

# THE CORPORATIZATION OF PERSONHOOD

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*This Article explores the burgeoning practice of investing in people as if they were corporations. Sometimes pitched as a way to pay-off student loans or fund a business idea, people now have the opportunity to sell shares of their future income to investors in exchange for cash today. Such transactions create a financial relationship closely analogous to that of a corporation and its shareholders. This Article considers how existing law applies to this new practice, and whether today's rules are responsive to the unique challenges these arrangements present. I argue that, despite raising both constitutional and public policy concerns, these transactions should be permitted. Rather than outlaw such dealings, the nature of the financial relationships at issue means that they should be subject to securities regulation. Securities law alone, though, is insufficient; it is solely focused on protecting investors, leaving the broader social concerns raised by investing in people unaddressed and the more vulnerable parties to these transactions—those selling shares of themselves—without protection. To respond to these issues, I set forth a complementary regulatory template that would, among other things, require certain disclosures and set certain boundaries on these novel financial relationships.*

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## I. INTRODUCTION

“The startup is *you*.”<sup>1</sup>

Financial innovation has brought us something once confined to the realm of dystopian science fiction.<sup>2</sup> The latest invention turns you into a corporation and your life into a security. A number of startup companies have recently launched platforms that allow individuals to invest in people as if they were corporations.<sup>3</sup> In one model, investors give young

1. Upstart, a company described *infra* note 3, initially used this pithy statement as its slogan. See Sam Wakoba, *Upstart—The Startup Is You*, TECHZULU (Aug. 9, 2012), <http://techzulu.com/upstart-the-startup-is-you/> (emphasis in original) (including a screenshot from when Upstart’s website first launched). See also Alison Griswold, *Upstart: Can Crowdfunding Your Education and Career Really Work?*, FORBES (Aug. 10, 2012, 5:48 PM), <http://www.forbes.com/sites/alisongriswold/2012/08/10/upstart-can-crowdfunding-your-education-and-career-really-work/> (ascribing this catchphrase to Upstart).

2. See generally DANI KOLLIN & EYTAN KOLLIN, *THE UNINCORPORATED MAN* (1st ed. 2009) (describing a world in which everyone is incorporated and shares of people are bought and sold).

3. These include Lumni, Thrust Fund, Enzi, Fantex, and Pave. About, LUMNI, <http://lumni.net/about/> (last visited Jan. 30, 2015); Kim-Mai Cutler, *Entrepreneurs Offer Their Life’s Future Earnings for an Investment*, VENTUREBEAT (Mar. 3, 2010, 11:59 PM), <http://venturebeat.com/2010/03/03/life-investment/> (describing how the Thrust Fund marketplace works); ENZI, <http://www.enzi.org> (last visited Jan. 30, 2015); FANTEX BROKERAGE SERVICES, <http://fantex.com> (last visited Jan. 30, 2015); *What Is Pave?*, PAVE, [http://support.pave.com/knowledge\\_base/topics/what-is-pave](http://support.pave.com/knowledge_base/topics/what-is-pave) (last visited Jan. 30, 2015). Upstart was a leader in this arena until a recent and abrupt change to a

adults money for further education or entrepreneurial endeavors in exchange for a specified percentage of their prospective income.<sup>4</sup> This is like investing in a corporation in exchange for a certain number of shares: the key to both arrangements is that investors swap capital for a portion of future earnings.<sup>5</sup>

This Article closely examines this new development. Because in finance and accounting, claims to future earnings like those involved here are considered equity investments,<sup>6</sup> I refer to what is now occurring as “human-equity investing.”<sup>7</sup> I describe the history, evolution, and current structure of human-equity investing, then consider the appropriate societal response.

Since these arrangements countenance a form of ownership in people,<sup>8</sup> it could be argued that they should be outlawed on constitutional or policy grounds. I argue, though, that neither provides justification for doing so. I also contend that, while human-equity investments likely qualify as “securities” under the federal securities laws and are thus properly regulated thereunder, securities regulation is an inadequate counterweight to the challenges these arrangements pose. Because securities law is only concerned with investors, it leaves the most vulnerable parties to these transactions—those sharing equity in themselves—without protection. Securities rules also do nothing to address the broader social concerns human-equity transfers implicate. For these reasons, I propose the creation of a new regulatory framework that would complement securities regulation and fill these gaps.

Although the practice of investing in people is in its infancy, the idea was first proposed many years ago by Milton Friedman, who suggested it as a way for students to finance attendance in professional schools.<sup>9</sup> Though the recommendation was not directly embraced until

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lending-based business model. See Davie Girouard, *Sunsetting Income Share Agreements on Upstart*, UPSTART BLOG (May 7, 2014), <http://blog.upstart.com/post/84980267394/sunsetting-income-share-agreements-on-upstart>. Cumulus Funding embraces the investing model but promotes itself as the investor, rather than as a platform for others. See CUMULUS FUNDING, <http://www.cumulusfunding.com/> (last visited Jan. 30, 2015). 13th Avenue Funding seeks to facilitate nonprofit community-based investing in low-income students to help fund their educations. See *How to Build Your Own College Financing Community*, 13TH AVENUE FUNDING, <http://13thavenuefunding.org/styled-2/index.html> (last visited Jan. 30, 2015).

4. See *infra* text accompanying notes 85–123.

5. See WILLIAM J. CARNEY, *CORPORATE FINANCE: PRINCIPLES AND PRACTICE* 101–02 (2d ed. 2010).

6. See EDWIN J. ELTON ET AL., *MODERN PORTFOLIO THEORY AND INVESTMENT ANALYSIS* 17 (8th ed. 2010); GARY A. PORTER & CURTIS L. NORTON, *FINANCIAL ACCOUNTING: THE IMPACT ON DECISION MAKERS* 15–16 (7th ed. 2011).

7. Shu-Yi Oei and Diane M. Ring also refer to these arrangements as transactions in human equity, reaching the conclusion after scrutinizing such relationships pursuant to tax- and bankruptcy-law doctrine that seeks to draw the boundary between equity and debt. See generally Shu-Yi Oei & Diane M. Ring, *The New “Human Equity” Transactions*, 5 CAL. L. REV. CIRCUIT 266 (2014) (discussing examples of transactions in human equity in light of debt-equity analysis).

8. See *infra* text accompanying notes 131–32.

9. Milton Friedman *The Role of Government in Education*, in *ECONOMICS AND THE PUBLIC INTEREST* 123, 135–43 (Robert A. Solo ed., 1955) [hereinafter Friedman, *Role of Government*]. The concept also appears in a footnote to one of Professor Friedman’s earlier works. See MILTON

now, Friedman's proposal was the intellectual progenitor of the income-contingent student loan—a debt instrument where repayments after graduation are capped at a certain percentage of income for lower-wage earners.<sup>10</sup> His idea also reached the periphery of sports. Poker players, for instance, have long been “staked” by backers, who pay tournament entrance fees in exchange for shares of the winnings.<sup>11</sup>

The startups launching now, though, have far broader ambitions. Companies have adopted different approaches for bringing together human-equity investors and human-equity investees (i.e., those selling equity in themselves). One model, which appears to have the highest ceiling, is essentially human crowdfunding. Pave, for instance, hosts a website where individuals can sell a percentage of their future income to wealthy investors.<sup>12</sup> True to Friedman's vision, many seek the money to refinance existing student loans or fund further schooling.<sup>13</sup> But the platform is not so limited; many others, for instance, are looking to raise money to launch entrepreneurial ventures.<sup>14</sup>

Some may argue that selling shares in yourself should be illegal. One reason is that owning equity in people rings of slavery. While it is by no means the same thing, it could be maintained that owning the right to another's future income suggests a neo-feudalistic relationship that is in the same vein. The analogy between the two suggests that these arrangements may constitute a form of slavery in contravention of the Thirteenth Amendment. I consider this possibility and conclude that, despite the similarities, Supreme Court precedent makes clear that human-equity investing passes muster.<sup>15</sup>

It could also be argued that Congress, state legislatures, or the courts should outlaw these arrangements as against public policy. In particular, transactions in human equity could be banished on moral grounds.<sup>16</sup> Organ sales and prostitution are prohibited in large part because transactions in body parts and sex are viewed as inappropriately commodifying.<sup>17</sup> The same thing could be said here. Allowing people to sell shares in themselves corporatizes—and perhaps thereby degrades—the idea of personhood.

I argue, however, that there is room for debate over just how problematic human-equity investments are, and that the question of whether

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FRIEDMAN & SIMON KUZNETS, *INCOME FROM INDEPENDENT PROFESSIONAL PRACTICE* 90 n.20 (1945).

10. See *infra* Part II.B.

11. Alexandra Berzon, *Full House: \$1 Million Hold 'Em Ante*, WALL ST. J., June 30, 2012, <http://online.wsj.com/news/articles/SB10001424052702304830704577496963159635408>.

12. See *What is Pave?*, *supra* note 3.

13. See *You Are in Good Company*, PAVE, <http://www.pave.com> (last visited Jan. 30, 2015).

14. See *id.*

15. See *infra* Part IV.A.

16. See generally Martha M. Ertman, *Mapping the New Frontiers of Private Ordering: Afterword*, 49 ARIZ. L. REV. 695 (2007) (describing the debate surrounding such prohibitions).

17. See *id.*

to outlaw the practice based on commodification or other policy concerns can only be decided through a social cost-benefit calculus.<sup>18</sup> The devaluation of personhood that these instruments express is a cost that accompanies them, but this and other costs may be outweighed by the value they bring to the contracting parties, and to society at large. Human-equity investing, for instance, has the potential to broaden access to higher education and improve education finance—potential that would be squelched if such dealings were barred.<sup>19</sup> In the end, I conclude that there is no compelling case that these transactions do more harm than good, and that human-equity investing, therefore, should be allowed.<sup>20</sup>

Regulation, rather than prohibition, is appropriate. Because courts have broadly construed what constitutes a security for regulatory purposes, I argue that investments in people fall under the securities-law regime.<sup>21</sup> This means those looking to sell human equity must comply with the manifold requirements of the federal statutes. While the specter of compliance may give them pause, the recently enacted Jumpstart Our Business Startups Act (“JOBS Act”) has opened up potentially attractive new ways to lawfully court investors.<sup>22</sup> Limiting sales to the wealthy, for example, is a way to largely circumvent the regulatory structure.<sup>23</sup>

Though the securities laws now better accommodate human-equity investments, the rules themselves are not set up to adequately police these instruments. The regime’s sole emphasis is on protecting investors,<sup>24</sup> but, in this case, it is both buyers and sellers who need protection. Human-equity investments are taking shape as complex instruments, where there is the potential for fraud and misunderstanding on both sides of the table.<sup>25</sup> Therefore, to complement the securities laws, there should be an additional layer of oversight aimed primarily at protecting those selling equity in themselves.<sup>26</sup> The rules could be set up and administered by the Consumer Financial Protection Bureau (“CFPB”), and would require not only disclosure, but also compliance with substantive limits on such matters as how much equity a person may agree to sell and for how long such equity may be transferred.<sup>27</sup> These and similar rules would allow a market in human equity to exist, while mitigating the risk of abuse. Prescribing limits on these contracts would also reduce the social harm that comes with treating people like financial assets—something the securities laws were never equipped to handle.

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18. See *infra* Part IV.B.

19. See *infra* text accompanying notes 214–16.

20. See *infra* Part IV.

21. See *infra* Part V.A. I also consider more briefly the applicability of other relevant legal regimes, including wage assignment laws, *infra* note 153, usury laws, *infra* note 312, and federal lending laws, *infra* notes 307, 317.

22. See *infra* Part V.B.

23. See *infra* text accompanying notes 289–93.

24. See Jeff Schwartz, *Fairness, Utility, and Market Risk*, 89 OR. L. REV. 175, 181 (2010).

25. See *infra* Part IV.B.2.

26. See *infra* Part VI.

27. See *infra* Part VI.

Part II of this Article looks at the intellectual foundation of investing in people, as well as previous instantiations of the idea. Part III then describes its recent rise. In this Part, I describe three of the most prominent equity-sharing ventures, with an emphasis on the workings of Pave, which typifies the crowdfunding model. In Part IV, I consider whether these instruments should be outlawed on the basis of the Thirteenth Amendment or public policy. I conclude that neither warrants this result. Part V then looks at the regulation of human-equity investing. I argue that while these arrangements are rightfully regulated as securities, this oversight framework would fail to protect those selling their equity or broader social interests. Therefore, in Part VI, I recommend a complementary regulatory structure that would ensure, among other things, that those who agree to sell shares in themselves know exactly what they are getting into.

## II. THE HISTORY OF EQUITY INVESTMENTS IN PEOPLE

A direct embrace of Milton Friedman's suggestion that people sell equity in themselves to finance professional education has only recently occurred. But his recommendation earlier spurred the creation of educational loans that incorporate this concept. The other, completely unrelated, area where the idea had gained traction prior to the burgeoning interest now occurring is in professional sports.

### A. *Milton Friedman and Financing Professional Education*

Friedman fleshes out the idea of equity investing in people in his 1955 article, *The Role of Government in Education*.<sup>28</sup> He begins by noting that not all of those seeking higher education are fortunate enough to have their schooling paid for by their parents or other benefactors.<sup>29</sup> Friedman sees a role for government in assisting these individuals, but only if their aim is a college education, rather than a professional degree.<sup>30</sup> College attendance, Friedman argues, yields positive externalities, or as he puts it, "neighborhood effects," because society as a whole is better off with an educated populace;<sup>31</sup> this broader social good justifies government intervention. Friedman sees professional education, though, as a purely private investment, where the student fully captures the gains in the form of higher compensation.<sup>32</sup> Thus, Friedman argues, the market should be the source of external financing, rather than the government.<sup>33</sup>

In other contexts, funding gaps can be closed by taking out a loan. Friedman notes, however, that traditional loans are not well-suited for

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28. Friedman, *Role of Government*, *supra* note 9.

29. *Id.* at 125–26.

30. *Id.* at 126.

31. *Id.* at 124–25.

32. *Id.* at 126, 135.

33. *See id.* at 135–39.

education. First, there is no collateral. If a lender makes a loan to finance the purchase of a factory, and the borrower defaults, then at least the lender can take the factory. But if someone does not pay back an education loan, in a “non-slave state,” the lender cannot take the defaulting borrower.<sup>34</sup> Friedman also argues that educational loans are risky. Though a professional education generally leads to a higher salary, there is a wide distribution around the mean depending on “ability, energy, and good fortune.”<sup>35</sup> The lack of collateral and high risk means that these loans will be expensive—so expensive that the terms would violate usury laws or at least be too costly to be attractive to borrowers.<sup>36</sup> The answer, according to Friedman, is equity investments in people:

The device adopted to meet the corresponding problem for other risky investments is equity investment plus limited liability on the part of shareholders. The counterpart for education would be to “buy” a share in an individual’s earning prospects: to advance him the funds needed to finance his training on condition that he agree to pay the lender a specified fraction of his future earnings. In this way, a lender would get back more than his initial investment from relatively successful individuals, which would compensate for the failure to recoup his original investment from the unsuccessful.<sup>37</sup>

Friedman opines that “[t]here seems no legal obstacle to private contracts of this kind, even though they are economically equivalent . . . to partial slavery.”<sup>38</sup>

Though he envisions these instruments for use in financing only law and other professional degrees, Friedman’s logic is not self-limiting. Under his analysis, equity investments in people fill a void whenever personal loans would be too risky.

### B. *Human-Equity Investing and Income Contingent Loans*

Friedman’s idea was not wholeheartedly adopted in the education realm, but it was not ignored. Rather, the concept of investing in people to fund their education morphed into the income-contingent loan (“ICL”).<sup>39</sup> In these financial arrangements, students borrow the necessary funds and pay back a certain percentage of their income until the loan is repaid or the repayment period expires.<sup>40</sup> If the term of the loan ends before the loan is fully repaid, the borrower has nevertheless satisfied the repayment obligation. Capping repayment at a portion of income provides relief for low-income borrowers. ICLs, therefore, borrow from

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34. *Id.* at 137.

35. *Id.*

36. *Id.* at 137–38.

37. *Id.* at 138.

38. *Id.* Although Friedman prefers a private market in human equity, he also recommends that the government serve as the human-equity investor as a fallback. *See id.* at 144.

39. MIGUEL PALACIOS LLERAS, *INVESTING IN HUMAN CAPITAL: A CAPITAL MARKETS APPROACH TO STUDENT FUNDING* 48 (2007).

40. *Id.* at 123.

Friedman the idea of income-linked payments, but repurpose the practice as a way to make student loans more affordable for those envisioning less remunerative careers. Before expansion of the federal loan program in the 1970s, a few universities experimented with different versions of ICLs.<sup>41</sup> In the early 1990s, ICLs became public policy as part of the federal lending landscape.<sup>42</sup>

Yale had an ambitious ICL program in the 1970s.<sup>43</sup> At Yale, the students promised to pay back 0.4% of their income for every \$1000 they borrowed.<sup>44</sup> Rather than treat each student individually, however, the debt of an entire entering class was pooled together. Each member of the class was obligated to pay the income percentage corresponding to the amount borrowed until the debt load of the entire cohort was paid off, including principal plus interest, or until the end of the repayment period (thirty-five years).<sup>45</sup> The pooling created cross-subsidization. Yale offered the same terms to all students with the idea that the payments by the higher earners would offset those of the lower earners.<sup>46</sup> The school's collectivist approach stands in contrast to Friedman's proposal, where everyone is an island. Under Friedman's individualistic approach, all students are valued in terms of their future earnings prospects and receive only so much as warranted pursuant to this valuation.<sup>47</sup>

With the advent of federal student loans, Yale discontinued the program.<sup>48</sup> The school's experiment is considered a flop. Yale had difficulty collecting from its wealthier alumni, who started balking at their large payment obligations.<sup>49</sup> Fearing soured relations with its former students, Yale failed to vigorously demand payment.<sup>50</sup> Without the backing of the high earners, the system began to collapse, and the remaining loan balances were forgiven in 2001.<sup>51</sup>

ICLs, though, live on in the federal student loan program. Traditionally, the federally subsidized student loan is paid off in monthly in-

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41. See *id.* at 47.

42. See Philip G. Schrag, *Federal Student Loan Repayment Assistance for Public Interest Lawyers and Other Employees of Governments and Nonprofit Organizations*, 36 HOFSTRA L. REV. 27, 30–31 (2007). ICLs have also been used as a mechanism for educational funding abroad. See LLERAS, *supra* note 39, at 131–43.

43. See William M. Bulkeley, *Some Yale Alumni Find That They Owe Their Alma Mater a Real Debt*, WALL ST. J., Feb. 23, 1999, <http://www.wsj.com/articles/SB919722795412915000>; Timothy Noah, *Yalie Crybabies*, SLATE (Feb. 23, 1999, 12:05 PM), [http://www.slate.com/articles/news\\_and\\_politics/chatterbox/1999/02/yalie\\_crybabies.html](http://www.slate.com/articles/news_and_politics/chatterbox/1999/02/yalie_crybabies.html).

44. Bulkeley, *supra* note 43.

45. *Id.*

46. *Id.*

47. See Friedman, *Role of Government*, *supra* note 9, at 141–42.

48. Noah, *supra* note 43.

49. See Bulkeley, *supra* note 43.

50. See LLERAS, *supra* note 39, at 125–31; Noah, *supra* note 43.

51. See *Yale to Erase Alumni Debts in 2 Loan Plans*, N.Y. TIMES, Apr. 13, 1999, <http://www.nytimes.com/1999/04/13/nyregion/yale-to-erase-alumni-debts-in-2-loan-plans.html>.



stallments over its term.<sup>52</sup> Beginning in 1993, however, the government began introducing a series of income-contingent repayment options, all with the same basic structure, but each with more favorable terms than the previous iteration. The 1993 version was the “income contingent repayment plan.”<sup>53</sup> This was complemented by “income-based repayment” (“IBR”) in 2007,<sup>54</sup> which was followed by “pay as you earn” repayment (“PAYE”) at the end of 2012.<sup>55</sup>

Under PAYE, monthly loan obligations are capped at ten percent of “discretionary income.”<sup>56</sup> This is the difference, on a monthly basis, between a person’s adjusted gross income (line 37 on an IRS Form 1040) and one hundred fifty percent of the poverty line, which is keyed to a borrower’s family size and state of residence.<sup>57</sup> Loan amounts not repaid after twenty years are forgiven.<sup>58</sup> PAYE is only available to those with a “partial financial hardship,” meaning that the amount they would owe under a standard ten year repayment plan would be greater than ten percent of their discretionary income.<sup>59</sup> The result of PAYE’s intricate structure is that income-linked repayment is only available to, and useful for, those with relatively low incomes and relatively high debts. Only borrowers in this situation would, absent PAYE, owe more than ten percent of their discretionary income each month.<sup>60</sup>

PAYE differs from Friedman’s conception of human-equity investing in that, like Yale’s program, students are not individually evaluated and awarded reflective terms. The lack of individual pricing means that some PAYE participants must be subsidized. In Yale’s program, high earners subsidized the less well-remunerated; under PAYE, the federal government fills this role.<sup>61</sup> Also in contrast to Friedman, under PAYE,

52. See U.S. DEP’T OF EDUC., YOUR FEDERAL STUDENT LOANS: LEARN THE BASICS AND MANAGE YOUR DEBT 25 tbl.9 (2010), available at [https://studentaid.ed.gov/sites/default/files/your-federal-student-loans\\_1.pdf](https://studentaid.ed.gov/sites/default/files/your-federal-student-loans_1.pdf).

53. See Schrag, *supra* note 42, at 30–31.

54. See *id.* at 34–35.

55. See Press Release, U.S. Dep’t of Educ., Education Department Launches ‘Pay As You Earn’ Student Loan Repayment Plan (Dec. 21, 2012), available at <http://www.ed.gov/news/press-releases/education-department-launches-pay-you-earn-student-loan-repayment-plan>; cf. Press Release, The White House, We Can’t Wait: Obama Administration to Lower Student Loan Payments for Millions of Borrowers (Oct. 25, 2011), available at <http://www.whitehouse.gov/the-press-office/2011/10/25/we-cant-wait-obama-administration-lower-student-loan-payments-millions-b> (announcing the new repayment program).

56. FED. STUDENT AID, *Overview of Direct Loan and FFEL Program Repayment Plans*, U.S. DEP’T OF EDUC., <http://studentaid.ed.gov/repay-loans/understand/plans> (last visited Jan. 30, 2015).

57. *Id.*

58. *Id.*

59. *Id.*

60. One additional innovation, found both in IBR and PAYE, is a special benefit for those who go into public service. Eligible public-service employees can have their remaining loan balances forgiven after ten years. See Schrag, *supra* note 42, at 41. Public service includes governmental and non-profit work. See *id.* at 46 n.75.

61. Federal student loans are subsidized in a variety of ways. For descriptions, see CONG. BUDGET OFFICE, A CBO STUDY: COSTS AND POLICY OPTIONS FOR FEDERAL STUDENT LOAN PROGRAMS 16 (2010), available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/110xx/doc11043/03-25-studentloans.pdf> (describing the interest rate subsidy); CONG. BUDGET OFFICE, OPTIONS TO CHANGE INTEREST RATES AND OTHER TERMS ON STUDENT LOANS 3–7 (2013), available at <http://>

the government lays claim to a portion of a student's *discretionary* income, rather than *total* income.

While PAYE is a long way from human-equity investing, a glimmer of Friedman's ideas remain. The basic structure of PAYE, whereby participants fund their educations with a percentage of their future income, rather than through fixed monthly payments, is rooted in Friedman's vision.

### C. *Human-Equity Investing and Financing Athletes*

Equity investing in people has been adopted much more cleanly in professional sports. Junior golfers and tennis players who aspire to the professional ranks have been known to accept money from investors in exchange for a share in their future earnings.<sup>62</sup> Poker players have similar arrangements; investors may provide all or part of the entry fee for a specific tournament in exchange for a share of the prize money.<sup>63</sup> More sophisticated arrangements also exist. Some backers have a portfolio of poker players, called a "'stable' of 'horses,'" whom they support over the long-term in exchange for a piece of the winnings.<sup>64</sup> There are even funds that assemble portfolios of players as if they were stocks.<sup>65</sup>

In 2008, Randy Newsom, a minor league baseball player at the time, attempted to expand the concept to mainstream sports.<sup>66</sup> On his website, Real Sports Investments, he attempted to raise \$50,000 by selling 2500 shares of himself for \$20 apiece.<sup>67</sup> Each share would entitle the holder to 0.002% of his pay should he make it to the major league.<sup>68</sup> If the entire allotment was sold, this would account for four percent of Mr. Newsom's career earnings.<sup>69</sup> While he originally hoped that other professional and aspiring professional athletes would follow his lead, he decided to shut down his website before that could happen out of fear that he was violating the securities laws and the rules of Major League Baseball.<sup>70</sup>

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[www.cbo.gov/sites/default/files/cbofiles/attachments/44318-StudentLoans.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/44318-StudentLoans.pdf) [hereinafter TERMS ON STUDENT LOANS] (describing student loan subsidies and estimating their costs); see also Aaron N. Taylor, *Undo Undue Hardship: An Objective Approach to Discharging Federal Student Loans in Bankruptcy*, 38 J. LEGIS. 185, 203–04 (2012).

62. See Roy Furchgott, *For Sports Investors, Dividends May Be Ringside Seats*, N.Y. TIMES, Dec. 29, 1996, <http://www.nytimes.com/1996/12/29/business/for-sports-investors-dividends-may-be-ringside-seats.html>; Josh Levin, *Bullpen Market*, SLATE (Jan. 25, 2008, 5:27 PM), [http://www.slate.com/articles/sports/sports\\_nut/2008/01/bullpen\\_market.single.html](http://www.slate.com/articles/sports/sports_nut/2008/01/bullpen_market.single.html).

63. Berzon, *supra* note 11.

64. *Id.*

65. See *id.*

66. See Levin, *supra* note 62.

67. *Id.* See Alan Schwarz, *Buying Low: Minor Leaguer Takes Stock of Himself*, N.Y. TIMES, Feb. 1, 2008, [http://www.nytimes.com/2008/02/01/sports/baseball/01minors.html?pagewanted=print&\\_r=0](http://www.nytimes.com/2008/02/01/sports/baseball/01minors.html?pagewanted=print&_r=0).

68. See Schwarz, *supra* note 67.

69. Levin, *supra* note 62.

70. See Schwarz, *supra* note 67; cf. Michael Lewis, *The Jock Exchange*, UPSTART BUS. J. (Apr. 16, 2007, 12:00 AM), <http://upstart.bizjournals.com/culture-lifestyle/culture-inc/sports/2007/04/16/The-Jock-Exchange.html?page=all> (praising the idea of equity investing in athletes).

OneSeason was another effort in this vein. In this online market, there were initial public offerings (“IPOs”) for professional athletes at \$5 per share.<sup>71</sup> The stock would then trade on OneSeason’s exchange, rising and falling with on-field performance.<sup>72</sup> At one point the value of the market reached over \$300,000.<sup>73</sup> The trouble with this platform, though, was that individuals were technically trading only “synthetic ownership interests.”<sup>74</sup> The shares were in no way tied to the players’ actual earnings and therefore had no intrinsic value. Eventually, something spooked the market, and it collapsed. OneSeason shut its doors several years ago.<sup>75</sup>

Such woes have prevented human-equity investing from extending beyond ICLs and the periphery of sports.<sup>76</sup> Despite these failures, entrepreneurs in the field today are looking to push the concept into the mainstream.

### III. EQUITY INVESTING FOR EVERYONE

Equity investing in people is the basis for a wave of recently-launched startups.<sup>77</sup> Each has its own unique business purpose and platform. There has been a well-publicized launch of a new professional athlete exchange, while other startups seek to make these instruments broadly available as a way to fund education and entrepreneurship. In this Part, I briefly describe three of the most prominent ventures—Fantex, Pave, and Lumni—with a focus on Pave, as it is the most ambitious.

As its name suggests, Fantex is the company behind the new athlete exchange.<sup>78</sup> It is similar to its predecessors in the sports arena in that it hopes to create a vibrant market where professional athletes are traded

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71. Sean Gregory, *Playing the Jock Market*, TIME, Oct. 3, 2008, <http://content.time.com/time/arts/article/0,8599,1847296,00.html>.

72. *See id.*

73. *Id.*

74. *Id.*

75. *See* Brian Osborne, *OneSeason.com’s Season Comes to a Close*, GEEK (Nov. 16, 2009, 6:37 PM), <http://www.geek.com/news/onesession-coms-season-comes-to-a-close-981432/>.

76. In the entertainment industry, there has been some experimentation with financial arrangements that resemble human-equity investing. Most famously, David Bowie sold to investors \$55 million worth of bonds at a 7.9% interest rate backed by royalties from his record catalogue. *See* Nick Fleming, *Bowie: Man Whose Bonds Fell to Earth*, TELEGRAPH (Mar. 25, 2004, 12:01 AM), <http://www.telegraph.co.uk/news/uknews/1457666/Bowie-man-whose-bonds-fell-to-earth.html>; *Bowie Bonds Under Review*, BILLBOARD (May 28, 2003, 12:00 AM), <http://www.billboard.com/articles/news/70882/bowie-bonds-under-review>. Because Mr. Bowie forfeited his right to the future income he would have received from his catalogue in exchange for the \$55 million up front, he put himself in a position similar to that of a human-equity investee. There is also a fantasy market, the “Hollywood Stock Market,” where players can buy “shares” of actors and movies with “Hollywood Dollars,” and “[w]atch their values rise or fall based on their success . . . .” *What is HSX Anyway?*, HSX, <http://www.hsx.com/help/> (last visited Jan. 30, 2015). Unlike OneSeason’s experiment, no real money is at stake, and the platform appears to be thriving. *Id.*

77. *See supra* note 3 (noting various new startups centered on human-equity investing).

78. *See What is Fantex?*, FANTEX, <https://fantex.com/> (last visited Jan. 30, 2015).

like stock.<sup>79</sup> Its biggest advance from previous iterations is that it has big-name participants, including Arian Foster, a star running back, and Vernon Davis, a star tight end, both of whom have agreed to sell shares of their future income.<sup>80</sup> The former, for instance, has agreed to part with twenty percent of his future earnings for \$10 million.<sup>81</sup> Interestingly—and somewhat morbidly—investments in these athletes are indefinite.<sup>82</sup> If, for example, Mr. Foster licenses his likeness for use on a popular line of shoes, investors would continue to profit from the commercial arrangement even after Mr. Foster has passed away. Like an equity investment in a corporation, Fantex investments would have the potential to payout in perpetuity.

Though the company has received a great deal of attention, Fantex is off to a rocky start. Both Mr. Foster and Mr. Davis were injured after signing on.<sup>83</sup> As a result, offerings in both individuals were postponed.<sup>84</sup> In addition, Fantex is relatively unimaginative. IPOs in famous athletes may be entertaining, but they have limited social import. Fantex's focus on an infinitesimal segment of the population means that it lacks the transformative potential of other new ventures.

The same cannot be said about Pave. In its nascent marketplace, young people, who are referred to as “Talent,” put shares of their future income up for sale to investors, who are called “Backers.”<sup>85</sup> Generally speaking, Talent seek the money to start businesses, retire existing student debt, or fund postsecondary education, including college, professional degrees, and specialty training.<sup>86</sup> Several, for example, seek financing for computer programming boot-camps.<sup>87</sup> Only individuals between the ages of eighteen and forty are eligible to participate.<sup>88</sup>

To attract funding, Talent are encouraged to promote themselves on the website with a “compelling photo,” a brief biography, and a video

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79. See Peter Lattman & Steve Eder, *If You Like a Star Athlete, Now You Can Buy a Share*, N.Y. TIMES DEALBOOK (Oct. 17, 2013, 8:31 AM), [http://dealbook.nytimes.com/2013/10/17/want-a-piece-of-a-star-athlete-now-you-really-can-buy-one/?\\_r=2](http://dealbook.nytimes.com/2013/10/17/want-a-piece-of-a-star-athlete-now-you-really-can-buy-one/?_r=2).

80. Peter Lattman, *A Second N.F.L. Player Signs Public Offering Deal*, N.Y. TIMES DEALBOOK (Oct. 31, 2013, 1:06 PM), <http://dealbook.nytimes.com/2013/10/31/fantex-adds-another-athlete-to-its-ip-o-roster/>.

81. Lattman & Eder, *supra* note 79.

82. See Fantex, Inc., Registration Statement (Form S-1), at 5 (Oct. 31, 2013), available at <http://www.sec.gov/Archives/edgar/data/1573683/000104746913010117/a2217205zs-1a.htm> (“[T]he Fantex Series Arian Foster is intended to track the performance of Arian Foster's brand over his lifetime, which could potentially be very short, and thereafter.”).

83. Mike Ozanian, *Good News for Investors: Fantex Unplugged by Injuries to Foster and Davis*, FORBES (Dec. 4, 2013, 12:35 PM), <http://www.forbes.com/sites/mikeozanian/2013/12/04/good-news-for-investors-fantex-unplugged-by-injuries-to-foster-and-davis/>.

84. *Id.* Mr. Davis' offering eventually went forward and ownership interests traded for around \$10.50 per share in July 2014. See *Fantex Vernon Davis*, FANTEX, <https://fantex.com/fantex-vernon-davis-215595> (last visited Jan. 30, 2015).

85. *What is Pave?*, *supra* note 3.

86. See *Success Stories*, PAVE, <https://www.pave.com/success-stories/> (last visited Jan. 30, 2015).

87. See Karim Bishay, *How Do I Pay for Dev Bootcamp?*, DEV BOOTCAMP (Feb. 12, 2014), <http://devbootcamp.com/2014/02/12/paying-for-dev-bootcamp/>.

88. *What are the Requirements for Talent?*, PAVE, <https://www.pave.com/introduction/talent> (last visited Jan. 30, 2015).

clip.<sup>89</sup> They are also advised to build buzz for their funding campaigns by sharing their progress on Facebook and other social networking sites.<sup>90</sup> One Talent, Grace Rodriguez, has a photo of herself wearing Google Glass and describes herself this way: “I work to empower passionate people to solve real problems. I play to inspire and innovate. I aim to change the world. Starting yesterday.”<sup>91</sup>

Backers also share a photo and brief biography on Pave. Tom Whitnah, for instance, lists himself as a “Facebook Software Engineering Manager,” who is a “mountain unicycling techie.”<sup>92</sup> Clicking on a Backer brings up, among other things, pictures of all the Talent in a Backer’s portfolio. Mr. Whitnah has invested in eight individuals.<sup>93</sup> The ability to invest is limited to “accredited investors,”<sup>94</sup> which, as defined by the securities laws, essentially means financial institutions and wealthy individuals.<sup>95</sup>

Part of Pave’s ambition is to engender mentoring relationships between Talent and their Backers. It seeks to create a “relaxed and rewarding environment for young people and experienced people to share experiences, collaborate and [build] connections.”<sup>96</sup> The heart of the relationship, though, is financial. Talent can elect to share income for five or ten years<sup>97</sup> and are only permitted to part with up to a ten percent stake.<sup>98</sup>

How much money each Talent can raise within these parameters is driven by the valuation the person receives from Pave. The company employs a “proprietary model”<sup>99</sup> to predict each Talent’s future income based on things like school attended or attending, major, and standardized tests scores.<sup>100</sup> Pave then present values for these predictions using a required rate of return of seven percent, meaning that, if all goes according to plan and a Talent earns exactly as predicted, the Talent’s Backers

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89. See *Campaign Toolkit*, PAVE, <https://www.pave.com/financial-assistance-millennials> (last visited Jan. 30, 2015).

90. See *id.*

91. See *Grace Rodriguez*, PAVE, <http://www.pave.com/user/524c5253afe8f91c47090810> (last visited Jan. 30, 2015).

92. *Tom Whitnah*, PAVE, <https://www.pave.com/user/52b8c513afe8f925ca49b543> (last visited Jan. 30, 2015).

93. *Id.*

94. *Who Is Eligible to Invest on Pave?*, PAVE, [http://support.pave.com/knowledge\\_base/topics/who-is-eligible-to-invest-on-pave](http://support.pave.com/knowledge_base/topics/who-is-eligible-to-invest-on-pave) (last visited Jan. 30, 2015).

95. See 17 C.F.R. § 230.501(a) (2014).

96. *What is Pave?*, PAVE, <http://www.pave.com/learn-more> (last visited Jan. 30, 2015).

97. *Student Loans Suck. We Can Help You Live Without Debt*, PAVE, <http://hello.pave.com/erase-student-debt-live-debt-free/> (last visited Jan. 30, 2015).

98. Tara Siegel Bernard, *Program Links Loans to Future Earnings*, N.Y. TIMES, July 19, 2013, [http://www.nytimes.com/2013/07/20/your-money/unusual-student-loan-programs-link-to-future-earnings.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2013/07/20/your-money/unusual-student-loan-programs-link-to-future-earnings.html?pagewanted=all&_r=0). Backers can invest in increments as low as \$500. Matthew Milner, *Want 10% of My Salary?*, CROWDABILITY (Apr. 23, 2014), <http://www.crowdability.com/article/detail/544/want-10-of-my-salary#.VEwTf6Lo3Y>.

99. *Our Model*, PAVE, <https://www.pave.com/funding-model> (last visited Jan. 30, 2015).

100. *Id.*

earn seven percent on their money.<sup>101</sup> Based on the cash-flow prediction and rate of return, the company assigns each Talent a “funding rate”—this is the amount of money that the person may charge for each one percent of income shared.<sup>102</sup>

For example, assume one particular Talent has elected to share income for ten years and that the model predicts that over that time period this person will earn \$200,000 per year. If a Backer purchases a one percent share of this Talent’s future income, the Backer would expect to receive \$2,000 per year. At a seven percent rate of return, this income stream is worth about \$14,047. That would be this Talent’s funding rate—the amount this person would charge for a one percent share. With a \$14,047 funding rate, a Talent could raise about \$140,471 without crossing the ten percent cap.

In contrast, take an individual for whom the model projects an expected annual income of only \$50,000. This equates to \$500 per year for a one percent share. Discounted at a seven percent rate of return, this stream of future cash flows is only worth—and will therefore only cost—about \$3,512. The decreased funding rate reflects the lesser earnings prospects of this individual. The lower rate hurts the Talent because it means that this person can raise far less money. Sale of a ten percent stake in this case would only yield about \$35,118.

There is a strong analogy here to the pricing of a corporate IPO. The higher the company’s valuation, the higher its share price, and the more money the founders can raise. Moreover, if the founders wish to raise a specified sum, a higher share price means they need to sell fewer shares. This allows them to keep a larger share of their business.<sup>103</sup> Similarly, students with higher valuations can raise more money and keep a larger share of their future income, as compared to students with less glowing financial projections. Just as Friedman envisioned, there is a clear advantage for more lucrative careers.<sup>104</sup>

The specifics of the relationship between Talent and their Backers are laid out in Pave’s “Income-Linked Payment Agreement.”<sup>105</sup> Pave keeps this agreement confidential but discloses many of the main provisions on its website. One key term is the definition of “income” for sharing purposes. Pave equates this to “total income” as calculated on Line 22 of IRS Form 1040.<sup>106</sup> In one sense, this definition is quite broad. In ad-

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101. *See id.*

102. *Id.*

103. *See* Jeff Schwartz, *The Twilight of Equity Liquidity*, 34 *CARDOZO L. REV.* 531, 537 (2012).

104. *See* Friedman, *Role of Government*, *supra* note 9, at 142.

105. Charles Luzar, *Pave Has Crowdfunded Individuals . . . Now They Will Fund Groups*, *CROWDFUND INSIDER* (Feb. 4, 2014, 9:00 AM), <http://www.crowdfundinsider.com/2014/02/31292-pave-crowdfunded-individuals-now-want-fund-groups/> (quoting Oren Bass, COO of Pave, “Investing in talented, motivated individuals with IPAs is now being recognized as a stable, very exciting way of investing, effectively turning talent into an asset”).

106. *What Counts as Income?*, *PAVE*, <https://www.pave.com/introduction/talent> (last visited Jan. 30, 2015).

dition to salary and business income,<sup>107</sup> this line item includes, among other things, interest, dividends, alimony, and capital gains.<sup>108</sup> But this tax-based calculation of income does not fully capture equity compensation. While the tax treatment can be complex, the basic rules are that stock grants are included in income once the stock is vested and stock options are included once they are exercised.<sup>109</sup> The result is that Backers lose out on the value of unvested stock and unexercised options. Absent specially-targeted language in Pave's proprietary agreement, this is a surprising gap.

In a departure from pure equity sharing, Pave builds in two types of protection for Talent. With a strict equity investment, a Talent who turns out to be the next Mark Zuckerberg would end up paying Backers an exorbitant amount. While it could be argued that this is just part of the bargain, the company has elected to give these high-fliers an out—albeit at a steep price. Talent has the option to end the sharing term upon payment of five times the amount raised.<sup>110</sup>

On the flipside, there is also a provision for Talent concerned about paying their Backers in lean times. In any year that Talent earns an amount less than one hundred fifty percent of the poverty line, no money is owed to Backers.<sup>111</sup> If Talent goes back to school, payments are also forgiven while enrolled, but these years are tacked onto the end of the sharing term.<sup>112</sup>

The remaining material terms that Pave makes public involve its own compensation. The company imposes an onboarding fee of three percent of the amount raised by Talent<sup>113</sup> and a servicing fee of 1.5 percent of each payment Talent remits to Backers.<sup>114</sup> It then charges a variety of fees that impact Talent who fail to live up to their administrative responsibilities under the funding agreement. For example, Talent are required to pay their Backers monthly based on their earnings during the

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107. The “business income” category is where earnings would be captured for those who are self-employed. Taxpayers are supposed to subtract their business losses from their business income and report the remainder on line 12, which is taken into account in total income. The mathematics are performed on Schedule C. See INTERNAL REVENUE SERV., FORM 1040 (2013), available at <http://www.irs.gov/pub/irs-pdf/f1040.pdf> [hereinafter FORM 1040]; INTERNAL REVENUE SERV., FORM 1040 (SCHEDULE C) (2013), available at <http://www.irs.gov/pub/irs-pdf/f1040sc.pdf> [hereinafter SCHEDULE C].

108. See FORM 1040, *supra* note 107.

109. See INTERNAL REVENUE SERV., PUBLICATION 525 TAXABLE & NONTAXABLE INCOME 11 (2013), available at <http://www.irs.gov/pub/irs-pdf/p525.pdf>; G. Edgar Adkins, Jr. & Jeffrey A. Martin, *Restricted Stock: The Tax Impact on Employers & Employees*, GRANT THORNTON, [http://www.grantthornton.com/staticfiles/GTCom/Tax/CBC%20files/Restricted\\_stock\\_tax\\_impact.pdf](http://www.grantthornton.com/staticfiles/GTCom/Tax/CBC%20files/Restricted_stock_tax_impact.pdf) (last visited Jan. 30, 2015).

110. *Can an Individual Exit the Contract Early?*, PAVE, <https://www.pave.com/introduction/backer> (last visited Jan. 30, 2015).

111. *Is There Ever a Time that I Don't Need to Share Income?*, PAVE, <http://www.pave.com/introduction/talent> (last visited Jan. 30, 2015).

112. *Id.*

113. Bernard, *supra* note 98.

114. *Id.*

term.<sup>115</sup> To assure compliance, Talent are required to submit their annual tax returns to Pave, which then compares what the Talent paid over the year to what they should have paid based on their taxable income.<sup>116</sup> If the discrepancy is greater than twenty-five percent, Pave charges an under payment fee of five percent of the underpayment.<sup>117</sup> There are also a variety of other fees potentially implicated in the payment and reconciliation process, including a late payment fee, a late tax return fee, and a returned payment fee.<sup>118</sup>

One final startup of note is Lumni. It differs from Fantex and Pave in that it has a well-defined social mission and only facilitates indirect human-equity investments. Lumni seeks to provide funding for low-income students who are the first in their families to attend college.<sup>119</sup> Because of this mission, Lumni pitches itself to investors as a way to earn both a monetary and a social return.<sup>120</sup> With Lumni, funds do not flow directly to the students; rather, they go to the educational institution.<sup>121</sup> Though it has more ambitious goals internationally, within the United States, its focus is on helping college students fill the gap that is often left between the amount they can finance through federal student loans and the full expense of a college education,<sup>122</sup> which can be thousands of dollars.<sup>123</sup>

Lumni also takes a different approach to connecting investors with those seeking funds. Whereas Pave plays the role of market-maker, Lumni acts more like a mutual fund manager. The company puts together “diversified pools of students,”<sup>124</sup> which it calls “human capital funds,”<sup>125</sup> and investors buy shares in these pools.<sup>126</sup> The money they invest goes to fund students, who pay back into the fund a set percent of their future income for a predetermined term.<sup>127</sup> As in Pave, each investee is individually valued. The amount they receive towards their educa-

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115. *How Do Talent Payments Work?*, PAVE, <https://www.pave.com/introduction/backer> (last visited Jan. 30, 2015).

116. *See Example Prospect Agreement*, PAVE, <http://www.pave.com/shared/static/images/example-prospect-agreement.pdf> (last visited Jan. 30, 2015).

117. *Id.*

118. *Id.*

119. *About Lumni*, LUMNI, <http://www.lumni.net/about/> (last visited Jan. 30, 2015).

120. *See For Potential Investors*, LUMNI, <http://www.lumni.net/forpotentialinvestors/> (last visited Jan. 30, 2015).

121. *See About Lumni*, *supra* note 119.

122. *See Lumni Fills the Gap in Funding College Education*, LUMNI, <http://www.lumniusa.net/lumni-fills-the-gap-in-funding-college-education> (last visited Jan. 30, 2015).

123. *See id.*; Erin Dillon & Kevin Carey, *Drowning in Debt: The Emerging Student Loan Crisis*, EDUCATION SECTOR 2 & Chart 3 (July 8, 2009), available at [http://people.ucsc.edu/~bmalone/Analyses\\_files/CYCT\\_Student\\_Aid.pdf](http://people.ucsc.edu/~bmalone/Analyses_files/CYCT_Student_Aid.pdf); *see also* CONSUMER FIN. PROT BUREAU, PRIVATE STUDENT LOANS 10 n.10, 85 (2012), available at <http://www.consumerfinance.gov/reports/private-student-loans-report/>. Federal PLUS loans are an additional supplement. Parents are the borrowers on these instruments, which do not have the same limits as the traditional, and more favorable, Stafford loans. *See id.* at 10.

124. *For Potential Investors*, *supra* note 120.

125. *For Corporations*, LUMNI, <http://www.lumni.net/forcorporations/> (last visited Jan. 30, 2015).

126. *See About Lumni*, *supra* note 119.

127. *Id.*



tion and what percent of their future income they are required to share in return is set by Lumni analysts who “forecast individual students’ income curves.”<sup>128</sup>

Lumni, Fantex, and Pave are representative of the growing interest in human-equity investing. This innovative form of funding erases longstanding financial boundaries and has the potential to reshape how people pay for life’s most important and expensive things, but it brings with it significant legal and policy concerns.

#### IV. THE LEGALITY OF INVESTING IN PEOPLE

The novelty of human-equity investing begs questions about its legality. Skeptics could conceivably challenge it as a form of slavery in violation of the Thirteenth Amendment or as contrary to public policy. In this Part, I consider, and ultimately reject, both objections.

##### A. *Thirteenth Amendment Analysis*

Is Friedman’s remark that human-equity investing is tantamount to “partial slavery” correct?<sup>129</sup> Slavery itself is much more nefarious than what is happening here. It is involuntary and the owner has full control over the enslaved person. At the same time, however, his claim strikes a chord. The intuitive link between the two relationships has to do with their underlying economics, where there is a difference in degree but not in kind. Enslaved individuals owe one-hundred percent of their income to their owners, while human-equity investees typically give up far less. Moreover, unless regulation is put in place, there is nothing to stop people from selling larger and larger stakes in themselves and allowing investors to have greater and greater control over their future activities. Indeed, market pressure will likely push in this direction as the business of investing in people evolves.<sup>130</sup> Such a deepening of the relationship would make the comparison to slavery even more poignant.

The slavery analogy also rings true from a corporate perspective on ownership. People are viewed as owning part of a corporation when they have purchased a portion of the company’s stock.<sup>131</sup> And, from a corporate perspective, human equity is just like stock. Corporate stock gives the holder a claim to the future profits of the company, just as human

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128. *For Potential Investors*, *supra* note 120. As of 2011, Lumni had raised over \$17 million and funded nearly 2000 students with a default rate of under three percent. David Bornstein, *Instead of Student Loans, Investing in Futures*, N.Y. TIMES OPINIONATOR (May 30, 2011, 8:25 PM), [http://opinionator.blogs.nytimes.com/2011/05/30/instead-of-student-loans-investing-in-futures/?\\_r=2](http://opinionator.blogs.nytimes.com/2011/05/30/instead-of-student-loans-investing-in-futures/?_r=2). The company was founded in 2002, but only expanded to the United States in 2009. *Our Story*, LUMNI, <http://www.lumniusa.net/about/our-story> (last visited Jan. 30, 2015).

129. Friedman, *Role of Government*, *supra* note 9, at 138.

130. *See infra* text accompanying notes 174–77.

131. The Revised Model Business Corporation Act, for example, defines corporate shares as “the units into which the proprietary interests in a corporation are divided.” REV. MODEL BUS. CORP. ACT § 1.40(22) (2012).

equity entitles the holder to a share of the investee's future income.<sup>132</sup> Thus, by analogy to corporate shareholders, human-equity investors look like owners of people—something traditionally associated with slavery.

Despite these similarities, however, the contrast between human-equity investing and slavery is sufficient to take these arrangements out of the purview of the Constitution's prohibition. The Thirteenth Amendment is made up of two brief sections. According to section 1, "[n]either slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction."<sup>133</sup> Section 2 says that "Congress shall have power to enforce this article by appropriate legislation."<sup>134</sup>

The issue under section 1 is whether human-equity investing qualifies as "slavery" or "involuntary servitude" as those terms have been interpreted. The definition of slavery has been confined to include only that which was targeted by the Amendment itself—"the institution of African slavery as it had existed in the United States at the time of the Civil War."<sup>135</sup> Since equity investing in people is clearly not the same, it is not slavery under the Constitution.

"Involuntary servitude" has been interpreted only slightly more broadly. According to the Supreme Court, this phrase was "intended to extend 'to cover those forms of compulsory labor akin to African slavery which in practical operation would tend to produce like undesirable results.'"<sup>136</sup> More specifically, involuntary servitude applies to "situations in which labor is compelled by physical coercion or force of law."<sup>137</sup>

Stripped to their core, human-equity investments do not require "labor." The investees must share the fruits of their labor, but they are not actually required to work. No labor is therefore compelled. But promises of future effort can be implied in some of these relationships. For example, let us say that a Talent promises to use money raised through Pave to launch a new business; this promise carries with it an implicit obligation to work at making the venture a success.<sup>138</sup> One could also imagine an equity-sharing agreement wherein investees agree to actually seek employment commensurate with their credentials.

With language like this, investees must work, or at least seek work, to avoid liability for breach of contract. Thus, labor is arguably compelled, perhaps not by "physical coercion," but by "force of law." This is not the legal compulsion, however, that the Court has in mind. In the

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132. See CHARLES P. JONES, INVESTMENTS: ANALYSIS AND MANAGEMENT 348–50 (Marissa Ryan ed., 6th ed. 1998) (discussing the valuation of common stock and the role of earnings therein).

133. U.S. CONST. amend. XIII, § 1.

134. U.S. CONST. amend. XIII, § 2.

135. *United States v. Kozminski*, 487 U.S. 931, 942 (1988).

136. *Id.* (quoting *Butler v. Perry*, 240 U.S. 328, 332 (1916)).

137. *Id.* at 943.

138. Failing to take such actions could also constitute fraud, or as discussed *infra* note 285, securities fraud.

Court's eyes, this language makes it illegal for the government to force someone to work on threat of criminal sanction.<sup>139</sup> Human-equity investments—even if investors mandate future labor—are distinguishable, because no such threat compels investee agreement. Nor would breach of such a contract constitute a criminal offense. While “force of law” makes the arrangement binding, it does not compel entry or performance.<sup>140</sup>

Section 2 gives Congress the right to draft specific legislation consistent with section 1.<sup>141</sup> Pursuant to this authority, Congress outlawed peonage in 1867 under the Anti-Peonage Act.<sup>142</sup> Peonage is a form of involuntary servitude, whereby the peon is forced to serve the master to pay off some debt.<sup>143</sup>

Not being debt, human-equity investing falls outside of the statute's language. Debt, as traditionally defined, requires the repayment of a certain sum with interest.<sup>144</sup> Here, there is no interest, and there is no set sum to be repaid. Nevertheless, there is a structural similarity between this new form of financing and peonage. In *Bailey v. Alabama*, for example, Bailey received a \$15 advance.<sup>145</sup> In exchange, he promised to work for his employer for one year at a salary of \$12 per month.<sup>146</sup> To pay off the advance, he agreed to forfeit \$1.25 of the \$12 each month to his employer.<sup>147</sup> This is similar to equity investing in people in that a share of future income is traded for an upfront capital contribution.<sup>148</sup>

In *Bailey* the Supreme Court found no fault with the structure of the relationship. Bailey had been convicted of a crime and sentenced to hard labor for violating the contract pursuant to a statute criminalizing the breach of such agreements.<sup>149</sup> The Court overturned the conviction and

139. *Kozminski*, 487 U.S. at 943.

140. Because of involuntary-servitude concerns, courts do not specifically enforce employment contracts. See RESTATEMENT (SECOND) OF CONTRACTS § 367 (1981) [hereinafter RESTATEMENT]; Stewart E. Sterk, *Restraints on Alienation of Human Capital*, 79 VA. L. REV. 383, 445 (1993). Thus, if an investee breaks a promise to work for a certain employer, or even an investor, damages would be the only remedy. Involuntary-servitude language also sometimes shows up in opinions on noncompetition agreements. See William Lynch Schaller, *Jumping Ship: Legal Issues Relating to Employee Mobility in High Technology Industries*, 17 LAB. LAW. 25, 29 n.17 (2001). While specific enforcement may be denied on such grounds, the viability of the agreement itself is determined through a public policy analysis. See RESTATEMENT, *supra* §§ 188, 376; ORLY LOBEL, TALENT WANTS TO BE FREE: WHY WE SHOULD LEARN TO LOVE LEAKS, RAIDS, AND FREE RIDING 49–75 (2013) (surveying different approaches to assessing the enforceability of noncompetition agreements).

141. See U.S. CONST. amend. XIII, § 2.

142. Ch. 187, 14 Stat. 546 (1867) (current version at 18 U.S.C. § 1581 (2012)).

143. See *Clyatt v. United States*, 197 U.S. 207, 215 (1905).

144. *Gilbert v. Comm'r*, 248 F.2d 399, 402 (2d Cir. 1957) (“The classic debt is an unqualified obligation to pay a sum certain at a reasonably close fixed maturity date along with a fixed percentage in interest payable regardless of the debtor's income or lack thereof.”).

145. 219 U.S. 219, 229 (1911).

146. *Id.*

147. See *id.* at 230.

148. There is an important distinction, however, in that the *Bailey* arrangement involved a set amount to be taken out of a known salary, while human-equity investing involves a set percentage of unknown future earnings. A closer analogy to *Bailey* are pension advances, which I discuss *infra* notes 226, 312.

149. See *Bailey*, 219 U.S. at 236.

held the statute unconstitutional.<sup>150</sup> Thus, even if a court were to look past the language of the Anti-Peonage Act and to the structure of the relationship, precedent still supports human-equity investing. The only limitation from *Bailey* is that legislatures may not criminalize breach. In the end, while there are similarities between human-equity investing and both involuntary servitude and peonage, prohibitions on such relationships fail to provide grounds for finding transactions in human equity unconstitutional.<sup>151</sup>

### B. Public Policy Analysis

Though neither legislatures nor courts have outlawed these arrangements, both have the authority to do so upon concluding that they violate public policy.<sup>152</sup> Society prohibits the sale of organs and babies on such grounds;<sup>153</sup> it could likewise prohibit the sale of human equity. I argue *infra*, however, that such an outcome is unwarranted.

The decision whether a certain type of arrangement violates public policy necessarily involves the weighing of competing concerns. Private contracts have the potential to benefit, as well as harm, both the transacting parties and society at large. A class of transactions should only be outlawed if, on balance, it appears that they do more harm than good. When conducting this sort of analysis, it makes sense to err on the side of permissiveness. What will happen is difficult to predict *ex ante*. If arrangements are outlawed, then society will never know the benefits that could have been; whereas, if they are permitted and problems arise, they can be outlawed at that time. Outright prohibition is also an extreme response and should be undertaken only if regulation would not address societal concerns.

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150. See *id.* at 245.

151. There is some intuition behind the idea that these arrangements constitute an illicit tax. As with the income tax, the investees here agree to give up a percent of their income each year. The resemblance may pose a problem because under the Constitution only the government—in particular, Congress—has the power to tax. Ronald J. Krotoszynski, Jr., *Reconsidering the Nondelegation Doctrine: Universal Service, the Power to Tax, and the Ratification Doctrine*, 80 IND. L.J. 239, 241 (2005). The similarity, though, does not render human-equity investing unconstitutional. According to the Supreme Court, “the essential feature of any tax [is that] it produces at least some revenue for the Government.” *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S.Ct. 2566, 2594 (2012). The private nature of human-equity transactions thus insulates them from constitutional concerns.

152. See *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 410–11 (1983) (describing states’ authority); *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 228 (1899) (describing congressional authority); RESTATEMENT, *supra* note 140, § 178(1) (describing courts’ authority).

153. See 42 U.S.C. § 273–274e (2012) (prohibiting organ transfers); John Lawrence Hill, *Exploitation*, 79 CORNELL L. REV. 631, 654 (1994) (stating that baby-selling is “illegal in every state”). Federal and state laws also regulate employee wage assignments. See MICHAEL B. SNYDER, 2 COMPENSATION AND BENEFITS § 20:164 (2014). Generally speaking, this is when employees instruct their employers to pay some of their salaries to other parties. See *id.* § 20:165; see also *Am. Fin. Servs. Ass’n v. Fed. Trade Comm’n*, 767 F.2d 957, 964 (D.C. Cir. 1985); see, e.g., 29 C.F.R. § 531.40(a) (2014) (defining wage assignment for purposes of the Fair Labor Standards Act). Because this is not how human-equity agreements are structured, they should generally fall outside of the scope of these regulations. Nevertheless, the rules illustrate preexisting social concern for this type of arrangement.

Because of the complexity of the question, the Restatement (Second) of Contracts instructs courts to engage in exactly this type of analysis when considering whether to void contractual terms on policy grounds. Courts are to reach “a decision as to enforceability . . . only after a careful balancing, in the light of all the circumstances, of the interest in the enforcement of the particular promise against the policy against the enforcement of such terms.”<sup>154</sup> The Restatement also sets out a presumption in favor of enforceability, instructing that “[e]nforcement . . . be denied only if the factors that argue against enforcement clearly outweigh the law’s traditional interest in protecting the expectations of the parties . . . and any public interest in the enforcement of the particular term.”<sup>155</sup> While neither Congress nor state legislatures are bound to apply this methodology, Congress has signaled its support for this type of framework by mandating that agencies use cost-benefit analysis when making policy,<sup>156</sup> and states have similarly signaled their support.<sup>157</sup>

This type of approach, therefore, is not only analytically sound, it is also the one to which courts and legislatures would likely turn if asked to decide the legality of human-equity arrangements. Because reasonable minds can differ as to how the social good compares to the social harm, these contracts should be permitted.

### 1. *Benefits to the Transacting Parties*

As outlined in Part III, transactions in human equity are already taking place. Assuming for the moment that the transacting parties understand what they are getting themselves into, the existence of this nascent market suggests that these instruments are creating value. If informed parties are entering into these deals, it means the bargains they are striking are making each side better off.<sup>158</sup> The aggregate benefits derived by all of the parties engaging in these transactions are a large component of the total social benefits these instruments provide.

The size of these private benefits is a function of how useful human-equity investing actually is. If it looks as though many investors and investees would find it attractive, then these may be a boon to social welfare. On the other hand, plenty of innovative products fail because there is a general lack of demand or a lack of demand at the price point necessary for producers to make a profit. Human-equity investments may be one such casualty. An examination of why investors and investees would be attracted to these products, as well as the drawbacks that may cause

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154. RESTATEMENT, *supra* note 140, § 178 cmt. 3(b).

155. *Id.*

156. See Exec. Order No. 12,291, 3 C.F.R. 127 (1981).

157. See generally MACARTHUR FOUND., STATES’ USE OF COST-BENEFIT ANALYSIS: IMPROVING RESULTS FOR TAXPAYERS (2013), available at [http://www.pewtrusts.org/~media/legacy/uploaded\\_files/pcs\\_assets/2013/PewResultsFirst50staterereportpdf.pdf](http://www.pewtrusts.org/~media/legacy/uploaded_files/pcs_assets/2013/PewResultsFirst50staterereportpdf.pdf) (discussing how states employ cost-benefit analysis in determining legislative actions).

158. See HENRY N. BUTLER & CHRISTOPHER DRAHOZAL, ECONOMIC ANALYSIS FOR LAWYERS 50 (2d ed. 2006).

them to shy away, provides insight into how widespread this new form of finance has the potential to become.

a. Benefits to Investors

Investors are looking to maximize return while minimizing transaction costs and risk. If these instruments offer a way to do so that is potentially better than alternative arrangements, then they will draw interest from investors. While human-equity investing presents some intriguing opportunities, there are also reasons for investors to be wary. The inherent pitfalls in these arrangements raise the cost of contracting and incentivize investors to seek restrictive contractual terms at which investees may balk.

Though investors are traditionally interested in a monetary return, one way investments in people potentially stand out is by offering a unique psychic return to investors. For example, part of the investors' returns from education-linked investing may be the good feelings they experience from helping fund the schooling of deserving young people.<sup>159</sup> While investors could donate to a scholarship fund for needy students, this lacks the personal connection that is possible with human-equity investing. Because investors may get more satisfaction out of helping an identifiable person whom they select, these arrangements may create a higher-value-giving opportunity.<sup>160</sup> Similarly, people may wish to invest in star athletes on a platform like Fantex, not really as a way to get rich, but rather to increase the entertainment value of watching professional sports.<sup>161</sup>

There also appears to be at least one area where such investments may yield an attractive monetary return. According to a recent Brookings Institution study, the average returns for college are about fifteen percent,<sup>162</sup> which compares favorably to the stock market's average of around seven percent.<sup>163</sup> Since graduate degrees may also offer high returns,<sup>164</sup> contributing to another's education may provide one's portfolio with an earnings boost.

Startups are also promoting human-equity investing as a way to fund entrepreneurs.<sup>165</sup> While there does not appear to be the potential for

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159. See *supra* note 120 and accompanying text.

160. Kiva, a nonprofit organization that intermediates peer-to-peer microfinancial loans, emphasizes the personal connection in giving. See Stephanie Strom, *Confusion on Where Money Lent via Kiva Goes*, N.Y. TIMES, Nov. 8, 2009, <http://www.nytimes.com/2009/11/09/business/global/09kiva.html>. There was a minor controversy because the connection between donors and beneficiaries is not as direct as Kiva once made it appear. See *id.*

161. See *supra* notes 78–84 and accompanying text.

162. Michael Greenstone & Adam Looney, *Where Is the Best Place to Invest \$102,000—In Stocks, Bonds, or a College Degree?*, BROOKINGS (June 25, 2011), <http://www.brookings.edu/research/papers/2011/06/25-education-greenstone-looney>.

163. *Id.*

164. See Cecilia Capuzzi Simon, Editorial, *R.O.I.*, N.Y. TIMES, July 22, 2011, <http://www.nytimes.com/2011/07/24/education/edlife/edl-24roi-t.html>.

165. See, e.g., *What is Pave?*, *supra* note 3.

increased returns in this arena, these arrangements could decrease diversification-related transaction costs. Typically, venture capitalists invest in one of an entrepreneur's businesses, which may succeed or fail. Investing in human equity, though, allows people to fund all of an entrepreneur's ventures during the term. Because of this diversification, investing in the entrepreneur rather than the entrepreneur's venture provides a less risky way to fund start-up companies. While diversification is only effective when the underlying investments are uncorrelated,<sup>166</sup> the eventual success of serial entrepreneurs suggests that, even though the same person is involved in each business, the rise or fall of each is at least partially independent.<sup>167</sup> This type of diversification is, therefore, something investors may wish to pursue.

The novelty in human-equity investing, though, is not the diversification itself but the way of doing so. Investors could do something similar by investing in each of an entrepreneur's ideas. But this approach would be cumbersome and involve far greater transaction costs, as it would involve repeated investigations and dealings with respect to each business proposal. Human-equity arrangements could provide such diversification at a lower cost.

Investing in people also provides a form of diversification on a broader scale for which there is no analog. As just noted, the addition of uncorrelated assets reduces risk in a portfolio. In one sense, investing in people is not that helpful in this regard, because the performance of people as an asset class is likely correlated to that of the stock market in that both will rise and fall with the economy. As the economy grows and improves, the stock market rises, more people have jobs, and those who are employed earn higher wages. From this vantage point, therefore, there appears little to gain.

But investing in people is uncorrelated with the stock market in one key respect. With economic growth comes more wealth in society. This wealth is split between corporate investors, who benefit in the form of higher firm profits, and employees, who take home larger salaries.<sup>168</sup> Thus, while both profits and wages grow with the economy, the extent to which they grow varies depending on how the additional wealth is split. By investing in human equity, people can diversify away the risk posed by differing splits over time. While many are implicitly diversified, because they own one hundred percent of the equity in their own earnings, investing in others would provide them with protection on a broader

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166. See JONES, *supra* note 132, at 181–87.

167. See Paul Gompers et al., *Performance Persistence in Entrepreneurship*, 96 J. FIN. ECON. 18, 18 (2010).

168. See Margaret Jacobson & Filippo Occhino, *Labor's Declining Share of Income and Rising Inequality*, FED. RESERVE BANK OF CLEVELAND: ECONOMIC COMMENTARY (Sept. 25, 2012), <https://www.clevelandfed.org/Newsroom%20and%20Events/Publications/Economic%20Commentary/2012/Labors%20Declining%20Share%20of%20Income%20and%20Rising%20Inequality>.

scale. Retirees—who, as a cohort, invest a great deal of money,<sup>169</sup> yet are outside the workforce—could also benefit.

Diversification and other advantages of human-equity investing mean that this financial innovation does indeed add something to an already crowded investing marketplace. The difficulty, however, is in exploiting these novel opportunities. Contracts in which human equity is transferred involve asymmetric information and naturally give rise to moral hazard and enforcement problems. These raise the risks associated with investing in people and, as a result, dampen its appeal.

*Asymmetric Information.* The value of a human-equity investment depends on the future prospects and plans of the investee, who has far better knowledge of these things than the investor. This type of information imbalance makes contracting unattractive. Consider the prospect of investing in students' educations. The investor's first step is to sort prospective investees by anticipated future earnings: those with the highest income forecasts should get the best terms. Such projections, however, are highly uncertain. Investors must rely in part on what prospects say about their future plans. But some may lie. Indeed, the temptation to dissemble or exaggerate is great in this arena, because proof of fraud seems almost impossible. If a student fails to follow the articulated educational or career path, and opts for a much less lucrative alternative, who can say whether this was as anticipated, or driven by later circumstances. And, even if people tell the truth, projecting a student's future income is dicey. It is difficult to figure out who has the drive, intelligence, and skill to make good on their vision. These information problems—which are most stark in the educational context, but are an inescapable part of these arrangements—raise the risk of human-equity investing.

*Moral Hazard.* Once people purchase insurance that protects them from the downside of risky behavior, they have less incentive to avoid that behavior. People with health insurance, for example, may be more inclined to engage in extreme sports.<sup>170</sup> This phenomenon is known as moral hazard.<sup>171</sup> It is an issue in the context of human-equity investing because these instruments can be conceptualized as a form of insurance.

In agreeing to share a portion of their future income in exchange for an upfront payment, investees have partially insured themselves against the prospect of low income in the future. This is clearest in the professional sports context. Arian Foster procures some insurance against a career-ending injury or a drop-off in performance by selling twenty percent of his future income for \$10 million.<sup>172</sup> The side-effect is that, because he has cashed out some of his earnings up front, he has less reason to be concerned about how well he will be compensated in the future. As a re-

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169. See LIMRA, FACT BOOK ON RETIREMENT INCOME 2010 at 35 tbl.20 (2010) (showing financial assets of retirees).

170. See BUTLER & DRAHOZAL, *supra* note 158, at 290.

171. *Id.*

172. See Lattman & Eder, *supra* note 79.



sult, he may train less dutifully, leading to declining performance and less future compensation for himself and his investors. Moral hazard is also salient when investing in students. Once they have deposited their investors' money, they have an incentive to study less or pursue less well-paid career alternatives. Such incentives increase the riskiness of human equity.

*Enforcement.* Investors in human equity have reason to be concerned about whether their investees are sharing all that they should. With a loan, it is easy. The debtor owes a certain amount each month. In human-equity investments, though, investees could lie about their income, or contrive some way to receive compensation that falls outside the terms of the agreement. It would not be difficult, for instance, for investees to delay compensation that they expect to receive in the last year of the term until shortly after their payment obligation expires.<sup>173</sup> Both outright deceit and manipulation of compensation result in underpayment. The potential for investees to engage in such schemes translates to both heightened risk and monitoring costs.

The effect of all of these problems with human-equity investing is not necessarily to drive investors away, but rather to shape how they approach these arrangements. To make such investments worthwhile, investors must take precontractual and contractual steps to mitigate these concerns. One way to address some of these risks is through due diligence. If money is being sought to fund the remainder of an individual's time in college, for instance, investors could ask questions about this person's university, major, and class standing. High performing students in engineering and science majors at certain universities likely have higher expected future incomes than others.<sup>174</sup> While such sorting cannot eliminate information asymmetries, it would narrow them and therefore allow for more accurate pricing.

Issues can also be addressed in the contract itself. The most direct response to the increased risks identified above is to demand a higher rate of return. If investors are compensated for taking on the risk of moral hazard, for example, then the issue is moot. Investors could also push for contractual language that disallows earnings deflating choices. For instance, it could be a breach of the investing agreement for students to switch their major from engineering to art, to pursue a graduate degree in certain fields, or to take a job with nonprofits or the government after graduation. By channeling students towards lucrative options, such provisions eliminate moral hazard and reduce the risk that students are embellishing or misrepresenting their future plans. Terms such as these

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173. A related concern is that investees could declare bankruptcy during the term, putting investors in a compromised position. *See infra* note 181.

174. Similarly, Warren Buffet reportedly quipped to a group of Columbia Business School students, "I would pay \$100,000 for 10 percent of the future earnings of any of you." Greenstone & Looney, *supra* note 162.

could be a prerequisite for funding students with hazy future income prospects.

Contractual language can also mitigate the enforcement and monitoring problems inherent in income-sharing agreements. Pave's model, where income is calculated based on an individual's tax filings, likely puts a dent in underreporting.<sup>175</sup> It is one thing to defraud an individual investor, but it is quite another to cross the Internal Revenue Service. The problem of delayed compensation can be addressed with longer terms. As the Fantex agreement shows, the term can even be indefinite.<sup>176</sup> The toughest issue is likely defining "income" so as to capture unconventional compensation arrangements and efforts to hide earnings. But it likely can be done. For instance, it would take a great deal of imagination to circumvent Fantex's eight-page definition.<sup>177</sup>

At the end of the day, there are a lot of reasons for investors to be nervous. The anxiety means they must demand a relatively high rate of return, in addition to other safeguards, to make such investments worthwhile. As discussed *infra*, the viability of human-equity markets depends on whether investees will be willing to sell stakes in themselves on such terms.

#### b. Benefits to Investees

The willingness of investees to agree to the investors' terms depends on the availability of substitute means of financing. Investees have reason to comply if selling equity is the best available alternative. While there are a number of areas where this option may look appealing, in most cases investors will not be willing to offer terms to match more traditional financial arrangements.

In the educational space, there appears to be a narrow—yet important—band where the interests of investors and students intersect. Cutting against the equity option is the fact that students who can fund their education through federally-subsidized loans have no reason to give this new alternative a look. Such loans should always be cheaper because payments are deductible<sup>178</sup> and federal subsidies drive interest rates down.<sup>179</sup>

Equity is likewise more expensive than debt in the corporate context; equity's flexibility, though, is what makes up for its higher price. Corporations are willing to pay the larger cost of capital that goes along with equity because, unlike debt, there are no fixed payments attached to it. Human-equity investments offer a similar advantage over fixed-rate

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175. See *supra* note 106 and accompanying text.

176. See *supra* note 82 and accompanying text.

177. See Fantex, Inc., Brand Agreement, Exhibit B (Oct. 30, 2013), available at [http://www.sec.gov/Archives/edgar/data/1573683/000104746913010747/a2217440zex-10\\_2.htm](http://www.sec.gov/Archives/edgar/data/1573683/000104746913010747/a2217440zex-10_2.htm).

178. See 26 U.S.C. § 221(a) (2012); *Student Loan Interest Deduction*, FINAID, <http://www.finaid.org/otheraid/studentloaninterestdeduction.phtml> (last visited Jan. 31, 2015).

179. See *supra* note 61.

loans: while preset payments can become unmanageable if the borrower's income sinks, an equity obligation ratchets down proportionally. Those worried about low or volatile future earnings would find the latter option appealing. But, as discussed in Part II, the availability of ICLs as part of the federal student loan program means that equity-like flexibility is already built in. Federal loans thus have the upside of lower cost without debt's typical rigidity. Ultimately, the only true advantage human-equity investments have over federal loans relates to bankruptcy. Student loans are only discharged in cases of severe financial hardship (an extraordinarily high standard),<sup>180</sup> whereas obligations related to human equity would likely be released without this showing.<sup>181</sup> This alone, though, is probably not enough to make these instruments attractive, especially considering that bankruptcy risk translates to less generous terms.

Where human equity can play a role, however, is in cases where subsidized lending is insufficient. As noted earlier, federal loans may leave students with unmet need of several thousand dollars—a gap that often gets filled through private loans.<sup>182</sup> Although payments on these loans are deductible, they often carry high floating interest rates, which can reach levels double that of subsidized loans, lack ICL features, and are treated like federal student loans in bankruptcy.<sup>183</sup> In all likelihood, these terms are exorbitant. Since the government makes a profit at the rates it charges,<sup>184</sup> the inherent risk of education funding does not appear to be driving the increased pricing in the private market. Rather, the lenders appear to be exploiting their monopolistic position.<sup>185</sup> Instead of succumbing to this, students may be willing to agree to the rate of return and other terms human-equity investors require. With investors in the picture, there is the potential for competition to develop between private lenders and these new entrants, resulting in better alternatives for students.

While equity is typically more expensive than debt, in this case, the situation may be reversed. The average interest rate for private student

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180. See 26 U.S.C. §§ 1328, 523(a)(8) (2012); see also CONSUMER FIN. PROT. BUREAU, *supra* note 123, at 70, 71 n.161; SUSAN A. BERSON, *THE MODERN RULES OF PERSONAL FINANCE FOR PROFESSIONALS* 48 (2008).

181. The bankruptcy treatment of human equity has not yet been decided. But in the absence of special legislation like that pertaining to student loans, these obligations should be treated like any other claim, which means they could be discharged in bankruptcy. See BERSON, *supra* note 180, at 61; CONSUMER FIN. PROT. BUREAU, *supra* note 123, at 71.

182. See Dillon & Carey, *supra* note 123. See generally CONSUMER FIN. PROT. BUREAU, *supra* note 123 (analyzing and making recommendations with respect to private student loans).

183. See CONSUMER FIN. PROT. BUREAU, *supra* note 123, at 9–14 & fig.1, 70–71 & n.161.

184. See TERMS ON STUDENT LOANS, *supra* note 61, at 1; CONG. BUDGET OFFICE, *ESTIMATING THE VALUE OF SUBSIDIES FOR FEDERAL LOANS AND LOAN GUARANTEES 1* (2004), available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/57xx/doc5751/08-19-creditsubsidies.pdf>.

185. Even though their rates are likely too high, because the government has certain advantages in terms of collection, private lenders would likely not be able to match the government's rates outright. See TERMS ON STUDENT LOANS, *supra* note 61, at 6.

loans in 2012 was 7.8%.<sup>186</sup> Meanwhile, as noted above, Pave targets a seven percent rate of return, making it the better deal if its income forecasts are accurate.<sup>187</sup> Moreover, private loans are based on creditworthiness, whereas human-equity transactions are based on potential.<sup>188</sup> A student with rosy prospects but lackluster credit—perhaps merely as a result of having too few credit cards—might, therefore, receive a much better rate by parting with an equity share. Thus, human-equity agreements may present students with a more flexible and lower cost alternative to private loans.<sup>189</sup>

This option, though, likely does not have the same allure in the entrepreneurial context. While this type of investing allows venture capitalists and the like to more cheaply diversify their investments,<sup>190</sup> it is very difficult to predict who will be successful. In picking which students to back, markers like where a person goes to school and what they major in are useful, but these are less important determinants of a successful entrepreneur.<sup>191</sup> A key piece of information seems to be whether the individual has a history of founding successful startups.<sup>192</sup> People in this category, though, would likely have many attractive funding alternatives if they need outside financing at all.

In the alternative, many of the individuals seeking funding likely have a specific idea in mind. Investors might be willing to fund based on the quality of this idea. But if this is really the basis of the funding, then a more traditional angel or venture-capital investment in the business itself makes more sense. In addition, there is a significant downside to these arrangements from the entrepreneur's perspective. Human-equity investments create personal liability, whereas typical venture arrangements only lay claim to the assets of the business entity. For these reasons, it is difficult to see much of a market in funding entrepreneurs.

People may also see equity sharing as a way to insure against job loss. This is why athletes may be willing to sell equity on a website like Fantex. As noted above, these contracts offer athletes a way to hedge the risk of injury.<sup>193</sup> By trading a share of their future income for an up-front payment, they have guaranteed a portion of their earnings, even if they are hurt and released from their team. While athletes can already buy insurance, and top professionals receive so-called guaranteed contracts that payout regardless of injury, there may still be a role for human equi-

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186. CONSUMER FIN. PROT. BUREAU, *supra* note 123, at 12.

187. *See Our Model*, *supra* note 99 and accompanying text.

188. CONSUMER FIN. PROT. BUREAU, *supra* note 123, at 12, 79.

189. Even students who do not choose to share human equity should benefit. The pressure of this potentially attractive alternative should put pressure on private lenders to lower their rates.

190. *See supra* notes 165–67 and accompanying text.

191. *See* Laura Entis, *In Football and in Entrepreneurship, Why Is It So Hard to Predict Success?*, *ENTREPRENEUR* (Jan. 31, 2014), <http://www.entrepreneur.com/article/231171> (discussing things venture capitalists look for in the people they are funding, including “hunger” and a “chip on their shoulder”).

192. *See* Gompers et al., *supra* note 167, at 18.

193. *See* Lattman & Eder, *supra* note 79; *supra* text accompanying note 172.

ty.<sup>194</sup> By spreading the risk in the market, there is the potential that equity investors could provide a cheaper way to insure for those athletes not fortunate enough to have contractual guarantees. This may be a niche within a niche, but at least for some professional athletes, selling their equity may make sense.

Moreover, job loss is not a worry that is confined to sports. Currently, the 99.9% of us who are not professional athletes have no way to insure our careers. The prospect that human-equity arrangements could fill that gap is intriguing. Unfortunately, this is a market where concerns about information asymmetry and moral hazard would be particularly troublesome. Investors would worry that only those who have a high chance of losing their job or who plan to quit would be interested in such insurance. But, if investors charge a high rate of return to compensate for this risk, those with relatively safer jobs may view the price as too high and opt out. Investors would thus be left with only those investees in whom they do not wish to invest.<sup>195</sup>

The way around this problem would be to sort investees by risk and charge accordingly. But it may be difficult to tell which investees are the chanciest. Two associates at the same law firm may have very different plans for the future. To address the risk that one may be planning a quick exit, perhaps human-equity arrangements could specify that resigning is a default under the agreement. Few, however, would likely agree to such a limitation. Thus, while sharing equity looks like a promising way to insure against job loss, a market in such contracts faces structural obstacles that would be hard to overcome.

Finally, there is the potential for human-equity investments to invade areas today occupied by more traditional lenders. Rather than secured loans, people could conceivably share equity in themselves as a way to finance large purchases; rather than credit cards, people could share equity to meet day-to-day expenses.

While opening up alternatives in these realms is attractive in the abstract, as in other areas, the chances of upheaval look thin. An individual can borrow at a low interest rate to buy an expensive asset, like a house or a car, by securing the investment with the purchased asset, whereas, as Friedman recognized long ago, there is no similar security in people.<sup>196</sup> Therefore, only those who cannot qualify for such loans would look to share equity. Few, though, would be willing to invest. If lenders are unwilling to put up their capital with security, it is unlikely investors would make a riskier unsecured investment.

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194. See Peter Keating, *Underwriting with the Stars: Inside the World of Insuring High-Caliber Professional Athletes*, ESPN (Oct. 8, 2009, 4:29 PM), <http://sports.espn.go.com/espn/news/story?id=4535414>.

195. See generally George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970) (discussing how asymmetric information can lead to market failure).

196. See Friedman, *Role of Government*, *supra* note 9, at 137.

If individuals need money to finance consumption, they turn today to credit cards or even payday lenders. But these options are troubling, because they come with terribly high interest rates.<sup>197</sup> Perhaps a better alternative for people in this position would be to sell equity in themselves. There is reason, however, to be dubious. This may be a legitimate avenue for those with sufficiently predictable and robust future earnings prospects, but this group is infrequently at the mercy of credit-card companies and payday lenders.<sup>198</sup> And for those with inconsistent or low incomes, human-equity investing could turn predatory. One could envision investors demanding extraordinarily high portions of an individual's earnings for a low upfront amount.<sup>199</sup>

While the impact of a new financial innovation can never be predicted with certainty, the considerations weighed in the above analysis suggest that, despite its novelty, human-equity investing is not poised to massively disrupt educational, entrepreneurial, or personal finance. That said, there is the possibility for these to become a real competitor to private student loans. Even if this is the only area where investing in people establishes a foothold, such arrangements would still make a group of students and investors better off.

## 2. *Concerns for the Transacting Parties*

The above discussed the potential development of healthy markets in human equity, where participants are choosing such arrangements, because they are better than their next best alternative. Contracts entered into in such markets benefit the contracting parties, and therefore increase aggregate social welfare. But people are boundedly rational, meaning that they lack the cognitive capacity, training, experience, and time to fully consider the ramifications of each decision they make.<sup>200</sup> This gives rise to the potential that investees and investors are entering into equity-sharing contracts without fully understanding the terms. When people enter into such contracts by mistake, social welfare decreases.<sup>201</sup> The potential for misunderstanding, therefore, must be considered in determining whether human-equity investing is a net positive for society.

Although there are greater concerns in this regard with respect to the investees, unwary investors may be victims as well. As previously noted, one thing that must be carefully drafted is the definition of what

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197. See Andrea Freeman, *Payback: A Structural Analysis of the Credit Card Problem*, 55 ARIZ. L. REV. 151, 161 (2013) (describing credit-card interest rates of around twenty percent); Steven M. Graves & Christopher L. Peterson, *Payday Lending and the Military: The Law and Geography of Payday Loans in Military Towns*, 66 OHIO ST. L.J. 653, 661 (2005) (describing payday loan interest rates of over 350 percent).

198. See Freeman, *supra* note 197, at 153.

199. This possibility is discussed in greater depth *infra* text accompanying notes 223–29.

200. Schwartz, *supra* note 24, at 204–07.

201. See *id.* at 186–87.

income the investor is entitled to.<sup>202</sup> An overly narrow delineation leaves investors exposed to abuse. Moreover, investors must be careful to understand exactly what they are investing in. The instantiations of the human-equity sharing concept tend to be more complicated than a simple swap of equity in exchange for an upfront payment.<sup>203</sup>

The Fantex arrangement is a good example. Investors in Fantex do not actually buy shares directly in athletes like Arian Foster. Instead, Fantex is the true rights holder; investors buy different series of “tracking stock” in Fantex that are linked to the company’s rights to the income of individual athletes.<sup>204</sup> For instance, if Arian Foster does well, Fantex’s right to Mr. Foster’s future income rises in value, and this should be reflected by an increase in the value of Fantex tracking stock linked to Mr. Foster.

While this is confusing in and of itself, the fine print about the tracking stock is more problematic still. It reveals that this stock is convertible, at the discretion of the company, into shares of Fantex itself.<sup>205</sup> Thus, investors in Mr. Foster, for example, are taking on not only the risk inherent in Mr. Foster’s career, but also the risk associated with Fantex—a startup trying to succeed where others have failed.<sup>206</sup> Because of this structure, investors could lose out even if Arian Foster has a Hall-of-Fame-caliber career. Many investors could fail to appreciate this added risk.

The potential that investors may be caught off-guard is no doubt troubling, but bigger concerns lie with the investees. They are likely less financially savvy and are taking on a long term and potentially onerous commitment.<sup>207</sup> A key worry is that investees may not understand how to compare the cost of equity capital with the cost of debt. While complicated lending terms can obfuscate a loan’s interest rate, in the typical fixed-rate note, the repayment terms are reasonably clear. The cost is less transparent with equity. When an investee agrees to take a certain sum in exchange for a certain share of future earnings, there is an implicit cost of capital, which is equal to the investor’s return expectations, but this figure is not so easy to recognize or calculate.<sup>208</sup> This makes it difficult for investees to tell, for example, whether sharing one percent of their income for ten years in exchange for \$10,000 is a better deal than borrowing \$10,000 and agreeing to pay it off in ten years at a seven percent in-

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202. See Fantex, Inc., *supra* note 177, at Exhibit B.

203. See *infra* text accompanying notes 239–41.

204. See Fantex, *supra* note 82, *passim*.

205. *Id.*

206. See Felix Salmon, *Bad Investment of the Day, Fantex Edition*, REUTERS (Oct. 18, 2013), <http://blogs.reuters.com/felix-salmon/2013/10/18/bad-investment-of-the-day-fantex-edition/>.

207. As discussed *infra* Part V, there is also less reason for concern with regard to the investors because they are protected by the securities laws.

208. For an explanation of the cost of equity capital and its relationship to investor returns, see Christine A. Botosan, *Disclosure and the Cost of Capital: What Do We Know?*, 36 ACCT. & BUS. RES. 31, 33 (2006).

terest rate.<sup>209</sup> If investees do not conduct the proper analysis, there is the risk that they will agree to share equity when a loan would have been the better option.<sup>210</sup>

There are also a variety of nuances that investees could easily miss. One is that they will typically be asked to share their pretax income.<sup>211</sup> A seven percent share of pretax income, though, is more like a ten percent share of take-home pay. Another issue is what counts as income. As noted above, Pave grants investors a stake in things like alimony and capital gains—incoming cash flows that people ordinarily do not think of as income.<sup>212</sup> Finally, as is again the case with Pave, investors or intermediaries may impose a variety of fees on things like missed payments, delayed submission of income documents, and underpayments.<sup>213</sup> These can add up. If investees fail to notice these terms, or they are not clearly disclosed, they could find themselves in a relationship that is far more onerous than what they had imagined.

Thus, while there are some niche markets where these arrangements may create value for investors and investees, given the novelty and complexity of these products, there is also the potential that many will regret their decision to buy or sell human equity. In terms of social welfare, the losses from the bad bargains may offset much of the gains from the good ones.

### 3. *Benefits and Costs of Human-Equity Investing*

The net welfare gain derived by the parties involved in these transactions is one component of their overall social value. These transactions, though, may make society itself better or worse off in ways that may not be internalized by the parties involved. A complete analysis of the welfare effects of these instruments must consider these positive and negative externalities as well.

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209. The answer depends on the investee's earnings expectations and how repayment on the loan is structured. Assume for simplicity that the individual would only pay interest on the loan for the first nine years, then repay the principal plus interest in the final year. This would mean paying \$700 in interest for ten years, plus \$10,000 in the tenth year. Human-equity payments of \$1400 per year for ten years result in a cost of equity capital that equates to the interest rate on this loan. Since \$1400 is one percent of \$140,000, investees should opt to share equity when they expect to earn less than that amount.

210. This same concern could have been listed for investors as well: for failure to accurately compare their options, they could make a human-equity investment when they should have lent their money instead. Those making this type of investment-allocation decision, though, are probably more sophisticated—and thus less apt to make this mistake—than those seeking funding.

211. See *Start Me Up: Helping Youngsters to Sell Stakes in Their Future*, ECONOMIST, June 15, 2013, <http://www.economist.com/news/finance-and-economics/21579490-helping-youngsters-sell-stakes-their-future-start-me-up>.

212. See FORM 1040, *supra* note 107.

213. See *supra* note 118 and accompanying text.



## a. Social Benefits

Human-equity investing may benefit society by providing an attractive alternative to traditional mechanisms of education finance. As noted above, in addition to offering equity's inherent flexibility, agreeing to share a slice of future earnings may actually cost a student less than signing up to repay interest and principal on a similar private loan.<sup>214</sup> In addition, the donative side of equity sharing may lead to more educational benefactors, who may be willing to invest in worthy and needy students for extremely low monetary returns.<sup>215</sup>

The arrival of more socially-motivated investors and the presence of cheaper financing—whether from investors or benefactors—renders education more accessible to the poor and brings down the total cost to students. While those receiving the education benefit the most from all of this, a less indebted and better educated workforce is also beneficial to society as a whole.<sup>216</sup>

Indeed, the current student-debt overhang is a significant social concern. Over one trillion dollars is currently outstanding,<sup>217</sup> \$150 billion of which is owed on private loans.<sup>218</sup> Among other things, burdening young people with such debt diminishes their ability to own a home and makes it less likely that they will start their own business.<sup>219</sup> Limiting their opportunities is both injurious to the students and harmful to the economy.<sup>220</sup> Moreover, the size of the outstanding debt may pose systemic risk not unlike that which triggered the financial crisis.<sup>221</sup> While human-equity investing is far from a panacea, its arrival offers the opportunity for students to move away from costly and inflexible private loans and thus provides one counter to these social ills.

The availability of this financing alternative may also directly impact significant student decisions. If a well-developed market for human equity were to develop, it would provide students with information about the value of different colleges and degrees, helping them decide which to choose. Market pricing might indicate, for example, that a student with a degree from school A, on average, collects a larger sum for a smaller por-

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214. See *supra* text accompanying notes 182–85.

215. See *supra* text accompanying notes 159–60.

216. See Michael Simkovic, *Risk-Based Student Loans*, 70 WASH. & LEE L. REV. 527, 533–34 (2013).

217. See Press Release, Consumer Fin. Prot. Bureau, CFPB Report Highlights How Challenging Student Debt Burdens Can Be a Roadblock to Opportunity 1 (May 8, 2013), available at <http://www.consumerfinance.gov/newsroom/report-highlights-student-debt-as-a-roadblock-to-opportunity-for-consumers/>.

218. See CONSUMER FIN. PROT. BUREAU, *supra* note 123, at 3.

219. CONSUMER FIN. PROT. BUREAU, STUDENT LOAN AFFORDABILITY: ANALYSIS OF PUBLIC INPUT ON IMPACT AND SOLUTIONS 7–9 (2013) available at [http://files.consumerfinance.gov/f/201305\\_cfpb\\_rfi-report\\_student-loans.pdf](http://files.consumerfinance.gov/f/201305_cfpb_rfi-report_student-loans.pdf).

220. See *id.* at 7–11.

221. Editorial, *Bursting Debt Bubble: Washington Takes Over the Student-Loan Market*, *Delinquencies Soar*, WALL ST. J., Mar. 4, 2013, <http://online.wsj.com/news/articles/SB10001424127887324662404578332633167660430>.

tion of income than those with a degree from school B. Information derived from the market is likely more accurate than the survey evidence and word-of-mouth that students rely on today. More transparency about future income prospects might, in turn, lead schools to compete more vigorously on job placement and cost.

This same dynamic could arise with respect to the choice of major. With markets for human equity, students would be able to see which majors are awarded with higher values by the investing community.<sup>222</sup> While how much money one expects to make is not the only thing, or even perhaps the most important thing, driving the choice of school or major, more accurate and direct information about this topic would improve decision making and, therefore, increase social welfare.

b. Social Costs

Broader social concerns with regard to these transactions can be broken down into two categories: coercion and commodification. Coercion occurs when peoples' dire economic conditions lead them to enter into bargains that they would not otherwise have considered.<sup>223</sup> As Professor Michael Sandel explains, "A peasant may agree to sell his kidney or cornea to feed his starving family, but his agreement may not really be voluntary. He may be unfairly coerced, in effect, by the necessities of his situation."<sup>224</sup> It can be argued that since such transactions are not truly voluntary, they should not be respected.<sup>225</sup> The worry in the human-equity context is that individuals may agree to share their future income when they are in desperate straits. This could result in a new class of financial instruments: predatory equity.<sup>226</sup> Providers of predatory equity could exploit peoples' condition just like predatory lenders.

Coercion is intuitively problematic, but it is worth considering why. With bounded rationality, the concern is that people are making mistakes that undermine their wellbeing. Coercion comes into play, though, even when there is no mistake. The idea is that, even if there is no reason to believe that a particular exploitative transaction decreases the wellbeing of the weaker party, society is degraded by permitting it to take

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222. See generally Simkovic, *supra* note 216 (making a similar argument for risk-based pricing in student loans).

223. See Note, *The Price of Everything, The Value of Nothing: Reframing the Commodification Debate*, 117 HARV. L. REV. 689, 690–91 (2003).

224. MICHAEL J. SANDEL, *WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS* 111 (2012).

225. See Margaret Jane Radin, *What, If Anything, Is Wrong with Baby Selling?*, 26 PAC. L.J. 135, 138–39 (1995).

226. See *supra* text accompanying note 197. Something like predatory equity has developed in the form of pension advances. In these arrangements, investors generally advance money to retirees in exchange for a portion of their pension. See also Jessica Silver-Greenberg, *Loans Borrowed Against Pensions Squeeze Retirees*, N.Y. TIMES, Apr. 27, 2013, [http://www.nytimes.com/2013/04/28/business/economy/pension-loans-drive-retirees-into-more-debt.html?pagewanted=all&\\_r=1&gwh=64F6F14410B9365AB93B3B06A6B2115D&gwt=pay](http://www.nytimes.com/2013/04/28/business/economy/pension-loans-drive-retirees-into-more-debt.html?pagewanted=all&_r=1&gwh=64F6F14410B9365AB93B3B06A6B2115D&gwt=pay). These instruments can come with extraordinarily high effective interest rates. *Id.*

place. The peasant in the above example may actually consider himself better off because of the deal, but society itself is worse off for having allowed the exchange to occur.<sup>227</sup>

Given that coercion exists even when the weaker party is fully informed, it only makes sense to condemn a transaction as coercive when the exchange is so one-sided or otherwise appalling that nobody of ordinary means would enter into it.<sup>228</sup> Human-equity investing does not qualify as such. The aspiring computer programmers and entrepreneurs selling equity in themselves on Pave's website, for example, appear legitimately intrigued by the idea, rather than driven to it by dire straits.<sup>229</sup> The desire for increased celebrity, rather than economic hardship, appears to be motivating the professional athletes that sign onto Fantex.<sup>230</sup>

But human-equity contracts could certainly morph into something more troubling. Arrangements where people agree to sell large portions of their future earnings for piddling sums up front would suggest coercion. So, too, would agreements that delegate a large say over an individual's future activities to investors. For example, coercion concerns would arise if a high school senior were to promise, in exchange for college funding, to pursue a certain career path or work for a certain employer for an indefinite or extended period of time after graduation. Thus, while agreements to share human equity are not per se coercive, they can be constructed as such. This suggests that, rather than outlaw these arrangements, coercion concerns can be addressed by placing outside limits on them. Potential boundaries are discussed in Part VI.

Commodification concerns likewise focus on the broader costs of certain transactions. For a transaction to be commodifying, there is no need for it to be coercive, nor must there be any sign of incomplete information or bounded rationality.<sup>231</sup> The worry here is that certain transactions degrade the thing that is purchased or sold. Professor Sandel has expressed the idea of commodification in a manner that is particularly apt here:

When we decide that certain goods may be bought and sold, we decide, at least implicitly, that it is appropriate to treat them as commodities, as instruments of profit and use. But not all goods are properly valued in this way. The most obvious example is human beings. Slavery was appalling because it treated human beings as commodities, to be bought and sold at auction. Such treatment fails

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227. See Alan Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1062 (1977).

228. See Note *supra* note 223, at 690 (describing how "substantive equality or inequality" are indicators of coercion).

229. See *You Are in Good Company*, *supra* note 13.

230. See William Alden, *Vernon Davis Breaks His Silence Over Fantex I.P.O.*, N.Y. TIMES DEALBOOK (June 4, 2014, 1:12 PM), [http://dealbook.nytimes.com/2014/06/04/vernon-davis-breaks-his-silence-over-fantex-i-p-o/?\\_php=true&\\_type=blogs&\\_r=0](http://dealbook.nytimes.com/2014/06/04/vernon-davis-breaks-his-silence-over-fantex-i-p-o/?_php=true&_type=blogs&_r=0).

231. See SANDEL, *supra* note 224, at 111; Schwartz, *supra* note 24, at 204–07.

to value human beings in the appropriate way—as persons worthy of dignity and respect, rather than as instruments of gain and objects of use.<sup>232</sup>

The argument here would be that, like slavery, transacting in human equity expresses the idea that people are commodities. In transmitting this impoverished notion of personhood, human-equity transactions degrade what it means to be human—a cost that everyone feels.

Identifying whether a class of transactions is commodifying is no easy feat. Reasonable minds often differ as to whether transacting in something ascribes the wrong value to it.<sup>233</sup> The question whether human-equity investing, in the abstract, is commodifying seems to fall into this category. While some may be troubled, others may find the idea of sharing a certain percentage of their income completely anodyne.

The central feature that some may view as worrisome is the individualized pricing. ICLs, for instance, do not give rise to these concerns, because everyone receives the same terms.<sup>234</sup> In these arrangements, nobody is kicking the tires on the students as if they were used cars. Instead of market values, ICLs express a social concern for those who choose less remunerative careers. It is when people are evaluated and compared based on their future earnings prospects, just like any other investment, that commodification concerns arise. Ascribing a market value to people based on what they are likely to earn may strike some as degrading.

Not everyone, though, would agree. People, after all, are valued all of the time. There is a “labor market” where individuals are valued by employers based on their credentials. Those with the best resumes get the best jobs and the highest compensation. Indeed, human-equity valuations can be seen merely as an attempt to predict what will happen in this market. Similarly, colleges value applicants based on, among other things, standardized test scores, which translate to admission and scholarship offers. Finally, lenders boil people down to a credit score before giving them a loan. People need to have certain minimum scores to receive credit, and those with the best scores receive the best terms. While human-equity investments are more commodifying than all of these—because it is the only case where people are valued precisely as investments—the analogy to these arrangements may cause some to be untroubled by the market values these instruments express.

Because the abstract debate regarding human equity is intractable, it is more productive to focus on a less controversial proposition—namely, that this type of investing is more or less commodifying depending on the shape it takes. The longer the equity-sharing arrangement, the more commodifying it is. Consider the extremes. An agreement to share income for a couple of years appears relatively benign. But an agreement

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232. SANDEL, *supra* note 224, at 9.

233. See generally Ertman, *supra* note 16 (discussing the commodification debate).

234. See *supra* text accompanying notes 60–61.

to share indefinitely starts to look like slavery—commodification’s archetype.

Since a key component of ownership is the ability to control, provisions that grant to investors control rights over the investee’s activities are also commodifying. When human-equity investees maintain the freedom to do as they please, these arrangements look more like ordinary financial transactions; the more control investees cede to investors, though, the more these individuals start to resemble human assets.

Whether human-equity investments are viewed as commodifying also depends on the extent to which these arrangements are financialized. One could easily envision a stock market of people—indeed, while restricted to professional athletes, this is what Fantex is creating.<sup>235</sup> Individuals are deeply commodified when they have a stock price and are traded on exchanges. Other steps, like assembling people into mutual funds (as is Lumni’s practice) or selling them short (which would be theoretically possible on secondary markets) are troubling along the same lines. In sum, the more the treatment of people mirrors that of financial assets, the more salient the commodification concern.

The commodification question also cannot be divorced from context. The history of slavery in the United States makes the idea of Caucasian investors owning the future earnings of African Americans particularly disconcerting. Along the same lines, because of historical and current inequality, the concept of a Caucasian male holding a portfolio entitling him to income streams resulting from the labor of women and minorities is similarly objectionable.

Inequality, in particular with respect to wages, also distorts the terms of the human-equity contracts themselves.<sup>236</sup> Because future income is the key to valuing human equity, pricing necessarily reinforces preexisting race and gender inequalities. Better career prospects for white men means that they will receive the best terms in these agreements. They would literally be ascribed a higher value; if traded on an exchange, they would have a higher price. Commodification in this context, therefore, is not only a harm in and of itself; it also amplifies gender and racial divides.

Another matter of context relates to the growing acceptance of corporate personhood.<sup>237</sup> That corporations are now being conceptualized as akin to people makes it more troubling that the reverse is now also gathering momentum. The expression of people as financial assets is all the stronger when financial assets are coming to be seen as people.

While it is tempting to let commodification swallow the debate about whether human-equity investing should be permitted, the concern

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235. See *supra* note 79 and accompanying text.

236. See Gowri Ramachandran, *Pay Transparency*, 116 PENN ST. L. REV. 1043, 1049–51 (2012).

237. See *Citizens United v. FEC*, 558 U.S. 310, 342–43 (2010) (granting free-speech rights to corporations akin to that of natural persons); Editorial, *The Rights of Corporations*, N.Y. TIMES, Sept. 21, 2009, [http://www.nytimes.com/2009/09/22/opinion/22tue1.html?\\_r=0](http://www.nytimes.com/2009/09/22/opinion/22tue1.html?_r=0).

is best viewed as a negative externality that should be weighed alongside other costs appurtenant to these arrangements. These instruments raise a range of concerns with respect to both the participants themselves and society as a whole. But they also have the potential to increase individual and social welfare. More than that, as discussed in Part VI, commodification and other concerns that stem from these arrangements can be mitigated through regulatory constraints. As a result, even when worries about commodification are added to the mix, a weighing of the cumulative costs and benefits does not establish a case for outlawing human-equity investing on policy grounds. In light of the competing considerations, a more narrowly-tailored solution is more appropriate. Well-targeted regulation has the potential to ameliorate many of the harms without destroying the benefits.

## V. SECURITIES LAW ANALYSIS

Securities regulation stands out as an existing legal apparatus that might apply to these instruments. The first question is whether human-equity investments fall under this regime. If so, the next question is whether the rules are responsive to the concerns raised above. I conclude that while securities laws likely apply, they are only partially on point. Coercion and commodification concerns are foreign to securities law. In addition, the rules focus on investors, but these transactions necessitate concern for a group about which securities regulation has nothing to say—the investees.

### A. *Applicability of Securities Law*

Securities laws apply if human-equity investments constitute “securities” as defined for purposes of the Securities Act of 1933 (“Securities Act”) and the Securities Exchange Act of 1934 (“Securities Exchange Act”).<sup>238</sup> Because the industry has adopted a variety of different funding models, this analysis is complex. At the heart of any equity-sharing arrangement is an agreement by the investee to share future income in exchange for capital.<sup>239</sup> The investor, however, is not necessarily the counterparty to this agreement. Instead, the transfer of equity often involves two steps. For example, in return for promised educational funding, students agree to share their incomes with Lumni, which then sells investors shares in investment funds backed by student earnings and remits the proceeds to the students’ educational institutions.<sup>240</sup> Similarly, in return

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238. Although each statute contains its own definition, the differences are immaterial. See 15 U.S.C. § 77b(a)(1) (2012) (defining “security” under the Securities Act); 15 U.S.C. § 78c(a)(10) (2012) (defining “security” under the Exchange Act); Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 908 n.141 (2011) (“[T]he definitions under the Securities Act and the Exchange Act are substantially similar, and result in only small differences in application.”).

239. See *supra* Part III.

240. See *About Lumni*, *supra* note 119.

for a monetary pledge, professional athletes agree to share their future incomes with Fantex, which issues investors tracking stock linked to the athletes' performances and gives the athletes the money raised.<sup>241</sup> In each case, the equity interests in people created and sold in the first step could be a security, the derivative instrument created and sold in the second step might qualify, or both might meet the definition.

What part or parts of the transaction qualify as a security is important because it determines who has obligations under the securities laws. For example, if it is only Fantex tracking stock that falls under the rules, then Arian Foster need not worry about compliance. If the equity in himself that is transferred to the company is a security, however, then he would be considered an issuer and subject to all of the regulations accompanying that status.<sup>242</sup> Because an initial transfer of human equity is always present in these transactions, this Article will focus on this component of the exchange.

If the SEC chose to scrutinize human-equity investments, this is not necessarily how the agency would proceed. It might elect to focus on the second stage of these transactions to avoid the issue of whether shares of people are securities and to put the onus on the platforms rather than the individuals.<sup>243</sup> But this approach is inefficient. The SEC would have to consider the manifold different ways human equity is repackaged and distributed. In addition, a game of whack-a-mole could develop, where new ventures continually create new equity distribution schemes to avoid the reach of the law. Industry participants could even abandon the second-step transaction. Human-equity investments could be handled like crowdfunding: investees could sell equity directly to investors with the platform charging a fee for matchmaking.<sup>244</sup> Thus, if the SEC were to only opine on the second stage it would likely only delay, but not avoid, the central question of whether human equity is a security.

The way to analyze this is to consider whether the agreement to transfer human equity is a so-called "investment contract." The legal definition of what qualifies as a security contains a vast list of instruments that we normally think of as securities, like stocks and bonds.<sup>245</sup> It also includes so-called investment contracts within its reach.<sup>246</sup> This vague reference has evolved into a heavily-litigated catch-all that could potentially encompass the unique type of instrument at issue here.<sup>247</sup>

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241. See Fantex, Inc., *supra* note 82, at 71; Fantex, Inc., *supra* note 177, at 2.

242. See *infra* Part V.B.

243. Cf. Andrew Verstein, *The Misregulation of Person-to-Person Lending*, 45 U.C. DAVIS L. REV. 445, 481 (2011) (suggesting that the SEC chose to scrutinize peer-to-peer lending platforms rather than individual lenders to save the latter from facing compliance obligations).

244. See Heminway & Hoffman, *supra* note 238, at 901–02, 902 n.104.

245. See 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

246. *Id.* §§ 77b(a)(1), 78c(a)(10).

247. See Jonathan Macey et al., *Helping Law Catch Up to Markets: Applying Broker-Dealer Law to Subprime Mortgages*, 34 J. CORP L. 789, 808 (2009).

In *SEC v. W.J. Howey Co.*, the Supreme Court determined what constitutes an investment contract.<sup>248</sup> According to *Howey*, it is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”<sup>249</sup> The case crystallizes the definition into four elements: whether there has been (1) an investment of money, (2) in a common enterprise, (3) to earn a profit, (4) solely from the effort of others.<sup>250</sup>

The first element is straightforward. In these arrangements, there is clearly an investment of money. Investors transfer money to the platform, which it uses to fund the investees. The “common enterprise” element, in contrast, requires some unpacking. To satisfy this requirement, courts generally look to see whether there is “horizontal commonality.”<sup>251</sup> This is present when investors pool their money to back the enterprise in question.<sup>252</sup> The idea is that there is a collection of investors whose stakes are tied together.

If the focus is exclusively on the first stage of the transaction, then horizontal commonality is arguably missing. At this stage, it is technically only the platform that is investing in the investee; therefore, there is no pooling of investor interests. Securities law precedent dictates, however, that courts look to the “economic reality” of transactions when applying *Howey*.<sup>253</sup> The reality here is that investors are pooling their money to back individual investees. The platform is merely a conduit for their investments. There would be no initial contract without the funding put up by the investors, and they are the ones who win or lose based on the future income of the investee. Under this more flexible analysis, this element of *Howey* is met.

Three examples illustrate why this flexible approach is correct. The first is the *Howey* decision itself. *Howey* involved an offering of “units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor.”<sup>254</sup> The purchase of the citrus grove property was separated out from the contract to provide services. The Court, though, did not look at these aspects of the relationship in isolation. Rather, it analyzed the transaction as a whole, reasoning that this arrangement was not merely a purchase of a piece of land, which would not be a security, but rather an investment in the citrus groves to be harvested and cared for by the issuer.<sup>255</sup> In this instance, the buyers were purchasing a security, because they were, in reality, contributing capital to earn money from the promoter’s business venture. Here, in an-

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248. 328 U.S. 293, 298–99 (1946).

249. *Id.* at 299–300.

250. *Id.* at 298–99.

251. Heminway & Hoffman, *supra* note 238, at 887.

252. *Id.*

253. *See, e.g.*, United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848 (1975).

254. *Howey*, 328 U.S. at 294.

255. *See id.* at 299–300.



alyzing the contract to sell human equity, a court would not blind itself to the entirety of the transaction. Rather, it would examine the agreement in the context of the total picture—a sale of equity in people to a group of investors.

The SEC's response to Peer-to-Peer ("P2P") lending is also instructive. P2P lending is strikingly analogous to human-equity investing; the only difference is that the funders are lenders who require a set return for their capital contribution, rather than equity investors.<sup>256</sup> Like in human-equity transactions, in P2P lending, individual lenders do not actually make loans directly to borrowers.<sup>257</sup> While the structure of the financing has evolved somewhat since, at the time the SEC took action, the loan itself was made by a bank with which the P2P platform had contracted, with the individual lenders indirectly funding the loan.<sup>258</sup> This bank then created a promissory note for each lender, which it assigned to the P2P platform, which then assigned it to the individual lender.<sup>259</sup>

In an administrative proceeding against a prominent P2P lender, Prosper Marketplace, the SEC concluded that these promissory notes were securities.<sup>260</sup> In determining that a common enterprise existed, the SEC reasoned that "the vast majority of Prosper loans are funded by more than one lender."<sup>261</sup> This logic ignores the technicality that each loan was made by a single bank and instead focuses on the economic reality of what was taking place. This is analogous to recognizing that human-equity investments are made by a group of investors, even though the arrangements are intermediated by an investing platform.

Finally, the way that securities distributions are analyzed is also consistent with a larger focus. To stay private, a company must perfect an offering exemption when it sells its shares.<sup>262</sup> Some of these require that the shares be offered and sold to a limited number of buyers.<sup>263</sup> Under the law, it would violate the terms of these exemptions if buyers were to immediately flip their shares to a prohibitively large number of purchasers.<sup>264</sup> By this logic, if there was an issue as to whether what is being sold is a security, courts should similarly look at the reality of the transaction—that the first buyer is but an intermediary for a larger pool of investors.

Looking at the realities of the transaction is also important for other elements of *Howey*, and for considering additional interpretations of

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256. For a more in depth description of P2P lending, see Verstein, *supra* note 243, at 452.

257. See Prosper Marketplace, Inc., S.E.C. Rel. No. 33-8984, 2008 WL 4978684, at \*2 (Nov. 24, 2008) [hereinafter Prosper Marketplace Release].

258. See *id.*

259. See *id.*; Verstein, *supra* note 243, at 476.

260. Prosper Marketplace Release, *supra* note 257, at \*2.

261. *Id.* at \*4.

262. See LOUIS LOSS ET AL., FUNDAMENTALS OF SECURITIES REGULATION 476-565 (6th ed. 2011) (discussing exemptions from the registration requirement).

263. For example, only thirty-five unaccredited investors may participate in offerings exempted under Rule 506. 17 C.F.R. § 230.506(b)(2) (2014).

264. See Schwartz, *supra* note 103, at 552.

what constitutes a common enterprise. Some courts, where not convinced horizontal commonality is present, allow vertical commonality to satisfy this element.<sup>265</sup> Strict vertical commonality requires that the investor's return and the promoter or principal's return be tied together.<sup>266</sup> Broad vertical commonality just requires that the investors' returns are tied to the promoter's or principal's effort.<sup>267</sup>

A focus on the economic realities reveals that both forms of vertical commonality are met. The true parties in interest are the individual investors and the individual investees. The latter are promoters because they are participating in the sales effort; they are also principals because they control their own actions in the same way that the head of a corporation controls its business. Strict vertical commonality is met because the investees and the investors share in the investees' salaries. As such, their fortunes are inextricably linked. Broad vertical commonality is met because whether a human-equity investment succeeds or fails is solely dependent on the efforts of the investee.

Under *Howey*, the next element is a profit-seeking motive. In Friedman's original conception, investors put their money in to earn a profit, so this element would be satisfied.<sup>268</sup> Some of the current startups, though, appeal to a mixed motive. *Pave* is mostly about making money, but the investors also get the satisfaction of helping young people succeed. *Lumni* is much more philanthropic in nature. The idea is that investments are partly a donation to needy students, and the website is explicit that investors earn both a monetary and social return.<sup>269</sup> The other-regarding nature of certain human-equity arrangements plays into the analysis of this element.

In considering mixed-motive investments, courts have required that the profit-seeking intention be more than an insubstantial reason for the investment of money.<sup>270</sup> The test is objective. Rather than focus on the internal motivation of each individual investor, courts focus on why, on the whole, investors might be attracted to the particular investing opportunity.<sup>271</sup> This analysis depends a great deal on the setup of each human equity investing platform. In *Pave*, for example, investors would likely be deemed to have a sufficient profit-seeking motive. While the investors might feel good about themselves, profit is ostensibly their main motivation. With regard to *Lumni*, it would depend on the degree to which investors are receiving below market returns given the risk they are taking

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265. THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* § 1.6[2][B] (6th ed. 2014).

266. *See id.*; Heminway & Hoffman, *supra* note 238, at 888.

267. Heminway & Hoffman, *supra* note 238, at 888–89.

268. *See* Friedman, *Role of Government*, *supra* note 9, at 138.

269. *For Potential Investors*, *supra* note 120.

270. *See, e.g., Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 561–62 (1979); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 856 (1975).

271. *See* JOSEPH C. LONG, 12 *BLUE SKY LAW* § 2:65 (2014); *see also McNabb v. SEC*, 298 F.3d 1126, 1132 (9th Cir. 2002) (conducting an objective inquiry into the motivations of buyers and sellers of notes).

on.<sup>272</sup> There is no bright line rule, but the lower the rate of return, the less likely the instrument would be considered a security. Thus, while in its purest form, human-equity investing easily satisfies this element, arrangements with a sufficiently donative purpose would fail this inquiry and therefore would not be considered investment contracts.

Finally, under *Howey*, investors must expect to earn their profits solely from the efforts of others. This element has been softened by later precedent, which allows the investors to contribute somewhat to the venture, so long as they lack “meaningful” control.<sup>273</sup> As currently structured, human-equity investors do not have meaningful control over the investees. Those who share equity in themselves are mostly free to do as they please. As discussed in Part IV, however, there is nothing to stop investors from demanding significant control over the investees in the future.<sup>274</sup> At some point, these provisions could cross the line.

In sum, equity shares in people as currently offered by for-profit ventures like Pave and Fantex fall rather neatly within *Howey*’s delineation of investment contracts. Equity-sharing platforms with a philanthropic structure, however, may fall outside of this legal construct, as would arrangements that grant substantial control to investees. This analysis suggests that, notwithstanding exceptions for special cases, the typical human-equity investment is a security.

Before accepting this counterintuitive conclusion, however, it is worth considering if there are any exceptions to *Howey*—any reasons why an instrument that technically qualifies as an investment contract would nevertheless be exempt from securities law. Investments in people, after all, were not what the drafters of the securities laws had in mind.

There are two grounds for making such a claim. First, a longstanding canon of statutory construction says that a “thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.”<sup>275</sup> The Supreme Court has looked to this language in considering what constitutes a security.<sup>276</sup> On this basis, it could be argued that investments in people are an example of something that does not comport with the intent and spirit of the securities laws.

Such a claim, though, would garner little traction. This provision has never been relied upon to reverse an investment-contract analysis. Additionally, it is quite arguable that regulating human equity does fall within the mission of securities regulation. The laws are designed to protect

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272. See, e.g., *Teamsters*, 439 U.S. at 561–62 (proportionally weighing sources of return).

273. *Robinson v. Glynn*, 349 F.3d 166, 170 (4th Cir. 2003).

274. See *supra* text accompanying notes 174–75.

275. *Forman*, 421 U.S. at 849 (1975) (quoting *Church of the Holy Trinity v. United States*, 143 U.S. 457, 459 (1892)).

276. See *id.*

people speculating on risky investments. That is exactly what is happening here.

The other argument for taking human-equity investing outside of the securities laws is the so-called context clause. The phrase, “unless the context otherwise requires,” precedes the statutory definition of a security.<sup>277</sup> What Congress meant by this is far from clear. Some courts have held that this caveat is inward-looking only. Under this interpretation, the definition of a security applies throughout the statutes, unless it is inapt in the context of particular provisions.<sup>278</sup> Others courts have been willing to read the context clause to apply outside of the statutes and to the factual setting in which the question of whether something is a security arises. Under this reading, instruments that would otherwise constitute securities may not be categorized as such because the court deems it inappropriate to apply the law literally given the circumstances.<sup>279</sup>

Even when courts are willing to extend the context clause this far, however, they are hesitant to rely on it. According to Judge Friendly in the Second Circuit,

[s]o long as the [securities-law] statutes remain as they have been for over forty years, courts had better not depart from their words without strong support for the conviction that, under the authority vested in them by the “context” clause, they are doing what Congress wanted when they refuse to do what it said.<sup>280</sup>

The judicial coolness to this exception suggests that human equity will not be spared from securities laws.

Legal precedent regarding so-called “death bonds” supports this conclusion. Death bonds are based on the transfer and securitization of life insurance contracts.<sup>281</sup> With life insurance, the insureds agree to make a series of payments over time in exchange for lump sum benefits paid out to their survivors when they pass away.<sup>282</sup> Individuals can transfer these contracts to third parties, who take over the premium obligations and get paid when the insured dies.<sup>283</sup> So-called death bonds are created when companies purchase a number of insurance contracts, pool them together, and sell shares in the pool.<sup>284</sup>

Substantively, what investors receive is a diversified pool of bets about death. And the investors are hoping the end is nigh. Because it means fewer payments in exchange for the life-insurance payout, the

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277. 15 U.S.C. § 77b(a) (2012); 15 U.S.C. § 78c(a) (2012).

278. See Steven J. Cleveland, *Resurrecting Court Deference to the Securities and Exchange Commission: Definition of “Security,”* 62 CATH. U. L. REV. 273, 308–09 (2013).

279. See *id.* at 309–12.

280. *Exch. Nat’l Bank of Chi. v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976).

281. Liam Plevin & Ian McDonald, *A Lively Market in “Death Bonds,”* WALL ST. J., Feb. 21, 2007, <http://online.wsj.com/news/articles/SB117202515665914431>.

282. *What is Life Insurance?*, FIDELITY, <https://www.fidelity.com/life-insurance-planning/what-is-life-insurance> (last visited Jan. 31, 2015).

283. Ariella Gasner, Note, *Your Death: The Royal Flush of Wall Street’s Gamble*, 37 HOFSTRA L. REV. 599, 599 (2008).

284. See Plevin & McDonald, *supra* note 281.

shorter the life-span of the individuals in the death-bond pool, the higher the investors' returns. While death bonds are not the same thing as human-equity investments, they represent a similar intrusion of finance into personhood. In fact, death bonds are worse. At least with human-equity investing, investor and investee are on the same side, whereas death bonds create a rooting interest in people's demise.

If courts were concerned about keeping investments in or regarding people outside the securities-law framework, this would have been where to do it. But they never took the opportunity. Courts have overwhelmingly held that death bonds and similar instruments are securities and have done so without even considering the context clause.<sup>285</sup> The courts' sterile doctrinal approach in this arena suggests that they would have little sympathy for a claim that the context clause requires special treatment for investments in people. The conclusion, therefore, stands: investments in human beings generally constitute securities.

### B. Securities Regulation

Transacting in securities has liability and compliance implications. If investees commit fraud, they could be sued under Rule 10b-5 of the securities laws,<sup>286</sup> which is in some ways more plaintiff-friendly than the common-law cause of action.<sup>287</sup> Wrongdoing with respect to securities could also be met with an SEC enforcement action.<sup>288</sup> Finally, and most importantly, investees need to register the sale of interests in themselves or find an applicable exemption.<sup>289</sup> Registration is off the table because of its costly requirements. One way to sell securities without registration is to comply with Rule 506.<sup>290</sup>

Prior to the JOBS Act, Rule 506 forbid general solicitation (i.e., selling securities to those with whom the issuer lacks a preexisting substantive relationship).<sup>291</sup> While the SEC had granted Internet sellers of securities some leeway through its interpretation of this prohibition, the rule nevertheless stood in the way of expansive marketing efforts.<sup>292</sup> But the JOBS Act, together with the SEC's implementing regulations, eliminated this ban in cases where sales are limited to "accredited inves-

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285. See Michele Meyer McCarthy, Annotation, *Federal Regulation of Viatical Life Insurance Programs, Viatical Settlements, and Viatical Investments*, 1 A.L.R. FED. 2D 269 (2005) (collecting cases on death bonds, referred to in the article as viatical settlements). A notable exception is *Life Partners*, which held that a death bond is not a security because profits were not derived solely from the efforts of others. See *SEC v. Life Partners, Inc.*, 87 F.3d 536, 538 (D.C. Cir. 1996).

286. See HAZEN, *supra* note 264, § 1.6[2].

287. See Robert A. Prentice, *Stoneridge, Securities Fraud Litigation, and the Supreme Court*, 45 AM. BUS. L.J. 611, 623-24 & nn.53-55 (2008).

288. See HAZEN, *supra* note 264, § 1.4[6].

289. See LOSS ET AL., *supra* note 262 (discussing exemptions from the registration requirement).

290. 17 C.F.R. § 230.506 (2014).

291. William K. Sjoström, Jr., *Relaxing the Ban: It's Time to Allow General Solicitation and Advertising in Exempt Offerings*, 32 FLA. ST. U. L. REV. 1, 13 (2004).

292. See Use of Electronic Media, Securities Act Release No. 7,856, 65 Fed. Reg. 25843, 25851-53 (May 4, 2000) (codified at 17 C.F.R. pts. 231, 241, 271).

tors.<sup>293</sup> As noted above, this is essentially institutions and wealthy individuals.<sup>294</sup>

The change to Rule 506 may partially explain the burgeoning interest in this area. Pave, for instance, may have been willing to bear the regulatory uncertainty surrounding whether human equity is a security because it knew that it could comply in any event by limiting sales to accredited investors. As discussed above, rather than wait and see, the platform allows only this elite category of investors to participate, thereby assuring regulatory compliance for itself and its Talent.<sup>295</sup>

The completion of the JOBS-Act-mandated crowdfunding regulations will create another alternative.<sup>296</sup> Once finalized, these rules will allow sellers of securities to market themselves to anyone, so long as a variety of regulatory requirements are met. Most importantly, issuers will only be permitted to raise \$1 million, there will be limits on how much any individual can invest, the investments will have to be sold—without advertising—through a registered intermediary, and sellers will be required to make initial and ongoing disclosures.<sup>297</sup> As commentators have argued in other contexts, the multitude of restrictions on crowdfunding, combined with the easing of the general solicitation rules, likely means that, if at all possible, investees and investment platforms will circumvent these extensive limitations and—like Pave and those selling equity on it—only do business with accredited investors.<sup>298</sup>

### C. *Responsiveness of Securities Regulation and the Need for a Complementary Regulatory Scheme*

As noted in Part IV, human-equity investing raises concerns regarding both the investor and the investee.<sup>299</sup> Securities regulation, though, is only focused on protecting the investor. While it is arguable whether the rules, particularly with the changes ushered in by the JOBS Act, accomplish even this, an examination of investor protection in the wake of this important statute is a broader issue, the analysis of which is beyond the scope of this Article. The flexibility to market freely when sales are lim-

293. See Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, § 201(a)(1), 126 Stat. 306, 313–14 (2012); Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Rel. No. 9,415, 78 Fed. Reg. 44771, 44771 (July 24, 2013) [hereinafter General Solicitation Release] (to be codified at 17 C.F.R. pt. 230).

294. See *supra* note 95 and accompanying text.

295. See *supra* text accompanying note 94.

296. See Crowdfunding, 78 Fed. Reg. 66428, 66429 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. 200).

297. See *id.* at 66430.

298. Cf. Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1605–06 (2013) (expressing doubt about the viability of crowdfunding). The JOBS Act also made going public more tenable through the so-called IPO On-Ramp, which provides special rules for “Emerging Growth Companies.” See Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, §§ 101-108, 126 Stat. 306, 307–313 (2012). Fantex is taking advantage of these eased regulatory obligations. See Fantex, Inc., *supra* note 82, at 15.

299. See *supra* Part IV.B.2.

ited to accredited investors may be wrong, but the issue does not turn on whether the investment is in a person or a business. The pressing issue in the human-equity context is the absence of any protection under the securities laws for those sharing equity in themselves. In addition, securities regulation is unresponsive to the threats these instruments pose to society as a whole. In the next Part, I set forth a regulatory template to fill these gaps.

## VI. A COMPLEMENTARY REGULATORY REGIME FOR HUMAN-EQUITY INVESTING

Part IV noted a variety of concerns with human-equity investing as they relate to the investees and to society at large. Investees might enter into bad bargains because of bounded rationality or insufficient information.<sup>300</sup> Even if investees fully understand the terms of their equity-sharing arrangements, society's well-being is compromised if fraught economic circumstances coerce people to enter into these relationships.<sup>301</sup> Finally, the corporate view of personhood that these express may represent a step backwards for society.<sup>302</sup> Disclosure rules complemented by outside limits on contracting can mitigate these concerns.

### A. Disclosure Requirements

One key concern is that investees may not understand the true cost of the money that they are receiving from investors. As noted above, the calculation of the cost of equity capital is unintuitive.<sup>303</sup> Because there is an analogous worry when individuals take out loans, the regulatory approach in that arena can guide the response in this one.

While the concept of an interest rate is relatively straight-forward, loans can have complex fees and terms.<sup>304</sup> And even interest rates can be disclosed in manners that render them difficult to understand.<sup>305</sup> Federal truth-in-lending laws are the response.<sup>306</sup> These laws standardize the presentation of key items and require the disclosure of certain things that

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300. See *supra* text accompanying notes 209–13.

301. See *supra* Part IV.B.3.b.

302. See *supra* Part IV.B.3.b.

303. See *supra* note 209 and accompanying text.

304. Home loans, for instance, can come with a baffling array of terms. See generally BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, INTEREST-ONLY MORTGAGE PAYMENTS & PAYMENT-OPTION ARMS—ARE THEY FOR YOU? (2006), available at [http://www.fdic.gov/consumers/consumer/interest-only/mortgage\\_interestonly.pdf](http://www.fdic.gov/consumers/consumer/interest-only/mortgage_interestonly.pdf) (describing two options that gained popularity during the run-up to the financial crisis: interest-only loans and option adjustable rate mortgages).

305. For example, interest can compound at various increments (e.g., daily, monthly, or annually), which makes rates difficult to compare. To address this, truth-in-lending laws require disclosure of an annual percentage rate, which mandates disclosure of interest rates in annual terms. See 15 U.S.C. §§ 1606, 1637, 1637a, 1638 (2012).

306. See Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513, 628–29 (2005).

lenders might otherwise omit.<sup>307</sup> While there is certainly room for debate about whether these rules require the right amount of information in the right format, the core concept is sound and can be applied to human-equity investing.<sup>308</sup>

Regulators could mandate that investors include certain minimum disclosures in the equity-sharing agreement. Most importantly, they should require that this document include (1) the term of the agreement; (2) the investor's future income forecast for the investee over the term; (3) a definition of what exactly counts as "income" for purposes of the agreement; (4) the fees charged by any intermediaries for origination and thereafter; (5) the dollar sum that the investee is receiving in exchange (after origination fees have been taken out); (6) the cost of equity capital that relates (2) and (5); (7) the percent of income the investee is required to annually remit; (8) the amount of dollars the percentage set out in (7) equates to on an annual basis based on the income forecast set out under (2);<sup>309</sup> and (9) the sum of the payments in (8), which would represent the total dollars the investee would pay out over the term based on the investor's income forecast.

Regulators should also mandate disclosure of what happens to investees if they exceed or underperform income forecasts by set percentages. For example, the form could be required to include how much money investees would owe investors, in both percentage and dollar terms, if they were to surpass income expectations or fall below them by twenty-five percent. This would drive home the costs and benefits of the flexibility that is the key component of equity sharing. Also important in all of this is how the information is presented. A combination of narrative explanation and tabular presentation would make matters clearest to investees.

An example would help to illustrate how the key components of the above disclosure requirements could look in practice. Assume an individual is offering to invest \$14,000 in an investee for five percent of the investee's income for five years, that the intermediary charges a \$900 fee

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307. *See id.* at 629.

308. *See generally id.* at 630–33. The federal laws themselves, as embodied in The Truth in Lending Act, would likely not apply. The statute is applicable when there is an extension of "credit," defined as "the right granted by a creditor to a debtor to defer payment of debt." 15 U.S.C. § 1602(e); 12 C.F.R. § 1026.2(a)(14) (2014); *see* DEE PRIDGEN & RICHARD M. ALDERMAN, CONSUMER CREDIT AND THE LAW § 5:1 (2014). Since there is no obligation to repay the initial investment in a human-equity transaction, there would appear to be no deferred payment of any debt. The official interpretation of "credit" supports this reading. It excludes from the definition, "[i]nvestment plans in which the party extending capital to the consumer risks the loss of the capital advanced," providing as an example, "an arrangement with a home purchaser in which the investor pays a portion of the downpayment and of the periodic mortgage payments in return for an ownership interest in the property, and shares in any gain or loss of property value." 12 C.F.R. § 1026, Supp. I, Part 1, 2(a)(14)(1)(viii). Because investors in human equity risk the loss of their initial outlay and share in income gains and losses, their investments would likely qualify as exempted "investment plans." *Id.*

309. Expressing payments in dollar terms makes the true cost more concrete for investors. *Cf.* Jeff Schwartz, *Reconceptualizing Investment Management Regulation*, 16 GEO. MASON L. REV. 521, 570–71 (2009) (discussing the value of dollar-based disclosure in the investment fund arena).



to arrange the transaction, and that the investor's income forecast for the investee is as follows in years one through five: \$60,000, \$65,000, \$70,000, \$75,000, and \$80,000.

The investment agreement should first clearly lay out the exact amount of dollars that the investee will be receiving, the term, and the repayment obligation in percentage terms. This document would be prepared by the platform in cooperation with the investor and presented to the investee as follows:

Total Capital Contribution by Investor: \$14,000

Less Transaction Fees:<sup>310</sup> \$900

The Amount You Will Receive: \$13,100

*In Return You Will Pay: Five Percent of Your Income for Five Years*<sup>311</sup>

This should be accompanied by a table that includes the investor's income forecast for the investee and what the investee's repayments would look like should those expectations prove correct.

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310. Other fees should also be disclosed and explained separately.

311. The inclusion of a clear definition of "Income" should also be mandated. Most importantly, rules should require that investors clearly articulate the extent to which they expect to receive a portion of the money that comes in from sources other than career endeavors. For example, if investors expect a portion of alimony or investing returns that materialize during the term—as is the case with *Pave Backers*—this expectation needs to be made clear. *See supra* notes 107–08 and accompanying text. The concern here is that investees would intuitively expect that only career-related earnings are shared; while there is nothing intrinsically wrong with a broader agreement, special steps should be taken so that investees are on notice that they are liable for more.

TABLE 1: FORECASTED INCOME STREAM AND RELATED PAYMENTS

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	
<i>Your Income Forecast</i>	\$60,000	\$65,000	\$70,000	\$75,000	\$80,000	
<i>Percent You Owe to the Investor</i>	5%	5%	5%	5%	5%	
<i>Percent You Owe to the Investor in Dollars</i>	\$3,000	\$3,250	\$3,500	\$3,750	\$4,000	<u>Total:</u> \$17,500

A narrative accompanying this table should make clear that this is only an estimate and that if the investee's income is higher or lower, the investee's repayment obligation would vary substantially. To illustrate this point the following tables and accompanying description should be included:

"Your repayment obligations could be significantly higher or lower than what is estimated above. The following charts illustrate what would happen if your future income is twenty-five percent higher or lower than what the investor has forecasted it will be."

TABLE 2: HYPOTHETICAL YEARLY INCOME AND RELATED PAYMENTS  
(25% Above Investor Forecast)

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	
<i>Your Income 25% Above Forecast</i>	\$75,000	\$81,250	\$87,500	\$93,750	\$100,000	
<i>Percent You Owe to the Investor</i>	5%	5%	5%	5%	5%	
<i>Percent You Owe to the Investor in Dollars</i>	\$3,750	\$4,063	\$4,375	\$4,688	\$5,000	<u>Total:</u> \$21,876

TABLE 3: HYPOTHETICAL YEARLY INCOME AND RELATED PAYMENTS  
(25% Below Investor Forecast)

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	
<i>Your Income 25% Below Forecast</i>	\$45,000	\$48,750	\$52,500	\$56,250	\$60,000	
<i>Percent You Owe to the Investor</i>	5%	5%	5%	5%	5%	
<i>Percent You Owe to the Investor in Dollars</i>	\$2,250	\$2,438	\$2,625	\$2,813	\$3,000	<u>Total:</u> \$13,126

Finally, the contract should be required to explain the investee's cost of equity capital in terms that make the rate comparable to a loan. For example, the document could explain that:

[A]lthough this is not a loan, the payments you make to the investor are similar to payments on a loan. If your payments turn out to be as estimated in Table 1, you are paying the equivalent of a ten percent interest rate. If you make twenty-five percent *more* than the income forecast in Table 1, and therefore pay as described in Table 2, you are paying the equivalent of a nineteen percent interest rate. Finally, if you make twenty-five percent *less* than the income forecast in Table 1, and therefore pay as described in Table 3, you are paying the equivalent of a zero percent interest rate. Thus, because your payment obligations vary with your income, you may end up paying much more or much less than you would on a comparable loan.

Disclosures along these lines should ensure that investees have a good idea of what they are agreeing to. The template contains two key pieces of information that are crucial to the investee's understanding, but that investors would be tempted to omit. Requiring that investors disclose their income forecast makes it so that investees can judge whether they are being fairly valued. An unreasonably low income forecast would be a sign that an investee should steer clear. Mandating that investors disclose the investee's cost of equity capital is also essential. Without this, investors might not fully understand how the cost of this form of financing compares to a loan. If this figure is not made clear, investees could reasonably, though incorrectly, think that the percent they are required to remit to investors each year is what equates to the interest rate.

*B. Contractual Limits and Limits on Transfer*

Disclosure mitigates concerns about investee misunderstanding, but broader social concerns about coercion and commodification remain. Investees could still be coerced through economic hardship into accepting grossly disproportionate terms. These arrangements still commodify people and, as a result, reinforce the undervaluation of women and minorities.<sup>312</sup> Substantive limits on human-equity investing would respond to these concerns, even if they would not extinguish them.

Coercion concerns can be addressed by outlawing contractual terms that appear unreasonable or, at least, unconscionable. For example, the rules could mandate that the cost of equity capital not exceed a certain figure, like twenty-five percent. Anything beyond this number smacks of usury.<sup>313</sup> One problem with a cap like this in the human-equity context is that investors can artificially deflate their reported income forecasts, thereby nominally reducing the investees' cost of equity capital below the threshold. The answer to this is to have a cap on how much investees will be required to payout on income that exceeds the forecasts. For example, the rules could specify that investees are not required to remit any portion of their incomes on amounts more than thirty percent in excess of the investors' original estimates. This way, if investors attempt to circumvent the cost-of-equity-capital cap, they run into the repayment cap.<sup>314</sup>

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312. See *supra* text accompanying notes 235–36; Lattman & Eder, *supra* note 79; Ramachandran, *supra* note 236, at 1051.

313. Cf. Graves & Peterson, *supra* note 197 (discussing usury law and its weaknesses). State usury laws themselves would likely not apply. Usury generally requires that there be a loan and that the loan “be repayable absolutely and at all events.” RICHARD A. LORD, 9 WILLISTON ON CONTRACTS § 20:4 (Francis M. Dougherty et al. eds., 4th ed. 2011). Human-equity transactions fail both requirements. For the purposes of usury law, a “loan consists of the provision of a sum of money by one party to another who thereby becomes bound by a contract to return an equivalent amount with or without an additional sum payable for its use.” *Id.* at § 20:5. Because there is no requirement to “return an equivalent amount” in a human-equity transaction, there is no loan. Moreover, what is owed is not absolute; rather the amount repaid is contingent on the investee’s earnings. These instruments are more closely analogous to equity investments in a business, transactions to which the usury laws do not apply. See *Duffy v. Gilmore*, 51 A. 1026, 1027 (Pa. 1902); *Case v. Fish*, 15 N.W. 808 (Wis. 1883). One emerging area that is somewhat analogous, and where the issue of usury has come up, is litigation finance. Although structures vary, the basic idea is that investors provide money to litigants with repayment terms contingent on the results of their suits. Usually, these arrangements are found to be outside the scope of usury law. See Wendy Gerwick Couture, *Securities Regulation of Alternative Litigation Finance*, 42 SEC. REG. L.J. 5, 6 n.13, 16 (2014). There is also an analogy to pension advances. As noted *supra* note 226, these products involve an exchange of capital for a portion of future pension payments. Pension advances more closely resemble loans because repayment obligations are a fixed amount of a fixed income rather than a percentage of unknown future earnings. See Silver-Greenberg, *supra* note 226 (describing an advance in which a retired marine traded “\$353 . . . of his \$1033 monthly disability [check] . . . for five years in exchange for \$10,000 . . . up front”). Whether pension advances are subject to usury law is currently a subject of dispute among litigants, regulators, and industry. See *id.* (describing litigation of pension advances); Jessica Silver-Greenberg, *New York State Investigating Pension-Advance Firms*, N.Y. TIMES DEALBOOK (May 7, 2013, 2:14 PM), <http://dealbook.nytimes.com/2013/05/07/new-york-state-investigating-pension-advance-firms/> (describing government investigation into these arrangements).

314. A downside of this limitation is that it prevents investors from benefitting from those rare investees who legitimately—and breathtakingly—exceed expectations. This lost profit opportunity might chill the market because it might be the potential to benefit from extraordinary cases that draws

Similarly, there should be a cap on the percent of their equity that people are permitted to sell. The more a person agrees to sell, the more commodifying the arrangement. In the extreme, the transfer of one hundred percent of one's equity flirts with slavery. More than fifty percent is also discomfoting. If a person has a healthy income, there is no need for them to sell this much; if they do not, then they likely could not afford to live off of the percent they retain. Thus, it is hard to imagine an individual agreeing to sell such a large stake without some type of coercion. In fact, these same concerns likely surface at even a lower threshold. A cap at something like thirty-five percent would, therefore, be justifiable.

Regulators should also limit the length of the sharing term and the ability of investees to delegate control over their futures to investors. What happens to people over their lives is extremely unpredictable, and this is particularly so for a large category of potential human-equity investees—students and young adults. Given this uncertainty, there is no reason for a person to agree to share income for a long term, absent compulsion by economic circumstances. These arrangements are also inherently less commodifying when they are for shorter terms.<sup>315</sup> Twenty years seems like a reasonable outside limit.<sup>316</sup>

The delegation of control to investors is also worrisome—as people give up control to others, they begin to look like their assets; there is also an outside boundary, past which control provisions appear coercive. Absent coercion, for instance, it is difficult to imagine an investee agreeing to give investors veto power over what jobs they may accept and when they may quit—at least over an extended amount of time. It is impossible to imagine, however, all of the potential types of control arrangements and delineate exactly which are problematic. That being the case, a more workable approach would be to provide that any such provisions automatically expire in five years. The time limit itself makes control agreements less disconcerting and ensures that, in any case, they would be relatively short-lived.

The trickiest problem is what to do about the extent to which the commodifying aspect of human-equity investing reinforces, and potentially exacerbates, preexisting income inequality. Since women and minorities earn lower incomes, they will receive lower values in these arrangements.<sup>317</sup> There appear to be three options. One is to forbid investors from considering income differences accountable to race and sex. When projecting future incomes, investors would be required to use a blended model that includes everyone. The risk is that the disparities in income are so wide that doing this would destroy the market. Highly-

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people to human-equity investing in the first place. A way to structure this cap to avoid this result is to make it waivable upon specific consent by the investee.

315. See *supra* Part IV.B.3.b.

316. Fantex's business model, where human-equity transfers last indefinitely, would have to be altered to conform. See *supra* note 82 and accompanying text.

317. See Ramachandran, *supra* note 236, at 1049.

compensated men, for instance, would be undervalued and withdraw from the pool of potential investees. Knowing this incentive to withdraw, investors would want to lower the estimates for their models. But doing so would be illegal. Unwilling to overpay, investors would exit the market, and it would collapse.

In the alternative, the government could allow race and gender to be recognized while subsidizing human-equity investments in groups with traditionally lower incomes. For example, assume that, because of lower earnings projections associated with her gender, a woman is only able to collect \$10,000 from investors for a certain percentage of her income, but a similarly situated man could collect \$12,000. A government subsidy could make up the difference. The trouble with this approach is that, while it would equalize matters for participants, it does nothing for those outside the market. In addition, individualized subsidies would be problematic to implement. The government could not possibly know and then offset the discount applied in each industry by each investor. Therefore, it would have to develop rough figures that would overcompensate some and undercompensate others.

A final option, which is likely the best, would be to allow investors to take race- and gender-based income distinctions into account but to tax the platforms an amount that would then go towards efforts to study and ameliorate the root causes of income discrepancies. A percentage could also go to scholarships for women and minorities. This approach would not kill the market and is feasible to implement.

It is also the best match for the type of harm that this aspect of human-equity investing implicates. The use of race and gender in income forecasting is not typical discrimination. That would be where investors give worse terms to people with equivalent projected income streams based on such traits. Such discrimination should be illegal.<sup>318</sup> Rather, using these traits to model future income lays bare the reality of income inequality. In this sense, it is analogous to the legal practice of using gender to determine life insurance terms: providers give better rates to women, because they live longer.<sup>319</sup> The former reflects underlying realities about

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318. This type of discrimination is illegal in the lending context. *See* 15 U.S.C. § 1691 (2012). For the reasons discussed *supra* note 308, this prohibition likely does not apply to human-equity investing. *See* 15 U.S.C. § 1691a(d) (2012) (defining credit for purposes of the Equal Credit Opportunity Act as “the right granted by a creditor to a debtor to defer payment of debt”). Racial discrimination, however, would be prohibited under 42 U.S.C. § 1981. *See* *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) (affirming that “§ 1981 prohibits racial discrimination in the making and enforcement of private contracts”).

319. *See* Mary L. Heen, *From Coverture to Contract: Engendering Insurance on Lives*, 23 *YALE J.L. & FEMINISM* 335, 383 (2011). On the other hand, women traditionally pay more for health insurance. Robert Pear, *Gender Gap Persists in Cost of Health Insurance*, *N.Y. TIMES*, Mar. 19, 2012, [http://www.nytimes.com/2012/03/19/health/policy/women-still-pay-more-for-health-insurance-data-shows.html?\\_r=0](http://www.nytimes.com/2012/03/19/health/policy/women-still-pay-more-for-health-insurance-data-shows.html?_r=0). Under the Affordable Care Act, however, this is not allowed. *Id.* The case of health insurance, though, is distinguishable from human-equity investing. The grounds for higher-priced health insurance are dubious whereas wage disparities are real. *See id.* In addition, the price discrimination with respect to insurance is unnecessary if, as the Affordable Care Act envisions, everyone is

income and the latter about life expectancy. As in the life insurance context, it does not seem appropriate to outlaw a practice rooted in true distinctions. Nevertheless, in the human-equity context, reliance on such traits is much more troubling because it reflects a deeper social problem. It even aggravates the problem by creating a further disadvantage rooted in the underlying discrimination. Because the use of race and gender in this context arises out of a larger societal issue, it seems the best matched response is to require that those involved contribute funds to respond to it.

The foregoing regulations would do much to address concerns that arise at the time of signing, but regulations should go one step further. Regulators should address what happens to equity-sharing agreements after they are signed; namely, they should mandate that such accords are nontransferable. Under existing contract-law principles regarding the delegation of personal-service contracts, investees would probably not be able to assign their obligation to make payments.<sup>320</sup> But there is nothing that prevents investors from transferring their right to receive them. Once this happens, though, shares in people could be traded like stock. From a purely financial perspective, there is reason to allow this to occur. If there were a liquid market in people's future income streams, it would drive down the cost of equity capital for the investees. A company's cost of equity capital, for example, is lower when its stock trades on a liquid market.<sup>321</sup> Indeed, this is one reason for an IPO.<sup>322</sup>

But liquid markets in people are unlikely to become widespread. Such markets are built on a steady diet of current information.<sup>323</sup> Very few investees would raise enough money, however, to make a commitment to ongoing disclosure worthwhile. And, if a liquid market were to develop, it would be deeply commodifying. Names and pictures accompanied by moving price quotes would fully equate people with financial assets. While the cost-benefits calculus is by necessity intuitive, the decrease in the cost of equity capital does not appear to be worth this degree of degradation. Therefore, transfer should be outlawed.<sup>324</sup>

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insured. In this case, if everyone is charged the same rate, and women are truly more expensive to insure, their cost is offset by overcharging men.

320. Contract law forbids delegation where the "delegated performance is not as satisfactory as personal performance." RESTATEMENT, *supra* note 140, at § 318 cmt. C. This would be the case in human-equity investing because performance is uniquely tied to the individual investee.

321. See Schwartz, *supra* note 103, at 536–38.

322. See *id.* at 543.

323. See *id.* at 582.

324. Fantex's nascent secondary market in athletes illustrates both the struggle with creating liquid markets in people and the commodification that such engender. Vernon Davis, the one athlete that has gone public, trades lightly, as shown on his Fantex webpage, which displays Mr. Foster and the shares linked to him in the same way as shares in GE are shown on Yahoo! Finance. Compare *Fantex Vernon Davis*, *supra* note 84, with *General Electric Company*, YAHOO! FINANCE, <http://finance.yahoo.com/q?s=GE> (last visited Jan. 31, 2015). Under my proposal, Fantex could still sell shares in athletes, but it would have to promise the investors their pro rata piece of the athletes' income streams. Investors would not be able to buy an athlete with the hopes of flipping the person for

This regulatory template declaws human-equity investing without interfering with its potential for good. As discussed earlier, these instruments potentially benefit students by enabling them to fund their educations in a more affordable and flexible manner.<sup>325</sup> Regulations in line with the above provide protection for participants and society but should not detract from this potential. Moreover, securities-law research has shown that greater regulation creates stronger securities markets.<sup>326</sup> Thus, there is reason to suspect that the regulations proposed herein would help human-equity investing succeed—in a socially palatable form.<sup>327</sup>

### C. *A Role for the Consumer Financial Protection Bureau*

The newly created CFPB seems like the natural body to create and enforce regulations along these lines. The body was created to help individuals navigate financial decisions and protect them from abusive practices in connection with consumer financial products.<sup>328</sup> Credit cards and mortgages, for instance, are two things that the CFPB oversees.<sup>329</sup> Investments in people are similar to these instruments and implicate many of the same concerns. Just as when people take out credit, when they agree to share equity in themselves, they undertake to make payments in the future in exchange for money up front. A key worry in both contexts is that consumers might agree to unfavorable terms that they do not fully understand. While human equity presents novel twists on this concern, as well as other challenges, the CFPB's experience with related financial products makes it a good fit to oversee this new alternative.

## VII. CONCLUSION

The blossoming of human-equity investing poses a number of social challenges. The inherent commodification involved with buying and selling equity in people is troubling in its own right and raises the specter of slavery. There is also the potential that participants in these transac-

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a higher price. While an exchange in athletes may seem less offensive than one for you and me, there is no principled distinction.

325. See *supra* Part IV.B.3.a.

326. See Schwartz, *supra* note 103, at 582.

327. In April 2014, while this Article was in press, Senator Marco Rubio proposed a bill to regulate what I have called human-equity transactions and what he calls “income share agreements.” See Investing in Student Success Act of 2014, S. 2230, 113th Cong. (Apr. 9, 2014). Senator Rubio's bill covers more topics than my proposal but goes into less depth with regard to investee protection. While his bill includes some of the safeguards I mention, such as limits on how much future income can be shared and for how long, it leaves out a great deal. See *id.* at §§ 102(b)(3), (4). Among other things, the bill fails to mandate disclosure of the investor's income forecast or the cost of equity capital. His proposal, however, includes things that are beyond the scope of this Article. For instance, he proposes taxation rules for income share agreements and that obligations under such arrangements be essentially nondischargeable in bankruptcy. See *id.* §§ 102(c)(2), 201.

328. See *Creating the Consumer Bureau*, CONSUMER FIN. PROT. BUREAU, <http://www.consumerfinance.gov/the-bureau/creatingthebureau/> (last visited Jan. 31, 2015).

329. *About Us*, CONSUMER FIN. PROT. BUREAU, <http://www.consumerfinance.gov/the-bureau/> (last visited Jan. 31, 2015).



tions—particularly the investees—may fail to understand the full implications of equity-sharing arrangements. As I have argued, however, neither constitutional jurisprudence nor public policy supports the invalidation of these transactions.

Instead, regulation is the correct social response. With proper oversight, the benefits of this financial innovation—most importantly, its potential to broaden access to and improve the financing of higher education—would very likely outweigh the costs. Today, because these instruments meet the legal test for “securities,” they should be regulated under the securities-law regime. But securities law contains nothing to protect investees or mitigate commodification and other broader social concerns that arise in this context. Therefore, human-equity investing should be subject to an additional layer of regulation that, among other things, requires certain disclosures, and sets outside limits on the content of these arrangements. This compromise solution would allow society to move forward with a new financial instrument that is both exciting and troubling. At the same time, however, it would disarm the innovation of its most worrisome features and thereby forestall the incursion of finance into personhood.

