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In this issue:

Federal Trade Commission Action Makes for a Cautionary Tale on Donation Based Crowdfunding

While much recent attention has been focused on the potential for equity crowdfunding under federal and state law, there still remain hundreds of websites which offer the opportunity to consumers to make “donation” or “pledge” based contributions to businesses. In these cases no equity is acquired by the consumer who instead receives, usually, something of modest value (e.g., T-shirts, hats, an opportunity to get a product free or at reduced price when it is produced). These transactions are not securities offerings under the law.

A June, 2015, case before the U.S. District Court for the District or Oregon, Portland Division, is the Federal Trade Commission’s first legal action for deceptive tactics of a business developer who utilized the donation based site Kickstarter to raise funds for a new business developing and selling a board game.

The defendant Eric Chevalier did business as The Forking Path, Co., and in May 2012 initiated a Kickstarter campaign to raise $35,000 in donations for the development, production, and distribution of a board game. That funding was to be completed in 30 days. The project’s homepage on the Kickstarter site represented that financial backing received would be used to bring the game to retail shops “around the world.” The homepage also indicated that depending on the amount of donation the donating consumers would receive specific award deliverable—like a copy of the game or a pewter figurine of one of the game’s characters. Launching the funding campaign also obligated Chevalier to refund consumers money if no award deliverable was provided or if the total funding received fell short of the required amount. The board game was to be ready for delivery in November 2012.

In practice, Chevalier raised $122,874. Within a month of the beginning of the campaign, Chevalier began posting a series of updates explaining that the game’s development and production had been held up by production issues, patent infringement issues, and other delaying events. These explanatory updates continued until July 2013–more than a year after the beginning of the funding effort–at which point Chevalier indicated that after sustaining expenses associated with production he was “approaching a point of no return.” Nothing further happened on Chevalier’s part: no return of consumers’ funds and no provision of an award deliverable.

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On complaints from numerous consumers, the FTC initiated it action noting that Chevalier did not use the monies received for development, production and distribution of a new game but instead used them "for miscellaneous personal equipment, rent for a personal residence, and licenses for a separate project." The FTC's complaint asked for a permanent injunction to prevent future violations and redress to consumers to include refund of monies paid.

While the take-away for businesses is that the FTC will pursue legal action against deceptive practices associated with donation based crowdfunding, the stronger message is for consumers: not to rely on the terms of service of a crowdfunding platform for assurance of specific performance or return of funds.

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