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Social Purpose Corporations: The Next Targets for Greenwashing Practices and Crowdfunding Scams

Tina H. Ho*

With an increased focus on corporate social responsibility,¹ various states have recently created a for-profit corporate entity that considers both social and shareholders' interests.² These for-profit corporations, such as benefit corporations, balance both shareholders' profits and public interests.³ In addition to corporations' traditional purposes of profit maximization, these for-profit corporations also strive to create public benefit to the community and environment or even to the corporations' employees, supply chain, and customers.⁴

Washington State has followed this trend and created a for-profit business entity known as a "social purpose corporation," emphasizing that the requirements and regulations related to this entity should be flexible in legislating corporate behavior.⁵ Washington's social purpose corporation statute was intended to provide more flexibility than was afforded by the

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¹ Archie B. Carroll & Kareem M. Shabana, *The Business Case for Corporate Social Responsibility: A Review of Concepts, Research, and Practice*, 12 INT'L J. OF MGMT. REVS. 85, 85 (2010).

² H.R. 2239, 62nd Cong. (Wash. 2012).

³ Evangeline Gomez, *The Rise of the Charitable For-Profit Entity*, FORBES (Jan. 13, 2012), <http://www.forbes.com/sites/evangelinegomez/2012/01/13/the-rise-of-the-charitable-for-profit-entity/>.

⁴ *Id.*

⁵ John Reed & Anne Wellman Lewis, *The Social Purpose Corporation*, STARTUP LAW BLOG (May 8, 2012), <http://www.startuplawblog.com/2012/05/08/social-purpose-corporation/>.

comparable benefit corporation statutes.⁶ However, by allowing such flexibility, fraudsters can utilize social purpose corporations for greenwashing practices and crowdfunding scams. This article will discuss the rise of greenwashing and crowdfunding scams, the reasons why social purpose corporations are the next targets for these scams, and what Washington State’s legislature can do to protect legitimate social purpose corporations that benefit society’s welfare and to deter deceptive practices and potential scams. The article will focus on Washington’s social purpose corporation legislation because Washington was the first state to create a social purpose corporation.⁷ However, the article recognizes that the analysis and prescribed solutions in this article can be applied to other states that have pending or recently passed social purpose corporation legislation.⁸

INTRODUCTION

Both “environmentally friendly” and “crowdfunding” are terms that have gained tremendous attention in the general population in the last few years. Specifically, environmental marketing has been growing exponentially since the 1990s and there has been a drastic jump in the quantity of products that claim to be environmentally friendly.⁹ However in 2010, “[o]ne green marketing firm examined more than 12,000 different green advertising

⁶ *Id.*

⁷ *Social Purpose Corporation*, SECRETARY OF STATE, <http://www.sos.wa.gov/corps/SocialPurposeCorporation.aspx> (last visited Feb. 8, 2015).

⁸ Only one other state, Florida, had adopted a social purpose corporation entity in July 2014. The one difference between the Washington and Florida legislation is that Florida created both the benefit corporation and the social purpose corporation whereas Washington only offers the social purpose corporation in lieu of a benefit corporation entity. *See, e.g.,* Stuart R. Cohn & Stuart D. Ames, *Now It’s Easier Being Green: Florida’s New Benefit and Social Purpose Corporations*, 88 THE FLA B.J. 38, 38 (2014), available at <http://www.floridabar.org/DIVCOM/JN/JNJournal01.nsf/8c9f13012b96736985256aa900624829/c655f4f9d7d009b585257d7e004bcb18!OpenDocument>.

⁹ Nick Feinstein, *Note: Learning from Past Mistakes: Future Regulation to Prevent Greenwashing*, 40 B.C. ENVTL. AFF. L. REV. 229, 232 (2013).

claims and concluded that 95 percent were overly vague or unsupported.”¹⁰ Another report found that “of over 1,000 self-declared ‘green’ products reviewed, all but one engaged in some form of greenwash.”¹¹ Greenwashing refers to companies making “deceptive, misleading, and false” environmental claims.¹²

Crowdfunding has also gained significant visibility in the past several years. Although crowdfunding has the potential to raise much-needed capital for small businesses and entrepreneurs, it also creates a great potential for scams. A well-known crowdfunding scam on Kickstarter is “Kobe Red.”¹³ The project by Magnus Fun, Inc., claimed to be raising money for a Kobe beef-based jerky business, made with 100 percent organic feed- and beer-fed Japanese cows.¹⁴ In less than four weeks, Magnus Fun, Inc., raised more than \$120,000 from 3,252 backers, almost 50 times its initial goal of \$2,437.¹⁵ Luckily, just hours before the month-long fundraising efforts were to end and the funds were to be released to Magnus Fun, Inc., Kickstarter suspended the fundraising campaign when it was discovered that the project was a scam.¹⁶ Among other suspicious details, Magnus Fun, Inc.’s promises and taste testimonials displayed on its Kickstarter website proved to be fake and inaccurate.¹⁷ Further information regarding this scam is mentioned in Part IV, Section B of this article.

Greenwashing practices have gone rampant and there are already instances of crowdfunding scams nationwide and globally. This article will

¹⁰ David J. Gilles & Matthew T. Kemp, *Greenwash: Overselling a Product's 'Greenness'*, 85 WIS. LAW. 1, 4 (2012).

¹¹ Eric L. Lane, *Consumer Protection in the Eco-Mark Era: A Preliminary Survey and Assessment of Anti-Greenwashing Activity and Eco-Mark Enforcement*, 9 J. MARSHALL REV. INTELL. PROP. L. 742, 746 (2010).

¹² *Hill v. Roll Int'l Corp.*, 128 Cal. Rptr. 3d 109, 111 (Cal.Ct.App. 2011).

¹³ Eric Larson, *How the 'Biggest Scam in Kickstarter History' Almost Worked*, MASHABLE (Jun. 21, 2013), <http://mashable.com/2013/06/21/kickstarter-scam/>.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

argue, however, that the potential for both greenwashing practices and reward crowdfunding scams has *increased* with the creation of social purpose corporations in Washington. Because Washington's social purpose corporations have flexible filing requirements and few barriers to incorporation, they will likely be the next targets for these scams. Fraudsters may easily set up social purpose corporations with a broadly stated green or social purpose and prey on novice green or social investors. Also, through crowdfunding, fraudsters now have another vehicle for falsely obtaining money that they would normally be unable to obtain from sophisticated investors. In general, sophisticated investors are more likely to have the financial acumen and/or awareness to discover a scam.¹⁸ Crowdfunding portals such as Kickstarter target and cater to novice investors but provide little to no protection for these investors. Kickstarter states on its website "Kickstarter does not guarantee projects or investigate a creator's ability to complete their project. On Kickstarter, backers (you!) ultimately decide the validity and worthiness of a project by whether they decide to fund it."¹⁹

Part I of this article will introduce the concept of greenwashing and crowdfunding. Part II will provide a background on social purpose corporations, including their legislative history in Washington State. Part III will outline the reasons why social purpose corporations will most likely be the next targets for greenwashing and crowdfunding scams. Finally, Part IV will offer multiple legislative solutions to deter both types of fraud.

¹⁸ Thomas G. James, *Far from the Maddening Crowd: Does the Jobs Act Provide Meaningful Redress to Small Investors for Securities Fraud in Connection with Crowdfunding Offerings?*, 54 B.C. L. REV. 1767, 1769 (2013).

¹⁹ *Kickstarter Basics*, KICKSTARTER FAQ, <https://www.kickstarter.com/help/faq/kickstarter%20basics> (last visited Feb. 8, 2015).

PART I: INTRODUCTION TO GREENWASHING AND CROWDFUNDING

A. Greenwashing

Defined by one source as “disinformation disseminated by an organization so as to present an environmentally responsible public image,”²⁰ greenwashing is the practice of making one’s product seem more environmentally friendly than it actually is.²¹ Another source defines greenwashing as companies making “deceptive, misleading, and false” environmental claims.²²

Greenwashing occurs for a number of reasons, but it is mostly driven by profits.²³ Becoming environmentally friendly, or at least appearing environmentally friendly, looks good for a company’s bottom line.²⁴ Both consumer and investor choices prompt greenwashing. Generally, consumers and investors are more willing to buy and invest in products if they are environmentally friendly and many companies develop goodwill for developing a “green product.”²⁵ Additionally, many consumers are willing to pay extra for environmentally friendly products.

A combination of increased attention to environmental issues and consumers who are willing to alter their purchasing habits has prompted an increase in environmental marketing.²⁶ Surveys reveal a “growing segment of consumers who either reward or intend to reward firms that address environmental concerns in their business and marketing practices and who punish firms that appear to ignore the environmental imperatives.”²⁷

²⁰ Jacob Vos, *Actions Speak Louder Than Words: Greenwashing in Corporate America*, 23 NOTRE DAME J.L. ETHICS & PUB. POL’Y 673, 674 (2009).

²¹ *Koh v. S.C. Johnson & Son, Inc.*, No. C-09-00927 RMW, 2010 WL 94265 (N.D. Cal. Jan. 6, 2010).

²² *Hill*, 128 Cal. Rptr. 3d at 111.

²³ Vos, *supra* note 20, at 680.

²⁴ *Id.* at 674.

²⁵ *Id.*

²⁶ Feinstein, *supra* note 9, at 231.

²⁷ Ajay Menon & Anil Menon, *Environmental Marketing Strategy: The Emergence of Corporate Environmentalism as Market Strategy*, 61 J. MARKETING 51, 52 (1997).

Many times, the first company that makes steps towards being environmentally friendly can improve its market share through differentiation.²⁸ Once high-profile companies begin committing to certain environmentally friendly policies, such as McDonald's switching from foam containers to paper wrapping,²⁹ other companies follow suit, using the high-profile companies' actions as benchmarks for environmentally friendly policies.³⁰

The fear of bad publicity also creates an incentive for companies to advertise green practices. Pressures from external monitoring organizations like watchdog groups exert public pressure on companies to commit to protecting the environment.³¹ In 2009, Kimberly-Clark gained negative public attention for cutting down 200-year-old forests to produce its products such as Kleenex tissues, while simultaneously promoting the company's efforts to reduce carbon emissions.³² Greenpeace proceeded to launch an aggressive activist campaign against Kimberly-Clark.³³ In response, Kimberly-Clark released new environmental policies with the end goal of ensuring that 100 percent of the fiber used in its products will be from environmentally responsible sources.³⁴

Additionally, there is a rise in green investors, who are specifically looking to invest in companies that are green.³⁵ Currently, green investors

²⁸ Catherine A. Ramus & Ivan Montiel, *When are Corporate Environmental Policies a Form of Greenwashing?*, 44 BUS. & SOC'Y 377, 388 (2005).

²⁹ Feinstein, *supra* note 9, at 232.

³⁰ Ramus & Montiel, *supra* note 28, at 386.

³¹ *Id.*

³² Feinstein, *supra* note 9, at 234.

³³ *Kimberly-Clark and Greenpeace Agree to Historic Measures to Protect Forests*, KLEENCUT WIPING AWAY ANCIENT FORESTS, <http://www.kleercut.net/en/> (last visited Feb. 8, 2015).

³⁴ KIMBERLY-CLARK, *Fiber Procurement*, at 4 (2009), available at http://www.cms.kimberly-clark.com/umbracoimages/UmbracoFileMedia/Fiber%20Procurement%20Policy_umbracoFile.pdf.

³⁵ Vos, *supra* note 20, at 682.

control about 10 percent of the national market.³⁶ Business scholars have recognized that “[b]oth the analytic comparative statics and the numerical examples indicate that the number of green investors in an economy does affect the proportion of acceptable, unacceptable, and reformed firms in the economy and the costs of capital of those firms.”³⁷ For instance, when green investors boycott certain companies, fewer investors hold the stock of these firms, causing the share prices to fall.³⁸ As described in one article, “[t]he larger the market share controlled by green investors, the more expensive it will be to be labeled a polluter.”³⁹

Despite their best intentions, many green investors fall victim to greenwashing practices.⁴⁰ Green investors believe they are investing in corporations that have an honorable social or environmental purpose, but that is often not the case.⁴¹ According to Jacob Vos, “[w]ithout verifiable information it is difficult for investors to make informed decisions about environmentally responsible practices and companies.”⁴² The investors are only able to rely on corporate representations to the public, which are often major mischaracterizations of corporations’ actual activities.⁴³ With nothing to rely on besides the corporations’ own information, green investors end up investing in many corporations with so-called environmental practices that may not actually be helpful to the environment.⁴⁴ However, many corporations recognize this scenario as an opportunity to gain more

³⁶ *Id.*

³⁷ Robert Heinkel, Alan Kraus & Josef Zechner, *The Effect of Green Investment on Corporate Behavior*, 36 J. FIN. & QUANTITATIVE ANALYSIS 431, 444 (2001).

³⁸ *Id.* at 432.

³⁹ Vos, *supra* note 20, at 682.

⁴⁰ William S. Laufer, *Social Accountability and Corporate Greenwashing*, 43 J. BUS. ETHICS 253, 251, 254–55 (2003).

⁴¹ *Id.*

⁴² Vos, *supra* note 20, at 683.

⁴³ *Id.*

⁴⁴ *Id.*

investors, and “[m]any corporations creatively manage their environmental reputations for this very reason.”⁴⁵

The issue with greenwashing is that “[i]f a company can reap the benefits of a green reputation such as increased customer base or goodwill reputation without actually investing the time or money to substantially change its practices, the company is able to reap all of the benefits without any of the associated costs.”⁴⁶ Greenwashing “has become so rampant” that the Federal Trade Commission (FTC) issued standards known as “Green Guides”⁴⁷ pursuant to its authority to enforce Section 5 of the Federal Trade Commission Act (FTC Act), which generally prohibits deceptive-advertising practices.⁴⁸ Although not legally binding, the Green Guides “reflect the FTC’s approach to evaluating environmental marketing claims, and courts generally view them as persuasive authority.”⁴⁹ However, even with the Green Guides, greenwashing practices are still a common practice within many industries.

B. Crowdfunding

In addition to greenwashing practices becoming rampant, crowdfunding, as an internet-based fundraising model, has gained popularity in the last several years. Crowdfunding is designed for “startups—businesses still in their infancy.”⁵⁰ In the absence of available start-up capital, small businesses and entrepreneurs have started looking at crowdfunding as a low-cost means of locating potential investors and capital.⁵¹

⁴⁵ *Id.*

⁴⁶ *Id.* at 681.

⁴⁷ *Hill*, 128 Cal. Rptr. 3d at 111.

⁴⁸ 15 U.S.C. § 45(a) (2005).

⁴⁹ Gilles & Kemp, *supra* note 10, at 5.

⁵⁰ David Mashburn, *Comment: The Anti-Crowd Pleaser: Fixing the Crowdfund Act’s Hidden Risks and Inadequate Remedies*, 63 EMORY L.J. 127, 157 (2013).

⁵¹ James, *supra* note 18, at 1772.

Crowdfunding is raising capital online from many investors, the “crowd,” who each contribute small amounts of money to a single venture.⁵² The “crowd” has grown at an incredible rate due to the internet and the popularity of e-commerce platforms.⁵³ A recent report by Massolution stated that contributors across the world pledged \$2.7 billion in more than a million online campaigns in 2012, an 81 percent increase from 2011.⁵⁴ Gofundme, a crowdfunding site with the current highest internet traffic, has raised over \$710 million for personal fundraisers.⁵⁵

Crowdfunding is generally facilitated through peer-to-peer lending websites, which are commonly known as funding portals.⁵⁶ These websites provide a platform for individuals to invest funds, both domestically and overseas.⁵⁷ Although there are several models of crowdfunding including donation, lending, reward, pre-purchase, and equity/securities, this article will mainly focus on reward crowdfunding.⁵⁸ Reward crowdfunding portals, are gaining popularity rapidly and there is no specific legislation regarding the amount of capital that businesses and entrepreneurs may fundraise through reward crowdfunding.⁵⁹ This article will also discuss

⁵² Andrew A. Schwartz, *ROUNDTABLE: Keep it Light, Chairman White: SEC Rulemaking Under the CROWDFUND Act*, 66 VAND. L. REV. EN BANC 43, 44 (2013).

⁵³ Andrew C. Fink, *Protecting the Crowd and Raising Capital Through the CROWDFUND Act*, 90 U. DET. MERCY L. REV. 1, 3 (2012).

⁵⁴ Bettina Eckerle, *There Is More to Crowdfunding than the JOBS Act*, CROWDSOURCING.ORG, May 13, 2013, <http://www.crowdsourcing.org/blog/there-is-more-to-crowdfunding-than-the-jobs-act/29050>.

⁵⁵ CROWDFUNDING FOR EVERYONE, <http://www.gofundme.com/> (last visited Mar. 2, 2015).

⁵⁶ D. Scott Freed, *Crowdfunding as a Platform for Raising Small Business Capital*, 45 MD. B.J. 12, 13 (2012).

⁵⁷ *Id.*

⁵⁸ Reward crowdfunding is a type of crowdfunding where individuals receive a reward for contributing funds to a company. A more detailed explanation of reward crowdfunding is provided below.

⁵⁹ Although there are no restrictions on the amount of money a business or entrepreneur may raise through donation crowdfunding, there is an understanding that the donors do not expect to see any of their initial investment returned in social or public benefits.

equity/security crowdfunding as a basis for the suggested additional protections on reward crowdfund investors.

In donation crowdfunding, investors donate money to a cause without expecting to receive anything in return other than a possible tax benefit or satisfaction.⁶⁰ This type of crowdfunding can raise large amounts of capital. For instance, President Barack Obama's campaign used crowdfunding to raise about "\$1 million a day, all online, with more than a million sub-\$1,000 contributions" to raise \$75 million.⁶¹ Because investors in donation crowdfunding do not expect a return, no need for increased protection for investors exists, which is why an analysis relating specifically to donation crowdfunding has been omitted.

Lending crowdfunding occurs when "crowdfunders" make loans through websites, with or without interest, and expect to receive their principal amount back in the future.⁶² Interest-bearing loans are securities subject to Securities and Exchange Commission (SEC) regulations and therefore must be registered.⁶³ One scholar estimated that peer-to-peer lending alone has raised an estimated \$1 billion in funding for small businesses and will likely raise in excess of \$5 billion by the end of 2013.⁶⁴ Because SEC regulations provide strict registration requirements and damage remedies, no immediate need for increased investor protection exists, which is why an analysis relating specifically to lending crowdfunding has been omitted.

In reward crowdfunding, investors receive rewards or products in return for their investment.⁶⁵ Rewards are tangible benefits that cannot be

⁶⁰ John S. (Jack) Wroldsen, *The Social Network and the Crowdfund Act: Zuckerberg, Saverin, and Venture Capitalists' Dilution of the Crowd*, 15 VAND. J. ENT. & TECH. L. 583, 588 (2013).

⁶¹ Daniel M. Satorius & Stu Pollard, *Crowd Funding: What Independent Producers Should Know About the Legal Pitfalls*, 28 ENT. & SPORTS LAW 15, 16 (2010).

⁶² Wroldsen, *supra* note 60, at 588–89.

⁶³ *Id.* at 589.

⁶⁴ James, *supra* note 18, at 1772.

⁶⁵ Schwartz, *supra* note 52, at 47.

security.⁶⁶ For example, through reward crowdfunding, a business or entrepreneur can give a thank you note as a tangible benefit for their investment.

Reward crowdfunding through crowdfunding portal websites such as Kickstarter and IndieGoGo has gained popularity since 2009, growing into a \$1.5 billion market in just a couple of years.⁶⁷ In 2013 alone, three million people pledged \$480 million to Kickstarter projects, which is about \$1,315,520 pledged per day.⁶⁸ As of January 2015, over 7.7 million crowdfunders pledged more than \$1 billion dollars to Kickstarter projects.⁶⁹ One of Kickstarter's larger crowdfunded projects, "Pebble," raised over \$10 million in 36 days.⁷⁰ The largest Kickstarter project, "Coolest Cooler," had 62,642 backers (crowdfunders) and raised \$13,285,226, despite listing a fundraising goal of \$50,000.⁷¹ For reward crowdfunding, if the target goal is not reached, the crowdfunding websites will refund the money back to investors.⁷² Because reward crowdfunding does not involve sales or transfers of securities, reward crowdfunding websites currently operate without the SEC's oversight.⁷³

One example of a start-up company's ability to raise large amounts of capital through reward crowdfunding is Double Fine and 2 Player Productions. Double Fine and 2 Player Productions raised over \$3 million

⁶⁶ Wroldsen, *supra* note 60, at 588.

⁶⁷ Schwartz, *supra* note 52, at 47.

⁶⁸ *The year in Kickstarter*, KICKSTARTER, <https://www.kickstarter.com/year/2013/?ref=footer> (last visited Apr. 17, 2014).

⁶⁹ *Stats*, KICKSTARTER, <https://www.kickstarter.com/help/stats?ref=footer> (last visited Apr. 17, 2014).

⁷⁰ *Pebble: E-Paper Watch for iPhone and Android*, KICKSTARTER, <https://www.kickstarter.com/projects/597507018/pebble-e-paper-watch-for-iphone-and-android> (last visited Apr. 17, 2014).

⁷¹ *Coolest Cooler: 21st Century Cooler That's Actually Cooler*, KICKSTARTER, https://www.kickstarter.com/projects/ryangrepper/coolest-cooler-21st-century-cooler-thats-actually?ref=most_funded (last visited Feb. 8, 2015).

⁷² Mashburn, *supra* note 50, at 139.

⁷³ *Id.* at 130.

in one month from more than 87,000 individual crowdfunders for their game Double Fine Adventures.⁷⁴ After its first eight hours, the crowdfunding campaign reached its target funding amount of \$400,000 and surpassed \$1 million in 24 hours.⁷⁵ Crowdfunders were entitled to receive different rewards based on the amount they individually contributed to the campaign.⁷⁶

Pre-purchase crowdfunding is identical to reward crowdfunding, except that the reward is the item that is produced as a result of the crowdfunder's contribution.⁷⁷ The reward may be a copy of the video game or book that was created due to the crowdfunder's contribution.⁷⁸ This type of crowdfunding is also not subject to SEC regulations because it does not involve the sale of securities.

Finally, in securities crowdfunding, investors receive a share in the profits or some type of security in the start-up.⁷⁹ The security is an ownership interest in the company.⁸⁰ As of March 2012, "three thousand investors pledged to invest \$7.5 million when [unregistered] crowdfunding [securities] becomes legal."⁸¹ Until the SEC promulgates rules governing securities crowdfunding under the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (CROWDFUND Act), which will most likely be in October 2015, federal securities crowdfunding

⁷⁴ Wroldsen, *supra* note 60, at 590.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.* at 588.

⁷⁸ *Id.*

⁷⁹ Schwartz, *supra* note 52, at 48.

⁸⁰ Wroldsen, *supra* note 60, at 589.

⁸¹ 158 Cong. Rec. S2, 229–31 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown).

is illegal.⁸² However, Washington and several other states have enacted security/equity crowdfunding statutes.⁸³

As a brief overview of the national act, in 2012, Congress enacted the CROWDFUND Act,⁸⁴ which provides an exemption for crowdfunded securities to the Securities Act of 1933. The Securities Act of 1933 requires all securities to be registered with the SEC.⁸⁵ However, crowdfunded securities up to a certain dollar amount, as discussed below, will be exempt from registration requirements. For the first time ever, ordinary Americans will have the ability to go online and invest up to a specific annual amount, dependent on their annual income, without having to deal with SEC regulations.⁸⁶ The purpose of the CROWDFUND Act is to provide start-ups and small businesses access to a “big, new pool of potential investors—namely the American people.”⁸⁷ As a whole, the national Jumpstart Our Business Startups Act (JOBS Act) allows “private businesses to offer equity to anyone other than accredited investors in exchange for funding.”⁸⁸ The Act’s two primary goals are (1) to create a low-cost method for small

⁸² Mashburn, *supra* note 50, at 130; Office of Information and Regulatory Affairs, REGINFO.GOV, (Jan. 3, 2015), <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201410&RIN=3235-AL37>.

⁸³ *S.E.C.’s Delay on Crowdfunding May Just Save It*, N.Y. TIMES, Nov. 18, 2014, http://dealbook.nytimes.com/2014/11/18/s-e-c-s-delay-on-crowdfunding-may-just-save-it-2/?_r=0; Washington’s Jobs Act of 2014 (HB 2023) <http://apps.leg.wa.gov/documents/billdocs/2013-14/Pdf/Bills/Session%20Laws/House/2023-S.SL.pdf>; Rules promulgated by the Washington State Department of Financial Institutions (DFI), the securities regulator for the state promulgated rules, can be found at: <http://dfi.wa.gov/documents/rulemaking/securities/crowdfunding/proposed-language.pdf>.

⁸⁴ The CROWDFUND Act is Title II of the Jumpstart Our Business Startups Act (JOBS Act). H.R. 3606, 112th Cong. (2nd Sess. 2012).

⁸⁵ Schwartz, *supra* note 52, at 47.

⁸⁶ Barack Obama, US President, Remarks at JOBS Act Bill Signing (Apr. 5, 2012), <http://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing>.

⁸⁷ *Id.*

⁸⁸ Kara Scharwath, *Top 10 Crowdfunding Sites*, TRIPLEPUNDIT: A MEDIA PLATFORM FOR THE TRIPLE BOTTOM LINE (July 16, 2012) <http://www.triplepundit.com/2012/07/emerging-next-generation-crowdfunding-platform-roundup/>.

business owners and start-ups to raise up to \$1 million per year from the public and (2) to allow investors of moderate means to make investments.⁸⁹

Although crowdfunding has funded and has the potential to fund many beneficial and successful projects, the North American Securities Administrators Association (NASAA) has placed crowdfunding fraud at the top of its 2012 list of investor threats.⁹⁰ The internet has afforded fraudsters bountiful targets.⁹¹ The internet also makes it more difficult for investors to know whether a business is legitimate due to the lack of real-life encounters.⁹² In addition to listing non-existent projects or businesses, a real threat is fraudsters posing as registered funding portals.⁹³ For example, by using domain names similar to legitimate crowdfunding intermediaries, fraudsters are able to trick novice investors into investing.⁹⁴ Fraudsters may also indirectly solicit through spam e-mails and social media platforms such as Facebook and Twitter.⁹⁵ Therefore, the impersonal nature of the internet calls for more investor protection.⁹⁶

A renowned rewards crowdfunding scam is “Dirty Bird Sports,” which sought funding for a new college football video game through Kickstarter by offering perks for investors such as dinner with Jamal Anderson (a former NFL running back), a chance to test-play the game, and signed

⁸⁹ Schwartz, *supra* note 52, at 44.

⁹⁰ Beth Pinsker Gladstone, *Crowdfunding Scams Top Investor Threat: Regulators*, REUTERS, Aug. 21, 2012, 6:57 PM, <http://www.reuters.com/article/2012/08/21/us-investing-scams-threats-idUSBRE87K17W20120821>. Founded in 1919, NASAA is an investor protection association of 67 securities regulators from the territories, districts, and states of the United States, Mexico, and Canada. See *Our Role*, N. AM. SEC. ADMIN. ASS’N, <http://www.nasaa.org/about-us/our-role/> (last visited Mar. 1, 2015).

⁹¹ James, *supra* note 18, at 1780.

⁹² Karina Sigar, *Comment: Fret No More: Inapplicability of Crowdfunding Concerns in the Internet Age and the JOBS Act’s Safeguards*, 64 ADMIN. L. REV. 473, 481 (2012).

⁹³ James, *supra* note 18, at 1781–82.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1766 (2012).

helmets from former Ohio State football players.⁹⁷ The fraudsters stole images from 3D modeling artists and set a target fundraising goal of \$500,000.⁹⁸ In a short time, 13 investors contributed \$685.⁹⁹ The scam was discovered when Jamal Anderson was contacted, and he confirmed he had no knowledge of the project.¹⁰⁰ If the fraud had not been discovered before the money was released to the fraudsters, Dirty Bird Sports could have gotten away with at least \$500,000.

As illustrated in this section, greenwashing practices and crowdfunding scams are occurring with increased frequency. Corporate fraudulent misrepresentations and vague environmentally friendly purposes perpetuate greenwashing practices, which negatively affect both consumers and investors. Although the FTC issued Green Guides as a standard for evaluating deceptive environmental marketing claims, it has no legal effect. Additionally, with reward crowdfunding, there are no SEC regulations that protect novel investors. Moreover, with the impersonal nature of the internet there is additional cause for concern about scams.

PART II: SOCIAL PURPOSE CORPORATIONS

Above, the article explored two ways in which contemporary marketing and funding sources have lent themselves to consumer abuse and fraud. This article will now explore an emerging entity that will be the next target of these scams—social purpose corporations. Below is a brief overview of social purpose corporations in relation to Washington State.

While the primary objective of a traditional business corporation is to create economic value for its shareholders, the social purpose corporation now gives companies the latitude to also promote one or more broad goals of social responsibility, such as environmental

⁹⁷ Eric Camm, *Kickstarter and Scam Artists*, APEX LAW GROUP LLP (Feb. 11, 2013), <http://www.apexlg.com/?p=501>.

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

sustainability or committing to improve other aspects of the local, national, or world communities.¹⁰¹

In 2012, after considerable deliberation, the Washington Corporate Act Revision Committee created the social purpose corporation, making a deliberate decision to draft a slightly different version of the benefit or hybrid corporation than that adopted by other states.¹⁰² Washington was the first state to have a social purpose corporation¹⁰³ with only one other state following suit, Florida.¹⁰⁴ Washington intended for the social purpose corporation statute to provide more flexibility to the socially responsible entrepreneurs than that which was afforded by the comparable benefit corporation statutes.¹⁰⁵ The statute was not meant to legislate corporate behavior.¹⁰⁶ Rather, each social purpose corporation would be able to determine what corporate behavior is applicable to it by stating its purpose in its articles of incorporation.¹⁰⁷ In turn, the social purpose corporation's board and officers may be permitted to attach weight to the corporation's social purpose(s) in making business decisions and would not be held liable for doing so.¹⁰⁸ The statute allows officers to make a corporate decision that foregoes the typical shareholder's profit maximizing value in favor of one or more of the corporation's social purposes as stated in the articles of

¹⁰¹ Reed & Lewis, *supra* note 5.

¹⁰² *Id.*

¹⁰³ *Social Purpose Corporation, supra* note 7.

¹⁰⁴ Stuart R. Cohn & Stuart D. Ames, *Now It's Easier Being Green: Florida's New Benefit and Social Purpose Corporations*, 88 THE FLA B.J. 38 (2014), available at http://www.floridabar.org/DIVCOM/JN/JNJournal01.nsf/c0d731e03de9828d852574580042ae7a/c655f4f9d7d009b585257d7e004bcb18!OpenDocument&Highlight=0,Stuart,R,Cohn*.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

incorporation.¹⁰⁹ In June 2012, the social purpose corporation became available as a legal business entity in Washington State.¹¹⁰

As of December 1, 2014, there were 132 registered and 101 active social purpose corporations in Washington State, and that number is increasing weekly.¹¹¹ A social purpose corporation must declare its intent to produce positive short-term or long-term effects or minimize adverse effects through its business activities.¹¹² The effects may be “environmental or social, and can include the corporation’s employees, supply chain, customers, or the greater community, including local, state, national, or world.”¹¹³ Additionally, a corporation may have more than one social purpose for which it is organized.¹¹⁴

A corporation may incorporate as a social purpose corporation at any time.¹¹⁵ An existing corporation may become a social purpose corporation by approval of a two-thirds majority vote of stakeholders.¹¹⁶ A social purpose corporation may also choose to no longer be a social purpose corporation by a two-thirds majority vote.¹¹⁷

PART III: WHY ARE SOCIAL PURPOSE CORPORATIONS THE NEXT TARGETS?

After providing a brief overview of social purpose corporations above, this section will delve further into the flexible requirements and lack of investor protections under Washington’s social purpose corporation legislation. Specifically, the article will offer several reasons why social

¹⁰⁹ *Id.*

¹¹⁰ *Social Purpose Corporation*, *supra* note 7.

¹¹¹ *Steps to Becoming an SPC, What You’ll Need to Know*, SPC, http://www.spcwa.com/how_to_spc/steps_to_spc/ (last visited Apr. 17, 2014).

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ Wash. Rev. Code § 23B.25.030 (2012).

¹¹⁵ *Steps to Becoming an SPC, What You’ll Need to Know*, *supra* note 111.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

purpose corporations are the next targets for greenwashing practices and crowdfunding scams.

A. No Barriers to Entry and Flexible Requirements

There are essentially no barriers of entry to form a social purpose corporation. The easy, flexible requirements that a corporation must fulfill to incorporate as a social purpose corporation will allow fraudsters to set up multiple social purpose corporations and utilize these corporations to attract investors. Social and green investors will not be as wary when investing in apparent social purpose corporations, so they are prone to invest in fraudsters posing as such. There is currently nothing in place to protect these investors.

Only three requirements exist to incorporate a social purpose corporation: (1) the name of the corporation must include “social purpose corporation” or a version of SPC;¹¹⁸ (2) the articles of incorporation must state: “The mission of this social purpose corporation is not necessarily compatible with and may be contrary to maximizing profits and earnings for shareholders, or maximizing shareholder value in any sale, merger, acquisition or other similar actions of the corporation”;¹¹⁹ and (3) a social purpose corporation must have at least one general social purpose.¹²⁰ The corporation must “promote positive short-term or long-term effects of, or minimize adverse short-term or long-term effects of, the corporation’s activities upon any or all of (1) the corporation’s employees, suppliers, or customers; (2) the local, state, national or world community; or (3) the environment.”¹²¹ A social purpose corporation may, but is not required to, include a specific social purpose. If the corporation has designated a specific social purpose or purposes, this must be included in the articles of

¹¹⁸ Wash. Rev. Code § 23B.25.040(1)(a) (2012).

¹¹⁹ Wash. Rev. Code § 23B.25.040(1)(e) (2012).

¹²⁰ Wash. Rev. Code § 23B.25.020 (2012).

¹²¹ *Id.*

incorporation.¹²² Besides the three requirements above, the only other step required to incorporate as a social purpose corporation is to pay \$180 to register the company with the Washington State Secretary.¹²³

Additionally, the social purpose corporation legislation “seeks to impose accountability measures while maintaining a level of flexibility to serve the needs of each corporation.”¹²⁴ The legislature maintains flexibility by requiring the social purpose corporation to post informal annual progress reports on its websites without any specific guidelines or requirements.¹²⁵ Also, the corporation is given the legal authority, but not obligation, to define its compliance with social objectives either by itself or through a third party.¹²⁶ Unlike other jurisdictions that have similar benefit or hybrid corporations and mandate that the benefit or hybrid corporation utilize third-party standards to judge the corporation’s commitment to its social purposes, the Washington legislature decided not to include provisions in the social corporation legislation requiring shareholders to adopt third-party standards.¹²⁷ Rather, the Washington legislature provided that the corporation *may* decide to assess the corporation’s performance with respect to its social purpose or purposes based on third-party standards.¹²⁸ However, by providing such flexibility and essentially no mandatory accountability measures, the Washington legislature has effectively made social purpose corporations an easy target for greenwashing and crowdfunding scams. Also, because a social purpose corporation has flexibility in determining the

¹²² Wash. Rev. Code § 25B.25.040(1)(d) (2012).

¹²³ *Social Purpose Corporation*, *supra* note 7.

¹²⁴ C. Kent Carlson, G. Scott Greenburg & Patrick J. Loney, *Washington State Passes Legislation Authorizing Social Purpose Corporations: Bill to Permit Corporations to Seek Social, Environmental-Oriented Goals*, K&L GATES, (2012), available at http://m.klgates.com/files/Publication/ab22741e-e266-495a-a89e-31fc2b781778/Presentation/PublicationAttachment/57cf9b22-d313-44d8-bfcb-9777cd5f5ef0/WA_State_Social_Purpose_Corporations.pdf.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ Wash. Rev. Code § 23B.25.040(2)(b) (2012).

weight a social purpose may have on any of its business decisions, it may potentially place no weight on a social purpose while utilizing the valuable goodwill that is typically associated with a social purpose designation.

B. Flexibility in Defining a Purpose

Washington State specifically does not require the corporation's officers and directors to consider stakeholders of the public and social benefit.¹²⁹ Rather, the directors and officers *may* take these considerations into account when making business decisions.¹³⁰ The flexibility in defining the social purpose is advantageous to legitimate social purpose corporations, but also advantageous for greenwashing and crowdfunding fraudsters.

A common form of greenwashing occurs when corporations release broad, high-minded environmental policy statements.¹³¹ For example, a corporation may make a general commitment to preserving the environment.¹³² Although the corporation does not identify specific commitments or objectives, a high-minded environmental policy generates good publicity and the corporation is not bound to produce measurable progress towards its policy.¹³³

An example of a corporation that marketed its broad environmental policy is British Petroleum (BP), whose environmental policy is to strive for "no accidents, no harm to people and no damage to the environment."¹³⁴ However, it is impossible for BP to do no damage to the environment when its business relies on extracting scarce natural resources.¹³⁵ BP can continue

¹²⁹ Peter J. Smith, *Washington's Social Purpose Corporation*, THE APEX LAW GROUP LLP (2013), available at http://www.spcwa.com/wp-content/uploads/2013/06/Washing_tons_Social_Purpose_Corporation.pdf.

¹³⁰ *Id.*

¹³¹ Vos, *supra* note 20, at 681.

¹³² *Id.*

¹³³ *Id.*

¹³⁴ Shanta Barley, *BP Brings 'Green Era' to a Close*, BBC NEWS (May 11, 2009), available at <http://news.bbc.co.uk/2/hi/science/nature/8040468.stm>.

¹³⁵ Vos, *supra* note 20, at 681–82.

to work towards an impossible goal while ducking any allegations of perpetuating environmental problems by pointing to its noteworthy environmentally and socially beneficial goals and policies.¹³⁶ Also, by being overly broad in its aspirations, there is no way for BP to be held liable for not following its environmental goals when its practices are generally not environmentally friendly. Similarly, fraudsters can create a social purpose corporation and attract investors with its broad purpose and may avoid liability from stakeholders or the general public.

C. Lack of Available Information and Novice Investors

In addition to the flexible requirements, social purpose corporations are not required to disclose any financial information to the public and investors.¹³⁷ In fact, social purpose corporations are not required to possess audited financial statements and fraudsters could falsely produce such documents if requested or needed.¹³⁸ Novice green or social investors may not be as suspicious or wary of companies that provide unaudited financial statements or that do not provide all the information that other more developed corporations may provide. This is partly due to the fact that it is normal for start-ups and small businesses to lack financial information related to their business. Start-ups face limited “human, informational, and financial resources.”¹³⁹ Some suggest that “[m]any startups will not have done enough business to have generated sufficient financial information to disclose to potential investors.”¹⁴⁰

Of primary concern is that, through crowdfunding, any individual can invest in companies over the internet. Crowdfunding allows non-accredited

¹³⁶ *Id.*

¹³⁷ WASH. REV. CODE § 23B.25 does not list the requirement to disclose any financial information.

¹³⁸ *Id.*

¹³⁹ Mashburn, *supra* note 50, at 157.

¹⁴⁰ James, *supra* note 18, at 1768–69.

investors¹⁴¹ to invest in start-ups and small businesses.¹⁴² Also, given the multitude of online social network participants, online crowdfunding opportunities will likely attract many unsophisticated, non-accredited investors who may not be able to discern whether the listed project is a scam.¹⁴³ If sophisticated investors fall victim to fraud, then unsophisticated investors need more protection and safeguards in place. Online crowdfunding exposes investors to unknown financial risks and higher incidents of fraud.¹⁴⁴ Unsophisticated investors generally lack the necessary business or financial acumen to understand the risks involved with crowdfund investing or to understand in what they are investing.¹⁴⁵

There are several service providers that serve a risk-reduction function.¹⁴⁶ The providers, such as CrowdCheck, help investors make informed investments and avoid fraud by reviewing potential investments.¹⁴⁷ However, the cost for the services may exceed the amount to make it worthwhile for investors to invest. Since crowdfunding deals with smaller sums of money, expensive and detailed due diligence is not practical.¹⁴⁸ Investors will choose to donate in order to support the company's noble goals without performing the extensive research typically done for investments. Crowdfunding investors will rely either on the issuer's sales pitch or disclosed information.¹⁴⁹

For fraudsters posing as social purpose corporations, the only information that may be available to investors is any information that the fraudsters choose to reveal. Fraudsters may choose to disclose the annual report

¹⁴¹ "Accredited investor" is defined in 17 C.F.R. § 230.501(a) (2015).

¹⁴² Andrew A. Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1466 (2013).

¹⁴³ James, *supra* note 18, at 1778.

¹⁴⁴ *Id.* at 1768.

¹⁴⁵ *Id.* at 1768–69.

¹⁴⁶ *Services*, CROWDCHECK, www.crowdcheck.com/services (last visited Apr. 17, 2014).

¹⁴⁷ *Id.*

¹⁴⁸ Mashburn, *supra* note 50, at 165.

¹⁴⁹ *Id.* at 164.

publicly on the reward crowdfunding portal. Although the legislation requires that the annual report be publicly accessible at the corporation's web site address, it only mandates that it must be furnished to the shareholders.¹⁵⁰

Nevertheless, the requirements for the annual report itself are broad, requiring only a "narrative discussion concerning the social purpose or purposes of the corporation, including the corporation's efforts intended to promote its social purpose or purposes."¹⁵¹ Fraudsters can easily draft an annual report to comport to this general narrative discussion requirement. Although social purpose corporations are required to provide a social purpose report, it is unhelpful without a way to verify the accuracy of the reports.¹⁵² Once again, the Washington legislature suggests, but does not require, information regarding the short- and long-term objectives of the corporation related to its social purpose(s), any prior or future corporate actions taken or expected to be taken to achieve the corporation's social purpose(s), and any measures used by the corporation to evaluate its performance in achieving its social purpose(s).¹⁵³

D. Lack of Legal Recourse for Investors Under the Social Purpose Legislation

Finally, in addition to the flexible requirements, there are no specific legal remedies available for investors under the current social purpose corporation legislation.¹⁵⁴ However, a green investor who believes that they have been misled may bring a suit for fraud or misrepresentation. A crowdfund investor may also bring a suit for fraud against a scammer. Although some legal remedies are available to those who are defrauded, the financial obstacle may be too large of a hurdle for investors to overcome.

¹⁵⁰ WASH. REV. CODE § 23B.25.150 (1) (2012).

¹⁵¹ *Id.*

¹⁵² Vos, *supra* note 20, at 689.

¹⁵³ WASH. REV. CODE § 23B.25.150 (2) (2012).

¹⁵⁴ WASH. REV. CODE § 23B.25.080 only provides legal remedies to shareholders.

Because of the small dollar amounts in a crowdfunding offering, no single individual is likely to have made a large enough investment for litigation to be worthwhile.¹⁵⁵ Investors may only recover up to the amount invested, which for small investors may amount to less than the cost of bringing suit in the first place.¹⁵⁶ The limited dollar amount may lead to investors filing a class action suit to pool together the claims of investors.¹⁵⁷ However, the aggregate amount may still be too small to justify litigation costs. One study asserts that “smaller sized offerings hardly ever experience a securities-fraud lawsuit,” noting that less than 1 percent of offerings below \$5 million resulted in a class action lawsuit.¹⁵⁸ Another study noted that there must be at least \$20 million in damages to “make the class action economically attractive to plaintiffs’ attorneys.”¹⁵⁹

Because there is a lack of legal recourse, and therefore no punishment for fraudulent behavior, fraudsters are effectively encouraged to continue to scam investors.

PART IV: POSSIBLE SOLUTIONS

This article would like to suggest several solutions below that the Washington State Legislature should consider in order to protect investors.

A. Require Standardized Benchmarks and Third-Party Evaluations

The Washington legislature should amend the social purpose annual report section of the legislation to require that all social purpose corporations identify standard benchmarks and/or accreditation typically used in the field or industry to evaluate the corporations’ actions in furthering their social purposes. There should also be evaluations as to how

¹⁵⁵ Mashburn, *supra* note 50, at 165–66.

¹⁵⁶ James, *supra* note 18, at 1769–70.

¹⁵⁷ Mashburn, *supra* note 50, at 166.

¹⁵⁸ John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1543 (2006).

¹⁵⁹ *Id.* at 1544 n.28.

the corporations' prior and future actions towards achieving social purposes align with the benchmarks. Specifically, there should be at least one third-party evaluation of the corporations' progress towards their social purposes with the results made public to the investors.

It will be more difficult for fraudsters to falsely create a social purpose report if there is a certain standard or accreditation that needs to be used or obtained. Additionally, by requiring legitimized reports, the proposed legislative change will help investors become better informed. One scholar proposed, "[t]he growing wisdom is that companies must produce verified accountability reports—verified reports by auditors specializing in social accounting and auditing."¹⁶⁰

Several suggestions as to what a good environmental report should contain have emerged in attempts to address greenwashing practices. Particular to addressing greenwashing practices, there have been several suggestions as to what a good environmental report should contain. For example, a good environmental report should discuss a company's footprint using quantitative metrics and cover the central environmental issues such as air emissions, water pollution, hazardous waste disposal, energy consumption, greenhouse gas emissions, and notices of legal violations.¹⁶¹ The FTC's Green Guides might be acceptable benchmarks to evaluate social purpose corporations that have environmental friendly purposes. The absence of any required benchmark for a good environmental report could undermine social purpose corporations' legitimacy, so any benchmark provided by the Washington State Legislature will be an improvement. As one article states, "If for no other reason, with accusations of greenwashing and evidence of its practice, decisions to . . . forgo the requirement entirely strongly undermine an appearance of legitimacy."¹⁶²

¹⁶⁰ Laufer, *supra* note 40, at 259.

¹⁶¹ *Id.*

¹⁶² *Id.*

Additionally, the Washington State Legislature could use third-party standards similar to those used to evaluate benefit corporations in other states and through B-Lab.¹⁶³ B-Lab is a 501(c)(3) non-profit organization that supports and certifies benefit corporations.¹⁶⁴ Benefit corporation legislation does not determine what third-party standard is acceptable and appropriate and does not require the benefit corporations to adopt a specific third-party standard.¹⁶⁵ Rather, there are certain minimum requirements that the third-party standards must meet.¹⁶⁶ These include requirements that the report must be comprehensive, prepared independently of the benefit corporation, credible, and transparent.¹⁶⁷

Currently, the goal of preserving a social purpose corporation's flexibility has left the social purpose report legislation too broad, requiring only that the "narrative discussion *may* include the following information. . . ."¹⁶⁸ The legislation does provide some optional suggestions about what may be included in the social report, but leaves the decision about what to include in the report to the social purpose corporations themselves.¹⁶⁹ Even if Washington State's legislature provides some universal minimum requirement for the social purpose report, by not requiring a particular standard, the legislature can continue to provide flexibility to social purpose corporations.

¹⁶³ See *List of Standards*, BENEFIT CORP INFORMATION CENTER, <http://benefitcorp.net/third-party-standards> (last visited Feb. 20, 2015) (listing third party standards that a majority of B corporations use to assess their performance).

¹⁶⁴ More information regarding B-Lab can be found at <http://www.bcorporation.net/what-are-b-corps/the-non-profit-behind-b-corps>.

¹⁶⁵ *How Do I Select a Third Party Standard?*, BENEFIT CORP INFORMATION CENTER, <http://benefitcorp.net/third-party-standards> (last visited Apr. 17, 2014).

¹⁶⁶ *Criteria for Acceptable Third Party Standards*, BENEFIT CORP INFORMATION CENTER, <http://benefitcorp.net/third-party-standards/criteria-for-acceptable-third-party-standards> (last visited Apr. 17, 2014).

¹⁶⁷ *Id.*

¹⁶⁸ WASH. REV. CODE § 23B.25.150(2) (2012) (emphasis added).

¹⁶⁹ *Id.*

Arguably, by requiring third-party accountability, legitimate entrepreneurs will not have the ability to personally decide whether they have met the social goals they have set for themselves. Accordingly, it is also hard to measure impact. However, by allowing corporations to pick the third-party standard that would be most appropriate to evaluate their activities, entrepreneurs can pick how they would like to measure their social impact. The entrepreneur can also determine that it may be more appropriate to utilize a combination of standards. Therefore, a requirement that social purpose reports be accountable to third-party standards will not negatively affect legitimate social purpose corporations.

Another argument that may emerge is that it may be too burdensome for corporations to follow the extra benchmarks. However, other states have created benchmarks and requirements that exceed the suggested benchmark above and these standards have not deterred the creation of hybrid or benefit corporations.¹⁷⁰

B. Hold Crowdfunding Portal Websites Liable and Require Minimum Disclosures on the Websites

In addition to revising legislation, crowdfunding portal websites should be held liable for fraudulent activity or at least be required to take certain precautions to minimize fraud.

In the earlier mentioned scams, Dirty Bird Sports and Kobe Red, it was not Kickstarter, the crowdfunding portal site, that discovered the projects were a scam. Rather, in the Dirty Bird Sports case, Kickstarter suspended the project only when someone contacted Jamal Anderson and he confirmed he had no knowledge of the project.¹⁷¹ Additionally, in Kobe Red, Los

¹⁷⁰ This is supported by the fact that 27 states have passed legislation creating benefit corporations with 14 additional states that are working on benefit corporation legislation. Benefit corporations exceed or are at least on par with the suggested benchmark. *See State by State Status*, BENEFIT CORP INFORMATION CENTER, <http://benefitcorp.net/> (last visited Feb. 20, 2015).

¹⁷¹ Camm, *supra* note 97.

Angeles-based filmmakers who were conducting research for their documentary film, Kickstarted, discovered the scam.¹⁷² The filmmakers wanted to highlight successful crowdfunding projects and contacted Magnus Fun, Inc., Kobe Red's founders, through the "Contact Me" link on its Kickstarter website.¹⁷³ Several correspondences were exchanged between the filmmakers and Magnus Fun, Inc., and after several suspicious comments and announcements, the filmmakers hired a private investigator to look into the company.¹⁷⁴ The filmmakers published their findings on a social networking site, and showed among other things that: (1) the company was not registered in California as stated on Magnus Fun, Inc.'s Kickstarter website; (2) the email used to register Magnus Fun, Inc., with Kickstarter was the same as the one used to register another website—Uhadme.com—which was removed; and (3) none of the taste testimonials provided on Magnus Fun, Inc.'s Kickstarter website could be verified.¹⁷⁵ Kickstarter's essential avoidance of liability by stating in its FAQ section that funders (investors) are responsible for evaluating projects' legitimacy is even more concerning.¹⁷⁶ If something seems strange, it is up to the crowdfunders to submit a fraud report.¹⁷⁷

In the case of Kobe Red, ordinary filmmakers were able to discover red-flag issues by performing minimal checks on the company's name. This would not be unduly burdensome for the crowdfunding websites. It should not be up to the watchdog group or investors who have been scammed to discover the scam. Instead, the duty should be placed on the crowdfund websites to vet the social purpose corporations that may be scams before they are placed on the website. A crowdfunding site may argue that it should not be expected to undertake the due diligence necessary to vet all

¹⁷² Larson, *supra* note 13.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Kickstarter Basics*, *supra* note 19.

¹⁷⁷ *Id.*

the projects listed on its site. Crowdfunding sites may argue that the crowdfunding portals may eventually have millions of projects, and even minimal checks may become unduly burdensome. However, because the websites receive compensation for promoting the fraudulent organizations, they should at least verify they are promoting legitimate investment opportunities.

Under the JOBS Act, security/equity crowdfunding portals are held accountable and are “subject to rigorous oversight” by the SEC.¹⁷⁸ The JOBS Act mandates that these specific crowdfunding portals need to “screen issuers, educate investors, and track investor income levels.”¹⁷⁹ This mandate is only for security/equity crowdfunding portals and the reward and security/equity crowdfunding portals are different portals. However, because reward and securities crowdfunding portals list funding projects and collect and distribute the crowdfunded money, the legislature should consider treating both portals in a similar manner. The policy underlying this provision of the JOBS Act seems applicable to the reward crowdfunding portals as well: crowdfunding portals should be held liable because they are repeat players that can handle regulation and can accordingly spread the cost.¹⁸⁰ Just as fear and awareness of the high possibility of fraud for securities crowdfunding motivated Congress to pass the JOBS Act, these same concerns should compel the Washington legislature or even Congress to consider regulation overseeing reward crowdfunding websites.

This article is not suggesting that a crowdfunding site should have a fiduciary duty or strict liability. If the standard is strict liability, it would be too expensive for the crowdfunding websites to operate and may discourage them from operating or cause them to increase the percentage they obtain from the listed projects. This standard potentially would discourage

¹⁷⁸ Obama, *supra* note 86.

¹⁷⁹ Fink, *supra* note 53, at 22.

¹⁸⁰ Schwartz, *supra* note 52, at 56.

legitimate projects from listing their projects on the websites. The point of crowdfunding is to provide start-ups and entrepreneurs a less expensive option to obtain capital. This article is also not suggesting that crowdfunding websites should have no liability. However, there should be a responsibility for crowdfunding websites to take actions to reduce the risk of fraud. Once again, the JOBS Act's treatment of crowdfunding portals is a reasonable guideline and framework for legislatures to utilize when creating liability for crowdfunding portals.

Under the JOBS Act, crowdfunding portals are required to “take such measures to reduce the risk of fraud . . . including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person.”¹⁸¹ Crowdfunding portals are required to register and provide disclosures to educate the investors.¹⁸² Also, these portals must ensure that each investor (1) reviews the investment education information, (2) positively affirms that he or she understands that she or he could lose his or her entire investment, and (3) answers questions demonstrating that he or she understands the risks of speculative investments.¹⁸³ Finally, crowdfunding portals must act reasonably and in good faith when fulfilling their obligations.¹⁸⁴ Although obtaining a background and “securities enforcement regulatory history check” may seem too much for reward crowdfunding websites to take on, it is reasonable to require that reward crowdfunding portals act reasonably and act in good faith when listing projects on their crowdfunding sites.

There is a chance that crowdfunding sites may attract investors by stating that they have vetted the projects before listing them on their portals. But it will most likely never happen with the free market approach. Although a

¹⁸¹ Jumpstart Our Business Startups Act, 15 U.S.C. § 77d-1(a)(5) (2012).

¹⁸² *Id.* at § 77d-1(a)(3).

¹⁸³ *Id.* at § 77d-1(a)(4).

¹⁸⁴ Schwartz, *supra* note 52, at 57.

crowdfunding portal may attract investors by stating that it has vetted the projects before listing them on its portal, there will be a limit to the amount of liability the portal would be willing to undertake for listing misrepresentations or fraudulent opportunities.

Environmental regulation is a prime example of an instance where private market pressures are not helpful in bringing about an optimum balance between current needs and the protection of future resources. The market can be helped along by environmental legislation if the legislation turns over the right information to the market.¹⁸⁵

Thus, the Washington State Legislature or Congress should create universal regulations that hold online crowdfunding portals responsible for the scams perpetrated on their portals because crowdfunding portals should be held liable to the investors whom they attract to their websites.

Along with requiring the reward crowdfunding websites to act reasonably and in good faith in listing the projects on their sites, the state legislature should require crowdfunding websites to provide additional disclosures to those who wish to invest in the crowdfunding projects. Merely alerting the “crowd” that there may be some risks is insufficient. Most unsophisticated investors are unlikely to read or take notice of required disclosures, especially since prior history has shown that most readers ignore online disclosures such as terms of service.¹⁸⁶ The state should protect investors and maintain market integrity. State authorities retain jurisdiction over issuers or intermediaries in relation to fraud, deceit, or unlawful conduct.¹⁸⁷ Mandatory disclosure of information, including the risks of a particular investment, protects investors and is designed to provide investors access to information.¹⁸⁸ The CROWDFUND Act expressly preempts additional regulations from states regarding registration or qualification of securities

¹⁸⁵ Vos, *supra* note 20, at 690.

¹⁸⁶ Schwartz, *supra* note 52, at 46.

¹⁸⁷ Jumpstart Our Business Startups Act, 15 U.S.C. § 77(c)(1)(2015).

¹⁸⁸ Fink, *supra* note 53, at 27–28.

and crowdfunding offerings, issuers, or intermediaries before the securities may be sold.¹⁸⁹ However, because reward crowdfunding does not deal with securities, there is no regulation that prevents states from creating additional regulations.

Previously, Kickstarter only required that the project list the creator's company.¹⁹⁰ After May 19, 2014, Kickstarter does list a verified name in the creator-bio section.¹⁹¹ However, it is not clear from Kickstarter's website what process was taken in order to verify the name. Rather, the website only states that the creator's identity was verified through an automated process.¹⁹² Although Kickstarter recently amended its policies, other websites do not provide a verified name. This makes it extremely easy for scam artists to use the name of the social purpose corporation itself to tug on an investor's moral conscience to invest in their scams. Furthermore, by including a broad social or green purpose, the fraudsters will be able to scam unsophisticated investors who are attracted to those specific purposes.

While there should be additional disclosures on the crowdfunding websites, the SEC should not require as many of the disclosures as are required under the JOBS Act because reward crowdfunding does not relate to security/equity investments. Under the Act, Congress requires crowdfunding issuers to file a disclosure document to the SEC, intermediaries (including crowdfunding portals), and potential investors, which includes the following nine mandatory disclosures:

- (1) the issuer's name, legal status, physical address, and website address;
- (2) the names of the directors, officers, and shareholders with more than 20% ownership interest;
- (3) a description of the issuer's business and anticipated business plan;
- (4) a description of the issuer's financial condition;
- (5) a description of the stated purpose and intended use of the proceeds of the offering;
- (6) the

¹⁸⁹ Schwartz, *supra* note 52, at 50.

¹⁹⁰ *Kickstarter Basics*, *supra* note 19.

¹⁹¹ *Id.*

¹⁹² *Id.*

target offering amount and deadline to reach the target amount; (7) the price to the public of the securities or the method for determining the price; (8) a description of the issuer's ownership and capital structure; and (9) any other information the SEC may require to protect investors.¹⁹³

Additionally, before issuing securities, issuers are required to file disclosure documents with the SEC and make them available to possible investors.¹⁹⁴ The disclosure requirements differ depending on the amount of capital required by the offering. Offerings of \$100,000 or less require that issuers disclose income tax returns for the last fiscal year and unaudited financial statements certified as accurate by the principal executive officer.¹⁹⁵ Offerings between \$100,000 and \$500,000 require financial statements reviewed by an independent public accountant, and offerings between \$500,000 and the maximum \$1 million require audited financial statements.¹⁹⁶ Following a crowdfunding round, an issuer must file financial statements and a report on the results of the operation with the SEC and investors.¹⁹⁷

This article suggests that additional disclosures should include, at minimum, the following: (1) the project creator's name, legal status, physical address, and website address; (2) a description of the issuer's business and anticipated business plan; (3) a description of the stated purpose and intended use of the proceeds of the offering; (4) the target offering amount and deadline to reach the target amount; and (5) the annual social purpose report¹⁹⁸ if it is a social purpose corporation. The suggested disclosures align with a few of the requirements listed above in the JOBS Act. Although some may argue that the additional disclosures may be too

¹⁹³ 15 U.S.C. § 77d-1(b)(1) (2012).

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at § 77d-1(b)(1)(D)(i).

¹⁹⁶ *Id.* at § 77d-1(b)(1)(D)(ii)–(iii).

¹⁹⁷ *Id.* at § 77d-1(b)(4).

¹⁹⁸ The article assumes that there will be additional guidelines to social purpose reporting as suggested in Part A of the Possible Solutions.

burdensome for the flexible structure of legitimate social purpose corporations, corporations that seek security crowdfunding would need to meet the even stricter JOBS Act disclosure requirements. Even if they are not receiving a security interest, because they are obtaining funds, they should be able to meet at least the above suggested requirements.

Building confidence in the crowdfunding websites will allow investors to invest with confidence. Similar to the Crowdfunding Accreditation for Platform Standards for funding portals, there should be a similar accreditation program to regulate reward crowdfunding websites. Accreditation would be a “gatekeeper.”

One issue is that the crowdfunding websites have two masters: both the issuers (who may be fraudsters) and investors. The websites do not exclusively serve investor interests, similar to funding portals that may be retained and compensated by issuers and also owe duties to both the issuers and investors.¹⁹⁹ However, crowdfunding websites should have more of a duty to investors in order to ensure investor protection. Therefore, it should be clear that the crowdfunding websites should serve to protect the investors. Additionally, an investor may not be able to recover damages as the fraudsters may be insolvent.²⁰⁰ The reward crowdfunding websites should have some liability, and investors should be allowed to go after these websites to recover their losses if the fraudsters are insolvent.

C. Limit Crowdfunding Investments in Reward Crowdfunding Similar to Security Crowdfunding

Another solution, in addition to legislative revision and liability for crowdfunding websites, is to limit the amount of money an investor can invest through reward crowdfunding websites. Congress included a strict

¹⁹⁹ Joan MacLeod Heminway, *The New Intermediary on the Block: Funding Portals Under the CROWDFUND Act*, 13 U.C. DAVIS BUS. L.J. 177, 200 (2013).

²⁰⁰ Benjamin P. Siegel, *Note: Title III of the JOBS Act: Using Unsophisticated Wealth to Crowdfund Small Business Capital or Fraudsters' Bank Accounts?*, 41 HOFSTRA L. REV. 777, 798–99 (2013).

annual cap on the aggregate amount that a person may invest in crowdfunded securities.²⁰¹ For an investor with a net worth or annual salary below \$100,000, the annual cap would be the greater of 5 percent of the investor's annual income or \$2,000.²⁰² If an investor's net worth or annual salary is over \$100,000, the annual cap is 10 percent of her or his annual salary, up to a maximum of \$100,000.²⁰³ Intermediaries may only release the proceeds to an issuer when the aggregate capital meets or exceeds the target amount.²⁰⁴ Intermediaries are required to ensure that no investor has purchased crowdfund securities beyond their annual cap.²⁰⁵

The idea behind the annual investment cap was to ensure that the investor's loss would be affordable, ensuring that the investor would not lose his or her life savings. This cap should also apply to investors who wish to invest in reward crowdfunding projects in order to ensure that the investor will not lose her or his life savings. By creating this cap, people investing in the fraudulent social purpose corporations will not be substantially hurt beyond what they can endure.

D. Hold Fraudulent Issuers Accountable for Plaintiff's Attorney Fees

Finally, attorneys' fees should be awarded to victims of fraud. Fraudulent issuers should be held accountable for plaintiff's attorneys' fees in order to provide an economic incentive for attorneys to litigate. "Plaintiffs' attorneys must incur the up-front expenses of litigation in hopes of securing an award that offsets the cost of litigation, while these attorneys can hope to recover 30% of the award."²⁰⁶ Therefore, Washington State's legislature should provide regulation that the fraudulent issuers be held accountable for plaintiff's attorneys' fees, after it is determined that the investments were

²⁰¹ 15 U.S.C. § 77d(a)(6)(B)(i) (2012).

²⁰² *Id.*

²⁰³ *Id.* at § 77d(a)(6)(B)(ii).

²⁰⁴ *Id.* at § 77d-1(a)(7).

²⁰⁵ *Id.* at § 77d-1(a)(8).

²⁰⁶ Mashburn, *supra* note 50, at 171.

obtained through fraudulent measures. This would provide an economic incentive for attorneys to litigate a class action suit. Additionally, this may also deter fraudulent issuers because they will have more to lose than just returning the funds that were raised, especially if the investment amounts are minimal.²⁰⁷

CONCLUSION

Green corporations are important to maintain environment sustainability. As one source stated, “Truthful advertising about goods and services is an unequivocal social good. It reduces uncertainty and improves the quality of decision-making. It facilitates search, promotes competition, and increases the likelihood of consumer satisfaction.”²⁰⁸

Furthermore, crowdfunding is a new way for small businesses and entrepreneurs to obtain capital, bypassing the traditional venture capital route. It also allows small businesses to bypass the heavy legal, regulatory, and practical costs of issuing registered securities.²⁰⁹ This fuels the entrepreneurial investments and has potential for a huge impact. As President Obama remarked, these entrepreneurial ventures are critical to spurring the country’s economic growth.²¹⁰

Finally, companies have seriously considered corporate social responsibility when examining their reputations to consumers and the public due to social media. Overall, consumers have increasingly expected and focused on social responsibility by companies. In order to allow corporations the flexibility to incorporate social purpose into corporate values, state legislatures are recognizing a need to define a new hybrid entity for for-profit corporations that want to promote one or more social purposes. In the last two to three years and in increasing frequency, other

²⁰⁷ *Id.* at 172.

²⁰⁸ Lillian R. BeVier, *Competitor Suits for False Advertising Under Section 43(a) of the Lanham Act: A Puzzle in the Law of Deception*, 78 VA. L. REV. 1, 14 (1992).

²⁰⁹ Schwartz, *supra* note 52, at 1466.

²¹⁰ Mashburn, *supra* note 50, at 162.

states are adopting similar legislation to allow social entrepreneurs to incorporate one or more social purposes into their companies' missions.

However, if fraud is synonymous with social purpose corporation, society as a whole will be ultimately hurt as legitimate social purpose corporations have the potential to benefit society's welfare. The idea of social purpose corporations may inherit an unfavorable reputation and ultimately stagnate the start-up market. Therefore, the Washington State Legislature will need to add and amend current legislation in order to protect the investors. The legislature should try to prevent fraud upfront rather than waiting for this to become a substantial issue. Once Washington State's legislature takes preemptive steps to prevent fraud, other states may follow in protecting their for-profit hybrid entities.