

LEGAL CONSTRUCTIONS USED IN CROWDFUNDING²

I. Introduction

Crowdfunding (the word encompassing crowd and funding) is a relatively new, innovative type of financing, also known as community financing. The idea of this type of financing is based, in principle, the beneficiary presents their project/ idea to the Internet users via one of the *crowdfunding* platforms and determines the amount necessary to implement the project and the duration of the collection (the so-called *crowdfunding* campaign).

Community collection ushers us into a new manner of raising funds required to implement various types of projects (business, charity, artistic, sporting, etc.). As a source of financing, *crowdfunding* is therefore an alternative to classic ways of raising capital, such as bank loans, *venture capital* funds, bond issue or public offering.

Importantly, *crowdfunding* can finance both commercial ventures (supporting business plans of business entities - especially SMEs, most often *start-ups*, which operate in the field of new technologies), and non-profit projects (such as financing the beneficiary's medical treatment, travel, documentary film production, etc.). In each case, however, the subject of the collection are funds paid by the sponsors electronically.

Currently, the Polish law not only lacks any definition of the legal concept of *crowdfunding*, but there is also no wider legal legislation pertinent to this phenomenon. As a consequence, there appears a case for enquiring what existing legal constructions are applicable to the process of community collection? All the more so, because this type of pursuing capital is gaining in popularity year after year.

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However, the question yields no clear answer as *crowdfunding* is fragmented. In the practice of trading, at least five basic types of community collection have emerged.

II Types of *crowdfunding*

Common features of all types of *crowdfunding* include:

- 1) financing process participants, that is:
 - a) an entity seeking financing, presenting a project/object/intention (called the beneficiary), which can be both an business (engaged in business in any legal form and with any object of this activity), and an entity or natural person who does not conduct business activity;
 - b) sponsor – that is persons or entities (although it is not excluded that there will be only one sponsor) which have made a payment for the beneficiary's project. The financing community may be formalised or organised in any way – be it a fan community of a director who is looking for funding for his subsequent production - but this is not a necessary condition. The *crowdfunding* campaign is usually open, that is addresses an unlimited group of network users; and
 - c) *crowdfunding* platform, which albeit not necessary in theory, yet in practice most often occurs, acting as a kind of intermediary between the beneficiary and the sponsors³;
- 2) the object of the campaign: financing (directly – that is without the participation of the *crowdfunding* platform, or indirectly - through the *crowdfunding* platform) of an objective/project of any nature defined by the beneficiary. This objective does not need to be of a commercial nature, it may indeed be objectively absurd (such as financing research aimed at proving that the land is flat);

³ The list of Polish *crowdfunding* platforms includes: zrzutka.pl, polakpotrafi.pl, siepomaga.pl, or wspieram.to. The best known foreign *crowdfunding* platforms are: kickstarter.com, indiegogo.com, patreon.com, experiment.com, lendingclub.com or beesfund.com.

- 3) way of running a *crowdfunding* campaign, which is always conducted via the Internet (regardless of whether the *crowdfunding* platform participates in this process or not);
- 4) financial nature of the beneficiary's support - the sponsors in each case contribute money (in principle in any amount) by electronic channels;
- 5) as a rule, a predetermined campaign duration (the date until which the collection lasts), although a time limit is not an obligatory element of *crowdfunding*.

Particular types of *crowdfunding* may be distinguished by possible trade reciprocity between sponsors and beneficiary. Given trade reciprocity and its scope (equivalence), the following five basic types of *crowdfunding* can be identified:

- 1) *donation-based crowdfunding* – whereby sponsor contribute for a specific purpose without consideration (except for symbolic gratification from the beneficiary for instance in the form of thanks). This type of community collection is highly philanthropic and primarily supports charitable purposes (by way of illustration financing of a foreign operation of a sick child;
- 2) *rewards-based crowdfunding* - the sponsors receive a predetermined type of gratification in the form of a prize (for instance a card with the director's autograph or a mention in the credits of a film produced with the funds collected within the campaign), of much lower objective value than the amount transferred to the beneficiary. Accordingly, the trade provided by the parties (the beneficiary and each of the sponsors) is not equivalent in this case;
- 3) *pre-sales crowdfunding* – the beneficiary is provided with a specific amount for the production of a specific product, which is subsequently transferred to the sponsor. In this case, the parties' trade must be regarded as equivalent, whereas the beneficiary normally sets a minimum amount of contribution in this campaign, and prospective mutual performance by the beneficiary will be linked to this amount;
- 4) *crowdinvesting* also known as *equity crowdfunding* – the sponsor receives an appropriate number of units in the beneficiary's undertaking for its financial contribution (those may be shares in the share capital of the beneficiary's company). In this way, the sponsors become de facto investors in the beneficiary undertaking and, by becoming its shareholders, they are primarily granted voting rights (and hence in theory may

influence the operations of the entity), dividend rights, and the right to dispose of their units;

- 5) *crowdlending* - *sociallending* - *peer-to-peer lending*) – where the sponsors' contributions are refundable, that is the beneficiary must reimburse all the funds paid by all the sponsors in due time, along with a predetermined interest.

With various models of *crowdfunding* in place, as specified above, whose basic delimitation criterion is mutual trade being present (or not) on the part of the campaign beneficiary and possible scope (equivalence) of this performance, the applicable, existing legal constructions must be considered separately with respect to particular types of community collection.

III. *Crowdfunding* vs. public collection

Crowdfunding is often compared to a public collection in source literature. The opinions are also voiced that in the absence of any specific provisions, the so-called community collection should be governed by the Act on the Rules of Public Collections⁴. This stance cannot be shared.

The above Act, which came into force on 14 July 2014, introduced a legal definition of public collection. Under Article 1 (1) of this Act, "A public collection shall denote the collection of donations in cash or in kind in a public place for a specific, lawful purpose in the sphere of public tasks referred to in Article 4 (1) of the Act of 24 April 2003 on public utility activity and voluntary service (Journal of Laws of 2018, items 450, 650, 723, 1365 and 2019, item 37), and for religious purposes".

The consideration of this definition reveals the following major differences between *crowdfunding* and public collection:

- a) the public collection is about collecting contributions, whereas the object of *crowdfunding* is to raise funds, in principle (except for donation-based *crowdfunding*), for consideration not necessarily equivalent;

⁴ Act of 14 March 2014 on the Principles of Public Collections (consolidated text Journal of Laws of 2019, item 756).

- b) in public collections, contributions are collected only in cash or in kind, whereas crowdfunded financing is of non-cash nature (collection takes place via online banking);
- c) the public collection is held in a public place, which - according to Article 1 (2) of the Act on the Rules of Public Collections - means generally available places, in particular streets, squares, parks and cemeteries, which implies real space; the *crowdfunding* collections take place online (collection takes place via the Internet);
- d) public collection must have a specific, lawful purpose, coming under public tasks, and religious purposes, while *crowdfunding* can be dedicated to any legitimate purpose, including that going beyond public or religious goals.

The comparison dictates that *crowdfunding*, viewed as community collection, fails to meet the definition of legitimate public collection. Thus, *crowdfunding* is governed by the Act on the Rules of Public Collections, and *crowdfunding* is not subject to provisions (and restrictions) applicable to public collections. Specifically, it is not subject to the provision of Article 3 of the Act on the Rules of Public Collections, which limits the community of entities authorized to conduct public collections⁵, and does need to be notified to the Minister in charge of public administration (failing which, criminal liability arises under Article 56 of the Code of Petty Offences⁶), published on the public collection portal run by this Minister, and no report on the collection is necessary, which must be published on the public collection portal.

IV. Legal constructions used in particular types of *crowdfunding*

Crowdfunding is a relatively new⁷ and innovative economic phenomenon (a way of financing economic undertakings). This phenomenon - at least as far as the Polish legal system is concerned - is not yet accompanied by any comprehensive legislation. This being said, *crowdfunding* is by all means legitimate in Poland. Based on civil law, *crowdfunding* may be

⁵ Under Article 3 of the Act on the Principles of Public Collections, the "The following shall be entitled to conduct public collection, hereinafter referred to as the "organiser of the collection": 1) a non-governmental organisation within the meaning of Article 3(2) of the Act of 24 April 2003 on Public Benefit Activity and Voluntary Services; 2) an entity referred to in Article 3(3) of the Act of 24 April 2003 on Public Benefit Activity and Voluntary Services; 3) a social committee appointed to conduct a public collection. This catalogue is enumerative.

⁶ Act of 20 May 1971 - Code of Petty Offences (consolidated text Journal of Laws of 2019, item 821, as amended).

⁷ It is assumed that the first case of *crowdfunding* took place in the second half of the 1990s in the United States, when the musicians of the group Merillion received financial support from their fans for a concert tour. The first *crowdfunding* portal - Artist.Share.net – was developed in 2000 also in the United States.

pursued under Article 353¹ of the Civil Code⁸, providing for the so-called principle of freedom of contract. In other words, in the civil law sphere, both the project providers and *crowdfunding* platforms and supporting entities rely on the principle of freedom of contract, developing legal relations within *crowdfunding* on specific agreements named, modified and adapted to particular types of *crowdfunding*. These relations arise in principle on three levels: between the sponsors and the beneficiary, between the sponsors and the *crowdfunding* platform, and between the *crowdfunding* platform and the beneficiary.

Whereas *crowdfunding* is carried out in virtual space (via the Internet), the provisions of the on the Provision of Electronic Services apply to all types of community collection⁹. In particular, it concerns *crowdfunding* platforms, which must define the rules for the provision of electronic services, and make them available to the customer gratuitously before the conclusion of a service contract, and - at its request - in such a way that the rules may be obtained, reproduced and fixed via an ICT system at the customer's.

Where - regardless of the type of *crowdfunding* - the sponsor is represented by the consumer, the provisions of the Act on Consumer Rights will also apply¹⁰. In particular, it is worth noting the provision of Article 27 of this Act, whereby "A consumer who has concluded a distance or off-premises contract may, within 14 days, rescind it without giving any reason and without incurring any costs, except for the costs specified in Article 33, Article 34(2) and Article 35" of the cited legal act. As a consequence, it is vital that the rules of *crowdfunding* collection be appropriately worded, for example, refer to one of the exclusions from the right to rescind the contract, provided for in the said Act, or - more precisely - to Article 38(1) of the Act on Consumer Rights, whereby "The right to rescind a distance or off-premises contract shall not be available to the consumer with respect to service contracts if the business has fully rendered the service with the express consent of the consumer, which had been advised prior to the performance that it could not rescind the contract once the business has provided.

Given that *crowdfunding* may involve collection and processing of personal data of natural persons (in particular project sponsors), the provisions of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of individuals with regard to the processing of personal data and on the free movement of such data and

⁸ Act of 23 April 1964 Civil Code (consolidated text Journal of Laws of 2019, item 1145).

⁹ Act of 18 July 2002 on the Provision of Electronic Services (consolidated text Journal of Laws of 2019, item 123, as amended).

¹⁰ Act of 30 May 2014 on Consumer Rights (consolidated text Journal of Laws of 2019, item 134, as amended).

repealing Directive 95/46/EC (General Regulation on Data Protection)¹¹ may also apply to any type of *crowdfunding*. The provisions of the above regulation concern in particular *crowdfunding* platforms, which in principle collect and process project backers' personal data.

As regards the legal issues common to all types of *crowdfunding*, the issue of copyright should also be mentioned. It is obvious that with a view to attracting the largest possible number of potential sponsors, the project originator (beneficiary of a community collection) must present its concept. Such a project often constitutes an original, innovative idea, which may also include a work within the meaning of the provisions of the Act on Copyright and Related Rights¹². Public (online) presentation of an idea obviously poses a risk of its use by third parties, contrary to the intentions of the originator. Whereas no confidentiality agreements are concluded within *crowdfunding*, as a rule, the originator may not effectively protect their idea once it has been made public within the *crowdfunding* campaign (unless a project is based on, for example, already registered industrial property rights, etc.). Hence, the beneficiary of a community collection should carefully select the scope of data and information presented to the network participants as part of *crowdfunding* in order not to be exposed to copying or other use of their idea inconsistent with the beneficiary's intention.

As already pointed out, at least five basic types of *crowdfunding* can be identified. Due to their points of divergence, different legal constructions of civil law apply to the particular types.

The first three types of *crowdfunding* presented above (that donation-based *crowdfunding*, rewards-based *crowdfunding* and pre-sales *crowdfunding*) are often collectively called community sponsoring, as in these models, possible reciprocal trade, if any, is quite limited. In practice, sponsors stand little chance of potential profit in excess of the amount of funds they invested. For this reason, and due to the relatively low risk of fraud within this type

¹¹ Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (OJ L 119, 4.5.2016).

¹² Act of 4 February 1994 on Copyright and Related Right (consolidated text Journal of Laws of 2019, item 1231, as amended). Under Article 1 (1) thereof "The object of copyright shall be any manifestation of creative activity of individual nature, established in any form, irrespective of its value, purpose or form of expression (work)".

of community collections, legal requirements for this type of *crowdfunding* campaigns are generally easier to meet¹³.

The model of donation-based *crowdfunding* is based on a donation agreement. Unless the rules of the *crowdfunding* campaign provide otherwise, the sponsor (as a donor) and the beneficiary (as a donee) conclude an agreement on donation, stipulated in Articles 888-902 of the Civil Code. Pursuant to Article 888 § 1 of the Civil Code, "By a donation agreement, the donor undertakes to make a free donation to the donee at the expense of their assets". Accordingly, as part of such community collections, one should remember first of all that: a) the donor's declaration shall be made in the form of a notarial deed. However, a contract of donation concluded without the observance of that form shall become valid if the promised performance has been effected (Article 890 §1 of the Civil Code); b) the donor may impose upon the donee the obligation to perform or to desist from a certain act without making anyone the creditor (instruction) (Article 893 of the Civil Code); c) the donor may, in cases provided by law, revoke the donation and demand the performance be returned (Article 896 and Article 898 of the Civil Code); and d) the donee may have the duty to perform for the donor which fell into penury (Article 897 of the Civil Code). Although a donation will probably very rarely be revoked within *crowdfunding*, it is worth remembering that the rules governing the donation agreement provide for this scenario. As far as donations are concerned, it should also be pointed out that the donee will also have to pay inheritance and donation tax on the donation received¹⁴.

Within the framework of rewards-based *crowdfunding* and pre-sales *crowdfunding*, the most frequently used are legal constructions of a sales agreement, or an unnamed contract close to the sales agreement. A sales contract is a reciprocal contract, since the price is to be the equivalent of the value of the object of sale. Transferring this to the community collection, it may be pointed out that the sponsor's money corresponds to the beneficiary's performance, whereby a specific item/product will be delivered (in pre-sale *crowdfunding*), or a specific reward (in rewards-based *crowdfunding*). However, while the reciprocity of performance raises no doubts under pre-sale *crowdfunding* (where the value of an item delivered to a sponsor in the future corresponds to the amount of funds paid by it within the campaign), it is doubtful for

¹³ This is also confirmed by the Polish Financial Supervision Authority. See Załącznik nr 2: Modele *crowdfunding* w świetle obowiązujących przepisów prawa [in:] Raport z prac Zespołu roboczego ds. rozwoju innowacji finansowych (FinTech), November 2017 (access 19.09.2019: https://www.knf.gov.pl/knf/pl/komponenty/img/Raport_KNF_11_2017_60290.pdf).

¹⁴ See Act of 28 July 1983 on Inheritance Tax and Donations (consolidated text Journal of Laws of 2018, item 644, as amended).

rewards-based *crowdfunding*, with the objective value being usually much lower than that of funds transferred to the beneficiary. Hence, especially the latter will most frequently see unnamed mixed contracts, combining elements of a sales contract and other legal relations. In the case of such community collections, based on the legal structure of the sales contract, special attention should be paid to the issues of the seller's (in this case, the beneficiary's) liability for defects in the goods sold (implied warranty).

The legal structures employed under *crowdinvesting* will depend primarily on the type of share rights acquired by the project sponsors for the funds paid in. Apparently, the most effective vehicles that can be used for this purpose are the joint-stock company and the partnership limited by shares¹⁵. Code legal structure of these two types of commercial companies paves the way for a relatively free and informal trading in their shares, different ways of increasing their share capital, use of instruments such as subscription warrants, etc. If the beneficiary is a public company, then the provisions of the so-called Act on Public Offering¹⁶ will apply. For non-public companies, the provisions of the Commercial Companies Code¹⁷, which cover the share capital increase (including in particular the issues of open-end subscription and statutory capital) may apply. As it seems, the legal construction of a limited liability company. - due to, for example, the mandatory written form with signatures notarized for the contract of sale of shares, or a notarized form for the declaration of acquisition of shares - will not be widely used in equity *crowdfunding* campaigns.

In *crowdlending*, on the other hand, the legal construction of a loan agreement is used as a rule. The key to determining the legal regime governing such a contract is the question of the contracting parties and their possible legal status as consumers. For a corporate sponsor, beneficiary being a consumer, and the amount of the loan granted not exceeding PLN 255,550.00 or its equivalent in a foreign currency, the provisions of the Consumer Loan Act¹⁸ will apply. A written agreement should be then concluded, with the obligatory statutory elements, etc. Within *crowdfunding*, however, the sponsor is most often a non-corporate business. In such a situation, the provisions of the loan agreement, stipulated in Article 720-724

¹⁵ And from 1 March 2020 also a simple joint-stock company.

¹⁶ Act of 29 July 2005 on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies (consolidated text Journal of Laws of 2019, item 623).

¹⁷ Act of 15 September 2000. Commercial Companies Code (consolidated text Journal of Laws of 2019, item 505, as amended).

¹⁸ Act of 12 May 2011 on Consumer Loan (consolidated text Journal of Laws of 2019, item 1083).

of the Civil Code, will apply. The provisions of the Banking Law¹⁹ and the Act on Payment Services²⁰ are also an important factor in *crowdlending*.

Both within *crowdinvesting* and *crowdlending*, the Act on Investment Funds and Management of Alternative Investment Funds²¹ may also apply.

V. Draft legislation of the EU legislator

As mentioned above, the Polish legal system is short of comprehensive legislation referring directly to *crowdfunding*. The first attempt to provide for this form of capital raising has been made in the United States, where President Barack Obama signed the "JOBS Act" and its *Crowdfunding Act* on 5 April 2012. The importance of this way of seeking financing did not escape the notice of the European legislator. Whereas some EU Member States have adopted copyright community collection provisions in their legislation, and some of them follow only general legal guidelines and apply their earlier laws by analogy, which makes it rather difficult to carry out a cost-effective *crowdfunding* campaign in several countries in parallel, the European Commission began work in 2018 on the creation of an EU regulation on European providers of social financing for enterprises. As planned, the regulation will apply exclusively to *equity crowdfunding* - and *crowdlending*, in which offers of community collection do not exceed EUR 1 million determined for 12 months with reference to a specific project. The draft regulation also provides for a licence for the business of community collection provider. This draft is currently at the beginning of its legislative path, and its content is very likely to develop further²².

VI. Conclusion

Community collection is gaining in popularity as a way of raising funds for a variety of projects, including business projects. In the absence of the national, comprehensive legislation

¹⁹ Banking Act of 29 August 1997 (consolidated text Journal of Laws of 2018, item 2187, as amended).

²⁰ Act of 19 August 2011 on Payment Services (consolidated text Journal of Laws of 2019, item 659, as amended).

²¹ Act of 27 May 2004 on Investment Funds and Management of Alternative Investment Funds (consolidated text Journal of Laws of 2018, item 1355, as amended).

²² Draft Regulation available in Polish at: <https://ec.europa.eu/transparency/regdoc/rep/1/2018/PL/COM-2018-113-F1-PL-MAIN-PART-1.PDF> (access 19.09.2019).

pertinent to this phenomenon, coupled with the existence of several different types of *crowdfunding*, a number of different rules can be applied in this area, including both public and private law. However, there is no doubt that the existing rules governing *crowdfunding* campaigns are insufficient and may generate a number of interpretation doubts. As a result, the measures pursued by the EU legislator, seeking to cover the issues related to community collection across the EU, seem to be fully legitimate. Still, in view of the limited scope of the subject matter of the draft EU regulation, which is to refer only to equity- and debt-based *crowdfunding*, it also seems advisable for the national legislator to undertake prompt measures with a view to providing for the remaining types of community collections in a comprehensive manner.

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