



# STATE-LEVEL EQUITY CROWDFUNDING

Joe Wallin

[joewallin@dwt.com](mailto:joewallin@dwt.com)

(206) 757-8184

Andrew Schultheis

[andrewschultheis@dwt.com](mailto:andrewschultheis@dwt.com)

(206) 757-8143

# Equity Crowdfunding



- Equity rather than rewards based or pre-sales of goods or services
- To date, most crowdfunding platforms are rewards based or pre-sale platforms
- KickStarter and Indiegogo are not equity crowdfunding platforms
- They expressly prohibit the sale of equity

# State-Level



- What is state-level equity crowdfunding?
  - Equity crowdfunding pursuant to state laws designed to avoid application of the federal crowdfunding law
  - 13 states have now passed state equity crowdfunding laws
  - Most based on Section 3(a)(11) of the Securities Act of 1933
  - Maine based on Rule 504

# Why State-Level?



- Disappointment over federal law
- Avoids application of 1933 Act, if done correctly
  - So you don't have to comply with federal crowdfunding law when it comes into effect
- Still have problems under the 1934 Act, however
  - 500 non-accredited shareholders can trigger public co reporting obligations
  - JOBS Act fixed this for federal crowdfunding, not state

# Story of How the Law Came to Be



- Blog post
- GeekWire
- Coincidental meeting with Cyrus Habib
- Testimony
- Enthusiasm
- Work
- Lots of entrepreneurs going to Olympia to testify

# Blog Posts



- <http://www.startuplawblog.com/2012/07/25/washington-state-needs-its-own-crowdfunding-law/>
- <http://www.geekwire.com/2013/commentary-time-crowdfunding-law/>

# Effective When?



- Companies can start filing the “Crowdfunding Form” with the DFI on November 1, 2014
- You can find the law here:
  - <http://apps.leg.wa.gov/billinfo/summary.aspx?bill=2023>
  - <http://dfi.wa.gov/sd/rulemaking.htm#crowdfunding>

# Who Can Use the Law



- Washington entities
- Washington investors
- Rule 147
  - Watch out for 80% tests
- Must file the Crowdfunding Form with the DFI before you can proceed
- \$600 fee
- Financial statements in accordance with GAAP

# 80% tests



- The issuer derived at least 80 percent of its gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory; provided, however, that this provision does not apply to any issuer which has not had gross revenues in excess of \$5,000 from the sale of products or services or other conduct of its business for its most recent twelve-month fiscal period;
- The issuer had at least 80 percent of its assets located within such state or territory;
- The issuer intends to use and uses at least 80 percent of the net proceeds to the issuer from sales made pursuant to this rule in connection with the operation of a business or of real property, the purchase of real property located in, *or the rendering of services within* such state or territory; and
- The principal office of the issuer is located within such state or territory.

# Amounts



- \$1M in the aggregate
- Individual limitations that track the federal crowdfunding law
  - Less than \$100,000 in income or net worth 5% but at least \$2,000
  - More than \$100,000 in income or net worth 10% but capped at \$100,000

# From whom?



- Accredited and non-accredited individuals
- Limitations on amounts invested
- Legitimate friends and family offering

# My Favorite Clause



- <http://joewallin.com/2014/08/31/washington-equity-crowdfunding-favorite-clause/>
- "I acknowledge that I am investing in a high-risk, speculative business venture, that I may lose all of my investment, and that I can afford the loss of my investment";

# Escrow



- Must use an escrow
  - Must have a target minimum offering amount
  - Demonstrate to DFI the minimum makes sense
- Can't break escrow till you hit the minimum
- Investors can back out until you hit the minimum

# No Debt



- Can't use the law to issue debt
- This despite the law saying “securities”
- DFI policy choice
- DFI is concerned about companies not being able to repay debt

# No Convertible Debt



- See the last slide
- Investors frequently want convertible debt
- Convertible debt is frequently better than equity
  - Debt sits on top of equity
  - Valuation cap
  - Discount
  - See Mark Suster's blog post

# Preferred Stock Allowed



- But you have to meet special conditions
- See the proposed rules

# What Companies Don't Qualify



- Holding companies
- Investment companies
- Portfolio companies
- Development stage companies
- Companies with complex structures
- Blind pools
- Commodity pools
- Companies engaging in petroleum exploration or mining or other extraction industries
- Others too

# Financial Statements

- Not audited
- But in compliance with GAAP



# Quarterly Reporting



- Most burdensome part of the law
  - Executive officer and director compensation
  - Narrative discussion of business
  - Ownership info
  - Not financials
  - Open to public

# Bad Actor Due Diligence



- Reasonable inquiry test
- Tracks federal law
- Questionnaires

# Rule 147 Advertising Problems



- SEC has issued intrastate crowdfunding guidance
- Can't advertise out of state
- Can use technology to limit to IP addresses within a state

# What is a Portal?



- Broker-dealer
- Ports
- Local Economic Development Districts