ways. Consider Crowdspring, whose platform provides a place where users searching for creative designs can connect with a crowd of artists who are looking to sell their works (Schenk and Guittard, 2010). In particular, Crowdspring advertises itself as a place where businesses can source things like company logos. Users can go on the site, provide general ideas for a design, and

request proposals from the crowd. Artists then take the instructions, work out their ideas, and offer back potential designs from which the users can purchase their favorite ("Crowdspring").

Another example of crowdsourcing creative work is The Johnny Cash Project. Created by Chris Milk, The Johnny Cash Project is a collaborative art project that brings together contributions from many artists into a single work (Ehrlich, 2010). Anyone can register on the site and contribute a drawing to the project. These drawing are then combined to make a music video. Each person's work is part of the final artistic creation ("Johnny Cash Project").

These platforms raise two separate questions about copyright ownership. While Crowdspring implicates copyright's doctrine on works made for hire, the Johnny Cash Project raises issues about joint works/authorship. Fortunately for their users, both systems address these questions for them in their terms of use agreements. However, a crowdsourcer who decides to act outside of these platforms might not realize the copyright issues involved and could easily lose control over the work that the crowd produces.

Copyright Basics

Similar to Patent law, Copyright law gives authors certain rights to protect their works from improper use. Instead of pertaining to useful inventions, however, copyright protects original creative works (17 U.S.C. § 102, 2011). Once a work is copyrighted, its author receives various rights, including the ability to stop unauthorized copying, distribution, and/or public display (17 U.S.C. § 106, 2011).

Obtaining a copyright today is quite easy. Works automatically receive copyrights if they are original and fixed in a tangible medium of expression. Authors must only contribute "a modicum of creativity" to a work for it to be to be original (Feist Publications, Inc. v. Rural Telephone Service Co., 1991). A work is fixed when it is "sufficiently permanent or stable to be perceived, reproduced, or otherwise communicated for more than a transitory duration" (17 U.S.C. § 101, 2011). After creating the work, the author does not need to do anything else; a copyright is valid without registration.

Works Made For Hire

Typically creators own the copyrights to their works. They create their works, capture them in a tangible medium of expression, and the copyrights vests in the creators immediately thereafter (17 U.S.C. § 201, 2011). This changes, however, when a work is a "work made for hire." Under 17 U.S.C. § 101 (2011), works made for hire occur in two situations. First, works made by employees within the scope of their employment are works made for hire. Second, certain specially commissioned works can be works made for hire if the parties agree to such in writing.

While a crowdsourced creative work could fit in the second category, systems like Crowdspring more immediately implicate the first: works made by employees. Once again, the issue turns on who is an employee. Stated simply: employees make works made for hire and their employers own those copyrights; non-employees do not make works made for hire and they own their own copyrights. Accordingly, a court must first determine if a person is an employee or not to understand copyright ownership.

Fortunately, the U.S. Supreme Court has provided guidance on who is an employee under Copyright law. In *Committee for Creative Non-Violence v. Reid* (1989), Committee for Creative Non-Violence (CCNV) hired Reid to design and build a sculpture. After hiring him, CCNV left him to work with only minimal interference. He submitted a few proposals that the CCNV considered and rejected, but he operated mostly on his own. Once Reid was finished, CCNV paid and took possession of the sculpture. Soon, however, they began to argue over how CCNV could use the sculpture. Reid asserted copyright over it, claiming that he owned the intellectual property as its creator and could control its use. CCNV, however, felt that it owned the intellectual property because Reid was its employee.

The Court rejected CCNV's claim and sided with Reid. It instructed lower courts to look at twelve factors when considering employment status under Copyright (CCNV v. Reid, pp. 751-752). While similar, these are distinct from the seven factors used by FLSA to determine employment status. The twelve factors are:

> The hiring party's right to control how the product is accomplished;
> Who owns the tools that the worker uses;
> Where the work is done;
> The duration of their relationship;
> If the hiring person can give the worker more work;
> If the worker can self-decide when and how to work;
> The method of payment;
> If the worker can hire assistants without employer;
> Whether the employer is a business;
> If there are employee benefits;
> If the work is in regular business of the hiring party;
> Tax treatment of the worker.

A detailed analysis of these factors and their treatment in subsequent cases is outside of the scope of this paper. Nevertheless, a few observations are useful. To

paraphrase the Court in Reid (1989), the question is whether a relationship resembles a conventional employer-employee relationship. Nearly every time courts have held workers to be en employees under this clause, the hiring party has participated directly in creating the work (Nimmer, 2011, § 5.03). Essentially, if something looks more like a regular work situation, with a hands-on employer actively directing the worker and involved in the work, then the worker will be an employee and his work will belong to the employer. If, as in Reid, an employer mostly leaves a worker alone to complete a single task while using his own tools, he will probably not be considered an employee and he will own the work himself. Moreover, while highly skilled workers are not insulated from being employees, the task here is to weigh the factors against each other to determine the nature of the relationship between the hiring and working party.

If a worker is an employee under the copyright statute, the inquiry turns to the scope of employment. An employee who conducts work outside his scope of employment does not create a work made for hire. Courts addressing this prong usually consider three factors: 1. Is it the kind of work the employee was hired to perform; 2. Did it occur during authorized work hours; 3. Was it done, at least in part, to serve the employer (Nimmer, 2011).

Applying all these factors to a platform like Crowdspring, a crowdworker would likely not be considered an employee and would retrain copyright. Like Reid, crowddesigners work mostly independent of the employers, using their own equipment, for limited times, in their own spaces, and are paid by the project instead of hourly. Indeed, they may be even more independent than Reid himself was. Even though it seems

likely that a contracted design would probably be within the worker's scope of employment, these designers would probably own the copyrights to their works absent a written agreement changing the relationship, because they would likely not be employees under copyright.

So, a small business that crowdsourced its company logo design but did not receive the copyright to the design from the creator would not have the right to reproduce, distribute, or publicly display copies of that logo. Crowdspring solves this problem for its users by providing a readymade contract for them. However, no one needs Crowdspring to crowdsource creative designs, and there may be reasons to forgo this platform. Indeed, such work could even be done on Mturk or without any specific platform. Yet, such crowdsourcers must account for the works made for hire doctrine or they could lose control over their designs.

Joint Works

Turning to the Johnny Cash Project example, another way that Copyright law can affect crowdsourcing is with the joint works doctrine. 17 U.S.C. § 101 (2011) defines a joint work as a work that is created by two or more people who intend their contributions to be merged into inseparable parts of a whole. To be a joint author, each person must contribute independently copyrightable parts to the finished product (Gaiman v. McFarlane, 2004). As mentioned, it is easy for something to be copyrightable. So, a putative joint author must only contribute something that is original and not in the public domain, and both authors must intend to end up with a copyrightable final product.

The joint works doctrine is significant for crowdsourced creative works because each author owns them in common. Consequently, all authors to a work have equal rights to control, sell, and profit from it if it is sold, or can sue to recover their share (Davis v. Blige, 2007). A collaborative project like the Johnny Cash Project clearly implicates joint works issues. Its explicit purpose is to join artists' works together into a single art project. So, there seems to be an expectation that the users are creating a copyrightable work together by contributing parts which will be combined into an inseparable whole. If those pieces are copyrightable, then each artist could be a joint author and each would have ownership rights over the work.

Once again, like Crowdspring, the Johnny Cash Project addresses copyright ownership issues for its users. However, the danger for future crowdsourcers comes from how easy it is to use crowdsourcing to develop joint creative projects without using an extant platform or model. The Sheep Market (www.thesheepmarket.com), for example, created an online mosaic of hand drawn sheep by sourcing drawings from Mturk. Moreover, Kittur, Smus, and Kraut (2011) have proposed new mechanisms to automatically divide and combine complex tasks like article writing to be crowdsourced better. Indeed, the internet allows almost anyone to tap into the crowd's creativity. Thus, anyone considering crowdsourcing a collaborative project must consider Copyright law before moving ahead or they could potentially lose sole control over their works.

WHAT YOU CAN DO

The various scenarios we have discussed beg the question, what should someone who is considering crowdsourcing do? In short, do not panic! While lawyers may seem

often to preach doom and gloom about possible legal consequences, our intent is to empower readers with basic information to better consider their actions and possible effects of them. We suggest at least three lessons below.

Be Mindful of the Law

The first lesson might seem obvious: be mindful of the law. With new opportunities and technologies, one may naturally be tempted to rush in without worry, especially in virgin territories where no regulation is immediately apparent. For better and worse, however, the diverse scenarios we have considered show that legal regulation is everywhere. From employment to privacy, the law touches various dimensions of crowdsourcing. Furthermore, it is constantly evolving. While this may be obvious from the rapid development of securities regulations the FTC's approach to data security, it is also true throughout the law.

Legal challenges frequently fit old laws into new situations. As Felstiner (2009) argues, the FLSA, a statute from 1938, could apply to a method of business that was almost inconceivable when Congress created it. Moreover, it is possible that federal and state legislatures and agencies will create new laws and administrative rules to protect the growing crowd-workforce. Anyone interested in crowdsourcing should therefore consider the potential legal ramifications, weigh the costs and benefits, and proceed accordingly.

Use Contracts to Clearly Define Your Relationships

Our second lesson is to clearly define the relationship between employer and worker by contract before beginning any work. Patent law, for example, allows inventors to transfer their rights in a patent using written contracts (35 U.S.C. § 261, 2011).

Seymore (2006) writes that schools frequently require professors and graduate students to sign contracts before they are hired that assign away their rights in their inventions. Furthermore, some courts have found that researchers have a duty to assign their work to their employers in some situations. Even though the workers may be inventors in both instances, they are not owners and cannot control the invention. Similarly, Copyright owners can transfer or license some or all of their rights to their works with written documents (17 U.S.C. § 201, 2011). So, employers can have a copyright transferred to them, even if it initially belongs to their worker. Finally, crowdfunders can clearly state when a transaction represents a donation rather than an investment, with no expectation of profits offered. This avoids any confusion up front.

Online entities commonly use "clickwrap" or "browserwrap" agreements to define their relationships with their users. Anytime users click "I agree" or something similar to a list of terms before accessing a site, they bind themselves to the requirements therein. Clickwrap agreements are very popular, and most courts have held them to be valid contracts unless their terms are unconscionable (Davis, 2007). Indeed, all of the crowdsourcing systems discussed above require their users to accept such agreements before using the services. Of course, some things cannot be contracted away, like employment status under the FLSA or inventorship status. Some crowdsourcing agreements we have seen may not stand up in court. Still such contracts can help resolve many problems in advance and help to clarify the relationship boundaries between crowdsourcer and crowdworker.

Be Open and Honest

Our final suggestion is that crowdsourcers should always be open and honest about their expectations, work offered, and how they will treat the data they collect. As mentioned, the FTC has become increasingly aggressive in protecting data security. Accordingly, any crowdsourcing enterprise that collects and/or distributes user data must protect those data, as well as inform its users of what information it collects and how it will use that information.

More broadly, having clear expectations and policies might help crowdsourcers avoid legal conflicts in general. Consider Reid (1989) again. Reid and CCNV's legal dispute stemmed, in part, from their differing expectations. CCNV thought it rightfully owned the statue and could use it anyway it wanted. As the artist, however, Reid saw his creation differently. He would not allow CCNV to use it in ways that he did not intend. If the two parties had discussed these issues earlier, they may have been able to avoid litigation. Admittedly, communication cannot prevent all legal problems and it is impossible to predict every situation that may arise. Nevertheless, by being open, honest, and clearly stating their expectations, crowdsourcers can hopefully avoid legal troubles, and crowdworkers can understand their roles without false expectations.

CONCLUSION

As the crowdsourcing industry grows increasingly popular, it may face a variety of potential legal challenges. This paper introduces just four areas where legal regulation and crowdsourcing may intersect. First, under employment/labor laws, crowdsourcers may risk having crowdworkers deemed employees, potentially raising the costs of

conducting crowdwork. Second, though crowdwork can help design patentable inventions, crowdsourcers must pay attention to the rules of inventorship or their patent could be unenforceable. Third, while the crowdsourcing may be a great way of analyzing supposedly anonymous user data, business may run into data security regulations as both AOL and Netflix did. Finally, because of Copyright's ownership doctrines, crowdsourcers may lose solitary control over creative works unless they address the issues of works made for hire and joint works.

Further issues will undoubtedly arise as crowdsourcing develops, moves into new areas, and impacts a greater number of people. Future work in this area may look to the open source industry for guidance. This similar, but distinct industry has already weathered some legal challenges which may be instructive for crowdsourcers. For now, however, we simply suggest you look before you leap to avoid the potential legal pitfalls of crowdsourcing.

Crowdfunding: The Future of Fundraising and Startup Capital

INTRODUCTION

With the development of greater online connectivity and better social interaction technologies, crowdsourcing (Howe, 2006) has risen as a viable method of leveraging the growing pool of online labor, intelligence, and creativity of the internet crowd. Examples like Amazon Mechanical Turk (www.mturk.com), oDesk (www.odesk.com), InnoCentive (www.innocentive.com), Threadless (www.threadless.com), and Star Wars: Uncut (www.starwarsuncut.com) show how powerful crowdsourcing can be to accomplish a wide variety of tasks. Each have successfully brought together the crowd in new and fascinating ways to complete work that previously would have been done by an individual or business.

In this chapter, we study this intersection of technology, practice, and policy in the context of a particular crowdsourcing model: *crowdfunding*. While people have solicited donations forever, crowdsourcing uses developments in connective technologies to change how fundraising in significant ways. Whereas traditional fundraising models tend to collect larger amounts from fewer individuals, crowdfunding exploits the breadth and diversity of the Internet to solicit typically smaller contributions from a large number of people. This can be a powerful method of fundraising for any number of users. Already we have seen platforms effectively use microloans systems to raise money and interest in their charitable causes; political campaigns have raised astounding amounts of money by appealing to the crowd; artists, musicians, and game developers can use

crowdfunding to help fund their products; and small businesses can raise startup capital by appealing to the crowd on the internet and asking for support.

While crowdfunding arises in multiple forms, our interest lies in analyzing the emergence and legal evolution of *crowdfinance*, in which equity investment is offered to the crowd in exchange for funding (Bradford, 2011). While many types of crowdfunding have already made a significant societal impact, current federal securities legislation has largely prohibited crowdfinance. Under the Securities Act of 1933, anyone who offers a security to the general public must register with the Securities and Exchange Commission, a time consuming and onerous task that might not be available to most crowdfunders. Moreover, while there are some exceptions for small, private securities offerings, they prohibit using an open call to raise money, and thus conflict with crowdfunding.

Perceived shortcomings of existing policy in comparison to the potential benefits of crowdfinance has recently sparked renewed legal scrutiny of this policy, as well as the proposal of several alternative legal paths by which we might create laws that are more permissive of crowdfinance. As such, we believe that now is an apt time for us to review crowdfunding and crowdfinance, assess alternative legal visions for a future which includes crowdfinance, and consider future implications of new policy as technology, practice, and policy continue to evolve and collide.

The remainder of this chapter is organized as follows. First, it looks at what crowdfunding, is what are the different types of crowdfunding. It then considers how federal securities laws apply to crowdfunding, particularly crowdfinance. Next, this

chapter looks at whether several exemptions to securities laws could be useful in crowdfinance situations. Finally, it discusses the new crowdfunding legislation that Congress is currently considering.

WHAT IS CROWDFUNDING?

Jeff Howe (2006) defines *crowdsourcing* as the act of taking something that was once done by employees and outsourcing it to an undefined network of people via the internet in an *open call* for help. *Crowdfunding* takes these ideas from crowdsourcing and applies them to fundraising. Whereas crowdsourcing solicits people's spare seconds to complete small tasks, crowdfunding collects their spare change (Howe, 2009). In comparison to traditional, narrowly targeted fund raising campaigns, crowdfunding campaigns tend to seek as many contributors as possible, benefiting from the power of the Internet to reach wider, more diverse audiences. Crowdfunding also tends to solicit smaller, micro-contributions, which while individually small, in aggregate can amount to a significant source of revenue. Heminway and Hoffman (2011) describe crowdfunding as any internet-based business enterprise that seeks relatively small donations using a website to connect projects to potential funders. Their restriction to "business enterprises" is too strict, however, since many charitable organizations, or even individuals, are capitalizing on crowdfunding today. In fact, such small organizations or isolated individuals particularly benefit from crowdfunding, because it requires little more than an Internet-connection to solicit and begin collecting contributions. Belleflame, Lambert, and Schweinbacher (2010) emphasize the importance of the open call as a key ingredient

to notifying and enabling the crowd of potential supporters to participate in crowdfunding.

At the heart of crowdfunding is a financial transaction executed between two parties: the fundraiser and a financial supporter who contributes. As in traditional banking, a 3rd party often facilitates or mediates the transaction in practice. Ordanini, Miceli, Pizzetti, and Parasuraman (2011) emphasize the role of this 3rd party in crowdfunding: the Internet platform which enables fundraisers to solicit support from the crowd of potential contributors. However, the relationship between fundraisers and supporters is often far more than purely financial. For example, crowdfunding can connect producers and consumers in new ways which might be more difficult to achieve via traditional funding models. Burkett (2011) notes that financial supporters usually feel some affinity for the projects they choose to fund. Ordanini et al. (2011) suggest that crowdfunding provides an avenue through which consumers can be part of the selection, development, and production of new products. In addition to monetary support, contributors may also help to develop the projects themselves. Belleflame et al. (2010) similarly argue that crowdfunding can give fundraisers insight into their customers/audiences. It creates new channels for information and interaction between organizations and their customers that can be used for promotions, to support user-based innovation, or to learn about customer-interests while raising money.

In addition to enabling fundraisers to build new types of relationships with their patrons, crowdfunding is also enabling these relationships to form across larger geographic distances. Thanks to the Internet, crowdfunding enables organizations to

reach a more widely geographically dispersed population of potential supporters. Agrawal, Catalini, and Goldfarb (2011) write that investments for most crowdfunding ventures tend not to be purely local, unlike most small, early-stage business ventures. With traditional funding, the average distance between a venture capitalist and its target firm is about 70 miles. With crowdfunding, in contrast, they find that the average distance between investors and their investments in crowdfunding is larger 3100 miles.

As with other forms of crowdsourcing, both extrinsic and intrinsic forms of motivation are often at work in crowdfunding, impacting both fundraisers and their supporters. Gerber, Hui, and Kuo (2012) found that in addition to raising money and establishing relationships with their patrons, fundraisers also often seek to receive validation of their abilities, replicate the success of others, and to expand the awareness of their work through social media. Similarly, patrons may not simply seek rewards for their financial support, but may further look to help creators and the causes they believe in. In creative enterprises, patrons might wish to participate in the creative process alongside the fundraisers.

An increasingly diverse set of organizations and industries are now beginning to use crowdfunding. As an example of a charitable organization, consider GlobalGiving (www.globalgiving.org), which allows anyone to contribute online to development projects around the world. Since 2002, over 5,000 projects have received nearly $60 Million, from about 250,000 Global Giving users. In addition to supporting charitable causes, crowdfunding is also now "competing" with traditional micro-loan providers. Kiva (www.kiva.org), for example, was founded in 2005 to enable people to more easily

find and loan money to charitable causes of their choosing (Howe, 2008). These loans are extremely low risk, with 98.88% being repaid. In terms of industry, Aitamarto (2011) and Betancourt (2009) discuss crowdfunding as a method for raising revenue in journalism. As traditional business models in this field are losing economic viability, crowdfunding might provide a way to raise money while learning from the collective intelligence of the crowd at the same time. Aitamarto (2011) focuses on Spot.Us, an online platform that allows freelance journalists to pitch story ideas, and users fund the stories that they would like to be reported. Beyond just giving money, users can also comment on developing stories or pitch ideas, and even submit new information, sources, or ideas that might help the final product. Traditional editors still perform a function on Spot.Us, but the crowd is more directly connected with the creation of stories than in the past. Similarly, Kappel (2009) argues that crowdfunding might also provide a new source of revenue in the recording industry. He writes that *ex ante* crowdfunding can be effective in this industry by using "patronage perks" like special mentions in liner notes, autographed albums, or backstage passes to encourage support. Kappel notes that several Europeans companies have experimented with this type of funding, but there are barriers to entry in the U.S. market – like federal securities regulation – that might be problematic.

Both Schweinbacher and Larralde (2012) and Pope (2011) see crowdfunding as particularly valuable to new businesses that often have difficulty raising venture capital. It may be especially helpful for small businesses because it allows them to reach wider audiences of potential investors than they otherwise would be able to. Schweinbacher and Larralde (2012) write that traditional fundraising methods like loans, venture capital

investment, and angel investments are often difficult for new organizations to use. In contrast, crowdfunding can be a viable fundraising method for small organizations or projects where these other avenues for capital are unavailable. Similarly, Pope (2011) argues that crowdfunding might be especially valuable to very small companies with only a few employees that need relatively small amounts of capital.

MODELS OF CROWDFUNDING

While the definitions and examples of crowdfunding presented thus far convey the broad scope of practices which it encompasses, Bradford (2012) distinguishes five distinct models of crowdfunding: donation, reward, pre-purchase, lending, and equity. The driving force behind these distinctions is to model ways in which the different forms of crowdfunding interact with the law. In reviewing these categories, we do not perceive an important legal distinction between the pre-purchase model and the reward model. Consequently, our own organization and discussion of crowdfunding models below simply mentions pre-purchase as one example of the reward model.

1. The Donation model

In this category of crowdfunding, donors give money without receiving or expecting to receive any material item in return. Previously mentioned GlobalGiving exemplifies this crowdfunding model. Barack Obama's use of crowdfunding in his 2008 Presidential campaign would also fall in this category (albeit one might argue it useful to distinguish potentially self-benefitting versus purely altruistic forms of donation-based crowdfunding). Obama's campaign successfully organized millions of supporters online,

raising $750 million from 2 million donors in just 21 months, with 80% of the donations being less than $200 (Bradley, 2008; Brewer, 2011).

2. The Reward model

This model also seeks donations from the crowd without monetary compensation. However, the reward model offers other extrinsic incentives in the form of rewards to encourage people to donate. Often these rewards are materials goods, but they can be almost anything: from specialized thank you letters, to artwork stickers, etc. Here, Bradford distinguishes between the reward model and what he calls the prepurchase model. In the prepurchase model, artists give copies of the work they are seeking funding for. So, a musician might give a copy of her new albums to encourage donations. This, however, seems to be a specialized form of the reward model, rather than a distinct model itself. In the prepurchase model, the reward is the artwork instead of something else. So, it seems logical to consider them as one category instead of two.

Many platforms use the reward model. Kickstarter (www.kickstarter.com), for example, was founded in 2009 by Yancey Strickler and Perry Chen as a forum where users can post project ideas and seek support from the crowd (Martiniere, 2011; Schonfeld, 2011). Importantly, while it encourages users to offer incentives to their donors, it prohibits them from offering equity investments in their projects. Indiegogo (www.indiegogo.com), which bills itself as "the world's largest global funding platform," is another example of this model. Once again, it provides a space for people with project ideas to connect with donors, allowing users to offer different rewards to incentivize support. A third example of this model is RocketHub (www.rockethub.com). RocketHub

gives crowdfunders a community and infrastructure wherein they can seek "fuel" (funding) for their projects, and "fuelers" can "receive cool stuff" in exchange.

3. The Lending model

In this model, funders do not merely donate money. Instead they give loans with the expectation of repayment. Previously mentioned Kiva exemplifies this model, as does Deki (www.deki.co.uk), another platform to provide microloans for charitable causes. Deki is a UK not-for-profit organization whose mission is to help borrowers start small businesses and create a way out of poverty (dailycrowdsource.com). Meanwhile, Prosper (www.prosper.com) and Lending Club (www.lendingclub.com) offer a variation on the lending model that differs a bit from Kiva or Deki. Instead of focusing on charitable causes, Prosper and Lending Club allows users to loan money to people and business and earn interest from their loans.

4. The Equity Investment model (*crowdfinance*).

Crowdfinancers offer a percentage ownership of their project/company to people for investing. In doing so, they give people the chance to profit from the success of the ventures that they buy into. Unfortunately for potential crowdfinancers, however, deals like this might run into problems with federal securities laws. So, today there are not many platforms that allow crowdfinance. Nevertheless, at least one U.S. company, ProFounder (www.profoudner.com), claims to provide a way to use crowdfunding to offer equity investments. It does so by giving users information about the limited exceptions to securities laws, and providing them with tools to take advantage of them. Significantly, it does not provide a platform where users can advertise deals or collect

investments and it does not facilitate relationships with investors. Instead, it helps users find investors within their own communities, and gives crowdfunders the legal ability to offer equity to them.

THE CASE OF BUYABEERCOMPANY.COM

While Crowdfunding offers potential to successfully raise funds while building interest and support in a product/company, it can violate federal securities laws in some circumstances.

In 2009, the Kalmanovitz Charitable Foundation, owners of the Pabst Brewing Company, decided to sell the beer company for $300 million dollars. Hearing about the offer, Michael Migliozzi and Brian Flatow decided to try to buy it. Not having the money themselves, however, they decided to ask the crowd for help (Allen, 2010). Instead of a sophisticated fundraising plan, Migliozzi and Flatow simply set up a website – BuyaBeerCompany.com – and offered a deal to anyone who wanted to join in: give money and get a piece of Pabst. Initially, they did not collect actual donations; rather, they gathered pledges that they would collect once they raised the requisite $300 million (Singer, 2011).

Improbably, the Buyabeercompany.com fundraising campaign was tremendously successful. Only building interest in their company via their website, Facebook, and Twitter, and offering the chance to own a part of a famous beer brand, Migliozzi and Flatow raised $14.75 million in pledges in just three weeks, $100,000,000 by the end of 2009, and yet another $100,000,00 by March 2010 (Crowdfunding: Connecting Investors and Job Creators, 2011). Around this time, however, the Securities and Exchanges (SEC)

commission finally caught wind of BuyaBeerCompany. The agency informed Migliozzi and Flatow that they were under investigation for offering unregistered securities in violation of the Securities Act of 1933, and started the process that would eventually end the business. Finally, on June 8, 2011, the SEC issued a cease and desist order to Migliozzi and Flatow, ending the BuyaBeerCompany experiment before it collected any money at all (SEC, 2011). When BuyaBeerCompany closed, it had $282 million in pledges from 7 million people at an average of just $38 per pledge. (Migliozzi, 2011).

We can learn at least two lessons from this example. First, crowdfunding has amazing potential. Migliozzi and Flatow simply asked for support and offered people a simple, fair deal in an open call for support, and the response was impressive. Second, this story highlights the central debate in crowdfunding today: Under current law, crowdfinance is either illegal, or practically impossible for the average entrepreneur.

INVESTMENT CONTRACTS

The principle legal concern in crowdfunding is whether an offer falls under federal securities regulation and thus can be regulated by the SEC. As with BuyaBeerCompany, offers of securities must be registered with the agency or they are illegal. Still, not all offers are securities. Moreover, some offers fall under exemptions in law. These exemptions, however, are unavailable to most crowdfinance ventures.

Two federal statutes lay the groundwork for U.S. securities regulation.[1] Partially spurred on by the large number of fraudulent securities that contributed to the stock market crash in 1929, the U.S. Congress passed the Securities Act of 1933 to provide

[1] While there is some state regulation of securities, we limit this discussion to federal law.

protection against such events in the future. This act focuses on the distribution of securities, requiring registration of securities that are offered to the public for the first time, and certain disclosures from the issuers of those securities. In 1934, Congress passed the Securities Exchange Act, which, among other things, established the Securities and Exchange Commission, the agency that still oversees and regulates U.S. securities today (Hazen, 2009).

To fall under the ambit of the Securities Act of 1933 and the SEC's jurisdiction, a financial instrument must qualify as a "security" within the meaning of the law. 15 U.S.C. § 77b lists several different instruments that are "securities" under this law, including: notes, stocks, bonds, evidence of indebtedness, and "investment contracts." Unless there is an exception/exemption, securities must be registered with the SEC, and this agency has authority to regulate securities in several ways (Hazen, 2009). Since it is intended to provide investors with information to help them make safer investments, registration requires businesses to disclose information to the SEC about the principle parties making the offering, the nature of the business, and financial statements. The registration process is very rigorous, and it might be too difficult, time-consuming, and/or costly for most crowdfunders to use (Bradford, 2011).

The question is whether a crowdfunding offer constitutes an investment contract and is thereby a security under federal law. In 1946, the U.S. Supreme Court articulated a test to determine what constitutes an investment contract. The Court held that an investment contract is: (1) An investment of money in (2) a common enterprise with (3)

an expectation of profits (4) derived solely from the actions of others (SEC v. W.J. Howey Co., 1946).

Notably, Hazen (2009) writes that the definition an investment contract "depends not so much on what is actually being offered but how it is being offered, and what is being promised" (p. 28). Investor perception is key in determining whether something is a security or not. Courts will often look at how an investor understood a situation to make this determination. If an investor buys a financial instrument from a broker, a court is more likely to find it to be a security than if the same instrument comes from a layperson. So, a nonprofessional crowdfunding offer might look less like an investment contract than one which passes through a third party intermediary platform.

Even though they might be nonprofessional, however, crowdfinance projects clearly implicate this law. Consider again BuyaBeerCompany. Migliozzi and Flatow sought monetary investments in Pabst (an investment of money), from anyone who wanted to join in (probably a common enterprise), while offering an expectation of profit (a percentage company ownership), and the investors need only to give money. Though average crowdfunders like Migliozzi and Flatow would probably not be considered securities professionals, the other factors still weigh toward their offer being a security. Certainly the SEC thought so in this example. Importantly, almost any crowdfinance project would implicate this law; it is not limited to deals of a certain size or investor amount.

Exemptions to registration for certain types of investment offers

Even though many crowd equity investment schemes seem to fall under securities regulation, the law has several exemptions from registration that could apply. Ultimately, however, these provisions will not likely offer protection for crowdfunded equity investments.

Federal securities law permits certain private and/or relatively small offerings of securities by exempting them from registration. First, 15 U.S.C. § 77d(2), allows some private offerings without registration if the purchasers of the securities are able to evaluate the risks of the investment, have access to the kind of information that would ordinarily be available to the SEC, and agree not to resell the security. Rule 504 (17 C.F.R. § 230.504) permits a company to offer up to $1,000,000 in securities during any 12-month period without any disclosure requirements or limitation on the number of purchasers (SEC Rule 504, 2009). Rule 505 (17 C.F.R. § 230.505) raises this number to $5 Million, but increases the limitations on the issuer and the offering. It permits unlimited "accredited investors" – primarily banks, business, and high income investors – but only thirty-five non-accredited (SEC Rule 505, 2009). Finally, Rule 506 (17 C.F.R. § 230.506) creates a "safe harbor" for certain private offerings if the offering company only sells to an unlimited number of purchasers and up to thirty-five "sophisticated purchasers" – people who have sufficient knowledge and experience in finance and business such that they can evaluate the risks of their investment (SEC Rule 506, 2009).

Still, these exemptions will not be available to most crowdfinance ventures. As aforementioned, the exemptions are designed to give certain *private offerings* a way to

avoid registration. Any offer that involves a general solicitation violates these rules. Crowdfunding relies on the open call for investors; it is inherently non-private. Accordingly, the nature of crowdfunding seems fatal to using these exemptions in crowdfinance situations.

Nevertheless, ProFounder claims to enable people to use crowdfinance within the limits of Rules 504 and 506. However, it seems questionable whether ProFounder is, in fact, a true form of crowdfunding. As discussed, it does not actually provide a platform where people may advertise or sell their securities. Moreover, it does not facilitate connections between offerers and potential investors. Instead, ProFouder only helps people build their business and raise capital within the limits of the law, and not in the form of an open call for investment. While this might be a valuable service, it is questionable if it is truly crowdfunding.

THE FUTURE OF CROWDFUNDING

Crowdfunding's popularity has skyrocketed in the past few years. Kickstarter, for instance, has been tremendously successful, raising nearly $100,000,000 for 27,000 projects during 2011 alone (G.F., 2012). In February 2012, it had its first project to raise $1,000,000 in one day (Strickler, 2012). Kiva, meanwhile, has loaned nearly $300,000,000 from 1 million users since 2005 (Kiva, 2012). Because of success stories like these, the federal government has begun to explore ways make crowdfinance available to small businesses.

Currently, there are three crowdfinance bills active in Congress. One bill has already passed the House, and the Senate is considering two other versions of a law that

would open the door to many crowdfunding ventures that want to use the equity model. Any law that eventually passes will not provide *carte blanche* authority to raise money. It will, however, likely give significant ability for small businesses to use crowdfinance in ways that the current exemptions to not allow. Yet it will likely do so at the expense of the third party intermediary platforms that facilitate these deals.

On September 14, 2011, Rep. Patrick McHenry (R-NC), introduced into the House of Representatives the Entrepreneur Access to Capital Act (H.R. 2930). H.R. 2930 would dramatically change the law with regard to crowdfinance, and enable relatively small businesses to use this model to amass capital for their projects (Burke, 2012). In general, it would deregulate certain smaller investments, taking them from the SEC's purview. It does this by amending 15 U.S.C. § 77d to allow businesses that raise less than $1,000,000 per year to sell equity investment without registering with the SEC. Business would be able to raise up to $2,000,000 per year if they provide their investors with audited financial statements. Individual investors could only invest up to the lesser of $10,000 or 10% of their annual income per year.

After the limitations on business size, H.R. 2930 contains a list of requirements for either crowdfunding intermediary websites or on crowdfunders themselves. Though the law may remove investments that fall under this exception from direct review by the SEC, it offers some protection to investors by providing them with information and safeguards that are somewhat similar to registration requirements for non-exempt securities. So the act places burdens on the "third party intermediaries" that make these investments possible and/or onto the sellers themselves. These requirements are:

(1) Third party intermediary sites must warn investors that investing in inherently speculative and that investors can only spend a maximum of 10,000/10% of their annual income.
(2) They must warn investors that there are restrictions on resale of the securities. (3) They must try to reduce the risk of fraud in these offerings.
(4) They must give information about themselves (address, website, names employees) to the SEC.
(5) They must give the SEC the same access to the site that they give their investors.
(6) They must require investors to answer questions that show whether they understand the risks of investing.
(7) They must require issuers to set a fundraising goal and deadline. Further, they must withhold they money raised until it reaches at least 60% of that goal.
(8) They must carry out background checks on the issuers.
(9) They must give the SEC notice of the offering when it begins, including information about the offerer's name, address, website, purpose, and the target offering amount.
(10) They must outsource their cash management to qualified third party custodians.
(11) They must maintain their records according to the SEC's requirements. (12) They must enable issuers and investor to be able to communicate with each other through their websites.
(13) They must notify the SEC when the offering is complete.
(14) They cannot over investment advice.

This list creates something similar to the registration process that is required for public offerings. These new rules would provide potential investors with information about companies and about investing in general so that they could better investment choices. Moreover, they would create an additional layer of protection that an intermediary might not provide on its own, including things like instituting cash management protections, conducting background checks on issuers, and enabling communication between issuers and investors.

If the issuer decides to forgo using a third party intermediary, the bill would shift the burden to the issuer to provide the same investor information/caution that the intermediary would have to provide, with one addition: the issuer would have to disclose on their website that they have a financial interest in this deal. Thus, they would have to clearly state that they are issuing this deal with the intent of profiting from it so investors do not mistakenly think that it is a charitable cause.

A noteworthy provision of H.R. 2930 is that it would specifically preempts state law. Under the supremacy clause of the U.S. Constitution (art VI, Cl. 2), federal laws take precedence where they conflict with state laws, provided it falls under the powers granted to the federal government by the Constitution. When federal laws specifically withdraw state regulation over a particular are of the law, this is called "express preemption." (Maggs & Smith, 2011). By its text, H.R. 2930 would remove almost any state regulation of offerings that qualify under this new exemption. It would allow states to provide protection against and/or unlawful conduct, but they cannot directly regulate crowdfunded securities. Finally, the law would restrict investors from transferring the securities they purchase for the first year, except to sell them back to the issuer or to an accredited investor.

While H.R. 2930 has already passed the House, the U.S. Senate is debating two other crowdfunding exemptions of their own that are similar to, but distinct from the House bill. On Nov. 2, 2011, Senator Scott Brown (R-MA) introduced Senate bill 1791, Democratizing Access to Capital Act (S.1791). Then, on December 8, 2011, Senators Jeff Merkley (D-OR) and Michael Bennet (D-CO) proposed Senate bill 1970, the "Capital

Raising Online While Deterring Fraud and Unethical Non-Disclosure" (or CROWDFUND) Act (S.1970).

Both Senate bills would create more consumer protections than the House bill. First, the Democratizing Access to Capital Act would limit the amount of money that can a crowdfunder can raise per annum to $1,000,000, but would not permit this to increase. Moreover, it would restrict the amount that a single investor can invest to $1000 per year. The CROWDFUND Act would reduce the amount investors may invest in crowdfunding ventures even further. Once again, companies would only be able to raise up to $1,000,000 per year. However, S. 1970 would limit the individual investment amount across all crowdfunding ventures in one year to the greater of $500, 1% of the investor's income if he/she makes between $50,000 and $100,000, or 2% of their annual income if they earn over $200,000.

Both S.1791 and S.1970 put more emphasis on third part intermediaries than H.R. 2930. Neither bill would permit crowdfunders to offer equity investments by themselves. Instead, all crowdfinance ventures would have to pass through an established platform. Furthermore, both bills would put more burdens on the third parties than H.R. 2930. The Democratizing Access to Capital Act is similar to H.R. 2930 in this respect, but has notable differences. S.1970, on the other hand, differs more significantly from H.R. 2930 in attempting to offer greater protection for consumers. By juxtaposing the three acts, we can immediately see the differences, and potential points of conflict between the houses of government.

Requirements for intermediaries	H.R. 2930	S.1791	S.1970
Warn investors of the speculative nature of these investments	✓	✓	✓
Warn consumers that there are restrictions on resale of the securities	✓	✓	✓
Try to reduce the risk of fraud	✓	✓	✓
Provide the SEC with information about the intermediary (address, website, employees)	✓	✓	✓
Give the SEC investor-level access	✓	✓	✓
Require investors to answer questions about the risks involved with investing	✓	✓	✓*
Require issuers to set a monetary goal and deadline and must withhold the investments until they raise at least 60% of that goal	✓	✓	✓*
Carry out background checks on the issuers' principles	✓	✓	✓*
Give the SEC notice of the offering including information about the issuer (name, address, principles, purpose)	✓	✓*	✓
Outsource their cash management	✓	✓	✓
Maintain their records according to the SEC's requirements	✓	✓	✓

Provide a way for issuers and investors to communicate	✓	✓	✓
Notify the SEC when the offering is compete	✓	✓	
They cannot offer investment advice	✓	✓	✓
Offerings must be open to the public		✓	
Provide a way for investors and potential investors to communicate		✓	
Prohibit employees from investing in offers made through the intermediary or having a financial interest in an offering		✓	✓*
Create a method for investors to raise complaints		✓	
Provide disclosures such as about risks as the SEC determines			✓
Provide information about the issuer to the SEC and potential investors			✓
Allow investors to cancel their commitments to invest			✓
Try to ensure that investors do not exceed investment limits			✓
Protect the privacy of information collected from investors			✓
Not compensate people to provide information about investors			✓

(✓ *the provision is in the bill, but its language differs significantly from at least one of the other bills. Any difference in language needs to be reconciled.)

Meanwhile, setting the other important provisions of these two bills reveals several other differences.

Provision	**H.R. 2930**	**S. 1791**	**S.1970**
Third party intermediary required	No	Yes	Yes
Maximum offering size	$1,000,000/$2,000,000 with disclosures	$1,000,000	$1,000,000
Maximum individual investment	$10,000 or 10% annual income	$1,000	$500, %1 of income between $50,000 and $100,000, 2% income greater than $100,000
Third party intermediary must register with the SEC and/or any applicable self-regulatory organizations	No	No	Yes
Creates a cause of action for investors	No	No	Yes
Preempts state law	Yes	No; at least some state regulation permitted	States can bring action against fraud; Permits state registration if 50% or more of funds come from that state

S.1970 is clearly the strictest of any of the bills. It would significantly limit the amount any investor may invest in crowdfinance per year, and create many additional requirements for intermediaries beyond H.R. 2930 and S. 1970. Concurrently, even with its long list of requirements, H.R. 2930 it is still the most open of the three bills. It would

allow greater investment by investors, higher max-business size for offerers, and does not require third party intermediaries. Furthermore, it would preempt state regulation, thereby removing any additional protection from the states. S.1791, in some ways is a middle ground between the two. It would increase the protections offered to investors by lowering max investment limits, mandating that offers pass through intermediaries, and requiring that intermediaries build in things like complaint mechanisms and communications channels. It would also leave states with some ability to regulate these securities. Still, it is more similar to H.R. 2930 than it is to the CROWDFUND act.

At this point, S.1970 seems to have received the most attention in the Senate. In December, 2011, the Committee heard testimony from two experts, both of whom supported the CROWDFUND Act over S.1791. Harvard Law School Professor John C. Coastes IV noted that any law that Congress considered must delicately balance a trade-off between economic growth and investor protection. Anything that does not provide significant investor protection invites "catchy, high-risk, and very possibly fraudulent investment scheme[s]" (Examining investor risks in capital raising, Coastes, 2011, p. 10). For this reason, he was concerned about S.1791 and argued for S.1970, which offers more protections for consumers. Similarly, Mr. Mark Hiraide, a securities lawyer, partner at the law firm Petillon, Hiraide, Loomis, and former SEC attorney, agreed with Prof. Coates on the relative merits of the two bills. He argued that S.1970 is a better balance of the interests of facilitating access to capital while still providing investor protection. (Examining investor risks in capital raising, Hiraide, 2011).

With the support for greater investor protection, it seems likely that any potential law that the Senate passes will create significant requirements for third party intermediaries. Considering the areas where all three bills coincide, the requirements they would place on intermediaries range from basic to fairly sophisticated. For example, it should be relatively simple for a website to require potential investors to answer questions about risks and safe investing. Conducting background checks, however, requires a higher degree of work and sophistication. Indeed, even if an established platform like Kickstarter wanted to start offering crowdfinance, which already has a strong infrastructure and could conceivably move into this field quickly and effectively, it might not be prepared to be an intermediary under these bills.

Currently, debate has stalled in the Senate. However, on March 8, 2012, the House of Representatives passed H.R. Jumpstart Our Business Startups Act ("JOBS" Act), H.R. 3606 (Wolters Kluwer, 2012). As part of this legislation, the House included the already-passed H.R. 2930, sending it to the Senate once again, and urging action. With this renewed legislative interest, it likely that some crowdfunding exemption will soon become law.

CONCLUSION

The world of crowdfunding is rapidly developing, but still in flux. On one hand, examples like Kiva and Kickstarter show how effective this form of fundraising is, and will certainly continue to be in the future. On the other, crowdfinance is still largely illegal, and without action from the government, will stay that way. Nevertheless, it seems likely that the federal government will develop some exception for crowdfinance

soon. While the future is still bit unclear, perhaps next year we will all have a chance to buy a beer company together as a crowd of funders.

ADDENDUM

On April 5, 2012, after the writing of this chapter, the U.S. government enacted the JOBS Act, now Public Law Number 112-106. While the basis for the law was H.R. 2930, the law as passed included an amendment from the Senate, which made some important changes (Schuster, 2012). As predicted, the final law is a bit of a compromise between the House and the Senate – it is not quite as restrictive as the Senate bills and not as permissive as the House Bill.

As the law now stands, it allows people to raise up to $1,000,000 through crowdfunding. However, they cannot do so without using a licensed broker or a third party intermediary "funding portal" to make their investment offers. These funding portals must register with the SEC and provide users with things like information about the risks of investing and about the terms of specific offers. Furthermore, they must perform background checks on the issuers and try to ensure that investors are not investing more than maximum investment amounts established in the statute (Hanigan and Wickham, 2012).

Hanigan and Wickham (2012) write that the new law requires small businesses that want to use this exemption must give investors/potential investors and their brokers/funding portals or the SEC with certain financial statement. Moreover, the law requires these small business to provide some degree of credibility behind the validity of these statements. For offerings that are less than $100,000, the CEO of the business must

personally attest to the accuracy of their financial statements. For offerings between $100,000 and $500,000, businesses must hire accountants to review their statements. For offerings that are greater than $500,000, they must submit fully audited statements to the SEC. Finally, Hanigan and Wickham note that once an offering has succeeded, these companies must annually file statements with the SEC. Accordingly, the law allows crowdfinance deals to go forward, but places important safeguards for investors, and regulations on both third party intermediaries and the small businesses that want to use this new exemption.

Currently, even though the JOBS act is now law, the crowdfunding is still unavailable. The SEC notes that the law requires the agency to adopt rules that will implement the new laws. Until they do so, the crowdfunding exemption is not available to anyone. However, after the 270 day rule making window runs out (Schuster, 2012), this exemption should go into effect.

Online Private Agreements and Crowdsourcing

Contracts are critical to the efficient functioning of the online world even more than offline. Private agreements between individuals define and regulate our behavior online more than laws (Ballon, 2010). Indeed, these agreements are essential to the efficient and legal operation of any online service, including crowdsourcing service providers like Amazon Mechanical Turk (www.Mturk.com), Kickstarter (www.Kickstarter.com), and Crowdspring (www.crowdspring.com). Using what are called *click-wrap* and *browse-wrap* agreements, private agreements regulate user activity, attempt to insulate and/or control potential litigation, and help to define the boundaries between correct and incorrect behavior on the service. Despite their importance and near ubiquity, however, consumers generally do not read these agreements (Hillman & Barakat, 2008-2009). In this chapter, we examine how crowdsourcing platforms use these online agreements to bind their users to certain terms and conditions. We start by providing a primer on basic contract law and contract formation. We then assess the validity of standardized online form contracts formed through click-wrap or browse-wrap agreements. Next, we look at online agreements in the open source industry and a recent case that officially upheld their enforceability. Following that, we consider several provisions that are common to standardized form agreements – both online and off. Finally, we conduct a content analysis of the Terms of Use agreements (TOUs) from several different crowdsourcing platforms and services to better understand how the legal landscape around crowdsourcing is taking shape.

A Brief Primer on Contract Law

At their most basic, contracts are promises made between two parties to take some action. Obviously, however, many promises are not, in fact, contracts; it would be impossible for courts to give the power of law to every casual agreement. Instead, the law chooses to enforce certain bargained-for exchanges between parties because they have certain features that make them "contracts" under the law (Ferriell, 2009).

To be enforceable, all contracts must have at least three parts. (Rohwer and Skrocki, 2010). First all contracts must have an offer made by an offerer. The offer creates the power of acceptance in the offeree, defines the proper method(s) for acceptance, and opens the door for a contract to form. Second, there must be acceptance of the terms from the offerer by an offeree. Significantly, acceptance does not need to be expressed verbally or in writing. Rather, it can be inferred by how the parties conduct themselves after supposed contract formation. If, for example, an offeree begins using an offeror's product, a court might assume that the offeree has accepted the terms of the usage agreement. Third, all contracts must have "consideration." Consideration is that which induces the parties to exchange promises to conduct certain duties; it is the "bargained-for exchange" between the parties to the contract (American Law Institute, 1981). Ferriell (2009) describes consideration as a *quid pro quo*: each side to the contract gives and gets what they want out of the arrangement.

Even though the ideal of a bargained-for exchange might be an arms-length deal where both parties have equal opportunity and ability to negotiate contract terms, this situation is not necessary for valid contracts to exist. In fact, non-negotiated, standardized

form contracts made between parties at a distance from each other are quite common. Indeed, they make up most of the consumer contracts in the country (Goodman, 1999). Often called “contracts of adhesion” in a pejorative sense, these agreements are standardized take-it-or-leave-it agreements where consumers cannot obtain products or services without agreeing to the terms of the contract. There is no opportunity or ability to negotiate; one party defines all the terms and demands acceptance to them (Ferriel, 2010).

One of the most commonly used examples in the scholarship of these form contracts are insurance policies (Ferriell, 2010). Insurers offer potential policy holders deals, and the only way consumers can obtain a policy is to agree to the terms as written; there is no chance for discussion of the terms. Williston (2011) notes that that adhesion contracts in insurance policies are not automatically void. However, if there is any ambiguity in the terms, the court will usually interpret the unclear provisions against the drafter.

Even though insurance contracts might be a common example of contracts of adhesion, today online agreements are perhaps even more prevalent. Indeed any time we go online, we encounter these types of agreement whether we realize it or not. Even anecdotal experience reveals how common they are; whenever you click “I Agree” or something similar online, you are engaging in a contract, and potentially binding yourself to whatever terms are therein (Conklin, 2008). Indeed, sometimes you do not even need to click anything; the mere use of a site might make you party to a Terms of Use agreement.

While they might seem strange at first, non-negotiated, standard form contracts are most often enforceable. Ferriel (2010) writes that much of modern life would be impossible if adhesion contracts were unenforceable and all terms required independent negotiation. Standardized forms simplify the contracting process and reduce the transaction costs of entering into the many contracts we do almost daily. Accordingly, they are vital to the efficient operation of daily life, and affect nearly everyone who goes online.

A Contract in Cyber Space is Still a Contract

As discussed, we interact with standardized contracts everywhere and nearly every day. Anytime you click "I Agree" to the Terms of Use of a website, or even possibly every time you use a web service, you are agreeing to online standardized form contracts. While these agreements may pass commonly without challenge, there is some room for debate over their validity.

Even though they occur online, and the parties are clearly distant from each other, all contracts must still satisfy the basic requirements of offer, acceptance, and consideration (Conklin, 2008). In general, online agreements fall into two categories: *click-wrap* (also known as *click-through*) agreements and *browse-wrap* agreements. The major difference between them is the method of acceptance defined by the offerer.

Click-wrap agreements are agreements that are presented to users of a web platform before they can use the services that the site offers. They require users to affirmatively manifest assent to the terms and conditions of the website. As a prototypical

example, a site might require a user to register, and click a check box that says "I agree to the terms and conditions of this website" before being given access.

Browse-wrap agreements, on the other hand, do not explicitly require manifestation of assent to a website's terms before using its services. Instead, using the site itself constitutes assent. Moreover, the Terms of Use are located on another page and users are not specifically directed to them (Rambarran and Hunt, 2007). On Yahoo, for example, a user can access the site whether she creates an account or not; Yahoo holds users to their terms either way: "By accessing and using the Yahoo! Services, you accept and agree to be bound by the terms and provision of the TOS" (Yahoo.com). Accordingly, it does not matter if you specifically agree to these terms. Yahoo believes that simply by using its service, you are bound under its terms of use contract.

The legal analysis of the validity of both click-wrap and browser warp agreements starts with *ProCD v. Zeidenberg* (86 F.3d 1447). In ProCD, the Seventh Circuit Court of Appeals considered whether Matthew Zeidenberg was bound to the terms of a "shrink-wrap license" that was contained with a piece of software he purchased. Shrink-wrap licenses, also known as End User License Agreements (EULAs), are agreements that are inside software packaging and become active as soon as the end user breaks the cellophane around the box. Hence the name, "shrink-wrap license."

The Seventh Circuit Court of Appeals in *ProCD* held that such agreements are enforceable as long as they are valid according to general principles of contract law (Goodman, 1999). The district court originally held that the license was ineffective and Zeidenberg was *not* bound to its terms because they did not appear on the package. The

Seventh Circuit, however, disagreed with Zeidenberg and the district court. Judge Easterbrook wrote that such transactions, where money is exchanged before the detailed terms of the agreement are communicated between the parties, are extremely common in today's commercial world. Furthermore, an offerer may invite acceptance to the agreement as he sees fit. Here, ProCD's offer could be accepted by using the software. Accordingly, there was a valid agreement and Zeidenberg was bound by it.

CLICK-WRAP AND BROWSE-WRAP AGREEMENTS SINCE *PROCD*

Since *ProCD*, shrink-wrap, click-wrap, and browse-wrap agreements have become increasingly common. While the Seventh Circuit (and many subsequent courts) have upheld the validity of EULAs, click-wrap and browse-wrap differ in ways that could significant affect their validity.

After *ProCD*, courts have generally upheld click-wrap agreements as valid contracts. Nathan Davis (2007) writes that the first time a click-wrap agreement was tested in court was in 1998 in *Hotmail Corp. v. Van$ Money Pie* (47 U.S.P.Q. 2d 1020). In this case, Van$ Money Pie used Hotmail accounts to send thousands of spam email messages. Hotmail's Terms of Service included a prohibition against sending unsolicited bulk email messages. The court issued an injunction against Van$, stopping this prohibited behavior because it believed that Hotmail was likely to succeed on the merits of a breach of contract dispute. While the case did not proceed from here, it nevertheless shows that the court believed that a valid contract existed between Hotmail and Van$.

Since this case, Davis (2007) writes that courts have taken a fairly "straight forward approach" to analyzing click-wrap agreements (p. 582). These agreements must

satisfy the offer, acceptance, and consideration requirements like any contract. Offer and consideration are clear here: the terms themselves are the offer; the *quid pro quo* exchange is that the platform gets the user's acceptance to the terms and the user gets to use the product. As for acceptance of the offer, Davis (2007) writes that courts generally hold an action such as clicking "I Agree" generally constitutes such. Courts have only found lack of assent in three circumstances: where the user was not clearly required to show assent before the transaction; where the user was never required to show assent; and where the user's action arose before she showed assent.

Meanwhile, though click-wrap agreements have been almost uniformly upheld, browse-wrap agreements have received more scrutiny. Rambaraan and Hunt (2007) write that one concern of browse-wrap agreements is that they do not have the same guaranteed notice to potential offerees as click-wrap agreements. In *Specht v. Netscape Communications Corp* (2002), for example, now-Supreme Court Justice Sotomayor writing at that time as a judge on the Second Circuit, struck down a browse-wrap agreement for this reason. In this case, the plaintiffs downloaded Netscape's web browser, Communicator, using a service called "SmartDownload." When they did this, there was no click-wrap agreement to accept. Instead, there was a list of license terms that was only visible if the plaintiffs scrolled down to the next screen. Because the terms were not presented to the offerees, the court found that there was no clear manifestation of assent, and thus no agreement.

Kunz, Ottaviani, Zif, Moringiello, Porter, and Debrow (2003) write that, given the cases including and following *Specht*, a user likely assents to a browse-wrap agreement

and will likely be held to its terms if four elements are satisfied. First, the user must be given adequate notice. The existence of an agreement cannot be hidden from the user. Second, the user must have the opportunity to review the agreements terms. Third, the user is given notice that certain actions will show assent to the terms of the agreement. Finally, the user takes that action. While some courts have upheld agreements that do not satisfy all of these terms, Kunz et al. write that browse-wrap agreements which do contain these can be relied upon as valid.

UNCONSCIONABILITY

Though click-wrap and browse-wrap agreements may be valid ways of contract formation, a court can refuse to enforce a contract or any portion of a contract if it finds that the contract or clause is "unconscionable." The unconscionability doctrine is based on the court's equitable powers that permit it to reject agreements that are grossly unfair to one party. Importantly, Korobkin (2003) writes that this is the primary method that courts use to reject terms in form contracts, like click-wrap or browse-wrap agreements. Still, even though many online contracts might seem unfair, it is difficult for parties to successfully argue unconscionability to invalidate any contract, including the online variety.

Unconscionability of contracts has a long history in our common law. Ponte (2011) writes this doctrine has its roots as far back as Roman times. Though courts' powers to uphold good faith and fair dealing in contracts stems from its role in equity, unconscionability today is it is a question of law for courts to decide. Moreover, the common law principle of freedom of contract somewhat conflicts with this doctrine.

Accordingly, courts will only use this in instances of great unfairness and inequality between the parties (Williston, 2011).

Korobkin (2003) writes that the unconscionability doctrine is the primary way that courts use to reject terms in form contracts like click-wrap and browse-wrap agreements. Indeed, in many instances, the only defense against a well drafted click-wrap agreement might be that the term is so unfair that the court should not hold someone to its terms. To limit the application of the unconscionability doctrine, however, courts look for two types of unconscionability before invalidating a contract or contractual provision. (Williston, 2011). First, the contract must be "procedurally unconscionable." Procedural unconscionability refers to the creation of the contract – was it unfairly made, did the accepting party have notice of the agreement, were the terms hidden (like with validity in general), etc. It must also be "substantively unconscionable." This refers to the terms of the contract itself. Courts will look to see whether the effects of the contract are so unfair to one side of the agreement that it should not be enforced.

Looking at online form contracts, one common feature to all online agreements that weighs toward unconscionability is that they are all necessarily contracts of adhesion. The parties do not negotiate the contract terms, and indeed they probably never speak to each other directly. Moreover, the Restatement (second) on Contracts (1981) states that relevant factors to consider in an unconscionability analysis include things like the relative power in the contracting purpose. Certainly, in most online agreements, the drafter of the agreement – the online service – is in a position of power over the offeree.

Accordingly, there are factors that weigh in favor of unconscionability in any online agreement.

Still, unconscionability probably cannot be relied upon as way to escape bad contracts. In *Wold v. Dell Finical Services* (2009), a federal district court in Minnesota looked at the enforceability of an arbitration clause in a form contract created by Dell. Here, the court wrote that even though it "empathize[d] with Wold's position," it did not find this provision to be unconscionable. Merely because something is a bad deal for a consumer, even one in a poor bargaining position, a court will not necessarily find it to be unconscionable. Accordingly, though the unconscionability doctrine is available, it is probably not a reliable way out of online agreements.

CONTRACTS AND THE OPEN SOURCE MOVEMENT

Beyond drawing legal boundaries and proscriptions, private contracts have the ability to define the environment in which an industry operates. For example, private agreements have been particularly important for the open source movement. Indeed, without well-crafted agreements, open source might never have developed as well as it did. Crowdsourcing draws both its name and some basic characteristics from open source. Jeff Howe (2006), who coined the term "crowdsourcing," writes that it is "the application of Open Source principles [i.e. divided tasks and distributed labor] to fields outside of software." Because of this connection, it is useful to look at the role that contracts have played in the open source.

In *The Wealth of Networks*, Yochai Benkler (2006) writes that contracting online has been essential to the existence and growth of the open source movement. Like

crowdsourcing, open source depends on many people collaborating on a common goal. In something like software development, a situation with multiple creators contributing to a work could lead to problems with copyright law. Copyright however, which gives the power to control and prevent use, can conflict the ideals Richard Stallman had in mind when he developed the GNU operating system. Stallman envisioned a world where people could freely use information and software could be edited as necessary. Copyright often prevents with free sharing. So, Stallman created the GNU General Public License (GPL) to avoid some of the problems that stem copyright restrictions.

Kumar (2006) writes that Stallman's idea was to use copyright to protect people's right to use software instead of defending creators' monopolies over their creation. The GPL allows anyone to run software that falls under it, to make changes to that software, and requires any new software to remain under the same license. So, it binds people by contract to obey certain usage rights and restrictions that ensure the free distribution of the software.

The GNU GPL is only one of many open source licenses in operation today. Gomulkiewicz (2009) notes that the Open Source Initiative has certified over sixty licenses. Even with all these license agreements in operation, however, there has been some debate over their validity. Two questions have arisen regarding the enforceability of open source licenses: first, is there a legally enforceable agreement with offer, acceptance, and consideration; second, will courts enforce the terms of these licenses with injunctive relief (Gomulkiewicz, 2011).

Recently, the Federal Circuit validated the effectiveness of the open source licenses in *Jacobsen v. Katzer*. In this case, Robert Jacobsen ran an open source software group that designed programs for model railroads called the Java Model Railroad Interface (JMRI). The JMRI designed an application called DecoderPro that allows people to use their computers to program the chips that control their model trains. It was free to download and use, but included a file which included the JMRI "Artistic License." Katzer, meanwhile, offered a similar, competing piece of software called Decoder Commander. In developing Decoder Commander, one of Katzer's employees downloaded and used DecoderPro in it. He did not, however, did not abide by the terms of the "Artistic License" by failing to include: the authors' names, JMRI copyright notices, reference to a particular file, an identification of the original source of the definition files, and a description of the changes to the original code. Because Katzer did not follow the agreement, Jacobsen filed suit to stop Decoder Commander.

The court held that there was a valid agreement here and that Katzer was held to the terms of the Artistic License. In part, the court looked at the issue of consideration. Ultimately, it found that it was sufficient in this case. Consideration does not need to involve an exchange of money; there are numerous benefits for software users that are not merely economic. Accordingly, Katzer was bound by the terms of the agreement.

The open source movement and *Jacbosen v. Katzer* show how legal channels can be used to protect rights and draw boundaries between proper and improper usage. Moreover, they suggest that these terms can be used for more than just drawing legal proscriptions. Richard Stallman did not create his GPL simply to protect his software; he

did it to protect the freedom of exchange of ideas. In this, the open source movement reveals how powerful private agreements can be.

COMMON ONLINE AGREEMENT PROVISIONS

As we have seen, online agreements today are effective and, depending on a few factors, probably valid. Because of this, it is useful to understand their terms to know how they commonly regulate online behavior. In this section, we examine several boilerplate contract terms that appear in nearly all online standardized agreements.

Forum Selection Clauses

One clause that will be in almost every well-drafted online contract is a forum selection clause. As the name suggest, this is a provision that defines where litigants must bring suit for any issue stemming from the subject of the contract. Marcus (2008) writes that these clauses are pervasive across contracts because they give the offerer a degree of control over potential law suit by preventing against so-called forum shopping. When injured parties want to bring suit, they often try to sue in the most plaintiff-friendly location possible to maximize their chances for success. Forum selection clauses stop forum shopping by defining where a lawsuit arising from the subject of the contract may be filed.

The U.S. Supreme Court held in *Carnival Cruise Lines v. Shute* (1991) that a forum selection clause in a commercial form contract was valid. In this case, Shute, a cruise ship passenger, sued Carnival Cruise Lines for injuries she sustained due to a slippery deck mat. She filed in federal court in Washington, claiming her injuries were caused by negligence on the part of Carnival's employees. Each ticket, however, had a

Terms and Conditions agreement that required all suits to be filed in Florida. The Supreme Court held that the agreement was valid and the clause was reasonable and enforceable. Accordingly, Shute could not bring her case in Washington.

Following *Carnival Cruise Lines*, other courts have used this case to enforce online agreements as well. *Feldman v. Google* (2007), for example, found that a forum selection clause in a click-wrap agreement was valid. Google claimed that Feldman owed the company $100,000 for charges associated with his Google AdWords account. Feldman, however, argued that he was the victim of "click fraud" and did not owe Google this money. Feldman sued, seeking damages, disgorgement of any profits Google received from the click fraud, and restitution of any money he paid for these fake clicks.

The dispute turned on the forum selection clause. The court held that this was valid. Unlike *Specht,* the plaintiff has clear notice that he was bound to the AdWords agreement. Further, the provision was both reasonable and not procedurally or substantively unconscionable. So, the court decided that Feldman had to be held to the terms of the click-wrap agreement he assented to.

As in *Feldman*, forum selection clauses are likely to be enforceable unless they are unconscionable. Furthermore, they are in nearly all standardized form contracts, both online and off. Accordingly, it is useful to recognize these clauses and understand their purpose.

Limitations of Liability Clauses

Limitation on liability clauses are provisions that attempt to disclaim or prevent litigation on one or more potential areas of conflict. Without them, a service provider's

exposure to litigation could potentially be very broad. Accordingly, these clauses are typical among online Terms and Use agreements (Ballon, 2010).

Ballon (2010) writes that, while these clauses are generally enforceable unless they are unconscionable, some states will not enforce them where there is fraudulent conduct or gross negligence. *Smallwood v. NCSOFT* (2010), for example, refused to uphold a section of user agreement that attempted to avoid the plaintiff's claims for gross negligence.

Unfortunately, however, "gross negligence" is a bit difficult to define precisely. Stine (2011) and Proser and Keeton (1984) indicate that gross negligence is somewhere between ordinary negligence and recklessness. The common law holds that a person acts negligently if she does not use same care that a reasonable person. The standard for recklessness, in turn, is where someone intentionally does something, knowing that that this conduct creates an "unreasonable risk of physical harm to another." (American Law Institute, 1979).

While "gross negligence" remains difficult to precisely define, it is nevertheless clear that online agreements can limit their liability to some degree. Ballon (2010) notes these clauses are generally enforceable, particularly in click-through agreements where there is express assent. Without express or implied assent, they could be deemed invalid. Still, since online agreements are so frequently enforceable, and these clauses are so prevalent, it is useful to understand to recognize them.

Arbitration clauses

Arbitration clauses are provisions that require any action arising out of the subject of the contract to go through arbitration instead of a lawsuit. Until recently, the validity of these clauses was somewhat questionable. Ballon (2010) notes that some states courts refused to enforce these provisions because they could prevent the plaintiff from pursuing class action litigation. However, after a 2011 U.S. Supreme Court decision, arbitration clauses cannot be held invalid on these grounds.

The Supreme Court considered an arbitration clause in the case of *AT&T, LLC v. Conception* (2011). Here, Vincent Conception sued AT&T in California Federal District Court for charging sales tax on "free" phones. The contract between Concepcion and AT&T required arbitration of all suits, but did not provide for class-wide arbitration. Because of this clause, AT&T moved to compel arbitration. The District Court, however, denied the motion because the arbitration clause disallowed class action suits. Upon appeal, the Ninth Circuit affirmed, holding that the provision was unconscionable under California law. Ultimately, however, the Supreme Court, however, overruled the Ninth Circuit. It wrote that, where state law prohibits arbitration of a claim, the Federal Arbitration Act supersedes this rule. Accordingly, the provision in AT&T's contract was valid and enforceable.

McCoy and Allen (2012) write that after *Concepcion*, federal courts have been more likely to enforce arbitration provisions, even when there are state laws/standards that might conflict with the provisions. Because of this, it has become much easier for defendants to compel arbitration of individual claims when class actions suits are filed.

Accordingly, these sorts of provisions will likely be enforceable and popular among online agreements.

DMCA Safe Harbor clauses

Any online platform that hosts links to content that could infringe copyright should (and usually does) have a Digital Millennium Copyright Act (DMCA) notice provision. These provisions help to protect web services that might host or link to material that infringes copyright because of their users. Accordingly, any website that has user-generated content will likely have a DMCA notice provision, either as part of its Terms of Use agreement, or as a standalone section on the site.

In 1998, Congress passed the Digital Millennium Copyright Act to address several issues that were arising from the nascent internet. One action Congress took was to create certain "safe harbors" for websites that host infringing material from their users. These safe harbors allow providers of online services to avoid copyright violations where a user causes the infringement, if they follow certain rules.

According to 17 U.S.C. § 512(c), to fall under the safe harbor, websites must establish a method whereby copyright owners can contact the website, report infringement, and have the content removed. The person who posted the supposedly infringing content then must be able to file a counter notice. If the user files counter notice, the webservice will replace the content unless the copyright owner decides to escalate the complaint to a lawsuit.

The Second Circuit Court of Appeals recently considered the DMCA safe harbor provisions in *Viacom v. Youtube* (2012). In this case, Viacom sued Youtube for copyright

infringement on numerous works (videos) that Viacom owned. The district court granted YouTube's motion for summary judgment, holding that it did everything it had to do under the DMCA. Viacom then appealed to the Second Circuit. The Court of Appeals held that the District Court was correct in finding that only actual knowledge or awareness of infringing activity on the website could vitiate the safe harbor protections. However, a jury in this case could potentially find that Youtube did, in fact, have such knowledge. Accordingly, the Second Circuit held that summary judgment was incorrect and remanded the case for further hearings.

The Youtube case notwithstanding, this safe harbor is an extremely effective way to avoid legal problems associated with user-generated content. Indeed, DMCA safe harbor clauses are almost essential for websites today. Accordingly, they are both extremely common and extremely important. Any website that uses any kind of user generated content will likely have one of these provisions. Many, but not all, crowdsourcing services qualify as such. Indeed, infringing material could be something as simple as an image used in a user profile. Thus, many crowdsourcing platforms will probably have a DMCA notice section to their Terms of Use agreements or as part of their site.

CROWDSOURCING PLATFORM CONTRACTS SPECIFICS

Having reviewed several provisions that are common to all online standardize agreements, we now turn to look at TOU agreements from different crowdsourcing platforms. Here, we sampled several TOUs from platforms across the different types of crowdsourcing. We then assessed alongside each other to find similarities and

differences. We find that, though the language differs across the different services, the provisions are largely comparable. Wikipedia, however, with its focus on the free distribution of knowledge, and its connections to the roots of the open source movement, is notably different than many other TOUs in both content and style.

While the text and format of TOU agreements varies across platforms, they share much of the same content. Most often, TOUs start with an acceptance statement attempting to affirmatively bind users to the agreement. One Billion Minds, a platform that allows for example, holds that "By submitting an online application for membership to the One Billion Minds Community, you agree to the terms and conditions of this Agreement and of the Service we describe" (onebillionminds.com, crowdsourced innovation). Interestingly, Kickstarter – the popular crowdfunding platform – claims that its users are parties to the agreement without registering on the site: "By using the site or service in any manner, including by not limited to visiting or browsing the site, you agree to be bound by this agreement." (Kickstarter.com, crowdfunding). Likewise, Kiva (Kiva.org, crowdfunding) writes that "by accessing or using the Website [Kiva], you signify that you have read all of the terms and conditions in, and linked to, this Agreement … and you agree to be bound by this Agreement, whether or not you participate in Kiva's microlending program." These are noteworthy because, as aforementioned, it is questionable whether the browse-wrap construction of these agreements is enforceable. Nevertheless, because both services require registration before full usage of the site, this might not be a problem.

After the assent statement, TOUs usually have the boilerplate terms discussed above. RocketHub – a crowdfunding platform that is somewhat akin to Kickstarter – holds that "any arbitration will take place in New York County, New York, United States of America. Any Dispute not subject to arbitration … shall be decided by a court of competent jurisdiction within New York County, New York, United States of America, and you and RocketHub agree to submit to the personal jurisdiction of that court" (Rockethub.com, crowdfunding). Under this provision, not only must disputes be brought in New York, but also litigants cannot challenge the New York court's ability to hold power over them. Meanwhile, the Netflix Challenge – a contest conducted by Netflix to improve their movie recommendation algorithm – terms agreement binds people to bringing disputes in San Jose, California. "By entry and participation in the Contest, Participants, for themselves and their schools/companies if applicable, agree that the City of San Jose, State of California, United States of America will be the exclusive forum for any formal dispute resolution." (Netflix challenge, open innovation).

Arbitration clauses seem to be extremely common but not universal. They are in agreements across types of platforms, such as: Kiva (www.kiva.org, microloans), Amazon Mechanical Turk (www.mturk.com, microlabor), Crowdspring (www.crowdspring.com, crowdsourced creative work), the Netflix challenge (open innovation) and Bandcamp (www.bandcamp.com, crowdfunding). Interestingly, however, at least three crowdfunding platforms – Kickstarter (www.kickstarter.com), Indiegogo (www.indiegogo.com), and RocketHub (www.rockethub.com) – and a creative

project – the Johnny Cash Project (www.thejohnnycashproject.com) – do not have arbitration agreements.

Turning to the DMCA safe harbor clauses, these provisions are very common, as predicted, but are not in all agreements. Wikipedia, for example, does something a bit different than most DMCA provisions. It has takedown procedures and a registered agent as required by 17 U.S.C. § 512(c)(2). But it does not track the language of the law, as many agreements do. Section 512 provides a list of requirements that a website must have to fall under its protections. Most often, TOUs or independent DMCA provisions will follow this part of the law exactly. As a prototypical example, Indiegogo holds that:

> If you believe that your copyrighted work has been copied in a way that constitutes copyright infringement and is accessible via the Service, please notify Indiegogo's copyright agent, as set forth in the Digital Millennium Copyright Act of 1998 ("DMCA"). For your complaint to be valid under the DMCA, you must provide the following information in writing:
>
> 1. An electronic or physical signature of a person authorized to act on behalf of the copyright owner;
> 2. Identification of the copyrighted work that you claim has been infringed;
> 3. Identification of the material that is claimed to be infringing and where it is located on the Service;
> 4. Information reasonably sufficient to permit Indiegogo to contact you, such as your address, telephone number, and e-mail address;
> 5. A statement that you have a good faith belief that use of the material in the manner complained of is not authorized by the copyright owner, its agent, or law; and
> 6. A statement, made under penalty of perjury, that the above information is accurate, and that you are the copyright owner or are authorized to act on behalf of the owner.
>
> The above information must be submitted to the following DMCA Agent:
>
> Name: Danae Ringelmann
> …

Meanwhile, sites that do not deal with user generated content do not have DMCA provisions. So, platforms like oDesk and Games with a Purpose (www.gwap.com) do not have them, and might not need them. At the same time, Amazon Mechanical Turk, which

is somewhat similar to oDesk, includes a provision for DMCA takedown, but it is not part of its TOU.

Looking more closely at these two platforms similar platforms, oDesk and Amazon Mechanical Turk User Agreements, both of which create online labor markets, have several significant differences. For example, oDesk's agreement is about twice as long as Amazon's, based on word count. In general, oDesk regulates the relationship between work requestors and work providers in more detail than Amazon. As a simple example, oDesk "expects a consistent and high level of courtesy, respect and professionalism from all of its Users toward each other." Amazon does not state any comparable expectations. More significantly, oDesk provides a method for resolution of disputes that arise between workers and requestors. Amazon, in contrast, holds that it is not a party of any dispute between Requesters and Providers. Notably, it is not alone in withdrawing from user disputes. Crowdspring, Indiegogo, Kickstarter, and Kiva all have similar provisions, claiming to have no obligation to monitor or become involved in disputes. Nevertheless, even with their differences Amazon's and oDesk's agreements share many of the same provisions, both with each other and with other agreements.

Wikipedia, on the other hand, is markedly different from the other Terms of Use agreements. First, it does not contain any of the boilerplate terms in the other agreements. Instead, Wikipedia focuses entirely on proper user behavior and on the legal regulations of copyrightable user generated material. Before the Terms of Use begins in proper, it opens with the Wikimedia (Wikipedia's parent organization) Foundation Vision Statement: "Imagine a world in which every single human being can freely share in the

sum of all knowledge. That's our commitment." While this is not a binding provision, it nonetheless states up front Wikipedia's expectations for its users.

After this, Wikipedia dedicates most of the rest of its TOU to regulating its user generated content. Wikipedia requires material written for the site to be distributed with a Creative Commons Share Alike License. This license allows anyone to share or remix the work, but it must be attributed to its author and distributed under the same Share Alike license. Furthermore, all user-generated content must be distributed under the GNU Free Documentation license which operates similar to the Share Alike License.

Finally, unlike every other platform, Foldit has no terms agreement at all. Foldit is a free game which enables users to try to solve complex protein folding puzzles. These game communicates the solutions to these puzzles to scientists to study their real-world applicability. Interestingly, a user can register for an account and download and use the Foldit software without agreeing to any terms and conditions at all. This is surprising, especially considering the near-ubiquity of agreements across all kinds of websites and software. Moreover, recently several gamers used Foldit to help understand how an AIDS-related enzyme was constructed that scientists had been unable to unravel after years of work (Peckham, 2011). Though the gamers might have no claim over the products from their work, a Terms of Use agreement might be simple and effective way to insulate FoldIt from potential legal problems.

CONCLUSION

Even considering Foldit, the modern software and online service environment is almost entirely regulated by private agreement. Clickwrap and browse-wrap agreements

bind users to certain terms and protect service providers from some kinds of legal problems. While these agreements may not be as critical to the creation and development of the crowdsourcing industry as they have been to open source, they are nevertheless important to the proper operation of any web service. Furthermore, as use of crowdsourcing services increases, so does the likelihood of litigation. TOUs can both protect against legal problems and help users understand the identity of a website. Accordingly, online agreements will continue to be important and regulate behavior online; it is vital to understand what it means to click "I agree."

Conclusion

The development of the law as it applies to crowdsourcing is still in its infancy. At this point, there are very few statues or judicial decisions that speak directly to any form of crowdsourcing. In fact, a case law search for either crowdsourcing or crowdfunding reveals that the terms have been mentioned in only two cases. Moreover, neither case actually examines the legal consequences of crowdsourcing. *Kickstarter v. ArtistShare* (2012) considered whether Kickstarter's website infringes the other company's patent; a concurrence by Justice Alito in *U.S. v. Jones* (2012) briefly acknowledged the privacy concerns that GPS data from cell phones could present given the ability to crowdsource information from it. Ultimately, crowdsourcing is still a largely untouched topic by the courts.

Yet perhaps it is because of this dearth of guiding precedent that this area needs to be watched and studied. This thesis addresses only a few areas where crowdsourcing and the law might intersect. Certainly there are many more. For this reason, anyone considering using crowdsourcing must be aware both of how courts might apply existing laws as well as what laws Congress or any state legislature might enact in the future. Indeed, we see presently the legal landscape of crowdsourcing beginning to change with the federal government is starting to consider crowdfunding as a legitimate method to raise money. It seems probable that more laws will come into existence in the near future.

Ultimately, there is room for much more work to be done to study how the law applies to crowdsourcing. This thesis is a first step toward a greater understanding of

crowdsourcing and the law. Though crowdsourcing may be developing faster than the law, hopefully scholarship like this can help understand how this intersection of crowdsourcing and legal regulation might develop in the future.

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Vita

Stephen M. Wolfson holds a BA in Political Science and Juris Doctor degree from the Ohio State University. In 2008, he was inducted into the Order of the Coif, a national honors society that recognizes excellence in legal study.

Stephen's professional and research interests as an attorney are in the area of Intellectual Property law in general, and particularly copyright law. Since being admitted to the Oregon bar in 2009, he has submitted two *amicus curiae* briefs on copyright law to the United States Supreme Court: first in *Reed Elsevier v. Muchnick* and later in *Golan v. Holder*.

Stephen is originally from Chagrin Falls, Ohio, but he currently resides in Austin, Texas.

Stephen.m.wolfson@gmail.com

This thesis was typed by Stephen Manuel Wolfson.