Recommended Improvements to Washington's Equity Crowdfunding Law

By Daniel Neuman. I am a corporate and securities lawyer, working primarily with startups and early-stage companies in Seattle.

I testified yesterday before the Washington State House of Representatives Business & Financial Services Committee regarding the state's Equity Crowdfunding law, and presented a list of recommendations for how to improve the regulations and make the law a more effective fundraising tool.

Raising money is a hard job for startups. It is made harder because there is a lack of angel and venture capital financing in Seattle and around Washington, especially relative to the level top tech talent we have here. I believe Washington's Equity Crowdfunding law could become an important mechanism to fill this fundraising gap for startups by opening up the investment ecosystem to small investors. If implemented effectively, crowdfunding could be an alternative source of capital that will incentivize entrepreneurs to take risks needed to create successful, local businesses and will become an engine for job growth.

To date, however, there isn't a single Washington company that has raised money under this law, and only two have even had their application approved by the state's Department of Financial Institutions ("DFI"). By contrast, under Oregon's equity crowdfunding law, Oregon companies have raised $450,000. While there are some important differences (a maximum raise of $250,000 in Oregon vs. $1M in Washington), Oregon has much less onerous regulations. We should push to amend and repeal some of DFI's regulations. I recommend:

1. Don't require public disclosure of executive officer and director compensation. Disclosure to shareholders is sufficient.
2. Allow for convertible debt or straight debt, including revenue loans. Currently only equity is

allowed. The most common way startups raise their initial funding round is through convertible notes.
3. Don’t require review and approval by DFI, especially for smaller offerings (i.e., up to $250,000, like Oregon). This could lead to a more flexible two-tiered crowdfunding regulatory scheme with other lighter-weight requirements.
4. Don’t require escrow, especially for smaller offerings. It’s just another costly barrier.
5. Allow “accredited investors” to invest an unlimited amount. There’s no reason to cap them at $100,000.
6. Amend our laws to be harmonized with the SEC’s new regulations, particularly Rule 147A, which allows for crowdfunded offerings to be advertised on the internet and social media so long as securities are only issued to intrastate investors.
7. Allow online portals to earn a success fee (say 3-5%) upon closing a crowdfunded round without having to be a registered broker-dealer.
8. Allow entities to invest in crowdfunded offerings.
9. Allow the law to be used for real estate investments.
10. Repeal DFI’s rule specifying the preferences that preferred stock must have. Such preferences are not market.

If these improvements are made, more Washington business will be able to get off the ground and prevent entrepreneurs from fleeing to the Bay Area or elsewhere in search of capital. It will also attract other companies to move here as we continue to develop a more robust startup landscape.

The Business & Financial Services Committee seemed genuinely engaged and receptive to making at least some of these improvements during yesterday's hearing. The DFI also signaled its agreement with us that the law should address debt offerings and that the state should harmonize the rules to fall in line with the SEC's recent amendments. I am hopeful that the legislature and the DFI will be able to implement these recommended improvements in the near future.