CONSUMER PROTECTION AND INVESTMENT CROWDFUNDING: COMMENTS AT THE FUTURE OF STARTUP FINANCE: A SYMPOSIUM ON "INVESTMENT CROWDFUNDING"

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My background is in consumer protection. I've worked at the Federal Trade Commission. I worked at the Consumer Financial Protection Bureau ("CFPB").[1] And so that's what I'm going to talk about in my lens here.

This is a great book.[2] This is a really powerful, great book. I just want to make that really clear, and I mean that from somebody coming at it from a consumer protection perspective. This is not just a book about investment crowdfunding. This is maybe the best book I've read so far on just how to think about consumer protection in the internet age. Because of the way Schwartz focuses on private ordering, and on different ways of transmitting information, this book is a model for thinking about the whole economy and consumer protection regulation—from occupational licensing to you name it.[3]

The other reason that this is a great book is Schwartz doesn't wimp out. He doesn't flinch. He draws the lines and says this is the logic, this is the argument, this is right, this is wrong. I think the discussion he has in the book between information disclosure and primary versus secondary markets is itself worth the price of admission, to go through that distinction about information asymmetries.[4] As a result of reading this book, I'm now a new

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1. From 2020 to 2021, Zywicki was chair of the Consumer Financial Protection Bureau Task Force on Federal Consumer Financial Law.

2. The book referenced here is ANDREW A. SCHWARTZ, INVESTMENT CROWDFUNDING (2023).

3. *Id.* at 57–97.

4. *Id.* at 112.

participant in Wefunder.[5] I am basically the poster child for the book.

I was sitting there reading and thought, *I should see what one of these things are*. So, I googled top crowdfunding sites, and Forbes or some other credible source comes up and says—I think it said something like easiest to use. It was Wefunder, and I looked, and I saw in the book it was in here. All right—he (Schwartz) vouches for it, also.[6] Now, I'm the newest investor and brand ambassador for Oak & Eden Whiskey.[7] It is exactly as Schwartz said, and it's working. They started on September 1st; they're going to try to raise $10.6 million by December 1st. Since September 1st, they've raised $9.6 million on this crowdfunding site from this. And it's got everything he says.[8] It's got a pitch deck. It's got a video from the guys (the co-founders). I asked the guy a question on Facebook, and five minutes later, he responds. So, the whole thing is just fun. It's interesting, and I think I'm going to make some money from it, also. So, it really is a great, smooth sort of thing.

Let me just make three points substantively about why I think this is such a profound book about consumer protection and consumer financial protection, and why it deserves to be read by anybody who's thinking about consumer protection.

The first is that for a long time, the basis for most consumer protection regulation has been asymmetric information, with occupational licensing being the good example.[9] It's clear that it's a very poor way of regulating things. Mandated disclosure is also a poor way of doing things. Now, we have a much better way, and Schwartz lays it out right.[10]

From the internet, the information economy, the reputation economy, all these sorts of things, we're getting increasing evidence that this is much more powerful and more useful to consumers.[11]

5. WEFUNDER, https://wefunder.com/toddzywicki [https://perma.cc/R3KY-GUYA] (last visited Apr. 14, 2024).

6. SCHWARTZ, *supra* note 3, at 4, 67.

7. *Oak & Eden Whiskey*, WEFUNDER, https://wefunder.com/oakandeden [https://perma.cc/3XB4-8HJ3] (last visited Apr. 14, 2024).

8. *See id.*

9. Ryan Nunn, *How Occupational Licensing Matters for Wages and Careers*, BROOKINGS INST. (Mar. 15, 2018), https://www.brookings.edu/articles/how-occupational-licensing-matters-for-wages-and-careers/ [https://perma.cc/NV44-77DZ].

10. SCHWARTZ, *supra* note 3, at 49–53.

11. Dhruvi Dedhia, *The Price of Stars: The Economics of Online Ratings and Reviews*, MICH. J. ECON. (Nov. 27, 2023), https://sites.lsa.umich.edu/mje/2023/11/27/the-price-of-stars-the-economics-of-online-ratings-and-reviews/ [https://perma.cc/YB34-93TJ]; Chiara Farronato et al., *Consumer Protection in an Online World: An Analysis of Occupational Licensing* (Nat'l Bureau of Econ. Rsch., Working Paper No. 26601, 2020); Christopher Koopman et al., *The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change*, 8 J. BUS. ENTREPRENEURSHIP & L. 529, 539–43 (2015).

We've always understood that when the market drives disclosure, it generally drives disclosure towards the things that consumers care about, not the things that bureaucrats think consumers should care about,[12] and that's what we see here. It's providing information in a useful way to consumers, and it's just something that consumer protection attorneys and thinkers simply have not really internalized. What we see here is a new market, and it's really quite remarkable that the regulators haven't screwed this up already. They have done a pretty good job of letting this market exist and thrive.

There are some studies, for example, that show that consumers don't really care about government licenses. What they care about is your rating on Yelp and that sort of thing.[13] So, consumers are using this information already—this really explains the logic of it and explains why the internet can be such a powerful tool in this area.

The second thing I like about this book is we can think about consumer protection regulation as a three-legged stool—we've got markets, common law, and then regulation.[14] Regulation is the lumpiest and most ineffective way of dealing with most things because it's one-size-fits-all, it takes forever to do it, and it's subject to all kinds of public choice pressures and the biases of regulators. But that has become the default way that we think about solving consumer protection problems. Regulation should be the last resort, not the first resort.

The market itself is the most effective way of protecting consumers, which includes advertising, reputation, and repeat dealing, among other mechanisms. Moreover, the internet now makes us much more powerful starting with markets. But the other things that are very prominent and tend to get lost, I think, in the discussion, and Schwartz mentions it, are the simple old rules about fraud, contract, and tort. The common law is another way of providing consumer protection—warranties, anti-fraud, that sort of

12. *See* Todd J. Zywicki, *The Market for Information and Credit Card Regulation*, 28(1) BANKING & FIN. SERVICE POL'Y REP. 13, 14 (2009).

13. Dedhia, *supra* note 11.

14. For the model of the three-legged stool approach to regulatory policy, see Todd J. Zywicki, *Bankruptcy Law as Social Legislation*, 5 TEX. REV. L. & POL. 393, 400 (2001); For applications to consumer protection policy, see CONSUMER FINANCIAL PROTECTION BUREAU, TASKFORCE ON FEDERAL CONSUMER FINANCIAL LAW REPORT 244–45 (2021); Brian Johnson, *Remarks to Consumer Action: Toward a 21st Century Approach to Consumer Protection*, CONSUMER FIN. PROT. BUREAU (Nov. 15, 2018), https://www.consumerfinance.gov/about-us/newsroom/toward-21st-century-approach-consumer-protection [https://perma.cc/PR8U-J4UB]; J. Howard Beales III & Timothy J. Muris, *FTC Consumer Protection at 100: 1970s Redux or Protecting Markets to Protect Consumers?*, 83 GEO. WASH. L. REV. 2157, 2162 (2015).

thing. Schwartz keeps reminding us that there are anti-fraud laws out there that are still available to consumers in addition to the other private ordering mechanisms here.[15]

So, I think Schwartz is very calibrated about: start with the market, figure out how far the market takes us, think about what the market failure is, think about whether the common law solves that, and then what's left over at the end [is] for regulation. And I think he makes a very compelling case for where regulation can come in, how it can be useful, while allowing the other sorts of more flexible ways to flourish.

The last thing he says, and I'll close on this point, is there's two ways you can think about [consumer protection] from a law and economics perspective: you can think about loss prevention *ex ante* (before the fact) or loss mitigation *ex post* (after the fact).[16] A point Schwartz makes, and I think is a really powerful point that I've also thought about, is that one of the ways of dealing with the risk of consumer harm is to simply limit the amount a consumer can lose on a given investment, rather than try to prevent every person from losing money. There is a cost to this regulation. We just pile these regulations on consumers, trying to keep them from ever making a mistake and losing money, even if the total costs of those regulations (including foregone opportunities to *make* money) exceed the benefits.

But one of the ways consumers learn about bank accounts and that sort of thing is by making mistakes.[17] We make mistakes early in our life, but they're generally small mistakes, and we learn from them. As a result, we are less likely to make those mistakes in the future when the stakes may be higher.[18] So, there is a dynamic learning process that takes place, and one of the points Schwartz makes is: just limit the amount of people's exposure.[19] People will learn from it, and markets will learn from it. Moreover, don't treat

15. SCHWARTZ, *supra* note 2, at 57–69 (describing incidents of fraud on investment crowdfunding sites and legal remedies to those under traditional common law fraud doctrines).

16. *See generally id.*

17. Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASH. & LEE L. REV. 1141, 1174 (2012); Victor Stango & Jonathan Zinman, *Limited and Varying Consumer Attention: Evidence from Shocks to the Salience of Bank Overdraft Fees* 4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 17028, 2011); *see also* Thomas A. Durkin et al., *An Assessment of Behavioral Law and Economics Contentions and What We Know Empirically About Credit Card Use by Consumers*, 22 SUP. CT. ECON. REV. 1, 9 (2014) (describing how consumers learn about terms and conditions of consumer finance contracts).

18. *See* Sumit Agarwal, et al., *Learning in the Credit Card Market* 17 (Nat'l Bureau of Econ. Rsch., Working Paper No. 13822, 2008).

19. SCHWARTZ, *supra* note 2, at 121–26.

people like children, thinking that we can always keep them from losing money.

It has always been the case that you can go out and buy a $1,000 pair of loafers, but you can't go out and make a $1,000 investment in Oak & Eden, for which you actually get an asset in exchange (at least I hope) at the end of the day. But we have these worlds in which we just ignore the reality that people can spend their money on a lot of different things, and there's nothing fundamentally different here. We don't limit how much people can spend on a handbag, a car, a bottle of wine, or a sports ticket. Here, in the world of crowdfunding, we've even got more protections in place from that, and you might actually make some money off of this. So anyway, it's a great book, and I'll close there.

(The Q&A segment began with a question for Zywicki.)

Question: Share your own experience as someone trying to make these determinations as to the impact of private ordering and government regulation on the decision making where you're at.

As I got deeper into the book, everything that Schwartz diagnoses is actually what worked for me. First, you go in [Wefunder], and you see a product you like (for me it was Oak & Eden Whiskey). There was a lead investor who right up front said he had previously invested, I don't know, $300,000 or something. And he was investing like $75,000 or something in this round. . . . So, it's the lead investor that Schwartz talks about.[20] They (Oak & Eden) had a slide deck that explained it. They showed everything that they were doing, and it was just one of these things where I got it. They had a storefront down in Fort Worth. Here [within the slide deck] is their plans to expand. They said, "that makes sense." People will like that, right? I would go to that kind of thing. I know there's a market for this sort of stuff. So, it just made sense to me. . . . These guys had their act together, and it just gave me confidence, and there were a lot of people. It's a product that will be fun, and I will be both a consumer and an investor. But you have to use some judgment.

Closing Remarks

A final point to make about this market: Although people invest in these crowdfunded businesses to make money, it seems

20. *Id.* at 92.

clear to me that they are not investing *solely* to make money, for the economic returns. People invest in the New York Stock Exchange for the economic returns. People are investing in many of these crowdfunding enterprises because they think they're doing something for social good and, in some sense, they don't care exclusively about how much money they'll make off it. They can, and do, invest in companies that are doing good for the environment, women-owned startups, in a local soccer team, or a local coffee shop. So, it is often a sort of mix of economic and social motivations. I don't think the financial returns measure everything that these guys are doing as a public benefit corporation, for example. They're (startups/crowdfunding sources) meeting a need for people that isn't quite consumption. It's not quite investment. It's backing a project that they think is good for the world in a different way from just making a charitable contribution, and the financial return on that, I think, doesn't measure everything.