



**PROBLEMS ON PROTECTION OF
SHAREHOLDERS' RIGHTS FROM INVESTING IN
EQUITY CROWDFUNDING:
STUDY ON LIMITED COMPANY**

BY

MR. PHI PLOENBANNAKIT

**A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR THE DEGREE OF MASTER OF LAWS
IN BUSINESS LAWS (ENGLISH PROGRAM)**

FACULTY OF LAW

THAMMASAT UNIVERSITY

ACADEMIC YEAR 2015

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was approved as partial fulfillment of the requirements for
the degree of Master of Laws in Business Laws (English Program)

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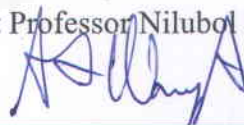
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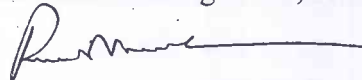
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ABSTRACT

Crowdfunding Platform allows SMEs with limited resources to jump from the old-fashioned funding schemes to new forms of relief via the internet. In other words, SMEs use online funding as a channel to get funding sources. Furthermore, Crowdfunding Platform has been developed to serve commercial purposes in which the investors expect seek returns from their investment. The equity provision arising out of Crowdfunding Platform basically functions the same as a corporation. The investor will receive a company's share for a certain amount in accordance with the value of the share being offered for sale.

Equity Crowdfunding, as recently adopted by the Securities and Exchange Commission (SEC), generally relies on the concept of capital increase and offering for the sale of shares in the limited company under the umbrella of the Civil and Commercial Code (CCC) and Securities and Exchange Act B.E. 2535. However, unlike that of the typical provisions, the new SEC's rules grant the exemption to the limited company to offer the shares for sale publicly subject to the conditions

imposed. In other words, it aims to unblock the restrictions of existing provisions in order to facilitate Equity Crowdfunding whereby the limited company is entitled to offer its shares for sale to other investors in addition to the original shareholders who have a shortage of funds at the early stage of the start-up and may not be able to inject more capital to continue the business. More importantly, the Crowdfunding exemption under the SEC's Notifications allows the private limited company to raise funds by offering the shares for sale to the public or public offering which is a similar concept to that of a public limited company except this public offering by a private limited company must be done online.

Equity Crowdfunding enables the issuers to launch the business model or project via a so-called Crowdfunding Portal or Funding Portal which is an online intermediary available for any prospect investor who is interested in such a project and finds it worth funding. Basically, the Crowdfunding Portals are the key intermediaries that match both parties when the target amount of contribution required in each project is achieved. In return, the contributing investors will receive the company's shares in a certain amount as per the par value ratio and become the new shareholders with the right and liability likewise those in the limited company under the CCC.

Equity Crowdfunding aims to raise funds from the retail or individual investors. That can be most of the non-sophisticated ones given its straightforward definition expressly extracted from the wordings itself which is to be funded by the crowd or to raise funds from the crowd. It is debatable whether or not they should be treated as professional investors who should bare all the risks in the ordinary course of business. Cases of fraud are taken into account as well as the level of their precaution and their bargaining power. The question remains whether or not they should be well protected in view of the consumer and to what extent they deserve such protection. In other words, how should they be protected by laws given that Equity Crowdfunding is the way to consume financial product where the fruits of this product are expected rather than the product itself.

Thai law, which is SEC's Notifications as aforementioned by virtue of Securities and Exchange Act B.E. 2535 comparing the US law and the UK law, does provide proactive measures to protect prospective investors. However, it is doubtful whether those involved in the sale afterwards continue to receive protection without a certain exit for the shareholders and whether there is an appropriate fiduciary duty for the controlling shareholders, including the controlling authority. Unlike the typical limited company whose shares belong to a close group of shareholders, Equity Crowdfunding limited companies offer its shares for sale to the public.

Therefore, a comparative study of these foreign laws and Thai laws concerning the protection of shareholders' rights in a limited company relying on Equity Crowdfunding should help in implementing effective rules to balance fundraising promotion with investors' rights after the funds have been injected. In this regard, the laws of the United Kingdom and the United States are subject matters to study as both nations have concrete statutory laws and case laws governing Equity Crowdfunding and protection of minority shareholders for this high value industry. The significant amount of investment and the number of concerning parties that have entered into this fundraising scheme with the express purpose of promoting startups and SMEs has been taken into account as well.

Keywords: Equity Crowdfunding, Limited Company, Shareholders, Issuer, Funding Portal, Crowd Investor, Shareholders Protection

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TABLE OF CONTENTS

	Page
ABSTRACT	(1)
ACKNOWLEDGEMENTS	(4)
LIST OF ABBREVIATIONS	(11)
CHAPTER 1 INTRODUCTION	1
1.1 Backgrounds and Issues	1
1.2 Hypothesis	8
1.3 Objectives of Study	9
1.4 Scope of Study	9
1.5 Methodology	10
1.6 Expected Result	10
CHAPTER 2 BACKGROUNDS OF EQUITY CROWDFUNDING, PRINCIPLES OF LIMITED COMPANY AND CONCERNING DIRECTOR'S DUTIES	11
2.1 Backgrounds and Definition of Crowdfunding	11
2.2 Type of Crowdfunding	13
2.2.1 Donation-based Crowdfunding	14
2.2.2 Reward-based Crowdfunding	15
2.2.3 Lending-based Crowdfunding	16
2.2.4 Equity-based Crowdfunding	17
2.3 Principle of Equity Crowdfunding	18
2.3.1 Concerning Parties	19
2.3.1.1 Issuer	20
2.3.1.2 Funding Portal	20
2.3.1.3 Escrow Agent	21
2.3.1.4 Investor	22

2.3.2 Funding procedures	22
2.3.3 Types of Investor	25
2.3.3.1 Accredited or Sophisticated Investor	25
2.3.3.2 Non-accredited or Unsophisticated Investor	25
2.4 Principle of Limited Company	26
2.4.1 Historical Backgrounds	26
2.4.2 Structures of Limited Company	27
2.4.2.1 Shareholders	28
2.4.2.2 Articles of Association	29
2.4.2.3 Director(s) and Board of Directors	29
2.5 Protection of Minority Shareholders	30
CHAPTER 3 FOREIGN LAWS AND REGULATIONS CONCERNING PROTECTION OF INVESTING SHAREHOLDERS IN A LIMITED COMPANY	33
3.1 The United States of America	33
3.1.1 Overview of Laws concerning Equity Crowdfunding in the United States of America	33
3.1.1.1 Backgrounds of Equity Crowdfunding	33
3.1.1.2 Arguments on Equity Crowdfunding	34
3.1.2 Restrictions on Offering of Limited Company's Shares	36
3.1.2.1 Model Business Corporation Act 1984	36
3.1.2.2 Securities Act 1933	37
3.1.2.3 Securities and Exchange Act 1934	38
3.1.3 Exemptions for Offering of Limited Company's Shares through Equity Crowdfunding	39
3.1.3.1 Jumpstart Our Business Startups Act 2012	39
3.1.4 Principle of Offering of Company's Shares	41
3.1.4.1 Incorporation of a Closely0held Corporation under Model Business Corporation Act 2002	41
3.1.4.2 Typical Offering of Company's Shares	42
3.1.4.3 Exemptions for Offering of Company's Shares in	

Equity Crowdfunding	42
3.1.5 Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding	43
3.1.5.1 Pre-Offering Stage of Company's Shares in Equity Crowdfunding	43
3.1.5.1.1 Issuer Requirements	43
3.1.5.1.2 Funding Portal Requirements	44
3.1.5.1.3 Restrictions on the Offering	45
3.1.5.2 During-Offering Stage of Company's Shares in Equity Crowdfunding	45
3.1.5.2.1 Issuer Requirements	46
3.1.5.2.2 Funding Portal Requirements	46
3.1.5.3 After-Offering Stage of Company's Shares in Equity Crowdfunding	47
3.1.5.3.1 Restrictions on the Resale	47
3.1.5.3.2 Ongoing Reporting Requirements	47
3.1.5.3.3 Controlling Authority	48
3.1.5.3.4 Protection of Minority Shareholders' Rights	48
3.2 The United Kingdom	49
3.2.1 Overview of Laws concerning Equity Crowdfunding in the United Kingdom	49
3.2.1.1 Backgrounds of Equity Crowdfunding	49
3.2.1.2 Arguments on Equity Crowdfunding	49
3.2.2 Restrictions on Offering of Limited Company's Shares	50
3.2.2.1 Companies Act 2006	50
3.2.2.2 Financial Services and Market Act 2000	51
3.2.3 Exemptions for Offering of Limited Company's Shares through Equity Crowdfunding	52
3.2.3.1 Companies Act 2006	52
3.2.3.2 Policy Statement 14/4: The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media	53

3.2.3.3 Financial Services and Market Act 2000	54
3.2.4 Principle of the Offering of Company's Shares	56
3.2.4.1 Incorporation of a private limited company under the Companies Act 2006	57
3.2.4.2 Typical Offering of Company's Shares	57
3.2.4.3 Exemptions for the Offering of Company's Shares in Equity Crowdfunding	57
3.2.5 Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding	57
3.2.5.1 Pre-Offering Stage of Company's Shares in Equity Crowdfunding	58
3.2.5.1.1 Issuer Requirements	59
3.2.5.1.2 Funding Portal Requirements	59
3.2.5.1.3 Restrictions on the Offering	59
3.2.5.2 During-Offering Stage of Company's Shares in Equity Crowdfunding	60
3.2.5.2.1 Issuer Requirements	60
3.2.5.2.2 Funding Portal Requirements	61
3.2.5.3 After-Offering Stage of Company's Shares in Equity Crowdfunding	61
3.2.5.3.1 Restrictions on the Resale	61
3.2.5.3.2 Ongoing Reporting Requirements	62
3.2.5.3.3 Controlling Authority	62
3.2.5.3.4 Protection of Minority Shareholders' Rights	63

CHAPTER 4 PROBLEMS AND RECOMENDATIONS TO IMPLEMENT THE PROTECTION OF CROWDFUNDING SHAREHOLDERS' RIGHTS	64
4.1 Overview of Crowdfunding	64
4.1.1 Background of Equity Crowdfunding	64
4.1.2 Public Hearing for Equity Crowdfunding	64
4.2 Laws concerning Offering of Limited Company's Shares	65
4.2.1 Civil and Commercial Code	65

4.2.2 Securites and Exchange Act B.E. 2535	66
4.3 Laws concerning Offering of Limited Company's Shares through Equity Crowdfunding	66
4.4. Principle of the Offering of Company's Shares	67
4.4.1 Incorporation of a Limited Company	67
4.4.2 Typical Offering of Company's Shares	68
4.4.3 Exemptions for the Offering of Company's Shares in Equity Crowdfunding	68
4.5 Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding	69
4.5.1 Pre-Offering Stage of Company's Shares in Equity Crowdfunding	69
4.5.1.1 Issuer Requirements	69
4.5.1.2 Funding Portal Requirements	70
4.5.1.3 Restrictions on the Offering	70
4.5.2 During-Offering Stage of Company's Shares in Equity Crowdfunding	70
4.5.2.1 Issuer Requirements	71
4.5.2.2 Funding Portal Requirements	71
4.5.3 After-Offering Stage of Company's Shares in Equity Crowdfunding	71
4.5.3.1 Restrictions on the Resale	71
4.5.3.2 Ongoing Reporting Requirements	72
4.5.3.3 Controlling Authority	72
4.5.3.4 Protection of Minority Shareholders' Rights	73
4.6. Analysis of Problems on the Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding	73
4.6.1 Consumer Protection Perspective	76
4.6.2 Shareholders Protection Perspective	80
4.6.2.1 Election of Directors	81
4.6.2.2 Dividends	82
4.6.2.3 Class of Shares	83

4.6.2.4 Dilution of Shares	84
4.6.2.5 Conflict of Interest and Related Party Transactions	85
4.6.3 Liquidity and Secondary Market	86
4.6.4 Securities Fraud	87
4.6.4.1 False Statement and Misleading	87
4.6.4.2 Misuse of Fund	89
CHAPTER 5 CONCLUSION AND RECOMMENDATIONS	91
5.1 Conclusion	91
5.2 Recommendations	93
5.2.1 Controlling Authority	94
5.2.2 Mandatory Provisions of Articles of Association	96
5.2.2.1 Preferential Right	97
5.2.2.2 Group of Shares	98
5.2.2.3 Tag-along Right	98
5.2.3 Minimum Shares Offered and Share Repurchase	99
5.2.4 Shareholders' Fiduciary Duties	100
5.2.5 Court Claim against Majority Shareholders	103
REFERENCES	106
BIOGRAPHY	113

LIST OF ABBREVIATIONS

Symbols/Abbreviations	Terms
AGM	Annual General Meeting of Shareholders
AOA	Articles of Associations
BOD	Board of Director
CCC	The Civil and Commercial Code
DBD	Department of Business Development, Ministry of Commerce
EGM	Extraordinary General Meeting of Shareholders
FCA	The Financial Conduct Authority (UK)
FSMA	The Financial Services and Market Act
FOS	The Financial Ombudsman Service (UK)
FSCS	The Financial Services Compensation Scheme (UK)
FTC	The Federal Trade Commission (US)
GBP	Great British Pound
IOSCO	The International Organization of Securities Commissions
IPO	Initial Public Offering
JOBS Act	Jumpstart Our Business Startup Act
MBCA	The Model Business Corporation Act
MOA	Memorandum of Association
Notifications	Notifications of the Capital Market Supervisory Board
PS14/1	The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media

SEC	Securities and Exchange Commission
SMEs	Small and Medium Enterprises
THB	Thai Baht
UK	The United Kingdom
US	The United States of America
USD	US Dollar



CHAPTER 1

INTRODUCTION

1.1 Backgrounds and Issues

Given the limitation of access to funding sources for the Small and Medium Enterprises (SMEs), which are established in the form of a limited company based on the close relationship of the shareholders due to the lack of creditability and collateral, Crowdfunding Platforms provide an alternative to the typical fund arrangement. The banks and financial institutions have been playing a key role in funding a business in return for fees and interests. Wealthy investors would instead participate as the direct stakeholder by investing the fund in return for the company's shares. However, the banks and financial institutions tend to release the fund only when there is sufficient collateral to secure the risks in case the borrower becomes unable to repay the loan. On the other hand, most of the wealthy investors tend to focus on the tangibly existing and high return projects. Of course, these funding sources are not easily reachable due to the limited number of wealthy investors and the complicated funding procedures and conditions required by the banks for other ordinary venture capital.

As the result, Crowdfunding Platforms allows SMEs with limited resources to jump from the old-fashioned funding schemes to the new relief via the internet. In other words, they use online funding as a channel to get to their funding sources. This online funding scheme was originally initiated for the purpose of funding charity events in the form of donations. The event sponsors who stop by the webpage, if they like, donate their money until the target amount is achieved to start and complete the project. To put it another way, it is the crowd who is online that funds and makes the project happen. This online funding concept also works in various scenarios that need contribution from the public or even a group interested in the same subject, such as, film, concerts, and art exhibitions that require a certain amount of money to run the project. Definitely, these are nothing in terms of investment and economic returns, but simply the merit and mental reward for the contributor. Even though many of the

projects offer some gifts or privileges attributed to certain monetary assistance. For example, placing the names of contributors on a film's end credit, allowing exclusive backstage visits, or offering limited edition souvenirs.

Accordingly, Crowdfunding Platform has been developed to serve the commercial purpose in which the investors undoubtedly expect gifts for their investment. The merits and small pieces of rewards have been turned into debt and equity in exchange for the fund provided. In other words, the project owners or issuers may agree with the investors to borrow the money to facilitate the operation whereas the principal will periodically be repaid together with the agreed interest regardless the collateral. This simple financing mechanism does not make a clear cut distinction between the Crowdfunding Platform and the typical banking arrangement, the latter equity provision seems to play the most proactive role in leading this platform.

The equity provision arising out of Crowdfunding Platform basically functions on the concept of corporations. That is to say that the investor will receive the company's shares in a certain amount in accordance with the value of share being offered for sale. In response to the statistics report on the number of business registration by the end of the third quarter of 2015 produced by the Department of Business Development (DBD), it is underlined that the most typical and popular business organization is the limited company which has been registered with the DBD in the total amount of 47,159 companies or at the average of 5,240 companies per month. Given this large number of limited companies having been incorporated, whilst over 97.2% of business nationwide are SMEs which are considered new start-ups with limited resources with, say, insufficient capital and assets with fewer chances to obtain enough to operate the business. Equity Crowdfunding, therefore, has become an option allowing fundraising via the internet.¹

¹ Department of Business Development, Ministry of Commerce (2015), "*Information on Legal Entity Registration as of April 2015*", https://www.m-society.go.th/article_attach/14057/17901.pdf (accessed on 10 November 2015).

Equity Crowdfunding as recently adopted by the Securities and Exchange Commission (SEC) according to its notifications generally relies on the concept of capital increase and offering for sale of shares in the limited company under the umbrella of Civil and Commercial Code (CCC) and Securities and Exchange Act B.E. 2535. However, the new SEC's rules grant the exemption to the limited company to offer the shares for sale publicly subject to the conditions imposed unlike that of the typical provisions. In other words, it aims to unblock the restriction of existing provisions in order to facilitate Equity Crowdfunding whereby the limited company is entitled to offer its shares for sale to other investors in addition to the original shareholders who have a shortage of funds at the early stage of start-up and may not be able to inject more capital to continue the business. More importantly, the Crowdfunding exemption under the SEC's Notifications allow the private limited company to raise funds by offering the shares for sale to the public or a public offering which is a similar concept to that of a public limited company, except this public offering by a private limited company must be done online.

Equity Crowdfunding by its nature originally enables the issuers to lodge the business model or project via an online intermediary. A so-called Crowdfunding Portal or Funding Portal is available for any prospect investor who is interested in such a project and finds something that would be worth funding. Basically, the Crowdfunding Portals are the key intermediaries that make the pairing for both parties when the target amount of contribution required in each project is achieved. In return, the contributing investors will receive the company's shares in a certain amount as per the par value ratio and become the new shareholders with the right and liability likewise those in the limited company under CCC.

Notwithstanding, although the main purpose of Equity Crowdfunding is to promote more opportunity for SMEs by eliminating the barrier for the source of funds, the SEC's notifications tend to impose many restrictions to protect prospective investors. Such protection seems to apply at the early stage of fundraising and without concrete exit for the prospect investors once they become the shareholders. There is no doubt that the investors definitely expect a return for their investment one way of

another. In this case, the return is profitable net asset value of the shares or dividends. Given no secondary market available for the sale of shares unlike in listed companies, the shareholders in a limited company are attached to the corporate entity and depend on how well the business is operated by the directors whom are elected by the meeting of shareholders and, of course, the controlling shareholders who have majority votes.

The incorporation of limited company basically relies on the element of trust among a small group of shareholders who have close relationship with each other and seek to benefit from the business jointly invested like a start-up company. On the other hand, the prospective investors who become the new shareholders via Equity Crowdfunding thereafter do not share the same basis since they can be any interested person willing to invest in the company based on the potential business model, standout product, or innovation that comes out from the idea of the start-up. According to these facts, they eventually depend on the individual starters or founders as the key person rather than the entity throughout their investment. Of course, it is ordinarily acceptable in the case of loss as the general risks of investment. However, what if the loss is not directly caused by ordinary factors and performance but is due to the lack of transparency of the key people whose idea originated the fundraising.

Firstly, the simplest problem that can be easily seen is that the controlling of the company relies on the majority shareholders who have the majority votes. In this case, they are the founders or original shareholders of the limited company relying on Equity Crowdfunding, of course, the ones who need funding from the crowd, but do not want to lose control of their company. This corresponds with the facts that none of the issuers is giving up the significant portion of company's shares to the crowd investors other than a slight amount which does not have any impact on their control. Moreover, many of the issuers are even offering the shares without any voting rights attached in order to enjoy the extreme advantage of this fundraising mechanism whose purpose greatly secures the founders by enabling them to raise a large amount of funds without sacrificing their share of business ownership.

Secondly, as the crowd investors participate in the company through the offering of shares after the incorporation, they do not have any chance to negotiate the terms of Articles of Association which is the charter of the company and the agreement between the original shareholders in the first place upon the incorporation. This means that the crowd investors, once they become shareholders, do not have any choice other than to unconditionally comply with the existing Articles of Association made by and agreed upon by the original shareholders. For example, the quorum of the meeting of shareholders may be constituted merely by the attendance of original shareholders. In this case, crowd investors are easily excluded from the company even if they legally exist with ordinary voting rights. As a result, it can be simply said that the election of directors and dividend distribution are subject to the absolute discretion of the original shareholders having the majority vote in the company. The crowd investors realistically have little to no influence over the company despite of their financial support and return of shares.

Thirdly, given the limit of investment as specified by the SEC with the maximum of 50,000 Baht per investor per a crowdfunding company and the maximum aggregate of 500,000 Baht per investor to invest in the other crowdfunding companies within a period of one year², the crowd investors will automatically face a situation in case the original shareholders increase the capital to dilute the share portions of the crowd investors because they are restricted by the regulations to invest more money to buy the shares newly issued as a result of capital increases in order to secure their voting rights in the company. Moreover, even if the offering of shares for sale under this fundraising scheme is similar to that of the public limited company under the Public Limited Company Act B.E. 2535 and Securities and Exchange Act B.E. 2535, there are critical restrictions for the resale of shares as part of this crowdfunding exemption under SEC's Notifications as well as the typical restriction under the existing statutory in which the shareholders of a limited company are only

² Notification of the Capital Market Supervisory Board No. TorChor.7/2558, Clause 7

eligible to resell their unlisted shares by Peer-to-Peer or Over-The-Counter (OTC)³. In other words, there is no secondary market for the shares acquired through Equity Crowdfunding which make them illiquid or hardly to resell if the crowd investors want to exit or divest their funds.

Fourthly, the entire process of the offering is done online and the prospectus is exempted. The SEC is not a directly responsible authority but it is monitored and controlled by a private entity namely, the Funding Portal. Keep in mind that the only available legal sanction to be imposed on the Funding Portal is merely a revocation of license⁴. It is worth noting that this could possibly lead the process to a potential threat of securities fraud from the pre-stage of fundraising throughout the post-stage when the campaign has been achieved. The securities fraud in this regard could involve the false statement and misleading of the information by the issuers in order to solicit the crowd investors since the prospectus which should have been reviewed by the SEC and even the filing are exempted. The misuse of funds having been raised by the issuers also needs to be taken into account since the original shareholders have the majority votes to absolutely control the company as well as its financial transactions which may result in the conflict of interest and related party transactions. In addition, the online security cannot be overlooked as Equity Crowdfunding itself is an online fundraising mechanism which directly relates to electronic payment.

Fifthly, despite of the recognition of directors' fiduciary duties by virtue of CCC for those of a private limited company and the Public Limited Company Act B.E. 2535 for those of a public company limited, the shareholders' fiduciary duties governing the controlling shareholders or majority shareholders in a limited company

³ Association of Thai Securities Companies, "*Knowledge on Money Market*" (2015), http://www.asco.or.th/uploads/upfiles/files/iba_knowledge_ed1.pdf (accessed on 10 November 2015).

⁴ Notification of the Capital Market Supervisory Board No.TorChor.7/2558,Clause 41

does not explicitly exist under the statutory laws of Thailand⁵. In this case, the original shareholders with the majority of votes take advantage of the crowd investors who are the minority shareholders. In other words, the abuse of controlling power from, say, leading the company into related party transactions in which they gain benefits as mentioned above, the available remedies for the minority shareholders is to take legal action against the majority shareholders based on the tort or contract laws. As a result, there should be other legal solutions to protect the minority shareholders and at the same time facilitate the business growth.

Sixthly, Equity Crowdfunding aims to raise funds from the retail or individual investors that can be most of the non-sophisticated ones given its straightforward definition expressly extracted from the wordings themselves that is to be funded by the crowd or to raise funds from the crowd. It is borderline whether they should be treated as professional investors who should bare all risks in the ordinary course of business or even in case of fraud taken into account of the level of their precaution and the bargaining power, or whether they should be well protected as a consumer and to what extent they deserve such protection. In other words, how should they be protected by laws given that Equity Crowdfunding is the way to consume financial product where the fruits of this product is expected rather than the product itself. For example, if the business does not perform well according to the plan that was part of the campaign at the early stage due to various reasons, there should be an independent mediator who draws the line for this situation and fairly settles disputes for the parties like a consumer protection authority.

Thai law, which is the aforementioned SEC's Notifications as Securities and Exchange Act B.E. 2535 comparing the US law and the UK law, does provide the proactive measures to protect prospective investors. Those after sale implications to continue protection are still doubtful without a certain exit for the shareholders and

⁵ Nontawat Nawatrakulpisut. **Principles of Laws for Partnership, Limited Company, Public Limited Company**. 3rd ed. Bangkok : Winyuchon Publishing. 2015, Page 343.

appropriate fiduciary duty for the controlling shareholders. These include controlling authority and noting that the Equity Crowdfunding limited company offers its shares for sale to the public unlike the typical limited company whose shares belong to a close group of shareholders. Therefore, a comparative study of these foreign laws and Thai laws concerning the protection of shareholders' rights in a limited company relying on Equity Crowdfunding should help implement the effective rules to balance the fundraising promotions with the investors' right after the funds have been injected. In this regard, the laws of the United Kingdom and the United States are subject matters to study as both nations have concrete statutory laws and case laws governing Equity Crowdfunding and the protection of minority shareholders. This high value industry has taken into account the significant amount of investment and the number of concerning parties having been entered into this fundraising scheme so far with the main purpose to promote the startups and SMEs.

1.2 Hypothesis

When the fundraising via Equity Crowdfunding is completed, giving the issuers adequate funds to run the project hosted through the limited company of majority shares owned by the founders or the original group of shareholders of the issuers where they are also the directors, the prospect investors will then become the new shareholders of the company. With the fact that the SEC's Notifications limit the amount of investment for each investor to buy shares through Equity Crowdfunding, it implies that they will turn to be the minority shareholders in a limited company. They are minority shareholders in the circumstance that they greatly depend on the skills of issuers operated by the individuals or founders whom they might not even knew before. On one hand, the responsibility of such individuals as the key and controlling persons should be greater than that of the ones in an ordinary limited company where its shares are not for sale to the public. On the other hand, there should be measures to provide the fair exits and sufficient protection for the investors, if their advantages are taken by such key persons. Thus, it is important to find an amicable solution for the post-stage of fundraising to ensure that the investing

shareholders' rights will be protected in order to eventually promote Equity Crowdfunding.

1.3 Objectives of Study

- a. To study general concepts of methods and provide a reasonable background for crowdfunding, especially on the type of equity based crowdfunding. In addition, to studying the legal concepts for the directors and the original shareholder's duties and responsibilities in a limited company offering shares for sale to the public through Equity Crowdfunding.
- b. To study the situations concerning crowdfunding in foreign countries i.e. the United States and the United Kingdom and the legal mechanisms to protect the investing shareholders, by analyzing the existing statutory laws and case laws.
- c. To study the recent laws concerning Equity Crowdfunding in Thailand. In addition, to analyze the existing provisions for the directors and original shareholder's duties and responsibilities in a limited company offering shares for sale to the public through Equity Crowdfunding
- d. To propose legal amicable solutions for the after sale protection of shareholders' rights as well as promoting Equity Crowdfunding.

1.4 Scope of Study

This thesis will be focusing on recent provisions of laws regarding crowdfunding in Thailand by analyzing the Notification of the Capital Market Supervisory Board No.TorChor. 7/2558, Notification of the Capital Market Supervisory Board No.TorChor. 8/2558, and studying regarding the director's and original shareholder's duties and responsibilities on Civil and Commercial Code (CCC) and Securities and Exchange Act B.E. 2535 of Thailand, with comparisons between the United States and United Kingdom's laws and methods. The aim is to find a solution for protecting investing shareholder's rights in the limited company via Equity Crowdfunding raising funds.

1.5 Methodology

The study methodology is based on documentary research with an emphasis on legislative provisions in Thailand and foreign countries, including legal articles, government publications, information in online databases, expert's opinions as well as case studies both domestic and international.

1.6 Expected Results

- a. To understand the general concept of equity crowdfunding, its nature of offering shares to the public and the legal consequences.
- b. To understand the requirement for the director's and original shareholder's duties and responsibilities and legal protection for investing shareholders who invest through Equity Crowdfunding.
- c. To understand the laws and regulations concerning Equity Crowdfunding and director's and original shareholder's duties and responsibilities in the United States and the United Kingdom.
- d. To understand the laws and regulations concerning Equity Crowdfunding and director's and original shareholder's duties and responsibilities in Thailand.
- e. To provide the recommended solutions to protect the investing shareholders' right after purchasing equity in the limited company through Equity Crowdfunding.

CHAPTER 2

BACKGROUNDS OF EQUITY CROWDFUNDING, PRINCIPLES OF LIMITED COMPANY AND CONCERNING DIRECTOR'S DUTIES

2.1 Backgrounds and Definition of Crowdfunding

Thanks to the development, widespread availability, and affordability of the internet, people around the world, regardless of where they are, can connect to each other. Distance and physical conditions are no longer obstacles for economic activity. This fact is confirmed by the increasing popularity of e-commerce where people are able to transact in business and trade in a single click. This effects all fundraising, from the largest listed firms launching their initial public offering (IPO) to smaller ones like Small and Medium Enterprises (SMEs).

According to the World Bank, SMEs play a major role in most economies, particularly in developing countries. Formal SMEs contribute up to 45 percent of total employment and up to 33 percent of national income (GDP) in emerging economies⁶. These numbers are significantly higher when informal SMEs are included⁷. SMEs are less likely to be able to secure bank loans than large firms. Instead, they rely on internal or personal funds to launch and initially run their enterprises⁸. Fifty percent of formal SMEs do not have access to formal credit⁹. The World Bank is increasingly looking to develop more innovative forms of SME financing, including Equity Crowdfunding¹⁰.

⁶ The World Bank, "Small and Medium Enterprises (SMEs) Finance" (2015), <http://www.worldbank.org/en/topic/financialsector/brief/smes-finance> (accessed on 14 November 2015).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

Given the more strict regulations applicable to the banks and financial institutions, as well as those imposed by them due to repeated financial crises mainly arising out of non-performing loans, without collateral, guarantor and track record, the start-up firms and SMEs have very limited access to these sources of funds. Even if there exists other traditional sources i.e. Private Equity, Venture Capital, and Angel Investors, the number of these are very few compared to that of SMEs¹¹. Moreover, these firms appear to be selective and focus only on the areas of their expertise with a high potential of turnover within a short period of time.

Crowdfunding, a term derived from the context of funding from the crowd, is basically the mechanism to raise small amounts of money from a large number of people or crowd via the internet. Here the fund seekers demonstrate their campaigns on the website soliciting from visitors of the same interests to join the program via funding with the promise that the money will be utilized in accordance with the objectives of the proposed campaign, even if there is no guarantee on the achievement¹². This fundraising scheme was simply initiated to fulfill the charity's need for donations. Donors would not expect anything in return for contributing. Subsequently, the scheme has evolved to promise rewards or other forms of valuable returns from the fund seekers even offering part of the business.

In support of enabling the more flexible access to the source of funds for SMEs, Crowdfunding is an alternative relief for the start-up business seeking funds to raise money directly from the crowd. Over 3 billion of the world's internet users by the end of 2015 have participated according to the data provided by the World Bank¹³. This may sound overabundant, but it is undeniable that once a thing goes online, it can be observed by any internet users all over the world. In order to study

¹¹ Bradford, C. Steven. "*Crowdfunding and the Federal Securities Laws.*" Colum. Bus. L. Rev. 5 (2012).

¹² *Id.*

¹³ The World Bank. "*Internet User (per 100 people)*"(2015), <http://data.worldbank.org/indicator/IT.NET.%20USER.P2> (accessed on 14 November 2015).

how Crowdfunding plays an important role in driving SMEs as an alternative fundraising, it is advisable to understand all types of Crowdfunding and its development from the early stages to how it has been utilized and classified for each purpose.

2.2 Types of Crowdfunding

Generally, Crowdfunding can be classified in two main categories; namely Non-commercial Crowdfunding or Community Crowdfunding and Commercial Crowdfunding or Investment Crowdfunding¹⁴. The clear cut between these categories as brought up above is the expectation of profit in return of the money given. That is to say that people who contribute to the non-commercial campaigns do not financially benefit from their contribution, whilst people that invest in the latter do so in hopes of a return in their investment as the term straightforwardly prescribes. There are four sub-categories of Crowdfunding: (i) Donation Crowdfunding, (ii) Reward Crowdfunding, (iii) Lending Crow Funding, and (iv) Equity Crowdfunding. Donation and Reward Crowdfunding can be collectively referred to as Non-commercial Crowdfunding. On the other hand, Lending and Equity Crowdfunding fall under the umbrella of Commercial or Investment Crowdfunding.¹⁵

The parties involved in each type of Crowdfunding are referred differently depending on their roles. In Non-commercial crowdfunding, the people who financially sponsor or donate to the campaigns or projects are generally called “contributors”, and “campaigners” for the fundraisers. These contributors become “investors” in Commercial Crowdfunding. The campaigners will be called “issuers” in the sense that the repayment, in case of lending crowdfunding, and shares of the company, in case of equity crowdfunding, will be issued to the investors in return.

¹⁴ Andrew C Fink, “Protecting the Crowd and Raising Capital Through Crowdfunding Act”. 90 U. Det. Mercy L. Rev. 1, 4 (2012).

¹⁵ IOSCO. “*IOSCO crowdfunding an infant industry growing fast.*” (2015) <http://www.iosco.org/research/pdf/swp/Crow-funding-An-Infant-Industry-Growing-Fast.pdf> (accessed on 14 November 2015).

The big difference between Crowdfunding and other typical fundraising mechanisms is that it is done online via the intermediary or the online portal. The online portal is a platform whose function is to arrange and operate the beginning of Crowdfunding process until the end. In other words, it is simply a website that the fund seekers post their campaigns which are available to anyone who is interested to fund their campaigns regardless of how they are called in accordance with each type of crowdfunding. The online portal as the operator other than being an online venue for the fundraisers to present their campaigns through various forms of media, will also apply the procedure for fundraising in which the fundraisers have to follow. This fundraising procedure is a combination of the target amount of funds required and time limits to achieve said target. That is to say that the campaigns must be able to collect the full amount of money requested from the crowd within a certain period of time. Otherwise, the campaigns will be deemed a failure and the funds will be returned to the individual investors. Thus, online portals can be considered an underwriter and at the same time, an escrow agent, if the fund is pledged with it. Alternatively, the funds could be remitted from the crowd once the collective amount eventually hits the target within a stipulated period.

2.2.1 Donation-based Crowdfunding

Donation Crowdfunding reflects a classic type of fundraising that raises funds from the public for charitable purposes, except that it exists online. In other words, it is a variety of charities (mostly social services) asking people (usually an already existing community) to donate a small amount of money to support and enable a project. Nevertheless, it is not limited merely for non-profit arrangements despite it being its main purpose. Donation Crowdfunding may also be used to fund profitable enterprises or other kinds of needs that lack funds as well.¹⁶

The line between Non-commercial and Commercial Crowdfunding in this regard, is drawn by the contributors' lack of expected return for their donations or

¹⁶ *Supra* note 12.

contributions. The online portal or donation crowdfunding websites normally receive arrangement fees from the funds receivable by the campaigners. Given zero financial return and without the expectation of such from the contributors, this sub-category of crowdfunding falls under the regime of non-commercial basis even though it is the origin of what is now known as Crowdfunding.

2.2.2 Reward-based Crowdfunding

Reward Crowdfunding is a type of money-raising in which the campaigners promise the contributors that, if they contribute their money to help achieving the campaigns, they will receive non-financial benefits in the form of tangible goods or services i.e. a free gift set themed around the project, a ticket to a concert or event in which the money was raised for, etc. Reward Crowdfunding was originally launched by a group of people who shared the same interests (mostly artistic) and wanted to make their dream come true despite their lack of funds. For example, musical bands in need of capital can raise money from their fans to fund recording, marketing and concert transportation, and, in return, offer the contributors tickets to the concerts as a form of appreciation¹⁷.

Recently, Reward Crowdfunding has also been adopted for the development of innovative products or creative salable goods with potential starting with the early stages of creating a prototype. Upon rendering a presentation for these kinds of projects on the online portal, the contributors will be asked to essentially vote with their wallet by pledging to fund the campaigners to accomplish the innovation as soon as they receive sufficient amount of funds. The levels of rewards are varied depending on the amount of money contributed. The higher price the contributors has pledged, the bigger the reward they receive. Normally, the reward is the proposed product when it is finished. Normally, the contributions required to receive the product is less than the planned price allowing the contributors to receive a discount

¹⁷ *Id.*

while the campaigners can make profit when the product is sold at retail¹⁸. This scheme is also known as Pre-purchase Crowdfunding where the contributors expect to receive the products in return for their financial contribution.

Even with the contributors' expectation of the reward, this sub-category of Crowdfunding falls under the regime of non-commercial basis since the reward in form of tangible products is not treated as financial return unlike interest from loans and shares received from investing in the company.¹⁹

2.2.3 Lending-based Crowdfunding

Lending Crowdfunding shares the same function as a typical loan arrangement for a business with limited capital that needs funds to run their operation. The lender will lend out money to the business in return for the principal repayment and interest.²⁰ Notwithstanding, it can be an interest free loan where the lender expects to be repaid merely with the principal, even though, making nothing out of money invested should not be treated as a financial investment. In case the interest applies, this sub-category of Crowdfunding can be considered a commercial arrangement since the lender make profits from the funds provided. Business loans are also classified as debt securities.

The online portal for Lending Crowdfunding connects the investors with the entrepreneurs. The advantage of Lending Crowdfunding is that, if the investors find that the proposed business has a high potential growth with the capability to repay the principal and interest, they will directly lend money to those businesses. In other words, peer to peer lending. This allows the borrowers the lower costs with a less complicated procedure than applying for a loan from the banks. On

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

the other hand, the investors can expect regular income when they get back the principal with interest according to a certain repayment schedule as agreed upon.

Famous lending crowdfunding websites such as FundedByMe²¹ also provide strict controls on the borrowers' track record for the prospect lenders to ensure the debt repayment capability of the borrowers. According to the criteria imposed by FundedByMe, every company needs to have a turnover of at least fifteen thousand British Pound in early turnover, and have been registered for at least one and a half years. In addition to this, the information from credit bureaus has to give the company a favourable risk rating. For companies seeking a loan above forty thousand British Pounds, a personal guarantee is required. This means that the majority of shareholders and directors have to individually or jointly guarantee the full amount of loan.²²

2.2.4 Equity-based Crowdfunding

The concept of Equity Crowdfunding is both simple and revolutionary. The entrepreneurs or the issuers are able to use the internet to pitch business ideas to millions of potential investors and allow anyone with a few dollars to spend to become an investor.²³ It is the mechanism for companies seeking funds to offer the shares for sale to the public to raise fund for business operation. As a result, there is no direct return like rewards or loan repayment with interest even with the expectation of return from this investment²⁴. The investor will benefit from dividend receivable according to their acquired shares ratio as the shareholders in case the companies

²¹ FundedByMe. "*Loan-based Crowdfunding*." (2015), <https://www.fundedbyme.com/en/lend-money/> (accessed on 22 November 2015).

²² *Id.*

²³ Jeff Thomas. "Making Crowdfunding Work for the Unaccredited Crowd." *Howard Business Law Review Online*. Volume 4, 201, <http://www.hblr.org/2014/04/making-equity-crowdfunding-work-for-the-unaccredited-crowd/> (accessed on 22 November 2015).

²⁴ *Supra* note 12.

become profitable subject to the Articles of Association or Bylaw of the company, including the resolution of board of directors' meeting and shareholders' meeting.

In other words, Equity Crowdfunding is a purchase of securities in which the company's shares are being offered online via an intermediate website known as a Funding Portal. Similar to raising funds on the other crowdfunding websites as described above, the issuers will render the presentation of their business model on the Funding Portal available for any prospective investors to consider whether they wish to take part in the business towards its potential growth by investing in the company's shares. Therefore, this sub-category of Crowdfunding is notably the investment based Crowdfunding.

2.3 Principle of Equity Crowdfunding

Equity crowdfunding is an alternative fundraising mechanism that gives an unlisted business start-up access to the money of anyone who is interested to be a part of their business. It allows small commercial enterprises and entrepreneurs to raise capital through the sale of shares to a wider public.²⁵

Other than the purpose of fundraising, once the campaign is launched on the Funding Portal, it also provides a good opportunity for the startup to do a market test of their product or service models at the same time without having to spend the cost on producing real ones. This totally changes the traditional way of creating a new product or service by discarding the financial limits that impede innovation. On the other hand, the investors can also easily notice whether the business is likely to be successful or not by assessing the number of contributors who have already pledged their funds as well as the total amount of funds that have already been pledged so far, before making a decision.

²⁵ Dreamakerequity. "What is equity crowdfunding?" (2015), <http://www.dreamakerequity.com/index.php/how-it-works/> (accessed on 22 November 2015).

2.3.1 Concerning Parties

Basically, the Parties to Equity Crowdfunding consist of three: (i) the issuers, (ii) the Funding Portal, (iii) the investors²⁶. Although the escrow agent is also present because they are required to oversee the campaign compliance, the core parties are those aforementioned three since they are the ones who are directly involved with the fundraising. That is to say that without the matching between the need for fund by the issuer and the wish to support the campaign in the form of investment by the investor via the Funding Portal as the intermediary between these two parties, the so-called Equity Crowdfunding scheme would not have been constituted.

2.3.1.1 Issuer

The issuer in Equity Crowdfunding refers to the startups that need funds to grow their business but are limited to other funding resources due to their lack of credit and collateral, such as, banks, financial institutions, or even venture capital, etc. Since the equity or share of the issuer is given to the investors in exchange for financial support, by offering shares for sale, the issuer by its nature must be a legal entity in the form of either a publicly-held or closely-held corporation.²⁷ In other words, the issuer must have already been established as a limited company which can be either a private limited company or a public limited company where the share capital is the key element available for such legal entity to raise in exchange for issuing the ownership to the investor in form of shares.²⁸ Given that the issuers are startups with limited resources even if they have high business potential, it is reasonable that most of them are incorporated as a limited company.

²⁶ Zachary Robock, “The Risk of Money Laundering Through Crowdfunding : A Funding Portal’s Guide to Compliance and Crime Fighting” ,4 Mich. Bus. & Entrepreneurial L. Rev. 113 (2014).

²⁷ Notification of the Capital Market Supervisory Board No.TorChor.7/2558, Clause 5

²⁸ Notification of the Capital Market Supervisory Board No.TorChor.7/2558, Clause 5

The issuer's main responsibility is to disclose the up-to-date and correct information to the crowd investors in the early stage of the campaign launch and thereafter, which is the duty of disclosure.²⁹ This duty of disclosure is vital and linked to the fraud protection as soliciting the investors with false information is deemed violating the investors' right and a criminal offense.³⁰ That is to say that the issuers shall, in good faith, reveal their information with regards to the business process. For example: the purpose of fundraising, line of product or services, concept of business, market, financial status, exit strategy, etc. This includes corporate functions such as the board of directors, shareholding structures, type or class or group of shares, Articles of Associations, etc. so that the investors should have sufficient information for decision making.

2.3.1.2 Funding Portal

The Funding Portal as an online intermediary is a website where a campaign is launched to the public and advertises to crowd investors to buy the shares being offered for sale by the startups. In other words, its role is similar to that of the underwriter in the stock market, but with the less complications and less regulated functions since they are not allowed to give or provide any advice to the investors.³¹ The Funding Portal's main role is to provide a forum for the issuers and the crowd investors whereby it is responsible in verifying and categorizing the background and knowledge of the investors and determining whether or not they are sophisticated enough to invest through Equity Crowdfunding.

In this regard, the Funding Portal is basically regulated and licensed by the Securities and Exchange Commission and obligated to verify the

²⁹ Sharon Yamen, Yoel Godfeder. *"Equity Crowdfunding – A Wolf in Sheep's Clothing : The Implications of Crowdfunding Legislation under the JOBS Act"*. 11 *BYU Int'l L. & Mgmt. R.* 41 (2015).

³⁰ *Supra* note 27.

³¹ *Id.*

identity of the issuers as per the disclosure compliance and professional courtesy including to make the agreement with the issuers in order to ensure that they shall proceed responsibly throughout the fundraising and thereafter if the campaign becomes successful. Such agreement shall include the subscription procedures with a cooling-off period, updates on the significant changes of the issuers' details which may affect the investors' rights, updates on the use of funds having been raised, verification of investment limit for individual investors, etc.³² In addition, the Funding Portal shall announce the risk warning for investing in Equity Crowdfunding given the illiquid condition of this kind of securities.³³

More importantly, the Funding Portal is not allowed to hold the fund even if it is the funding intermediary. The Funding Portal is required to arrange the escrow agent to manage the fund transfer which is pledged by the investors during the fundraising to the issuers if the campaign is achieved within a stipulated period on the basis of "All or Nothing".³⁴

2.3.1.3 Escrow Agent

The escrow agent in crowdfunding plays the same role as it does in the ordinary course of business. Which is to mean it is the intermediary who supervises the contract compliance of both parties including holding and releasing the money pledged by one party to the other party when the condition of contract is fulfilled.³⁵ Given the concept of "All or Nothing",³⁶ the escrow agent will oversee when the fund hits the target which is the issuers' expected and sufficient amount to achieve the campaign and run the business. Once the target is met or, in other words,

³² *Id.*

³³ *Id.*

³⁴ Douglas J. Cumming, Gael Leboeuf, Armin Schwienbacher, "*Crowdfunding Models : Keep-It-All vs. All-Or-Nothing*" (2015), <http://leeds-faculty.colorado.edu/bhagat/CrowdfundingModels-KeppItAll-AllorNothing.pdf> (accessed on 26 November 2015).

³⁵ *Id.*

³⁶ *Id.*

when the offer meets with the acceptance under the condition that the accumulated amount of funds promised by the crowd investors to invest in the campaign reaches the total amount as stipulated by the issuers, the escrow agent will arrange the transfer of funds pledged by the crowd investors to the issuers.³⁷

2.3.1.4 Investor

The main target investors of Equity Crowdfunding is the mass individual investors consisted of those who have a variety of experiences and knowledge in investments and those who do not, but are eager to invest in the business when they find the campaign interesting and worth the risk after taking into account of the potential return of investment.³⁸ In other words, they are the middle class whose annual net worth relies on limited sources of incomes and their financial status is hardly considered wealthy.³⁹ These crowd investors are categorized into two types namely the sophisticated or accredited investor and non-accredited or unsophisticated investor.⁴⁰

Notwithstanding, the larger corporate body or legal entity which is a traditional investor such as Private Equity, Venture Capital and institutional investors are not totally excluded even if Equity Crowdfunding is the alternative scheme aiming to provide the startups or issuers with the new source of funds other than the traditional and large ones.⁴¹

2.3.2 Fundraising procedures

³⁷ Notification of the Capital Market Supervisory Board No. TorChor. 7/2558, Clause 27

³⁸ Jorge Pesok, "Crowdfunding : A New Form of Investing Requires A New Form of Investor Protection", 12 Dartmouth L.J. 146 (2014)

³⁹ *Supra* note 27.

⁴⁰ *Supra* note 39.

⁴¹ *Supra* note 30.

As described above, Equity Crowdfunding mainly involves four connecting parties: (i) issuers or the companies seeking fund, (ii) funding portals, (iii) escrow agents, and (vi) investors.⁴² The process begins from the issuers who are in need of financial support due to the lack of capital to start the business, but full of creative ideas and strong business plans as well as financial forecasts. Given that many websites are being operated as a Funding Portal for Equity Crowdfunding, the issuers can easily browse the search engine to find the one they prefer and sign up, even though all of these intermediaries have the same standard of practice. After signing up for fundraising, they will be guided through the requirements of how they should demonstrate their business presentation on the website for the investors' review. The Funding Portal, for example, CrowdCube regularly reviews the pitch created by the issuers before signing off for the launch to ensure that all information provided is correct and reliable based on supporting documents.⁴³

Upon launching the pitch, the available time limit on the website to collect the fund as per the target proposed shall be applied. During this period, the investors who decide to go with the campaign will choose how much they wish to invest in order to achieve the target amount in return of the company's shares. According to CrowdCube's rules, the issuers have 30 days starting when they launch the pitch to raise funds from the investors until the target amount is achieved. Otherwise, the campaign will be cancelled.⁴⁴ The investors directly transfer money to neither to the issuers nor Funding Portal as the interface allows them merely to pledge how much they wish to purchase the shares. The payment will be processed using the credit card details the investors provide when they first register their investment. Unless the goal is reached, no money is taken from investors.⁴⁵

⁴² *Supra* note 27.

⁴³ CrowdCube. "*Fund you business through equity: Before you start*" (2015), <https://www.crowdcube.com/pg/before-you-start-equity-1640> (accessed on 27 November 2015).

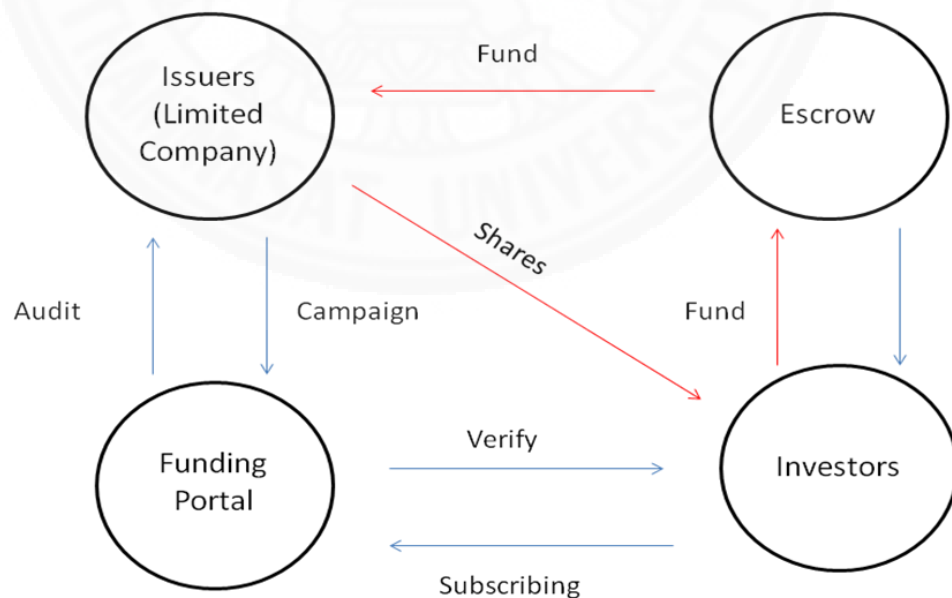
⁴⁴ *Supra* note 12.

⁴⁵ CrowdCube. "*A Guideline to Equity Investing: Making an Investment*" (2015), <https://www.crowdcube.com/pg/making-an-investment-equity-1632> (accessed on 27 November 2015).

Once a pitch is about to be accomplished, the Funding Portal will send investors a copy of the Articles of Association the company is seeking funds for, which outlines the constitution for how the business will be run. From this point, the investors will have seven working days to review the investment and decide whether they still wish to invest before it is made legally binding.⁴⁶ However, if a business hits its target before the stipulated period is over, the issuers may accept additional investment in exchange for releasing additional shares in the company, which can be at a higher percentage.

As soon as the investment has been processed, and the Funding Portal has completed all the necessary legal documentation, funds will be remitted to the company in exchange for shares. The Funding Portal will then send investors a copy of their share certificate via e-mail confirming that the investors are officially the shareholders in the company.⁴⁷

Here is the diagram describing the relation among all parties in Equity Crowdfunding:



⁴⁶ *Supra* note 12.

⁴⁷ *Id.*

2.3.3 Types of Investor

As mentioned earlier, there are two main types of crowd investors in Equity Crowdfunding: accredited or sophisticated investors and non-accredited or unsophisticated investors which are categorized as per the annual net worth including experiences and knowledge in the investment.

2.3.3.1 Accredited or Sophisticated Investor

The level of sophistication to determine whether the investor is qualified to invest through Equity Crowdfunding as the accredited or sophisticated investor depends on the variety of criteria under the different jurisdictions, but they share the same concept that the sophisticated or accredited investors shall possess the financial and business knowledge that allows them to appreciate the risks of the investment and are able to fend for themselves if they are provided with the appropriate type and amount of information or the access to this information.⁴⁸

The sophistication is also based on the wealth of the investors as their ability to take risks in regards to the investment through Equity Crowdfunding depends on how much money they have available and also their ability to recover such loss by other means or if such loss creates only slightly decreases their wealth. It should be fair to say that the more sophisticated or wealthier investors are presumed to be able to analyze the investment opportunity for themselves or bear the financial risks.⁴⁹

2.3.3.2 Non-Accredited or Unsophisticated Investor

⁴⁸ Joan MacLeod Heminway, Shelden Ryan Hoffman, “*Proceed at Your Peril : Crowdfunding and Securities Act of 1933*”, **Tennessee Law Review**, Vol. 78, p. 879, 2011, University of Tennessee Legal Studies Research Paper No. 154 , page 32

⁴⁹ Douglas S. Ellenoff, “Making Crowdfunding Credible”, 66 VAND. L. REV. EN BANC 19 (2013), page 20

On the contrary, the non-accredited or unsophisticated investor has the adverse qualifications as to the experiences and knowledge in investment including their annual income and/or net worth. In other words, they have limitations in analyzing the risks of investment as well as in bearing such risks due to the financial constraints and their ability to recover the loss by other means. However, most of the crowd investors which the issuers, through the Equity Crowdfunding scheme, aims to raise the money from, are the non-accredited investors. Thus, the laws concerning equity crowdfunding provide the limit of investment or investment cap for each individual investor. The Funding Portal is also required to evaluate the sophistication of the crowd investors by arranging a quiz that tests basic knowledge in regards to investing in this platform before allowing them to participate in the campaign.⁵⁰

Notwithstanding, both of these types of investors requires more comprehensive protection than the investors in the ordinary stock market due to the illiquidity of shares. There is no secondary market to trade and it is even worse if the transfer of shares is subject to restriction under the Articles of Association of limited company tailored by the original shareholders.

2.4 Principle of Limited Company

2.4.1 Historical Backgrounds

Partnership is the oldest and most famous basic model for relationships between people conducting business with a shared desire to profit. After the industrial revolution in the 1820s, business activities grew rapidly which accelerated the growing of separate legal entities which advanced in administrative purpose. At the beginning of the modern corporate era, nearly all incorporated entities were permitted through royal charters and privileged private acts granted to associations. Their main

⁵⁰ Notification of the Capital Market Supervisory Board No.TorChor.7/2558, Clause 23

purpose was to facilitate infrastructures. As time went on, the scope of businesses was enlarged and expanded. Consequently, litigation was a nightmare as the case might deal with hundreds of associations because the corporation was not separated from personal liability until 1844 after the first Joint Stock Companies Act 1844 was formed.

The Act allowed private citizens to register companies which was the first establishment of a separate legal entity. The Act also set the provisions allowed to shareholders to participate in the company's affairs such as attending general meetings.⁵¹ However, the liability of members was not limited. The emergence of rentier shareholders also accelerated the development of the limited liability scheme, as the Limited Liability Act 1855 was established. The Act allowed investors to limit their liability in case of business failure or to prevent personal liability. Before, a such scheme was not necessary because one who does business would do it by himself and the separation of ownership and the management was only theoretical.

More recently, investors tended to invest in several businesses and wish to not be involved in the day-to-day business. Hence, it shows that the ownership and control may be separated. More or less, these investors would like to be assured that the liability of company members is limited, even the management is out of control.⁵² As a result, the separation of personal finance, the separation of ownership and management, and the idea of limited liability influenced the recent formation of the modern private limited company.

2.4.2 Structures of Limited Company

The corporate entity is a juristic person and a separate legal actor. It contains a complex set of contracts between the numbers of parties such as

⁵¹ English Joint Stock Companies Act 1844 ss.26, 36 and 50.

⁵² Joseph E.O. Abugu, Primacy of shareholders' interests and the relevance of stakeholder economic theories, *Company Lawyer*, 2013, 34(7), 202-214.

managerial, employees, and investors.⁵³ The establishment of relationship between company members is a collection of contracts which is supported by the Nexus of Contract theory⁵⁴. This contract is more like a set of internal rules specifying the rights of each agent and performance criteria for each participants in the company. It shows a close relationship between each of the company's members. Under this theory, the most common members of the company are as follows:

2.4.2.1 Shareholders

Shareholders are those who own shares in companies which are synonymous with membership. There are several options to account for shares in the company. For instance, share subscription to the memorandum and articles of association at the company formation stage, purchase of shares, and transmission of shares. Liability of shareholders is limited by shares or the remaining share value to contribute in meaning that, once the accounted shares were paid up, there is no further liability for the debts of the company.

Under the view of Contractual Theory of the Corporation, it is assured that because the management is not run by investors directly, the liability of business practices should not harm them or, at least be limited by value of remaining contribution of share value. Similarly to the limited company by guarantee, members' liability for the debts of the company should not exceed their guarantees.⁵⁵ Generally,

⁵³ Frank H. Easterbrook and Daniel R. Fischel, "*Limited Liability and the Corporation*", The University of Chicago Law Review Vol. 52, No. 1 (Winter, 1985), pp. 89-117, 89

⁵⁴ Michael C. Jensen, "*A Theory of the Firm : Governance, Residual Claims and Organizational Forms*", Harvard University Press, December 2000 Journal of Financial Economics (JFE), Vol. 3, No. 4, 1976

⁵⁵ Department for Business Innovation & Skills, "Office of the Regulator of Community Interest Companies: Introduction and guidance notes, Chapter 3 : Limited Companies" (2015), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/524151/cic-12-1333-community-interest-companies-guidance-chapter-3.pdf November 2012 (accessed on 28 November 2015)

shareholders are considered to be the owners of company which will not take control directly in the day-to-day business practices but rather control the managerial side through shareholders meeting.

2.4.2.2 Articles of Association

A company Articles of Association or bylaw can be described as a “rulebook of the company” as it describes the duties of each party involved in the organization, company objectives and governing the administration. In other words, it is the agreement between the investors towards the incorporation. To put it simply, it is a shareholders agreement which is recognized by official registration under company laws.

2.4.2.3 Director(s) and Board of Directors

Company Director(s) and Board of Directors are a group of managers who run the day-to-day operations. Most company articles grant the director authority to be able to exercise decisions on behalf of the company. These people are at the core of the corporation and are sometimes called stakeholders because they hold a common stake in the business. In other words, they share the benefits and the losses. The backgrounds of this sharing common stakes has been influenced by the main idea of partnership and perhaps it has been developed from that. Furthermore, a restriction of prohibition on public offerings made to private company members is more closely held by shareholder arrangements through different types of contracts such shareholders agreements, the appointment of directors or even through company memorandum or articles.

Potentially, the offering of equity would then be restricted to the partners who have known each other for a long time. Although the separation of legal personality and limited liability that has been developed recently makes it easier for the investors, directors are still held accountable for their investments and assets. It may be true that the rentier investor will not likely be involved in the management

however, at the end of the day, the real management control will potentially be illustrated during shareholders' meeting. At that stage, it is likely that most investors would like to be assured that they share the same purpose in running the business. Therefore, trust and a close relationship between shareholders and directors is really essential.

2.5 Protection of Minority Shareholders

By nature of this fundraising scheme, crowd investors, regardless of their level of sophistication, will become the minority shareholders. In other words, the non-controlling shareholders in the issuing company. The purpose of boosting up the economy by providing a new fundraising mechanisms to the startups could not be achieved without the crowd investors who provide funding. Unless the protection of minority shareholders' rights is well covered by the legislation and duly implemented, the crowd investors are unlikely to contribute their savings when they feel unsafe. In other words, when the minority shareholders' rights are less protected, the investor, especially the individual or crowd investor, is unlikely to participate in the investment.

Rights to access certain details about a company's activities must be extended to all those who purchase shares in the firm. In fact, this information is a prerequisite for exercising many other rights.⁵⁶ The rights of all non-controlling investors and shareholders, whether major or minor, must be safeguarded. Smaller shareholders need to be guaranteed equal treatment to those with larger stakes in the firm, in terms of dividend policies and access to new security measures.⁵⁷ The wishes of the significant but non-controlling shareholders must be acknowledged and taken into consideration. Even if they hold a considerable proportion of the firm's equity, there is a high risk of stakeholders losing out unfairly if they are not able to enforce

⁵⁶ Rafael La Porta, Florencio Lopez-de-Silanes, Adrei Shleifer and Robert Vishny, “*The World Bank's Financial Sector Discussion Paper No. 1, Investor Protection: Origins, Consequences, Reform*”, September 2009, page 5

⁵⁷ *Id.*

their rights.⁵⁸ Some of the key shareholder rights that must be safeguarded are the rights to receive dividends on a pro-rata basis, to vote for directors, to be a part of shareholders' meetings, to be on the same terms as insiders when deciding on security-related issues, to take legal action against directors for expropriation, and to call special stakeholders' meetings, amongst others.⁵⁹ Generally speaking, inadequate protection of investor rights leads to the possibility of considerable expropriation and control becomes very valuable for the insiders as it allows the relatively efficient expropriation of company resources.⁶⁰

With regards to the control of the company through voting rights, the entrepreneurs establishing start-ups may be disinclined to surrender control by spreading control rights too thinly while there is a low level of investor protection.⁶¹ Secondly, one of the most obvious factors is the fact that distributing control among the other shareholders may hinder expropriation, as the outside investors need to be kept in the dark in order for this to happen. In circumstances where the investors are offered only weak protection, retaining full control may well be the most lucrative strategy for the leading shareholder.⁶² Furthermore, the even distribution of control among many shareholders may come at the cost of the private benefits premium for the entrepreneur, if a takeover of the company should occur. If entrepreneurs control the cash flow, expropriation will become less enticing and paying out dividends will be incentivized.⁶³ This requirement for higher ownership of cash flow in order to commit to reducing expropriation may be especially strong in countries lacking adequate shareholder protection.⁶⁴

The real economy is influenced by investor protection, by way of the latter's effect on financial markets. Economic growth can be boosted by financial

⁵⁸ *Id.*

⁵⁹ *Id.* page 11

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

development in three ways.⁶⁵ Firstly, savings can be increased. Secondly, these savings can be invested, with the subsequent accumulation of capital. Finally, financial development allows resources to be deployed more efficiently, insofar as the financial backers have some influence in how the entrepreneurs choose to invest capital.⁶⁶ This capital is thereby channeled in the most useful directions. Taken together, these three factors can, in theory, exert considerable influence on economic growth.⁶⁷



⁶⁵ *Id.* page 14

⁶⁶ *Id.*

⁶⁷ *Id.*

CHAPTER 3

FOREIGN LAWS AND REGULATIONS CONCERNING PROTECTION OF INVESTING SHAREHOLDERS IN A LIMITED COMPANY RELYING ON CROWDFUNDING

3.1 The United State of America

3.1.1 Overview of Laws concerning Equity Crowdfunding in the United States of America

3.1.1.1 Backgrounds of Equity Crowdfunding

In the United States, the Jumpstart Our Businesses Startups Act (the "JOBS Act") has been promulgated in 2012.⁶⁸ The promulgation of JOBS Act intended to generate more investment and boost up more employment towards the economic recession which one of those causes was due to the sub-prime crisis.⁶⁹ The JOBS Act is designed to make the fundraising much easier for the startups or emerging companies to raise capital from the public which is referred to as crowd investors through a loosening of regulatory restrictions applicable to private offerings, initial public offerings and certain newly public companies.⁷⁰ Subsequently, in 2013, the US SEC adopted new rules that relax the restriction on public offering to allow Equity Crowdfunding.⁷¹

⁶⁸ U.S. Securities and Exchange Commission, "*Jumpstart Our Business Startups (JOBS) Act*" (2015), <https://www.sec.gov/spotlight/jobs-act.shtml> (accessed on 5 November 2015).

⁶⁹ U.S. Securities and Exchange Commission, "*Press Release : SEC Adopts Rules to Permit Crowdfunding*" (2015), <https://www.sec.gov/news/pressrelease/2015-249.html> (accessed on 5 November 2015).

⁷⁰ *Id.*

⁷¹ *Id.*

The entities that benefit the most from Equity Crowdfunding are the smaller firms that are ill-equipped for the large costs of going public in a traditional manner. These firms benefit from higher liquidity of their stocks. Entrepreneurs benefit from crowdfunding as well as they are able to raise capital without giving up nearly as much equity as they would have to in a traditional transaction.⁷²

3.1.1.2 Arguments on Equity Crowdfunding

Because Equity Crowdfunding is facilitated through the internet, there is an inherent risk that the website could be targeted by hackers, shutdown, or possibly experience data loss. This would result in a loss of investment for crowd investors. There is also a liquidity risk to consider since there is no active secondary market for these shares. Therefore, it may be impossible for investors to sell their shares or, if they do manage to sell them, it would probably have to be at a large discount.

There is concern that only companies with inferior products would choose the Equity Crowdfunding route as opposed to traditional methods of raising capital.⁷³ In the traditional market, companies must abide by strict regulations and spend a lot of money convincing investors that their product is worth investing in.⁷⁴ Should a company choose traditional methods of raising capital, they would have to be underwritten and approved making it easier for the investor to feel safe investing in them.⁷⁵ Weaker companies might be tempted to forgo this expensive and demanding route and instead choose to raise capital through the much less regulated

⁷² *Id.*

⁷³ Gregoty Gaynor, Joel Morse, Mikhail Pevzner, “*The Crowdfunding Effect*” (2015), Strategic Finance, <http://sfmagazine.com/post-entry/october-2015-the-crowdfunding-effect/> (accessed on 5 November 2015).

⁷⁴ *Id.*

⁷⁵ *Id.*

crowdfunding channels.⁷⁶ These channels are more likely to attract unsophisticated investors who are unable to perform due diligence or do not demand the information that is traditionally disclosed in a routine underwriting.⁷⁷ There is also the chance that the investors are in a speculative bubble without any forewarning.⁷⁸

Equity Crowdfunding might give the unsophisticated investor a lot of the downsides of investing with few of the benefits. For example, the unsophisticated investor might trade on pro forma earnings which does not include some expenditures that impact future profitability. These amateur investors will also probably overestimate the persistence of earnings because of their inability to adjust for lower persistence of the accrual component of earnings.⁷⁹

Corporate malfeasance, such as accounting fraud, may also be an obstacle to the success and acceptance of Equity Crowdfunding.⁸⁰ The deregulation of underwriting rules could also be coupled with less scrutiny of the companies themselves.⁸¹ This leaves unsophisticated investors investing through Equity Crowdfunding vulnerable to deceptive claims and could incur more financial loss than traditional investors would.⁸² One potential fix for such fraud could be online communities that self-monitor various Equity Crowdfunding projects and provide Equity Crowdfunding regulation and feedback themselves.⁸³

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ James R. Frederickson and Jeffrey S. Miller, “*The Effects of Pro Forma Earnings Disclosures on Analysts' and Nonprofessional Investors' Equity Valuation Judgments*”, *The Accounting Review*: July 2004, Vol. 79, No. 3, page 667-686.

⁸⁰ *Supra* note 30.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

3.1.2 Restrictions on Offering of Limited Company's Shares

3.1.2.1 Model Business Corporation Act 1984

In 1950 the Modern Business Corporation Act (MBCA) was promulgated. It was a statute that shared similarities with the Delaware General Corporation Law and was generally forward looking in its scope. Because of the numerous governance failures and accounting frauds that occurred in the early part of this decade the Sarbanes-Oxley Act of 2002 was enacted⁸⁴. As the end of the decade approached and the country experienced a financial meltdown, the drafting body and custodian of the MBCA, the Committee on Corporate Laws of the American Bar Association Section of Business Law (Committee) has moved from traditionally enabling statutes that give most governance choices to private ordering to the accommodation of normative governance rules.⁸⁵

In a traditional company, the owner of a corporation are the shareholders. A board of directors is elected by the shareholders to monitor and participate in major corporate decisions.⁸⁶ The board of directors also elects officers and dictates the policy inside the corporation. These decisions are then carried out by officers and the employees of the corporation under the delegated authority of the board of directors.⁸⁷

Owners of the corporation are issued shares. If an individual is the sole proprietor of the business he is still issued 100% of the shares.⁸⁸ Ownership of a corporation can be transferred through the sales of the shares.⁸⁹ The corporation

⁸⁴ *Id.*

⁸⁵ John F. Olson, Aaron K. Briggs, "The Model Business Corporation Act and Corporate Governance: An Enabling Statute Moves Toward Normative Standards", 74:1 Law & Contemp. Probs. 31-43 (2011).

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

can sell more shares to add additional owners or by allowing current owners to sell their own shares to keep the amount limited.⁹⁰ In some businesses, the employees themselves are the shareholders and own all the shares. In these situations the shareholders limit the sale of shares so they can retain ownership.⁹¹

3.1.2.2 Securities Act 1933

The first federal legislation intended to specifically target and regulate a company's sale of securities was the Securities Act of 1933. The act made the registration of all sales of securities to be compulsory unless there was a specific exemption. Included in the registration was a prospectus, i.e., a disclosure that lists all material facts relating to the securities and the company that issued them.⁹² The act helped investors who were prone to misinformation regarding securities or people who purchased securities that should have been registered but were not. Civil and criminal penalties were included in the act should anyone violate its provisions.⁹³

A key provision included in the Securities Act of 1933 required no securities to be sold in interstate commerce without a registration statement created for the securities. Exemptions are provided for security transactions that are not public offerings.⁹⁴ For example, particular small offerings, intrastate offerings, and transactions by anyone other than the issuing company or underwriter.⁹⁵ The act was created to regulate companies wanting to raise capital through a public offering. The statute did not cover ordinary transactions that occurred over a stock exchange.⁹⁶

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² Elisabeth Keller . *"Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934."* Ohio State Law Journal 49, (1988): 329-352

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

Security law is supposed to protect investors from unethical business practices.⁹⁷ These laws force companies to abide by certain procedures and practices before they can accept investments in exchange for shares.⁹⁸ Registration with the SEC and state security agencies is required before a company can grant stock to the initial corporate shareholders. Many small companies are exempted from this process though under certain state and federal laws.⁹⁹ For instance, corporations that host a “private offering,” which is a sale of stock that is not advertised and is only sold to a limited number of people, is allowed under SEC regulation.¹⁰⁰

3.1.2.3 Securities and Exchange Act 1934

The Securities and Exchange Act of 1934 was enacted to address securities law. Unless covered by certain exemptions, issuers had to register with the Securities and Exchange Act 1934 in order to be traded on a national exchange market. This is not the same as registering an offering under the Securities Act 1933.¹⁰¹ These two laws are distinct but securities that were registered under the Securities Act 1933 act may have to be registered under the Securities and Exchange Act 1934 as well.¹⁰²

Issuers of securities registered under the Securities and Exchange Act 1934 are required to file reports with the SEC as a public service to provide requisite information about the company.¹⁰³ These disclosures apply to both companies with more than five hundred shareholders and more than five million in assets and companies with securities listed on national securities exchanges.¹⁰⁴ Any

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

false claims found in these documents may become liabilities to people who rely on these statements for prudent investing.¹⁰⁵

The Securities and Exchange Act 1934 allows the SEC to revoke or suspend the registration of a security if it is determined that the issuer has violated any rules or regulations stipulated by the Act.¹⁰⁶ Furthermore, the Securities and Exchange Act 1934 gives the SEC authority to suspend the trading of any security for no more than ten days.¹⁰⁷ It can also suspend trading in all securities for a maximum of ninety days or take certain measures to address major market disturbances if approved by the president.¹⁰⁸

3.1.3 Exemptions for Offering of Limited Company's Shares through Equity Crowdfunding

3.1.3.1 Jumpstart Our Business Startups Act 2012

Although Equity Crowdfunding raises money over the internet, it generally has not been used to sell or offer securities. This is because offering or selling securities must be registered with the SEC unless it can find an applicable exemption. Registration with the SEC is compulsory if the company offered shares of financial returns or profits from businesses activities. This allows companies to raise money over the internet without distributing profits back to the crowd investors.¹⁰⁹

An exemption was included in the JOBS Act to allow Equity Crowdfunding and established a regulatory structure for such transactions.¹¹⁰ It also created a Funding Portal to allow internet-based platforms or intermediaries to act as a

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ U.S. Securities and Exchange Commission, “*Final Rule : Corwdfunding*” (2015), <https://www.sec.gov/rules/final/2015/33-9974.pdf> (accessed on 7 November 2015).

¹¹⁰ *Id.*

middleman for the sale of securities without having to register as brokers to the SEC. These provisions are intended to help the startups and SMEs raise capital while still providing significant investor protections.¹¹¹

As required by the JOBS Act, companies are limited to raising one million dollars in any twelve month period through crowdfunding.¹¹² Should they choose to crowd fund, companies cannot do it on their own. Instead they must go through an intermediary registered with the SEC.¹¹³ These intermediaries are subject to strict regulations and requirements.¹¹⁴ Individuals who invest via Equity Crowdfunding are also limited in the amount they can invest in any twelve month period.¹¹⁵ If an individual investor has a net worth of less than one hundred thousand dollars, they are allowed to invest two thousand dollars or five percent of their annual income or net worth, whichever is greater.¹¹⁶ If the investor has a net worth of more than one hundred thousand dollars, he can invest ten percent of his income or net worth, whichever is greater, up to a maximum of one hundred thousand dollars.¹¹⁷

The SEC is given authority to write the rules that dictate how companies can utilize Equity Crowdfunding to raise money. It also outlines the responsibilities of the intermediaries.¹¹⁸ These regulations include what has to be disclosed to prospective investors as well as the requirements and operating procedures for the intermediaries.¹¹⁹

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

3.1.4 Principle of Offering of Company's Shares

According to the independent legislation held by the local administrations, the US as a federal republic has various versions of laws applicable to incorporation in each of its 50 states and the District of Columbia. Due to this fact it would not be practical to study all of those laws applicable in each specific state.¹²⁰ Thus, this thesis will focus on the Model Business Corporation Act (MBCA) and its substantial provisions that are widely adopted by over 20 states in their state laws. A closely-held corporation will be focused on as this kind of corporation shares the same legal concept of that of a limited company under the CCC especially in regards to restrictions on the sale of shares to the public.¹²¹

3.1.4.1 Incorporation of a Closely-held Corporation under Model Business Corporation Act 2002

A closely-held corporation, also known as a privately-held corporation, is a business organization established by a close group of partners or investors. The corporation is required to be registered with the state in order to become an independent juristic body with the rights and liabilities being separated apart from that of the individual shareholders.¹²² Whilst the legally established corporation is unlimitedly liable for the debts and obligations arising out of business activities, the liability of shareholders is limited only to the shared capital they have paid in full.¹²³ In other words, the shareholders in a private corporation shall not be liable for the debts owed by the corporation to creditors or any third parties in the course of business, other than the money they have invested by subscribing or

¹²⁰ State of Delaware, Department of State, Division of Corporations, "About the Agency" (2015), <http://www.corp.delaware.gov/aboutagency.shtml> (accessed on 7 November 2015).

¹²¹ *Id.*

¹²² Hamilton, Robert. **The Law of Corporations**. 3rd ed. St. Paul Minnesota: West Publishing Co., 1991. Page 127.

¹²³ *Id.*

purchasing shares issued by said corporation. The closely-held company is also known as Limited Liability Company or LLC.

3.1.4.2 Typical Offering of Company's Shares

As a corporation needs funds to operate its business, it issues the shares for subscription and/or sale to the investors for the purpose of fundraising. The shares issued by a closely-held corporation can simply be sold to a close group of investors. In other words, the founders or promoters are the same people as the shareholders after incorporation. The shares of a closely-held corporation are not available for public in both an initial offering by a corporation and a resale by the shareholders. This means that there is no secondary market to freely sell the shares of a closely-held corporation and the sale of shares is subject to the conditions set forth in MBCA, unless there is any federal exemption enacted by the Securities and Exchange Commission under the Securities Act of 1933 and the Securities and Exchange Act of 1934.¹²⁴

3.1.4.3 Exemptions for Offering of Company's Shares in Equity Crowdfunding

By virtue of the Jumpstart Our Business Startups Act of 2012 (JOBS Act), the closely-held corporation, herein after referred to as a "Company", as the unregistered corporation with the US SEC, is exempted from offering its shares for sale to the public under the regime of Equity Crowdfunding via the registered qualified online intermediary also known as a Funding Portal.¹²⁵ In addition to the existing exemption that allows only accredited investors with a high net-worth and appropriate income and institutional investors to enjoy this new investment platform, the Title III of JOBS Act recently enacted by the US SEC also make this investment

¹²⁴ *Id.* Page 12

¹²⁵ Poonhom Sookasang. "*Legal Measures to Facilitate the Offering of Equity Crowdfunding*". Thesis for Master of Law (Business Law). Faculty of Law. Thammasat University. (2014). Page 14

channel available for the individual or non-accredited investors subject to certain limits of investment amounts.¹²⁶ Therefore, it can be said that now the public can participate as third party shareholders in a closely-held corporation by purchasing its issued shares through Equity Crowdfunding. In other words, a closely-held corporation is no longer as closed as it used to be and should be according to the general principle of MBCA.

3.1.5 Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding

3.1.5.1 Pre-Offering Stage of Company's Shares in Equity Crowdfunding

JOBS Act generally divides Equity Crowdfunding into three parties: the (i) issuers who are the close-held corporations seeking funds by offering their shares for sale to the public; (ii) the Funding Portal which is the online intermediary where the issuers can post their campaign and offer the shares for sale; and (iii) the investors which are the entities or individuals regardless of being accredited or unaccredited who subscribe and purchase the shares offered for sale by the issuers, and become the shareholders thereafter.¹²⁷ This Equity Crowdfunding exemption involves many people including the individual investors which can be anyone on the street. The JOBS Act imposes the rules covering the early stage of the offering for sale until the fundraising is achieved as follows:¹²⁸

3.1.5.1.1 Issuer Requirements

Since the offering of the sale of shares is made to the public where the pitch prepared and launched on the platform by the issuers to solicit

¹²⁶ *Supra* note 70

¹²⁷ *Supra* note 110

¹²⁸ *Id.*

the investors similar to an initial public offering of a publicly-held corporation regulated by the US SEC, the companies owe duty of disclosure to the investors upon launching the campaigns. The issuers are required to file certain information with the US SEC and disclose the same to the investors including the Funding Portal to ensure that the investors have sufficient information to invest in the company.

The core information required to be disclosed by the issuers are the share price, target offering amount, specific period available for sale before closing, discussion of the company's financial condition, financial statements, description of the business, purpose of fundraising, information of the founders, key officers and directors or any person holding more than 20 percent of the issuers' shares, including related transactions.¹²⁹

3.1.5.1.2. Funding Portal Requirements

The Funding Portal is required to be registered with the US SEC before operating the platform as if it was a broker in the stock markets, although the rules applied to the brokers are more strictly regulated. As the intermediary providing a space for both the issuers and the investors, the Funding Portal is responsible to providing investors with educational material of how the platform works including the information disclosed by the issuers, warnings of associated risks, resale restrictions, and corporation and investment limits for the individual investors. It is also their responsibility to ensure the transparency of the campaigns by taking certain measures to reduce fraud. More importantly, the Funding Portal is not allowed to offer any investment advice or recommendations, solicit purchases, sell or offer to buy shares, compensate promoters and other persons for solicitations or, based on the sale of shares, hold, possess or handle investor funds or shares.¹³⁰ Any conflict of interest concerning the campaigns hosted on the

¹²⁹ *Id.*

¹³⁰ *Id.*

platform is to be avoided by the Funding Portal. For example, having a financial interest in the issuers other than the ordinary services fee receivable from them.

3.1.5.1.3. Restrictions on the Offering

Title III of JOBS Act now allows every type of investor, including individual non-accredited, to invest in a company seeking funds via Equity Crowdfunding. The Act, therefore, provides limits for investors and takes into account their level of sophistication and the amount of money they normally earn and save for investment. This amount tends to be moderate and, of course, lower than the accredited ones. In extreme cases it could be their entire lifetime savings.

As a result, individual investors with an annual income or net worth less than USD 100,000 is permitted to invest only USD 2,000 or 5 percent of the lesser of their annual income or net worth, whichever is greater.¹³¹ If both their annual income and net worth are equal to or more than USD 100,000, they are permitted to invest 10 percent of the lesser of their annual income or net worth.¹³² However, the aggregate amount of investment of one investor is limited to USD 100,000 within a 12-month period.¹³³ The maximum offering amount also applies to the issuers as they are not permitted to offer the shares for sale in excess of a maximum aggregate amount of USD 1,000,000 within a 12-month period.

3.1.5.2 During-Offering Stage of Company's Shares in Equity Crowdfunding

During the offering for sale of the company's shares by the issuers on the platform provided by the Funding Portal, both of them still have to

¹³¹ JOBS Act, Sec. 302

¹³² *Id.*

¹³³ *Id.*

maintain the ongoing requirements based on what they have been responsible for since the early stage.

3.1.5.2.1 Issuer Requirements

The issuers still owe the ongoing disclosure should the information earlier provided to the investors and Funding Portal upon launching the campaigns be changed. The maximum aggregate amount of fundraising through Equity Crowdfunding of USD 1,000,000 in a 12-month period has to be maintained even though the issuers are allowed to launch the campaign with only one platform and it would be easily noticed if they raised funds in excess of this limit.

3.1.5.2.2 Funding Portal Requirements

Funding Portal plays an important role in this ongoing stage to facilitate the fundraising and protection of investing shareholders. This protection includes monitoring fraud and compliance of the issuer requirements such as investor types and limits of investment to arranging the funds that have been raised to the issuers in successful campaigns via the escrow agent. As an online platform, it must make information disclosed by the issuers available on the website throughout the offering period and for a minimum of 21 days before any shares may be sold in the offering – that is before the campaigns have been achieved.¹³⁴ The communication channels allowing discussion among the investors pertaining to the offering on the platform must also be made available at all times.¹³⁵ Additionally, the Funding Portal is obliged to notify the investors upon receiving their subscription or commitment to buy the shares and confirm to them whether the campaigns were successful subject to the completion, cancellation and reconfirmation procedures.¹³⁶

¹³⁴ JOBS Act, Sec. 4A

¹³⁵ *Supra* note 110

¹³⁶ *Id.*

3.1.5.3 After-Offering Stage of Company's Shares in Equity Crowdfunding

Although the campaigns are completed and the funds have been transferred to the issuers in exchange for the shares given to the investors, the regulations of Equity Crowdfunding still prevail and apply to the parties.

3.1.5.3.1 Restrictions on the Resale

The resale restrictions apply to the investors or the purchasers of shares offered through Equity Crowdfunding. The investors, once they have acquired the company's shares, are restricted to resell those shares within the first year from the date of purchase, unless they are resold to the issuers or accredited investors as part of a registered offering, or to a member of the purchaser's family, or in connection with the purchaser's death or divorce, or other similar circumstances.¹³⁷

3.1.5.3.2 Ongoing Reporting Requirements

The issuers are required to continue the duty of disclosure even after the campaigns have been achieved on a yearly basis similar to the information disclosed at the time of offering. In other words, they need to update the financial status and general business disclosure by filing the annual report to the US SEC and make the same available to the investors by simply posting the report on their websites. This duty will continue until the shares are no longer held by the crowd investors.¹³⁸

¹³⁷ *Supra* note 135

¹³⁸ *Id.*

3.1.5.3.3 Controlling Authority

The US SEC, who granted the exemption for Equity Crowdfunding, closely monitors the fundraising process which is subject to the anti-fraud provisions even though it has more flexible filing requirements. The Federal Trade Commission (FTC), which is a consumer protection organization established by virtue of the Federal Trade Commission Act of 1914, also plays a proactive role as it has taken the first step to extend the scope responsibility to crowdfunding platforms by bringing a claim against the campaigner in a reward-based crowdfunding in *FTC v. Chevalier* for the misuse of funds raised from the crowd. In this case, FTC Bureau of Consumer Protection states that the consumers should be able to trust that their money will actually be spent on the project they funded. It is assumable that the FTC will not hesitate to take action should the same issue arise in Equity Crowdfunding.¹³⁹

3.1.5.3.4 Protection of Minority Shareholders' Rights

The principle of minority shareholders' rights is well recognized according to the precedents held by the Supreme Court. Other than the directors' fiduciary duties that are common between the directors and the corporations, there exist the fiduciary duties of the shareholders that the shareholder of a closely-held corporation owes to one another.¹⁴⁰ The common law also allows the shareholders, especially the minority whose advantage is taken though the abuse of majority's controlling power, to bring a claim to the court for relief as they are obliged to exercise their power in good faith and in the interest of the company as a whole including other minority shareholders.¹⁴¹

¹³⁹ Federal Trade Commission, "*Crowdfunding Project Creator Settles FTC Charges of Deception*" (2105), <https://www.ftc.gov/news-events/press-releases/2015/06/crowdfunding-project-creator-settles-ftc-charges-deception> (accessed on 12 November 2015).

¹⁴⁰ John C. Carter, "*The Fiduciary Rights of Shareholders*", *William & Mary Law Review*, Volume 29, Issue 4, Page 839

¹⁴¹ *Id.* Page 840

3.2 The United Kingdom

3.2.1 Overview of Laws concerning Equity Crowdfunding in the United Kingdom

3.2.1.1 Backgrounds of Equity Crowdfunding

Although Equity Crowdfunding was first developed in the US in the mid 2000s, the UK followed suit with the launch of Crowdcube which is one of the world leading Funding Portals in 2011.¹⁴² Since then, a myriad of other platforms and intermediaries have appeared. Many of these experiment with different models and target various niches. For example, Seedrs is the first crowdfunding platform to be regulated by the Financial Conduct Authority (FCA). Since then, the FCA has provided a regulatory framework and has actively monitored Equity Crowdfunding activity. For instance, after a period of active consultation, the FCA introduced new rules that created better protection for investors in 2014.¹⁴³

3.2.1.2 Arguments on Equity Crowdfunding

One of the reasons why crowdfunding is so appealing is because companies can avoid the terrible expensive prospectus which is usually issued only for listed companies looking to raise much larger funding rounds. The first issue raised is whether or not it is legal to raise finance for these unlisted companies from the general public. According to ‘Siding with the Angels’ by Nesta, angel investors can get an average financial return of two times with a holding period lasting just under four years. This results in a twenty two percent of Internal Rate of

¹⁴² Weinstein, Ross S. "Crowdfunding in the U.S. and Abroad: What to Expect When You're Expecting" *Cornell International Law Journal*: Vol. 46: Iss. 2, Article 6, (2013). Page 441

¹⁴³ British Business Bank, Department for Business Innovation & Skills, "Equity Crowdfunding in the UK: Evidence from the Equity Tracker" (2015), <http://british-business-bank.co.uk/wp-content/uploads/2015/03/230315-Equity-crowdfunding-report-final.pdf> (accessed on 5 December 2015).

Return.¹⁴⁴ Many angel investors can claim much of their investment via the UK Government's Enterprise Investment Scheme and Seed Enterprise Investment Scheme tax liability reductions.¹⁴⁵ These attractive returns tempt unsophisticated investors to invest in the opportunity without first doing their due diligence or considering the risk of investment loss.¹⁴⁶

Crowd investors seem to be constantly losing on existing equity crowdfunding platforms. The running theory is that since these investors cannot negotiate the companies' valuation, it creates a major detriment for their potential financial returns. On these crowdfunding platforms, entrepreneurs can set the value of their business without negotiating with potential investors. Because of this, crowd investors are unlikely to realize any significant returns from their investments. This highlights a key issue of equity crowdfunding: the platform provides entrepreneurs with access to capital but fails to properly compensate investors due to a low probability of financial returns.¹⁴⁷ The system inherently benefits companies and their creators without reciprocating those benefits to the investors.

3.2.2 Restrictions on Offering of Limited Company's Shares

3.2.2.1 Companies Act 2006

The UK was one of the first nations to establish regulations and operating procedures for companies. By virtue of the Companies Act 2006, the system of corporate law and governance sets the legal basis on which companies can

¹⁴⁴ Nesta, "*Crowdfunding Good Causes – Opportunity and Challenges for Charities, Community, Group and Social Entrepreneurs*" (2015), <http://www.nesta.org.uk/publications/crowdfunding-good-causes> (accessed on 5 December 2015).

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ Syndicate Room, "*The Problems with UK Equity Crowdfunding and Seed Investment*" (2015), [https://www.syndicatoroom.com/blog/what-is-the-problem-with-equity-crowdfunding-and-seed-investment-\(1\)-\(1\)](https://www.syndicatoroom.com/blog/what-is-the-problem-with-equity-crowdfunding-and-seed-investment-(1)-(1)) (accessed on 5 December 2015).

be formed and ran. These systems are a vital part of the legal framework in which business can be conducted. As the business world evolves, there is a risk that the archaic legal framework will become divorced from the needs current companies have and the new technologies that exist. Small and private business in particular experience obstacles that prevent them in competing in a competitive manner.¹⁴⁸

Private companies are prohibited by Section 755 from issuing shares to the public, or any section of the public under the Companies Act 2006.¹⁴⁹ ‘Any section of the public’ has been widely interpreted and can be applied to any group of people, no matter the number.¹⁵⁰ The companies own shareholders are treated as a section of the public for this express purpose.¹⁵¹ Unless covered by a specific exemption in Section 755, the company would only be allowed to issue shares to the public if it was converted to a Public Limited Company.¹⁵² Afterwards, it would be required to comply with all of the regulatory requirements for a PLC, including a minimum paid-up share capital of five thousand pounds.¹⁵³

3.2.2.2 Financial Services and Markets Act 2000

Under Section 85 of the Financial Services and Markets Act 2000 (FSMA), unless covered by various exceptions, there is a general barring of ‘transferable securities’ offered to the public without the approved prospectus by the Financial Conduct Authority (FCA).¹⁵⁴ Any section of the public is included, and, under Section 102B of the FSMA, there is the ability to offer transferable securities to the public if there is communication in any form to any individual in the UK who

¹⁴⁸ Kenan DÜLGER “*The Companies Act 2006 in the United Kingdom and its Impact on the English Legal System*”, Law & Justice Review, Volume:V, Issue:1, June 2014, page 112

¹⁴⁹ Companies Act 2006, Sec. 755

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ Financial Services and Markets Act 2000, Sec. 85

presents sufficient information of the securities and the terms of the offer to enable the investor to decide to buy or subscribe to the securities. There is no requirement for a prospectus if a private company's shares are not transferable securities.¹⁵⁵ However, it is possible for directors to face criminal charges if they mishandle this they usually do not take chances in this area. If a private company's shares are 'transferable securities', various exemptions for the prospectus may still apply.¹⁵⁶

Under Section 21 of the FSMA, there are strict controls on verbal and written communications between potential investors.¹⁵⁷ For example, unless permitted under the FSMA regulatory regime, it is illegal to have 'financial promotions.' Financial promotions are any invitation or inducement to invest in shares.¹⁵⁸ Any financial promotion given to a potential investor who is not already an existing shareholder is likely to be illegal.¹⁵⁹ Documents can only be provided to a potential investor if it has already been approved by an 'authorized' person under FSMA.¹⁶⁰ This involves compliance with the FCA's rules as well as the code of practice applied to the 'authorized person.' The resulting documentation is likely to be quite complex and expensive.¹⁶¹

3.2.3 Exemptions for Offering of Limited Company's Shares through Equity Crowdfunding

3.2.3.1 Companies Act 2006

¹⁵⁵ Financial Services and Markets Act 2000, Sec. 102B

¹⁵⁶ Financial Services and Market Act 2000, Sec. 102A

¹⁵⁷ Financial Services and Market Act 2000, Sec. 21

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ Financial Conduct Authority, "*Financial Services Register*" (2016), <https://www.the-fca.org.uk/firms/financial-services-register> (accessed on 7 December 2015).

There are some exemptions under Section 755 of the Companies Act 2006 that are available for shares being offered to specific groups of people. Private companies strive to ensure that at least one of the exemptions apply.¹⁶² The exemptions that allow share issues can be found in Section 756 of the Companies Act 2006 and are as follows: existing shareholders, close family members of existing or former shareholders, existing employees, close family members of existing employees, former employees, an employees' shares scheme, or existing debenture holders of the company.¹⁶³ It is important to note that, in Section 756 of the Companies Act 2006, it is not permitted to issue shares to anyone who does not have an existing or former connection to the company. Section 756 oddly enough allows offers to close relatives but not to former shareholders or employees.¹⁶⁴

3.2.3.2 Policy Statement 14/4: The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media

The Financial Services and Markets Act 2000 established the Financial Conduct Authority (FCA) as the UK's capital market regulator. The FCA issued Policy Statement 14/4 which became effective in April 2014.¹⁶⁵ The Policy Statement 14/4 outlined the new regulations for equity crowdfunding. Under these new regulations, investors can invest in already established or new businesses by buying investments in non-listed equity securities or units in an unregulated collective investment scheme.¹⁶⁶ According to the FCA, equity crowdfunding is seen as a valid business model that already operates under existing law.¹⁶⁷ Nevertheless, the Policy

¹⁶² Companies Act 2006, Sec. 755

¹⁶³ Companies Act 2006, Sec. 756

¹⁶⁴ *Id.*

¹⁶⁵ Financial Conduct Authority, Policy Statement re: "*The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media – Feedback to CP13/13 and final rules*" (2015), <https://www.fca.org.uk/news/ps14-04-crowdfunding> (accessed on 7 December 2015).

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

Statement 14/4 does not contain prescribed regulations but instead introduces approaches that can be used to handle relevant issues. The rules do not hinder the applicability of the existing legislation.¹⁶⁸

Firms that promote unlisted securities through equity crowdfunding can only communicate with specific investors such as professional clients, venture capital or corporate finance contacts, certified sophisticated investors, and retail clients who certify they will not invest more than ten percent of their net investible financial assets in unlisted securities. Should retail investors not receive any advice, applicable tests will be given to ensure that investors perceive all the risks involved.¹⁶⁹

While the FCA limits investment for unsophisticated investors at no more than 10% of their net investible assets, they do not impose any limit on sophisticated and high net worth investors.¹⁷⁰ The offering of shares constitute a financial promotion which, according to the FCA, cannot be made to retail investors unless the promotion is approved by an FCA-authorized firm or if it falls under an exemption from the financial promotion regime.¹⁷¹ Therefore, either the Funding Portal needs to be authorized by the FCA or an authorized firm approves of the financial promotion. Conducting any regulated activity without having said authorization is a criminal offense.¹⁷²

3.2.3.3 Financial Services and Markets Act 2000

The Financial Services and Markets Act (FSMA) 2000 is an Act of Parliament that is most notable for its role in creating the Financial Conduct Authority (FCA) which is a judicial body assigned with the task of regulating the

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

financial services industry in the UK.¹⁷³ The primary purpose of the act was to set forth the regulatory objectives and guidelines under which the FCA would operate. The FCA regulates firms in the UK providing financial products and services to both UK and international customers.¹⁷⁴

The FCA will also be responsible for countering financial crime. The FCA is to have regulatory oversight of client assets, a role which entails the identification and mitigation of risks. The FCA Position Paper states that the FCA is to continue the Client Asset Units' drive for higher standards in safeguarding client money and will aim to build on the FCA's intensive and intrusive supervisory approach.¹⁷⁵ The emphasis in the area of financial crime is on credible deterrence.

According to the FCA, the definition of consumers cover retail consumers who buy financial products for their own use or benefit either directly or through a regulated firm; retail investors in financial instruments, and a wide range of wholesale consumers including: any regulated firm that buys a product or service on behalf of another person, any regulated firm acting as an agent, investors in financial instruments, regulated firms trading across markets, non-regulated corporates who buy financial products for their own use, and issuers who are looking to raise capital who then buy services or advice from investment banks.¹⁷⁶

The FCA's protection of consumers covers not only direct conduct with consumers but also those in relation to the duty of protecting retail

¹⁷³ Financial Conduct Authority, "*Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014*" (2015), https://www.handbook.fca.org.uk/instrument/2014/FCA_2014_13.pdf (accessed on 7 December 2015).

¹⁷⁴ Financial Conduct Authority, "*The Financial Conduct Authority : Approach to Regulation*" (2015), www.fsa.gov.uk/pubs/events/fca_approach.pdf (accessed on 8 December 2015).

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

consumers.¹⁷⁷ The FCA must look at the impact poor conduct in wholesale markets has on retail consumers, even if the link is indirect. For example, structured products that originate in investment banks but are sold in the retail market are considered part of the FCA's purview.¹⁷⁸

The FCA works closely on the same roles and responsibilities towards the consumer protection in financial products with the Financial Services Ombudsman (FOS) and the Financial Services Compensation Scheme (FSCS) which have been established by virtue of the FSMA.¹⁷⁹ There exist the memorandum of understanding between the FCA and these aforementioned governing bodies to facilitate co-operation between them.¹⁸⁰ For example, the FCA and the FSCS works together on contingency planning for potential future failings of existing firms. Additionally, information sharing mechanisms give the FCA the ability to use the information held by the FOS on the firms' treatment of their customers and the handling of their complaints.¹⁸¹

3.2.4 Principle of the Offering of Company's Shares

The UK statutory laws governing limited companies is the Companies Act 2006. The Companies Act generally divided the corporation into 2 types namely a private limited company and a public limited company similar to that of MBCA.¹⁸² The private limited company can be further divided into a limited company by shares and limited company by guarantee.¹⁸³ This thesis will focus on a limited company by shares as the latter can operate without share capital so that it implicitly cannot offer the shares for sale through Equity Crowdfunding.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² Companies Act 2006, Sec. 4

¹⁸³ *Id.*

3.2.4.1 Incorporation of a private limited company under the Companies Act 2006

The Companies Act 2006 has combined the provisions concerning private limited company and public limited company in the same place.¹⁸⁴ The private limited company can be incorporated under the Companies Act where the registration with the Company House is required. Once the registration is completed, the liability between the company as a juristic body and the investors as natural persons who have subscribed for shares during the offering and have become the shareholders will be separated.¹⁸⁵ The liability of shareholders is limited to the unpaid amount of share capital which is the same as a closely-held corporation incorporated under MBCA.¹⁸⁶ In other words, if the shares subscribed are fully paid for by the shareholders, they will not be liable to the company's creditors even if the debts are over the share capital.

3.2.4.2 Typical Offering of Company's Shares

The shares issued by a private limited company can only be sold to the subscribers of a close investors group who wishes to do business together even though a minimum shareholder in a private limited company can be only one natural person.¹⁸⁷ The private limited company is prohibited to offer the shares for sale to the public.¹⁸⁸

3.2.4.3 Exemptions for the Offering of Company's Shares in Equity Crowdfunding

¹⁸⁴ *Id.*

¹⁸⁵ *Supra* note 126. Page 44

¹⁸⁶ *Id.* Page 45

¹⁸⁷ Companies Act 2006, Sec. 7

¹⁸⁸ Companies Act 2006, Sec. 775

While the Securities and Exchange Commission released Equity Crowdfunding exemptions and monitors the fundraising in the US, the Financial Conduct Authority (FCA) is the key player for the same function in the UK as the capital market regulator. Similar to the JOBS Act, the FCA has acknowledged Equity Crowdfunding exemption by issuing the policy statement: “The FCA’s regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media (PS14/4)”.¹⁸⁹ This exemption allows a private limited company to offer the shares for sale to the public which is typically prohibited by the Companies Act 2006, but subject to the Financial Services and Markets Act 2000 (FSMA).

3.2.5 Protection of Investing Shareholders’ Rights in a Limited Company relying on Equity Crowdfunding

3.2.5.1 Pre-Offering Stage of Company’s Shares in Equity Crowdfunding

Unlike the JOBS Act, PS14/4 generally outlines and acknowledges the new fundraising mechanism available for a private limited company to raise funds by offering shares for sale through an online platform while the conditions for offering under the Companies Act 2006 and FSMA still apply in addition to the FCA’s rules. In other words, a private limited company relying on Equity Crowdfunding is still obliged to the existing laws applicable to the offering of shares for sale to the public. According to PS14/4, the requirements for relevant parties to Equity Crowdfunding are made available in general as the subjects are referred to as the “Firms” and “Client”.¹⁹⁰ Although the latter term is clear that it refers to the investors, the Firms can also be interpreted as the issuers and/or the Funding Portal.

¹⁸⁹ *Supra* note 186

¹⁹⁰ *Supra* note 166.

3.2.5.1.1 Issuer Requirements

Even though PS14/4 and other existing regulations governing Equity Crowdfunding do not specifically mention the issuers' concrete duties as those of the JOBS Act, it is the implied duty and good faith of the issuers to disclose the correct information and to make sure that the financial promotions are clear, fair and not misleading in terms of the nature and performance of the assets invested in and the exit opportunities for the investors.¹⁹¹

3.2.5.1.2 Funding Portal Requirements

The basic requirement is that the Funding Portal must be authorized and regulated by the FCA where the registration is required. As the intermediary, the Funding Portal's duty is to ensure that the investors have sufficient knowledge and experiences needed to understand the risks associated before entering into campaigns.¹⁹² The most important risk made aware according to the topic of PS14/4 is that the shares being offered are illiquid and hard to price as unlisted securities without a secondary market available which is defined by the FCA as "Non-readily realizable securities", including, without limitation to the lack of dividends, loss of investment and dilution. In this regard, the Funding Portal needs to apply an appropriateness test for retail clients to ensure that they understand the risks.¹⁹³

3.2.5.1.3 Restrictions on the Offering

The shares being offered are non-readily realizable securities, other than institutional investors i.e. corporate finance and venture capital. They shall not be offered to a retail client, unless he is certified as a high net worth

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ *Id.*

investor with an annual income in excess of GBP 100,000 or net assets of GBP 250,000, or certified as a restricted investor who has not invested in excess of 10 percent of his net assets in Equity Crowdfunding.¹⁹⁴ The outstanding exemption is that the rules allow a self-certified investor who is qualified as a sophisticated investor after having passed an appropriateness test arranged by the Funding Portal to invest as well.¹⁹⁵

3.2.5.2 During-Offering Stage of Company's Shares in Equity Crowdfunding

3.2.5.2.1 Issuer Requirements

Given no specific rule providing certain limitations on maximum funds to be raised through Equity Crowdfunding, the exemptions concerning the offering of transferable securities to the public under the FSMA prevails and applies to the issuers.¹⁹⁶ Under the normal circumstances subject to FMSA, the prospectus needs to be published if the shares are offered to the public. However, if the amount of shares offered is worth less than GBP 50,000 within a 12-month period, the prospectus can be exempted. This is where most of the issuers in Equity Crowdfunding take advantage of this exemption.¹⁹⁷ Therefore, there exists the maximum amount of fundraising that the issuers need to monitor after the first campaign has been launched similar to that of the JOBS Act. Notwithstanding, the number of Funding Portal that the issuers may use is not clearly limited unlike that of the JOBS Act where the issuers are required to launch their campaigns on only a single Funding Portal.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ Financial Services and Market Act 2000, Sec. 85

¹⁹⁷ Financial Services and Market Act, Sec. 86 and 87

3.2.5.2.2 Funding Portal Requirements

The Funding Portal has the duties to keep the investor informed of the campaigns' progress whether or not they are successful within the deadline. As the intermediary, the transfer of total funds raised from the investors for successful campaigns are supervised by the Funding Portal. Nevertheless, the specific requirements to have the escrow agent handling the funds are not clearly stated in the FCA's rules unlike that of the JOBS Act even if the escrow account is being widely used by the Funding Portal.

3.2.5.3 After-sale Stage of Company's Shares in Equity Crowdfunding

The after-offering stage under the regime of UK Equity Crowdfunding on one hand has more flexible restrictions on the resale of shares by the issuers without a 12-month period prohibition as specified by the US JOBS Act. On the other hand, the controlling authorities are in place and actively function to protect investors.

3.2.5.3.1 Restrictions on the Resale

The restrictions on the resale process of shares acquired through Equity Crowdfunding in the UK is far more friendly than that of the US since there is no prohibited resale period after the purchase. Hence, other than the typical restrictions on the offering for sale of the private limited company's share under Companies Act and FSMA which prohibits the advertisement and solicitation to the public, the investors may freely resell their shares to any specific transferee even though it would not be easy to do so due to the illiquidity. However, this does not mean that the investors would fully enjoy this advantage as the resale within 3 years can make them lose all tax incentives granted upon the purchase under the tax relief

schemes namely the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS).¹⁹⁸

3.2.5.3.2 Ongoing Reporting Requirement

According to the Companies Act 2006 and FSMA, the annual report filing rests on the listed public company and non-listed public company upon the initial public offering and other significant changes of the company details.¹⁹⁹ The private limited company, even if relying on Equity Crowdfunding, does not have any duty to maintain the ongoing report of any change in the company.

3.2.5.3.3 Controlling Authority

Equity Crowdfunding is regulated by the FCA and falls under the regime of FSMA where the retail investors are to be guarded under the principle of consumer protection. The Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Services (FOS) are the key authorities looking after them. This implies that that the concrete authorities that were promptly established under the FSMA were in response to the issues which may arise out of Equity Crowdfunding. FSCS is the compensation fund covering investment lost caused by fraud of the issuers. The maximum compensation payable by FSCS if the result of investigation conducted comes out in favor of the complainer can be as high as GBP50,000 per person per firm.²⁰⁰

FOS was specifically established with the main objective to settle the complaint between consumers and businesses providing

¹⁹⁸ CrowdCube, “*Tax Relief Overview – EIS & SEIS*” (2015), <https://www.crowdcube.com/pg/eis-seis-tax-relief-overview-43> (accessed on 14 December 2015).

¹⁹⁹ Companies Act 2006, Sec. 442

²⁰⁰ Financial Services Compensation Scheme, “*A guide to the Financial Services Compensation Scheme*” (2015), <http://www.fscs.org.uk/what-we-cover/publications/> (accessed on 14 December 2015).

financial services of its regime covering all businesses regulated by FCA including investment products like Equity Crowdfunding. It functions as a small court with inquisitorial power to conduct investigation when the complaint is filed by the investors who are private individuals suffering from financial loss.²⁰¹ Both FSCS and FOS are dependent on the government and are funded by the fees collected from the members who are authorized by the FCA.

3.2.5.3.4 Protection of Minority Shareholders' Right

In addition to the case law where the protection of minority shareholders' rights was adopted, the Companies Act 2006 firmly stated the provisions on unfair prejudice petition allowing any of the minority shareholders whose advantage has been taken by the unfairly prejudicial conduct of the majority shareholders to bring a claim against them. Again, this is not a claim against the company, but the defendant in this case is the individual majority shareholders who excessively exercises their controlling power to the extent that it unfairly jeopardizes the minority.²⁰² The Companies Act 2006 allows the court do grant various reliefs as it thinks fit. One of the most outstanding reliefs is that that court may order the majority to buy out the minority's shares at a reasonable price, if the circumstance indicates that they are no longer the friendly partners to one another. Furthermore, the FMSA also allows any private person who suffers loss from FCA's authorized businesses to claim for damages arising out of the breach of statutory duty.

²⁰¹ Financial Ombudsman Services, "*your guide to the Financial Ombudsman Service*" (2015), http://www.financial-ombudsman.org.uk/publications/guides_for_firms.htm (accessed on 15 December 2015).

²⁰² LexisNexis, "*Minority Shareholder Protection – Overview*", (2015), <http://www.lexisnexis.com/uk/lexispsl/disputeresolution/document/393747/58XG-2F51-F18B-7005-00000-00/Minority+shareholder+protection%E2%80%94overview> (accessed on 15 December 2015).

CHAPTER 4

PROBLEMS AND RECOMENDATIONS TO IMPLEMENT THE PROTECTION OF CROWDFUNDING SHAREHOLDERS' RIGHT

4.1 Overview of Laws concerning Equity Crowdfunding in Thailand

4.1.1 Backgrounds of Equity Crowdfunding

Thailand adopted the Equity Crowdfunding scheme from foreign sources which are similar to that of the US and the UK laws in order to achieve the same purpose of promoting financial support for the startups and SMEs due to the limited sources of funds in the emerging market.²⁰³ The reason to provide this financial promotion is that it is recognized by the Thai government that crowdfunding platforms will help build channels for inclusive economic growth for every level of company resulting in the improvement of competitiveness and the development of innovation including the increase of the employment rate.²⁰⁴ Finally, it will help to drive the economy on a large scale. Therefore, the SEC has enacted the notifications in support of this financial promotion to allow the private limited company which is the popular business organization for the startups to offer shares for sale to the public via an online intermediary.²⁰⁵

4.1.2 Public Hearing for Equity Crowdfunding

Before the SEC's enactment of notifications with regards to the introduction of Equity Crowdfunding as the new financial promotion for the startups

²⁰³ The Securities and Exchange Commission, "*Equity Crowdfunding : the Alternative Fundraising and Investment in the Digital Era*" (2015), <http://capital.sec.or.th/webedu/upload/file-09062015160156866.pdf> (accessed on 15 December 2015).

²⁰⁴ *Id.*

²⁰⁵ *Id.*

to the public, the public hearing to sound out the feedback from the stakeholders and concerning parties was held by the SEC in 2014.²⁰⁶ The purpose of this public hearing was to provide the framework of Notification No. TorJor. 7/2558 re: Regulations on Offering for Sale of Securities through Electric System or Network which has been enacted thereafter as a result of majority agreement to let the SEC implement such scheme. The main concept of ‘all-or-nothing’ was also clarified before it was implemented with other criteria to run the scheme from the beginning until the end including but without limitation to the license application, rights and duties and restriction of all concerning parties namely the issuers, Funding Portal, escrow agent and investors.

4.2. Laws concerning Offering of Limited Company’s Shares

4.2.1 Civil and Commercial Code

Unlike the UK Companies act and the US MBCA, the Thai CCC specifies merely the provisions concerning the private limited company whilst the provisions concerning the public limited company are specified in the Public Limited Companies Act. Section 1102 restricts the limited company from public offering including any solicitation thereof.²⁰⁷ Thus, the typical private limited company, which does not sign for Equity Crowdfunding via the Funding Portal, is not entitled to enjoy this financial promotion and has to rely on a limited source of funds should it find itself in need of capital.

²⁰⁶ The Securities and Exchange Commission, “*Public Hearing Document No. OrKorMor 39/2557 re: The regulations enactment on the investment promotion and control for SMEs via Crowdfunding*” (2015), <http://capital.sec.or.th/webapp/phs/upload/phs141766334539-2557.pdf> (accessed on 15 December 2015).

²⁰⁷ Civil and Commercial Code, Sec. 1102

4.2.2 Securities and Exchange Act B.E. 2535

The restriction on the public offerings of a private limited company is reaffirmed by Section 34 of the Securities and Exchange Act that offer the sale of newly issued shares by a limited company under the Civil and Commercial Code. Regardless of whether it is made by the limited company issuing such shares or by shareholders of such a limited company, it shall not be made in the form of a general offering or to the public at large unless it is exempted or complies with the rules, conditions, and procedures as specified in the SEC's notification.²⁰⁸

4.3 Laws concerning Offering of Limited Company's Shares through Equity Crowdfunding

Recently, the SEC has enacted the four Notifications with regards to the exemption for Equity Crowdfunding allowing the limited company to offer the shares for sale to the public namely: (i) Notification of the Capital Market Supervisory Board No. TorJor. 7/2558 Re: Regulations on Offer for Sale of Securities through Electronic System or Network; (ii) Notification of the Securities and Exchange Commission No. KorJor. 3/2558 re: Exemption from Filing of Registration Statement for Securities Offered through Provider of Electronic System or Network; (iii) Notification of the Capital Market Supervisory Board No. TorJor. 8/2558 re: Rules, Conditions, and Procedures For Offering for Sale of Shares by Shareholders of Limited Company; and (iv) Notification of the Securities and Exchange Commission No. KorJor. 9/2555 re: Definitions of Institutional Investors and High-Net-Worth Investors.

The main Notification that is directly involved with the operation and function of Equity Crowdfunding is the Notification of the Capital Market Supervisory Board No. TorJor. 7/2558. At the same time, the Notification of the Capital Market Supervisory Board No. TorJor. 8/2558 deals with the offering for sale

²⁰⁸ Securities and Exchange Act B.E. 2535, Sec. 34

of shares by shareholders in the limited company. The Notification of the Securities and Exchange Commission No. KorJor. 3/2558 exempts public limited companies offering the sale of securities through crowdfunding platforms from filing the registration statement and draft prospectus with the SEC. The Notification of the Securities and Exchange Commission No. KorJor. 9/2555 categorizes the investors who are qualified to invest via crowdfunding platforms by considering the sophistication and net worth income of such investors.²⁰⁹

4.4 Principle of the Offering of Company's Shares

Thailand has only 2 main types of companies: the private limited company, simply referred to as the limited company under the CCC, and the public limited company under the Public Limited Company Act B.E. 2535. Only the public limited company can be listed under the Securities and Exchange Act B.E. 2535. Unlike the UK Companies Act which has a private limited company by shares and a private limited company by guarantee, the CCC allows only a limited company by shares.²¹⁰

4.4.1 Incorporation of a Limited Company

Unlike those of the US and the UK where there is no minimum number of shareholders required to form a limited company which can only be one, the CCC requires at least 3 individual promoters upon subscription and 3 shareholders which can be the same persons as the promoters upon the registration of a limited company with the Department of Business Development, Ministry of Commerce.²¹¹ Basically, this kind of business organization is formed on the principle of freedom of contract where the parties wish to set up a separate legal entity to seek profits and share them together according to agreed upon terms. Similar to the closely-held corporation

²⁰⁹ *Supra* note 126. Page 72

²¹⁰ Civil and Commercial Code, Sec. 1096

²¹¹ Civil and Commercial Code, Sec. 1097

under the US MBCA and the private limited company under the UK Companies Act, the liability of shareholders in a limited company is limited only to the unpaid shared capital.

4.4.2 Typical Offering of Company's Shares

The limited company is prohibited from offering the shares for sale to the public under the CCC and the Securities and Exchange Act. Moreover, the advertisement for sale or offering for sale to the subscribers upon the incorporation including resale of company's share by the shareholders thereafter is restricted. The sale and resale can only be communicated through a close group of investors. In other words, it can only be sold directly between the transferor and transferee under an agreement where the share transfer instrument is also required. As a result, Thai law shares the same restrictions on the sale and resale of company's shares with those of the UK law and the US law.

4.4.3 Exemptions for the Offering of Company's Shares in Equity Crowdfunding

Besides the existing general provisions under the CCC and Securities and Exchange Act on the restrictions on the shares offered for sale by a limited company to the public, the Securities and Exchange Commission (SEC) as a financial regulatory established by virtue of the Securities and Exchange Act has announced the notifications providing exemptions for the offering for sale of shares issued by a limited company to the public through Equity Crowdfunding. Although these SEC's Notifications altered only in the offering of restrictions set forth in the CCC and Securities and Exchanges Act, they have totally changed the principle or a close corporation immediately as it turns out to be available for the public participation similar to a public limited company.

4.5 Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding

4.5.1 Pre-Offering Stage of Company's Shares in Equity Crowdfunding

The Equity Crowdfunding exemptions are separately available in the SEC's Notifications and only application to a limited company relying on Equity Crowdfunding. The others out of this investment promotion still have to comply with the same restrictions on the offering and resale of shares. Basically, the SEC's Notification recognizes 3 parties involved with the scheme specifically the issuers, Funding Portal, and investors. This is the same as those of the US and the UK.

4.5.1.1 Issuer Requirements

The issuers must be a duly registered limited company or a public limited company. The maximum amount of funds being raised through Equity Crowdfunding or the amount of the offering shall not exceed THB 20,000,000 in the first 12-month period.²¹² The campaigns can be launched again in the following year after the first 12-month period, but the total offering amount including the previous one shall not exceed THB 40,000,000 Baht in total.²¹³ Given these requirements, it seems that Thailand has adopted the concept from the JOBS Act. The duty of disclosure is also similar to that of the US as the issuers are obliged to disclose the correct information to both the investors and Funding Portal.

²¹² Notification of the Capital Market Supervisory Board No.TorChor.8/2558, Clause

7

²¹³ *Id.*

4.5.1.2 Funding Portal Requirements

The SEC's Notifications outline the very detailed requirements on the Funding Portal as if it was a regulated broker in the stock markets. It is, however, not as strict as that imposed on the broker. The Funding Portal must be a registered company under the law of Thailand with at least THB 5,000,000 of fully paid share capital and is also permitted to operate as an intermediary by obtaining a license from the SEC.²¹⁴ Similar to the UK, the Funding Portal shall ensure that investors are properly categorized as to the limit of the investment and that they have sufficient knowledge and understanding of the associated risks by arranging the appropriate quiz for assessment. There are also the professional courtesy provisions on the Funding Portal with regards to the operation.

4.5.1.3 Restrictions on the Offering

The offering can be made to the institutional investors, venture capital, private equity, specific or accredited investors, and retail investors.²¹⁵ The investment limit applies merely to the retail investors as they are restricted to invest not more than THB 50,000 per business of the same issuer and not over THB 500,000 in total for additional investment in other businesses from different issuers.²¹⁶ This rule is similar to those applicable to the retail investors in the UK and the non-accredited investors in the US.

4.5.2 During-Offering Stage of Company's Shares in Equity Crowdfunding

According to the SEC's Notifications, Funding Portal plays the most important role in this stage to monitor the process as the intermediary which stays

²¹⁴ *Id.*

²¹⁵ *Id.*

²¹⁶ *Id.*

closest to the investment promotion, whilst the SEC is not a direct regulator nor responsible to the investors.

4.5.2.1 Issuer Requirements

The issuers, once they have launched the campaigns, still need to comply with the limitation on the maximum amount of funds being raised through Equity Crowdfunding at THB 20,000,000 for the first 12-month period and the total THB 40,000,000 for other rounds. The duty of disclosure still continues throughout the process should there be any change in the company details or any other change of the business for the issuers. These are quite similar to the laws in the US and the UK.

4.5.2.2 Funding Portal Requirements

The Funding Portal is required to arrange the escrow to handle the fund remittance in case the funds need to be returned to the investors due to unsuccessful campaigns or to be transferred to the issuers in case of successful campaigns. The cooling-off period for the cancellation of investment by the investors shall be made available 48 hours before the deadline. More importantly, Funding Portal is also required to implement fraud protection for the investors in case it is to be believed that the information is falsely disclosed, if there lack of material content, or if there is any unfair prejudicial conduct by the issuers. If so, the return of funds to the investors shall be arranged within 7 days as of when the incident takes place. Unlike the fraud protection in the US where the FTC is a government unit, the FSCS and the FOB are independent entities in the UK.

4.5.3 After-Offering Stage of Company's Shares in Equity Crowdfunding

4.5.3.1 Restrictions on the Resale

The resale of shares acquired through Equity Crowdfunding in a limited company by the investing shareholders as well as the original shareholders can only be offered to specific or accredited investors for a maximum number of 50 persons within a 12-month period, institutional investors, or among the existing shareholders in the limited company.²¹⁷ The advertisement on resale is prohibited, unless it is a distribution of documents relating to the resale within a close group of transferees.²¹⁸ This seems to be in line with the resale restrictions imposed in the US. Unlike the flexible rules where the resale is not restricted, the tax implications will apply instead.

4.5.3.2 Ongoing Reporting Requirement

Basically, the duty to disclose information i.e. company details, financial reports, business progress, etc. to the investors by the issuers and Funding Portal after the campaigns have been completed may continue depending on the agreement between the issuers and the Funding Portal as to how long this information will be updated and available on the website.²¹⁹ The investors may seek for the same information directly from the issuers according to the fundamental rights of shareholders in a limited company to access business information. The duty on filing regarding the resale of shares by the shareholders is exempted if the offer is made to accredited investors at a maximum number of 50 persons within a 12-month period, institutional investors, or among the existing shareholders in the limited company.

4.5.3.3 Controlling Authority

Unfortunately, as the shares offered through Equity Crowdfunding do not fall under the umbrella of Securities and Exchange Act because

²¹⁷ Notification of the Capital Market Supervisory Board No. TorChor. 8/2558, Clause 2 (1)

²¹⁸ *Id.*

²¹⁹ Notification of the Capital Market Supervisory Board No. TorChor. 7/2558, Clause 36 (4) (Kor)

they are not the shares issued by a listed company, the SEC does not have jurisdiction on any dispute arising out of Equity Crowdfunding even though the exemption is granted by them. Apparently, there is no other financial regulator in Thailand providing fraud protection for investors unlike the FSCS and the FOB in the UK and the FTC in the U.S.. The jurisdiction of the Office of the Consumer Protection Board (OCPB) is quite questionable as to whether the investors are consumers and whether it should be a consumer case between the financial services provider and customers or a civil case between business partners.

4.5.3.4 Protection of Minority Shareholders' Right

There are no provisions directly stated in the protection of minority shareholders' rights under the CCC unlike that of the UK Companies act on the protection of company members against unfair prejudicial treatment where the term; 'company members', also represents any of shareholders. In other words, the CCC does not have any provision directly allowing the shareholders to bring a claim against one another as part of the concerned limited company. Although the shareholder may sue the director who is in breach of his duty causing damage to the company under the CCC, this implication will not apply to the shareholder who is not the director.²²⁰ It means that the minority shareholder whose right is jeopardized by the majority shareholder is only entitled to take action based on the principle of good faith and other related laws concerning tort and contract.²²¹

4.6 Analysis of Problems on the Protection of Investing Shareholders' Rights in a Limited Company relying on Equity Crowdfunding

The main purpose of Equity Crowdfunding is to avail an early-stage business confronted with a lack of capital. This even possibly extends to any other

²²⁰ Busara Jatejumnongjit. *"The Protection for Minority Shareholders in a Limited Company"*. Thesis for Master of Law (Business Law). Faculty of Law. Chulalongkorn University. (2000). Page 122.

²²¹ *Id.* Page 123.

businesses requiring financial support on account of the general application of the SEC's Notifications who wishes to raise more funds from the public via online platforms by offering the equity to the investors in exchange of their investment. Such investors will then become the stakeholders in the business. Given this scenario, most of the companies seeking funds are undoubtedly incorporated as a limited company to meet the fundamental requirements of the SEC that the issuers shall be either a limited company or a public limited company since the registration process of a limited company is much less complicated compared with the of public limited company. This can be confirmed by the statistic records of a number of limited companies that have been registered with the Department of Business Development.

Previously and as generally applied, the CCC and the Securities and Exchange Act do not allow a limited company to offer its shares for sale to the public, unless otherwise permitted by the SEC. Since the SEC's exemption allows a limited company to sell its shares to the public through Crowdfunding, it has changed the traditional concept of a limited company which had been maintained from the past under the assumption that it is a close business organization formed by the a small group of partners whose purpose is to engage the same business together and share the profit as well as loss arising out of such investment with each other. That is to say the company members are somewhat, although not in every case, related to the extent that they are able to contribute their personal resources i.e. fund, labor, or properties to the business. In other words, the limited company is typically a kind of business organization preliminarily formed on a basis of trust established within a close group of entrepreneurs. Thus, other persons are excluded from taking part in the start-up limited company.

Unlike a public limited company, a limited company does not have the aim to raise funds from the public by offering its shares for sale. Upon the establishment of a limited company, the parties will enter into the Memorandum of Association (MOA) where they subscribe to a company's shares and agree on the objectives of the incorporation. Furthermore, they can initially agree on how the company will be managed including the rules of the company to be written on the Articles of

Association (AOA) covering the Board of Directors, sale or transfer of shares, dividend distribution, and so forth.²²² In many cases, the shareholders agreement or memorandum of understanding between the prospect shareholders would be made separately prior to the MOA and AOA to ensure that the terms and conditions as discussed and agreed upon will be adopted accordingly throughout the company's formation and after it has been fully operated.

It is can be said that limited company is a form of specific contract and of specific purpose among its investors whose intentions are to bind themselves with the contractual term governed by the provisions of laws concerning limited companies. In other words, the expression of mutual intention to establish a limited company by the parties and to abide by such intention as the investors from the early stage of subscription and thereafter as the shareholders is a material condition of this kind of contract according to the principle of Freedom of Contract.²²³ The parties are also entitled to agree differently from the statutes even though provisions exist governing such matters insofar as it does not conflict with business ethics and public order.²²⁴ For example, the conditions of the transfer of shares, the capability of the director, the quorum of the board of directors and the shareholders' meetings, etc.

The investors who become shareholders in a limited company through Equity Crowdfunding would not have a chance to agree with the issuers. Specifically the original company members i.e. the shareholders and directors at the early stage. The SEC's Notifications specify that the issuers shall be a limited company which can be interpreted that the company must have been incorporated by the time it offers its shares for sale through the Funding portal. In addition, Equity Crowdfunding by itself is the mechanism that allows the corporate entity seeking funds to raise money by selling its shares to the investors online. Hence, this affirms that the incorporation must have been completed if it is ready to launch on the website.

²²² Civil and Commercial Code, Sec. 1099 and 1108

²²³ *Supra* note 6, Page 152

²²⁴ *Id.*

Obviously, on one hand, it does logically make sense that the issuers would not sell their absolute right to control and manage the company to the investors as the founders wish to secure the idea and potential business that they have built up by remaining the majority shareholders and directors. On the other hand, it would not be the investors' wish to manage the business and run the company on their own as what they have contributed are the funds, not labor.

However, once the Equity Crowdfunding is achieved and the investors have turned into the shareholders in a limited company regardless of the class of share acquired, they will be the minority shareholders in the company with less voting rights than that of the original shareholders or the founders. Given that most of them are retail or unaccredited investors even if with the quiz's result says they are qualified to invest, it is crucial to study the comparative aspects of foreign laws in order to address how they should be well protected from this investment according to the following issues.

4.6.1 Consumer Protection Perspective

Although Equity Crowdfunding is the investment platform, the investors in Equity Crowdfunding are treated as consumers under the UK and US laws, especially, the retail or unaccredited investors who are the main target source of funds, whilst the Thai SEC tends to treat them with the same standard as applied to sophisticated investors whom are assumed to be aware of the associated risks before investing in companies seeking funds via Equity Crowdfunding.

Above all, Thailand does not have any direct responsible authority who actively monitors and takes action in case there is any issue that arises from Equity Crowdfunding other than the SEC's Notifications imposed on the Funding portal for the procedures and requirements regarding the primary stage of fundraising which mostly ends when the campaign succeeds. Their responsibility is to make the updated information of the issuers available after the sale of shares. To retain no

effective sanction, save for the revocation of certificate and restriction, allows the campaign to resume operating should the Funding Portal fail to do so.

The duty to disclose the correct information of the business and company details by the issuers is also loosely implemented as the SEC assumes no responsibility for any misleading information or any misfiling. The sale of shares in a limited company and public limited company, regardless whether are listed or non-listed by virtue of SEC's exemption on Equity Crowdfunding, is not subject to the available sanction concerning filings under the umbrella of Securities and Exchange Act. In addition, the SEC does not scrutinize the information provided by the issuers since the disclosure is carried out on a basis of self-declaration under the supervision of Funding Portal.

In case investors suffer any damages caused by such misconduct of the issuers, the investors may have to pursue a civil remedy against the issuers on their own under the contract and tort laws set forth in the CCC. Unlike other similar cases including but not limited to directors' misconduct, fraud, embezzlement, etc., the SEC is entitled to take action when the investors are defined as Client according to the provisions concerning sale and offering for sale of shares under the Securities and Exchange Act.²²⁵

According to the UK Financial Conduct Authority (FCA), Investment-based Crowdfunding or Commercial Crowdfunding, to be precise, Equity Crowdfunding is regulated under the scope of FCA consumer protections since they are allowed by this new type of investment platform to invest in new or established businesses by buying shares which is termed by the FCA as "non-readily realizable securities" where they are not listed on regulated stock markets and carry significant risks and specifically when they are sold over the internet.²²⁶

²²⁵ *Supra* note 221. Page 124.

²²⁶ *Supra* note 166.

In October 2014, FCA introduced new consumer protection rules for the sale of this kind of security. The rules include marketing restrictions so that the issuers may only sell shares to retail consumers who meet certain criteria as set forth in the Conduct of Business Sourcebook (COBS), Chapter 4 re: Communicating with clients, including financial promotions.²²⁷ Briefly, those are the retail consumers who take regulated advice, or qualify with a high net worth, or sophisticated investors, or confirm that they as self-certified investors will invest less than 10 percent of their net assets in these types of securities. These look similar to that of the US under the JOBS Act and what Thailand has adopted in the SEC's Notifications, other than the more precise definition of accredited or sophisticated investors who are not subject to the restrictions on the amount of investment.

The FCA also plays a very active role in supervising the Equity Crowdfunding by engaging with the Funding Portal and the issuer's management. They monitor their websites and review monthly management information. This is to ensure that the consumers are properly protected with regards to allowing only the appropriate type of investors to invest according to the criteria of COBS. The financial promotions are clear, fair and not misleading in terms of the nature and performance of the assets invested in and the exit opportunities available for the investors.²²⁸

By virtue of Financial Services and Markets Act 2000 (FSMA), in addition to the FCA's active role in supervising the Equity Crowdfunding, the UK has another two authorities. These are the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Service (FOS) which have been established to protect the retail or self-certified sophisticated individual investor from the unwanted consequences of investing through Equity Crowdfunding due to misleading

²²⁷ Financial Conduct Authority, "Conduct of Business Sourcebook", (2015), <https://www.handbook.fca.org.uk/handbook/COBS.pdf>

²²⁸ *Supra* note 166.

investment advice, negligence management of investments, misrepresentation, or fraud caused by the Funding Portal or issuers.

The distinction of duty between these two authorities is that FSCS may automatically compensate the retail investors in case the Funding or issuers has failed and cannot return their investments or money owed based on the above grounds, whilst the FOS functions as a small court to mediate and rule the dispute under the inquisitorial approach as well as grant the rewards or other reliefs to the consumers.

Similar to that of the UK, the US Federal Trade Commission (FTC) and its Bureau of Consumer Protection has recently taken an active role in investor protection in Crowdfunding as they took legal action against Erik Chevalier in *FTC v. Chevalier* in the District Court of Oregon²²⁹. Although the case was filed for fraudulent crowdfunding caused by the misuse of money raised under the regime of Reward-based Crowdfunding, it is worth noting that the FTC also recognizes Crowdfunding in view of consumer protection under its scope of responsibility and function of its dual mission to protect consumers as well as promote competition²³⁰. It can be seen that whilst the US's SEC regulates the safe harbor or exemption for Equity Crowdfunding and supervises the process from the early stage of fundraising until the campaign is achieved as the FCA does in the UK, the FTC is proactively taking actions in implementing the same investor protection as the FSCS and FOS do.

Although Thailand has the Office of the Consumer Protection Board (OCPB), its power is still questionable as OCPB may not be capable to extend its protection to Equity Crowdfunding as there is no clear decision as to whether or not the investors should be treated as if they were consumers or if they do not deserve the

²²⁹ Jeffrey Becker. "*FTC ruling sheds some light on investor protection in crowdfunding.*" **Chicago Diary Law Bulletin**. Volume 161, No. 126, June 29, 2015, [www.smbtrial.com/RC1ACS162/assets/files/Documents/18273 LB reprint Swanson Jun29-2015.pdf](http://www.smbtrial.com/RC1ACS162/assets/files/Documents/18273%20LB%20reprint%20Swanson%20Jun29-2015.pdf) (accessed on 17 December 2015).

²³⁰ Federal Trade Commission. "*What We Do.*" <https://www.ftc.gov/about-ftc/what-we-do> (accessed on 17 December 2015).

associated risks that ordinarily arise out of investing. Therefore, adopting the concept of Equity Crowdfunding without concrete and specific authority like those of the UK and the US to look after the issuer may cause problems down the road that will need to be solved.

4.6.2 Shareholders Protection Perspective

According to the law a limited company is managed by the Board of Directors (BOD), and subsequently, the BOD is controlled by a meeting of the shareholders. This means that the meeting of shareholders may pass a resolution to elect or dismiss a board member. The meeting of shareholders can also pass any resolution to ratify the directors' action or approve the transactions in relation to the business.

When the meeting of shareholders considers and resolves the agendas, the majority voting is a standard criteria applied to conclude the decision of the meeting. The vote can be counted according to the number of shareholders physically attending the meeting with voting rights or the amount of shares being held by each shareholder in case a poll is requested by at least two shareholders under the CCC.²³¹ In other words, it is simply a rule of one share - one vote, which may also be agreed upon in the AOA.

Thus, this majority rule applied in favor of majority shareholders significantly prejudices the voting rights of minority shareholders since the majority always overcomes the minority and may pass any unfair or unfavorable resolution over the minority. More importantly, the retail investors who have become the shareholders by purchasing the shares according to the limited amount as specified by SEC through Equity Crowdfunding, will then automatically fall into the status of minority shareholder and the AOA initiated by the issuers who are the original

²³¹ Civil and Commercial Code, Sec. 1190

majority shareholders despite having no chance to otherwise agree to nor modify the terms earlier.²³²

4.6.2.1 Election of Directors

It is of course the wish of every shareholder to have influence over the company's direction since they have signed up as the investors by purchasing company shares. Given that the law does not prevent shareholders from taking a position in the board, they can play a proactive role in leading the business by becoming the directors or by nominating any other natural person to preside on their behalf.²³³ As the directors must be elected or dismissed by the resolution of the meeting of shareholders, the majority rule shall apply to the voting.²³⁴

In case the poll is requested by at least two shareholders or as specified by AOA to implement the one share - one vote rule by counting the amount of shares acquired by the shareholders attending the meeting to conclude a resolution, the majority of shareholders who are the same persons as the original group of issuers will definitely win the vote because of the larger amount of shares on hand compared to the very few held by the retail investors.²³⁵

Thus, this does not guarantee that the right and interest of minority shareholders will be prudently considered by the directors whom are nominated by the different group of majority shareholders. More importantly, the majority shareholders may take advantage of such criteria to promote only themselves onto the board or their relatives and overlook those nominated by the minority shareholders in order to take absolute control over the company. As a result, it is very unlikely that the minority shareholders will be treated fairly, since they do not have any meaningful influence over the company.

²³² Civil and Commercial Code, Sec. 1108

²³³ Civil and Commercial Code, Sec. 1150

²³⁴ Civil and Commercial Code, Sec. 1151

²³⁵ Civil and Commercial Code, Sec. 1182

4.6.2.2 Dividends

According to the CCC, the dividends can be distributed to the shareholders only if the company becomes profitable subject to the resolution of the meeting of shareholders on a fiscal year end basis at the Annual General Meeting of Shareholders (AGM).²³⁶ Upon the same condition, the interim dividends can also be distributed in case the BOD approves it during the fiscal year.²³⁷

The distribution of dividends also requires the majority votes of the meeting of the shareholders, it all depends on the majority shareholders whether they want to retain cash flow generated from the business growth or return them in the form of dividends to the investors in accordance with the portion of shares acquired. This condition also applies to the distribution of interim dividends by the BOD except that the BOD's resolution shall be passed by counting the major number of directors who agree with the agenda since each director has one vote. If the directors are also nominated by the same group of majority shareholders, it is difficult to expect a resolution to the conflict on the same matter from the meeting of the BOD when the meeting of the shareholders says no when they all are on the same side.

There is no statute allowing shareholders to claim the distribution of dividends under the CCC even when the company has become profitable and has cash positive growth. The expectation on the return of investment that the retail investors had when backing the campaign by buying the shares offered can be failed by the issuers. This can happen when the issuers are the majority shareholders as well as the directors and have absolute control over the company. That is to say that the issuers are in a position to easily take advantage of the investors via Equity Crowdfunding as the return on investment is subject to the issuers' discretion, especially if they did not promise nor guarantee the fruitful investment in the first place.

²³⁶ Civil and Commercial Code, Sec. 1201

²³⁷ *Id.*

Above all, withholding the distribution of dividends does not fall under the breach of directors' duty causing damage to the company as the money is still listed as a company's assets. More importantly, the CCC neither provides any remedy nor any available legal actions to be taken by the minority shareholders against the majority shareholders in the case of failing to pay dividends other than the revocation of illegitimate meeting in regards to the quorum, the process of holding a meeting, and voting.²³⁸

4.6.2.3 Class of Shares

There are mainly two classes of shares in a limited company: ordinary shares and preference shares in accordance with the CCC. The distinction between these classes of shares is the right attached to them. The ordinary share contains ordinary rights pertaining to the voting and receiving of dividends where the shareholders holding this class of share is entitled to one vote per ordinary share and annual dividends if the company is profitable subject to the resolution of the AGM. The right attached to preference share may vary on the terms of AOA with the different rights from that of ordinary share.²³⁹ As it is termed 'preference', the right attached may be greater or less than that of the ordinary share. Whilst the preference share may provide holders the guaranteed amount of dividends for example, 10 percent of the profit generated at the end of each fiscal year, the voting right can be less such as five preference shares per one vote or even none.

It is crucial for the investors to understand their right that they may enjoy before subscribing to differently classed shares being offered by the issuers in Equity Crowdfunding as there exists no regulation regarding which class of shares shall be offered by the issuers and to what extent the rights are attached to the preference share, if issued and offered for sale, shall be specified. Especially, in case they did not have a chance to agree with the contents of the AOA and the right

²³⁸ Civil and Commercial Code, Sec. 1195

²³⁹ Civil and Commercial Code, Sec. 1108

attached to preference shares once specified cannot be altered thereafter under the CCC.²⁴⁰

As a result, the issuers may arbitrarily impose whatever conditions they want on the preference shares and sell them to the investors in order to weaken the influence of minority shareholders over the control of company by limiting their voting rights. Although this may be arguable to some extent as the investors do not wish to take a key role in running the business, it does not logically make sense for people to give away their money without any recourse.

4.6.2.4 Dilution of Shares

The dilution of shares is also a major concern since it directly impacts the voting rights of minority shareholders who are the retail investors with limited economic capability. The dilution of shares is a result of capital increase under the CCC whereby the new shares are issued for sale to raise more capital.

In order to enable capital increases, a special resolution must be passed by the meeting of shareholders requiring three-fourths of the total share capital to be presented at the meeting. In other words, it requires 75 percent of the majority vote, which is higher than the majority votes required to pass a normal resolution at over 50 percent of the total share capital present at the meeting. Nevertheless, the majority of the shareholders who are the issuers in the crowdfunding company can still push forward the scheme.

Although the CCC provided the pre-emption right or the right of first refusal for the original shareholders including minority shareholders to buy the newly issued shares in order to secure the same portion of shares and voting rights, the retail investors are unlikely to spend more money in doubling the acquired shares especially if the company is not profitable and there is no guarantee on the

²⁴⁰ Civil and Commercial Code, Sec. 1142

distribution of dividends. Even if they wish to do so, the SEC's Notification still limits the maximum amount of 50,000 Baht for a purchase of shares in each crowdfunding company. Hence, if they have fully invested in accordance with the limit, they are not entitled to buy more newly issued shares in response to the capital increase.

Given the above scenario, the portion of shares and voting rights of minority shareholders will gradually be diluted every time the capital is increased.²⁴¹ Eventually, the minority shareholders power and influence will fade from the company even though they are still holding the same amount of shares.

4.6.2.5 Conflict of Interest and Related Party Transactions

A related-party transaction is a business deal or arrangement between two parties who are joined by a special relationship prior to the deal. For example, a business transaction between a major shareholder and the corporation such as a contract for the shareholder's company to perform renovations to the corporation's offices, would be deemed a related-party transaction. The original shareholders are also the majority shareholders and the directors of the limited company raising funds via Equity Crowdfunding. The crowd investors who then become the minority shareholders in such a company by purchasing the shares could easily be taken advantage of as they are not eligible to control nor manage the business operation.

This conflict of interest, if conducted by the directors, could be subject to a lawsuit brought on by the stakeholders which could be any of the shareholders against such directors.²⁴² However, it is merely a civil remedy and time consuming litigation with additional cost that the shareholder must bear in advance

²⁴¹ Civil and Commercial Code, Sec. 1222

²⁴² Civil and Commercial Code, Sec. 1169

without any guarantee that it can finally be recovered as the result depends on the court's discretion.

4.6.3 Liquidity and Secondary Market

The SEC's exemption altered the concept of a limited company by enabling the sale of shares issued by a limited company to the public similar to the public offering in public limited company. However, such an exemption does not provide an exit for the shareholders to resell their acquired shares in the open market unlike those bought in the stock exchange. Thus, the transfer of shares in a limited company still falls under the typical regime of the CCC where the transfer of shares entered into a name certificate shall be effective by executing the share transfer instrument and subsequently being registered on the share registration book of the company book.²⁴³ In addition, the advertisement for both the first sale by the issuers and the resale by the investors are prohibited.²⁴⁴

According to the SEC's Notifications, the shareholders may resell their acquired shares of a limited company by virtue of this financial promotion specifically to less than or equal to 50 accredited or sophisticated investors within a period of twelve months, or to institutional investors, such as commercial banks, venture capital, private equity, or to original shareholders of the company i.e. the founders and other investors who have joined the campaign and have become shareholders for the project after it was launched on the website.

As a result, there is not really a proper exit available by virtue of the CCC for the shareholders or retail investors. when the business does not perform well or is being financially taken advantage or jeopardized under direction of the majority shareholders who are the founders and business owners and who play a key management role on the board. On the other hand, if the company is so profitable, it

²⁴³ Civil and Commercial Code, Sec. 1129

²⁴⁴ Civil and Commercial Code, Sec. 1102

is worth noting that the CCC does not allow the company to buy back shares from the shareholders as a limited company is prohibited from holding its own issued shares, even if this could possibly be the simplest exit because the founders do not have to spend their personal funds to buy back shares from the retail investors.²⁴⁵

4.6.4 Securities Fraud

4.6.4.1 False Statement and Misleading

It is unpreventable that whilst the Equity Crowdfunding provide the great benefits to the growth of economy, there is still the loophole for the criminal to take advantage of this online open fundraising scheme as the campaigns attract the crowd investors merely by the presentation on the website and most of the crowd investors decide to fund such campaign immediately without verifying those information and even the physical business address and operation of the issuer.

In 2015, the US SEC prosecuted the first case of fraud to take place via a Crowdfunding portal. A Texas-based petroleum company named Ascenergy had raised USD 5 million from 90 contributors on at least four Crowdfunding portals. Ascenergy insisted it had been collecting funds to drill oil wells using leases that had already been assessed and secured. This was a clear case of fraud, as no leases had been secured.²⁴⁶ The firm insisted that one of its employees had evaluated the leases but when this claim was investigated, it emerged that no such evaluations had taken place and that this person was not even employed by the company.²⁴⁷ Furthermore, he had not given Ascenergy permission to use his name or his résumé to raise funds. The company had lied and omitted information in order to

²⁴⁵ Civil and Commercial Code, Sec. 1143

²⁴⁶ U.S. Securities and Exchange Commission , "*Securities and Exchange Commission v. Ascenergy LLC et al*". Litigation Release No. 23394 / October 28, 2015, , Civil Action No. 2:15-cv-01974-GMN-PAL (D. Nev., October 13, 2015), <https://www.sec.gov/litigation/litreleases/2015/lr23394.htm> (accessed on 17 December 2015).

²⁴⁷ *Id.*

mislead its investors and give itself the appearance of being a legitimate outfit, an image which the portals and the public readily believed.²⁴⁸

Noted by The Commission were also Ascenergy's false claims to be in co-operative agreements with a number of legitimate firms and its use of these companies' logos on its website, all of which was done without permission. Ascenergy assured its financial backers that they were making a 'low risk' investment and held 'liquid' shares in the company; neither of these claims were valid.²⁴⁹ The mastermind behind this fraudulent operation, who almost avoided prosecution, spent the overwhelming majority of the cash on 'personal expenses', in the US SEC's words.²⁵⁰ The US SEC used the same parts of the federal securities laws that it has been citing for decades in order to file charges of fraud against Ascenergy.²⁵¹ The owners of Crowdfunding portals are expected to proactively prevent fraudulent activity on their website - this has been clarified by the SEC. The Commission has also been unequivocal in its position that Crowdfunding transactions are fully subject to the anti-fraud sections of securities legislation.²⁵²

Despite this, the Thai SEC is unable to take the same proactive action as its US counterpart as described above, in cases where the issuer is a limited company, even if it falls under the remit of the SEC's Notifications. The reason for this is that a limited company selling shares to the public or sourcing investors via Equity Crowdfunding is not categorized as a listed public limited company, according to the Securities and Exchange Act B.E. 2535, which is the Act that allows the Thai SEC to prosecute cases of fraud. Seeing as the filing and prospectus are also considered exempt, false claims are difficult to identify unless there is a thorough investigation. This could become an increasingly serious problem, therefore an

²⁴⁸ *Id.*

²⁴⁹ *Id.*

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² *Id.*

authority should be set up with the specific purpose of dealing with fraudulent activity relating to Equity Crowdfunding.

4.6.4.2 Misuse of Fund

Upon launching the campaigns through the Funding Portal, the issuers are subject to the disclosure requirements under the SEC's Notifications to ensure campaign transparency by using a fair, clear, and not misleading approach towards the information given by issuers in soliciting the investors to fund the company in return for its shares. The pitch shall generally include the company history, business plan, management profiles and, the most important thing, the objective of the fundraising which will be utilized in the course of business.

The Funding Portal is also obliged to ensure that the disclosure requirements are duly complied with by the issuers under the SEC's Notifications which have been specified in a very detailed manner regarding the professional standard of online platform providers as the Funding Portal is also deemed to be an underwriter on the more flexible rules applied unlike ordinary brokers of a similar nature in the stock market.

Additionally, the SEC's Notifications also extend the duty of Funding Portal to assess and evaluate the investors' background and their fundamental knowledge of investments, including the duty to warn investors of the associated risks for investing in Equity Crowdfunding. The return of funds to the investors as a fraud protection scheme also applies in case the Funding Portal finds that the issuers disclosed false information or behaved unfairly.

It seems that the issuers and the intermediaries in Equity Crowdfunding are somewhat well covered by the SEC's Notifications from the primary stage of fundraising throughout the campaigns' accomplishments. However, the post-fundraising stage as of when the investors have become the shareholders does not seem to be very effective as the Funding Portal is no longer officially obliged

to perform its duty after the transactions have been completed. Thus, it turns to be the direct liability among a limited company, its directors and shareholders in case any dispute arises.²⁵³

Once the shares are sold and the funds have been raised from the investors and placed in the company's bank account, they should be used for the prescribed purpose of the fundraising and for ordinary business overhead according to the pitch or campaign as proposed in the first place. Notwithstanding, since the majority shareholders controlling the BOD whose members are the same people as those of the group of founders or business owners, the funds can be used by any means they desire due to the fact they have absolute power when it comes to controlling the company.²⁵⁴ In practice, they can even legally pass any resolution of the meeting of shareholders or ratify or approve the BOD's action for all kinds of transactions related to conflict of interest as long as they can claim that these do not cause damage to the company nor the right of other shareholders.²⁵⁵

²⁵³ Civil and Commercial Code, Sec. 1169

²⁵⁴ Civil and Commercial Code, Sec. 1169

²⁵⁵ Civil and Commercial Code, Sec. 1151

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Given that the limited company is established by investors who are in mutual agreement to do business together, seek profits, and share what they have earned with each other even if their liability as the shareholders are limited only to the unpaid share capital, it should be acceptable to say that this kind of business organization is formed on the principle of the freedom of contract where the investors are entitled to agree on the terms based on their freewill as long as they are not in conflict with public ethics and civic order.

This means that they could even agree to alter the existing provisions of the law applicable to the shareholder's agreement and the company's Articles of Association. In other words, it is a contractual relationship formed between the investors who have a chance to negotiate the terms and conditions at an early stage of incorporation. That is to say that, to some extent, they all basically have equal bargaining power in this deal.

A limited company is set up by a small group of investors in order to fund the business in exchange for the company's shares as the limited company is a separate entity with separate liability from the individual investors whose liability is also limited to the unpaid share capital. In other words, the shareholders are not liable in excess of the funds they have already agreed to invest in the shares. However, this small group of shareholders may not have strong enough economic backgrounds to fund the business at the start-up stage or during the growth period.

Therefore, Equity Crowdfunding as the financial promotion mechanism provides an opportunity for the business in an emerging market to raise the funds on the internet where the shares issued shall be offered in exchange for the funds injected

by the investors. Simply stated, it is the offering for sale of the company's shares on the internet which has to be done via the regulated intermediary otherwise known as the Funding Portal. Given that the company law typically prohibits a limited company to offer the shares for sale to the public, Equity Crowdfunding is the exception enacted to promote more flexible access to the source of funds for the limited company.

The Equity Crowdfunding exemption has totally changed the principle of limited company since it turns a closely-held corporation into a publicly-held corporation, even if its legal status remains unchanged as a limited company and the laws concerning limited company are still fully and effectively applied to the corporate entity and legally outline the relationship and liability among all parties involved. This means that the directors and shareholders in a limited company abide by the same rules under the same laws even though the offering for sale of shares through Equity Crowdfunding turns them to be an open corporation by allowing the new shareholders to participate in the operation.

Notwithstanding, it is obvious that the original shareholder of the majority groups do not wish to lose control of the business they have initiated even if they need to be funded from them by giving the company's shares in return. As a result, it is apparent that the issuers are trying as much as they can to raise the highest amount of funds they would need in return of the smaller portion of shares being offered. In this regard, most of the issuers offer the smallest portion possible to the extent that the investors would not be able to effectively use their voting right in the shareholders' meeting. Also, many of the issues even offer the shares without voting rights attached.

Given that there is no secondary market for the limited company's shares acquired through Equity Crowdfunding, it makes it difficult to make the shares illiquid and even harder to price. The return of investment is also hardly to be expected or it could even be a loss of investment. Other associated risks are to be considered, especially fraud and unfair prejudicial conduct of the issuers as the

majority taking control of the company through the meetings of shareholders as well as the board of directors ability to easily jeopardize the right of minority.

It is undeniable that the associated risks on the crowd investors who are the main target source of funds in Equity Crowdfunding prevent this financial promotion from achieving success as the mechanism to provide SMES with the more flexible sources of fund will eventually turn to affect the issuers because nobody would want to take such risks. Therefore, the measures to protect the investors and the minority shareholders need to be appropriately implemented in addition to the existing protections under the SEC's Notifications and the CCC in response to the success of this fundraising scheme.

The comparative study in this thesis demonstrates that, although the rules concerning Equity Crowdfunding according to the SEC's Notifications in Thailand share similar implications with those of the US and the UK starting with the early stage of fundraising until after the campaigns goals have been reached, it seems that the US and UK have enacted the Equity Crowdfunding exemption for a limited company based on the concrete grounds of more tightened limited company laws than that of Thai laws taking into account investor's and shareholder's protection by the time this kind of financial promotion was introduced.

That is to say that they considered the aspect of consumer protection applicable to the investors in Equity Crowdfunding. Meanwhile the controlling authorities are in place and are functioning proactively to protect investors and the principle of the minority shareholder's right to protection is well recognized by both the statutory law and case law. Hence, these are worth noting towards the legal dynamics of Thailand Equity Crowdfunding.

5.2 Recommendations

In light of the above problems on the protection of shareholders' rights, in other words, the retail investors' rights in the post-stage Equity Crowdfunding after

they have backed the campaign by buying the shares and become the shareholders in a limited company, the recommendations in view of the comparative study of the UK and US laws that Thailand should adopt and implement are as follows.

5.2.1 Controlling Authority

Although the SEC has imposed the fundamental rules applicable to Equity Crowdfunding along with the exemptions, it seems that the SEC does monitor this kind of investment platform from a distance as the core responsibility to take action has mostly been shifted to the Funding Portal from the early stage of ensuring that clear, fair, and not misleading information is provided by the issuers throughout the returning of funds pledged by the investors if such a situation occurs.

Despite this key role given even though it is not as strict as that of the typical brokers regulated on the stock markets, the most effective sanction under the SEC's Notifications should the Funding Portal be in breach of duty is simply the revocation of license. Given the Funding Portal as a private commercial enterprise is also making profit out of successful campaigns (basically through a lump percentage basis of the total funds having been raised regardless of those receivable from the issuers or investors), the more it allows the campaigns to complete, the more money they are going to make.

Thus, it is quite doubtful if the Funding Portal will function properly as the professional intermediary without conflict of interest. The government authority should play a more efficient role in defining the Funding Portal in regards to law enforcement and the protection of shareholders. This should happen especially because minority shareholders who are retail investors have the least amount of bargaining power when it comes to the vote.

According to the UK law, FCA functions as the regulator for Equity Crowdfunding with an aim to protect the consumers by considering more than 70,000 regulated businesses on the list including the issuers and Funding Portal whether they

meet prudential standards that reduce the potential harm to the industry and consumers, if they fail.²⁵⁶

In this regard, the FCA is not a government body and is instead funded by the fee paid by the firms it authorizes. In other words, these firms are those who want to be registered with and authorized by the FCA to enhance their creditability as well as to receive a permission to trade.

In addition to the FCA, since Equity Crowdfunding platform is authorized by the FCA, the shareholders can make a claim to the FOS if they believe that they are treated unfairly. The FSCS also provides redress to the shareholders in case the platform (i.e. both the issuers and the Funding Portal) fails due to less than prudential standards performance and fraud. In other words, there is at least a guarantee for the shareholders that their investment is protected by these independent entities whose responsibility is not only to monitor the platform, but also proactively take actions when the issues concerning shareholders' rights arise.

In the US, the FTC as the government authority is the core organization directly responsible for consumer protection. Although the FTC's role in Equity Crowdfunding is ambiguous whether this platform specifically falls under the umbrella of the Federal Trade Commission Act, the FTC has seriously taken a step into Crowdfunding according to the first case filed against the issuer under Reward-based Crowdfunding with the remarkable justification in *FTC v. Chevalier* that:

“Many consumers enjoy the opportunity to take part in the development of a product or service through crowdfunding, and they generally know there's some uncertainty involved in helping start something new,” said Jessica Rich, Director

²⁵⁶ Financial Conduct Authority. "About us." <http://www.fca.org.uk/about> (accessed on 7 December 2015).

of the FTC's Bureau of Consumer Protection. "But consumers should be able to trust their money will actually be spent on the project they funded."²⁵⁷

Given the above justification, despite the fact that this is a case of reward-based investing, it is presumable that the same standards would apply to the Equity Crowdfunding on an analogy basis taking into account the FTC's aim to eliminate the misuse of funds being raised from the crowd regardless of their level of sophistication. It is not about the poor performance of business as that could have been foreseen by investors as part of the risk that they were willing to take. Instead it is the dishonesty and distortion of the primary objectives proposed to solicit the financial support. As a result, the implication should be to eventually promote the protection of shareholders' rights.

In summation, Thailand should also introduce the same concept of consumer protections similar to the UK and US approaches with the aim to eventually promote Equity Crowdfunding. This will encourage the crowd to invest when they feel that they have certain safeguards and are not left behind in this economic promotion scheme. This is important because most of these campaigns try to raise the majority of funds from the middle-class.

5.2.2 Mandatory Provisions of Articles of Association

Since investors will not have a chance to negotiate with the issuers in the first place upon incorporation when the founders or original shareholders agreed on the terms of the AOA or even that of the shareholder agreement, the investors, once they subscribe for the shares, will have to automatically comply with all terms in the effective AOA. That is to say that the investors as the minority shareholders will find it difficult to negotiate with the original majority shareholders when trying to provide themselves with appropriate protection thereafter due to the insignificant

²⁵⁷ *Supra* note 140.

number of acquired shares. Hence, they can be easily excluded from the benefits of a successful investment by the founders.²⁵⁸ In light of this problem, mandatory provisions should be implemented in the AOA of the issuers to restrict the extended regime and vague interpretation of the prevailing principle of Freedom of Contract under the contractual approach to the AOA as follows.

5.2.2.1 Preferential Right

Generally, the shares issued by a limited company are divided into two classes, namely ordinary shares and preference shares. In many cases, preference shares contain no voting rights or aggregated voting rights of a certain amount of shares such as 5 preference shares per 1 vote. The holder of preference shares may be entitled to receive a guaranteed portion of the dividend, say 10 percent of the share capital already paid up at the distribution date and prior to the holder of ordinary shares. However, such right attached to preference shares depend on how it is tailored according to the terms of the AOA based on the principle of freedom of contract.

Without the provisions of the CCC to guarantee that the favorable right to receive dividends must be attached with preference shares, the issuers may neglect to do so as they can merely state in the pitch that the campaigns have potential investment returns, whilst the preference shares issued for sale silently contain unfavorable rights. Therefore, in case the preference shares are offered by the issuers via Equity Crowdfunding, the AOA should clearly state how much percent of the dividend they may enjoy.

²⁵⁸ Hu Ying. *"Regulation of Equity Crowdfunding in Singapore"*. Working Paper. Centre for Banking & Finance Law, Faculty of Law. National University of Singapore. 21 March 2015. Page 61

5.2.2.2 Group of Shares

In addition to classification, the shares issued by a limited company can also be divided into as many groups as it is agreed upon in the AOA. Normally, the shareholders who are on the same side will stay in the same group to secure bargaining power against the other group. In practice, this is a typical arrangement in a joint venture company where there are two groups of parties doing business together or in a multi-national corporation where the groups of shares are divided according to the holders' nationality. The reason behind this grouping is to set the conditions on decision making which might include the formation of the quorum of meetings, nominating the directors, passing the resolutions, etc. For example, the quorum of the meeting of shareholders shall be formed only when Group A and Group B shareholders present at the meeting and the resolution shall be passed by the majority of votes of both groups.

This mechanism is very useful in terms of providing protection for the investors who are the minority shareholders in a crowdfunding company if they could be put together in the same group under the condition that their participation is required for significant matters. These matters include their investment i.e. the distribution of dividends, sale of majority shares to the third parties, approval of related transactions where there may be a conflict of interest like a loan to a director.

5.2.2.3 Tag-along Right

A tag-along term refers to a corresponding right entitling certain minority shareholders to participate in a sale by the other majority shareholders at the same time and at the same price for each share.²⁵⁹ In the event

²⁵⁹ Ian Ivory and Anton Rogoza. *"Drag along and tag along provisions: a Russian and English law comparison."* Practical Law. A Thomson Reuters Legal Solution. <http://uk.practicallaw.com/5-504-3676> (accessed on 2 December 2015).

that the founders or majority shareholders want to abandon the company where a campaign is hosted for Equity Crowdfunding thereafter regardless of successful investment, this provision will ensure the investors who are minority shareholders are not left behind. In other words, they are also allowed to leave on the same terms in a qualified sale of the company's shares initiated by the majority shareholders.²⁶⁰

Because there is only a limited, if not nonexistent, secondary market as defined by FCA as Non-readily Realizable Securities the shares bought from the issuers become illiquid and hard-to-price securities.²⁶¹ This right is applied in favor of the minority shareholders whose shareholding is even less liquid than that of the majority shareholders.²⁶²

5.2.3 Minimum Shares Offered and Share Repurchase

According to the provisions regarding limited companies set forth in the CCC, the meeting of shareholders may be summoned by the director or the resolution of the meeting of the BODs for both the AGM and the EGM. The shareholders may call for the meeting on a condition that they have to have the aggregated amount of shares of at least 20 percent of the share capital. Given this condition, the issuers may freely design the highest share price with the fewest possible amount of shares offered for sale via Equity Crowdfunding (such as less than 20 percent of the share capital) to make it legally impossible for the investors to hold a meeting.

Obviously, this advantage is an advanced safeguard for the business owners who do not want to lose control of the company, but it also jeopardizes other shareholders' rights to participate in the business that they have invested in. Thus, the minimum amount of shares offered under this investment scheme should be

²⁶⁰ *Supra* note 259. Page 75

²⁶¹ *Supra* note 166.

²⁶² *Supra* note 261

introduced to enable the minority shareholders to monitor their investment, even if they may not be able overpower the majority ones.

Unlike the UK Companies Act 2006, given that the CCC does not allow a limited company to hold its issued shares, it would not be possible for the issuers to use the share buyback as an amicable exit in case the business becomes successful and retains enough profit in the form of positive cash flow. The shares repurchased by a company can make the shares acquired by the investors more liquid because of the lack of a secondary market available and due to the fact that advertisement is prohibited so it is difficult to resell their shares to other parties.

In this regard, the founders do not need to spend their own money to retrieve absolute control back from the crowd investors and it also saves taxes instead of using the dividends receivable from the company to buy the shares back. Furthermore, it encourages the investors to receive the investment return sooner in the form of capital gains rather than waiting for dividends. Dividends are subject to the discretion of the majority shareholders and management and may never be paid, even if the company is profitable.

5.2.4 Shareholders' Fiduciary Duties

Obviously, there exists fiduciary duties of the directors in managing the company, namely, duty of loyalty and duty of care that must be exercised in an appropriate manner as the company's representatives have already set forth in the CCC. However, those of the controlling or majority shareholders to the minority shareholders are not recognized. As a result, the shareholders in a limited company do not have to exercise such fiduciary duties with each other.²⁶³

The only applicable legal principle that may be used in place of the shareholders' fiduciary duties is the general principle of good faith in the sense that

²⁶³*Supra* note 221. Page 122.

the majority shareholders shall not cause damage to the minority shareholders in exercising their rights.²⁶⁴ Notwithstanding, the recognition of minority shareholders' protection wherein their rights shall not be abused by the majority shareholders do exist under the jurisdiction of the UK and the US.

In the US, many precedents held by the Supreme Court confirm that the fiduciary duties among shareholders in a limited company do exist and that the controlling or majority shareholders shall not exercise their power to jeopardize the rights of minority shareholders.²⁶⁵ This is because the trust and confidence are the essential elements of a limited company taking into account the nature and scale of organization so that the shareholders substantially owe each other the same fiduciary duties as the business partners owe to one another.²⁶⁶ That is to say that they are obliged to deal fairly, honestly, and openly based on the duty of disclosure to secure transparency.²⁶⁷

The court further remarks that the directors as well as the shareholders in a limited company must discharge their responsibilities in compliance with the strict good faith standard as a close corporation with illiquidity of investment where the minority shareholders cannot easily resell their shares as an exit and may be trapped in a disadvantaged situation unlike those in the stock markets.²⁶⁸ In case any of the shareholders, even if he is the minority one, intentionally causes damage to the company and other shareholders, by voting or omitting to vote in favor of the business, it is held that said shareholder is in breach of his fiduciary duty of utmost good faith and loyalty.²⁶⁹

²⁶⁴ *Id.* Page 123

²⁶⁵ *Id.*

²⁶⁶ *Donahue v. Rodd Electrotpe Co. of New England, Inc.* 1 Mass. App. Ct. 876 (1974)

²⁶⁷ *Cressy v. Shannon Continental Corp.*, 177 Ind. App. 224, 378 N.E.2d 941 (1978)

²⁶⁸ *Supra* note 141. Page 839.

²⁶⁹ *Id.* Page 840

The fiduciary duties owed by the majority shareholders to the minority shareholders in a limited company is also affirmed by the court. It is held that the self-interest of these two must be balanced and determined whether that of the minority shareholders are jeopardized by the majority shareholders so as to favor themselves, unless they can demonstrate a legitimate business purpose as the least harmful course of action to the minority shareholders' interests and there is no other option prevails.²⁷⁰

The UK law recognizes the protection of minority shareholders' rights where the power of the majority shareholders is limited by the express statutory law and case law.²⁷¹ The common law rights apply in case the majority shareholders pass a special resolution to alter the AOA in bad faith to exclude the minority shareholders from the favorable terms that previously existed. The minority shareholders ask the court to suspend such alteration unless it is proved that this controlling power is bona fide exercised for the benefit of the company as a whole.²⁷² More importantly, the majority shareholders are not allowed to take advantage of the minority shareholders by passing a resolution involving fraud on the minority. For example, expropriation of the company's property under self-dealing transactions or expropriation of minority's shares by alteration of the AOA.²⁷³

On the statutory limitations of majority shareholders' power, the Companies Act 2006 provides specific protection for the minority shareholders allowing them to seek relief from the court. The outstanding provision of the Act is set forth in Section 994 and 996 for unfair prejudicial petition allowing the minority shareholders to take the majority shareholders to court when they were made the

²⁷⁰ Wilkes v. Springside Nursing Home, Inc. 370 Mass. 842, 353 N.E.2d 657 (Mass. 1976)

²⁷¹ Zipora Cohen. "Fiduciary Duties of Controlling Shareholders: A Comparative View." 12 U. Pa. J. Int'l L. 379 (2014). page 281., <http://scholarship.law.upenn.edu/jil/vol12/iss3/2> (accessed on 2 December 2015).

²⁷² *Id.* page 381

²⁷³ *Id.* page 381

victim of unfairly prejudicial conduct from the majority shareholders, which shall be emphasized in 5.2.5 below.

Since the SEC's Notifications on exception for Equity Crowdfunding have changed the concept of a close corporation of a limited company by permitting the third parties to participate in the business as the company's shares can be publicly sold on the online platform, Thailand should adopt the principle of shareholders' fiduciary duties and transform it to a specific statutory concerning limited companies to better protect the investors who are the minority shareholders. This would be a major improvement from the vague provision on general principle of good faith for universal interpretation.

5.2.5 Court Claim against Majority Shareholders

Generally, the claims raised by any of shareholders under Section 1169 of the CCC arises from the breach of directors' duty. In other words, it is a lawsuit filed against any director who has caused damage to the company and such court action is taken by a shareholder on behalf of the company subject to the condition that the company by other directors neglect to do so. Since the court action can be taken merely against the directors, it does not enable the shareholder to take legal action against the other shareholders, even if the damage is caused by him.²⁷⁴

As a result, the majority shareholders may in any way exercise their power to abuse the right of minority shareholders. For example, the majority shareholders who are also the directors may pass a resolution of the meeting of shareholders to increase the directors' remuneration payable by the company out of its generated profit instead of distributing such profit in the form of dividends to the minority shareholders who are not the directors.²⁷⁵

²⁷⁴ *Supra* note 221. Page 136

²⁷⁵ *Id.*

According to the precedent held by the US Supreme Court, the minority shareholders are entitled to sue the majority shareholders for abusing their rights. The famous case often cited is *Dodge v. Ford Motor Co.* where Ford was sued for distribution of dividends. Even if the defendant is a limited company, this case arose as Ford family members, as the majority shareholders, omitted to pay dividends to the plaintiff even though the company was dictated by them and the family members, acting as the director, could decide whether to pay the dividends.²⁷⁶ The final judgment was ruled in favor of the plaintiff as the minority shareholders had the right to enjoy the profit of the business they invested in and their minority interests had to be considered. It is also cited that:

“When you look at Dodge versus Ford, it’s not about the company obligation to pay a dividend, it’s about the ability of a majority shareholder abusing the minority shareholders,” said Nicholas Rogers, associate attorney at Gaskins Bennett Birrell Schupp LLP.²⁷⁷

In the UK, the same situation would fall under the provisions of Companies Act 2006 on protection of members against unfair prejudice. If a company member who is a minority shareholder feels that his interest is unfairly treated by the majority shareholders, he is entitled to file a petition to the court seeking appropriate reliefs. The cause of action is that the previous, ongoing, or potential company’s affairs are conducted by the majority shareholders are unfairly prejudicial to any of the minority shareholders who bring a case to the court as the petitioner. Given such contexts, every single minority shareholder’s right is well protected as he can take legal action even if the damage has not incurred nor is likely to incur.²⁷⁸

²⁷⁶ *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919)

²⁷⁷ Forbes. "*Can Apple Investor Sue for a Dividend.*" February 2012, <http://www.forbes.com/sites/thestreet/2012/02/17/can-apple-investor-s-sue-for-a-dividend/> (accessed on 2 December 2015).

²⁷⁸ Companies Act 2006, Sec. 994

Furthermore, if the court is satisfied with the petition filed by the minority shareholders, the court has very extensive power to grant various injunctions and reliefs to the petitioner depending on the circumstances as it may find appropriate taking into account the degree of conflict and the possibility of whether the parties are able to continue to do business with each other. The court may even order the majority shareholders to buy out the shares acquired by the minority shareholders at the fair price as determined by the court or have the company buy back the shares subject to the capital decrease since a limited company incorporated under the law of UK is eligible to hold its issued shares.²⁷⁹

Therefore, it would be very helpful to protect the crowd investors in a limited company. If Thailand also applies the same protection as those available in the UK Companies Act 2006 it will be more specific than having the minority shareholders rely on tort and contract laws when they come to the court. More importantly, the court would be provided with more realistic options to rule other than the typical compensation payable by the losing party.

²⁷⁹ Companies Act 2006, Sec. 996

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5. LAWS AND REGULATIONS

5.1 Thailand

The Civil and Commercial Code

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The Notification of the Capital Market Supervisory Board No. TorChor. 7/2558 re: Regulations on Offer for Sale of Securities through Electronic System or Network

The Notification of the Capital Market Supervisory Board No. TorChor. 8/2558 re: Rules, Conditions and Procedures for Offering for Sale of Shares by Shareholders of Limited Companies

Notification of the Office of the Securities and Exchange Commission No. SorMor. 11/2558 re: Determination of Fees for Filing of Registration Statement, Registration and Other Applications (No .36)

Notification of the Securities and Exchange Commission No. KorChor. 3/2558 re: Exemption from Filing of Registration Statement for Securities Offered through Provider of Electronic System of Network

Notification of the Securities and Exchange Commission No. KorChor. 9/2555 re: Determination of Definitions of Institutional and High Net Worth Investors

The Securities and Exchange Act B.E. 2535

5.2 The United States

The Jumpstart Our Business Startups Act 2012

The Model Business Corporation Act 2006

The Securities Act 1933

The Securities and Exchange Act 1934

5.3 The United Kingdom

The Companies Act 2006

Financial Services and Market Act 2000

Policy Statement re: The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media (PS14/4)

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