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Crowdfailure: Not a single company has been able to use Washington's 2-year-old crowdfunding law

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Jake Cuzdey used to own three homes. Now he rents one.

Cuzdey, who spent 10 years as a general contractor, and his business partner, Mark Lunde, poured everything they had into a small company that makes a six-in-one saw. Then they bet it all on Washington state's new crowdfunding law.

Nine months in, they have spent thousands of dollars on legal services with nothing to show for it.

"We've answered the same question over and over again, and the whole time I'm paying attorney fees," Lunde said. "I don't think the state really thought this process through."

Washington state lawmakers passed a law to legalize crowdfunding – a system similar to websites like Kickstarter and Indiegogo, but where companies sell equity instead of promising rewards in exchange for donations – more than two years ago. The goal was to help entrepreneurs like Cuzdey and Lunde get their small businesses off the ground.

Since then, though, not a single company has been able to use the law to raise money. Meanwhile, 30 other states have similar – and, in many cases, more successful – crowdfunding mechanisms. Oregon, for example, has crowdfunded 17 companies in little more than a year since the state passed crowdfunding rules.

The freeze-up in Washington has critics calling for reform to strip away the red tape that has kept entrepreneurs from being able to jumpstart their businesses.

Washington's crowdfunding law is largely aimed at small business entrepreneurs. These aren't the fast-growing software startups that attract angel investors hoping for a big payout. More often, they're companies like Cuzdey's, which need to buy materials to turn ideas into businesses.

If it works, the fundraising system could be a major windfall for



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Contractor and electric saw designer Jake Cuzdey (left) and CEO Mark Lunde of Cuz-D Industries with their Straight Flush Saw at their company headquarters in Lacey. The company has for nine months been trying to use Washington state's crowdfunding law.

Washington state. The amount of funds raised through crowdfunding is expected to surpass venture capital sources for this first time this year, according to an industry report. The Seattle area was ranked No. 6 on a list of the top cities for crowdfunding, including non-equity campaigns through Kickstarter and similar sites.

If equity crowdfunding becomes even half as successful as non-equity crowdfunding, the system could be a huge boost for Puget Sound-area small businesses. Kickstarter users have pledged \$2 billion to companies and individuals since the site's launch in 2009, and Washington state-based organizations had raised more than \$65 million on the site as of last year.

Despite the opportunity, Washington's equity crowdfunding law is unlikely to help in its current form. Some were holding onto hope that a federal crowdfunding law – which goes into effect May 16 – would provide a better option, but many expect that law will be even more expensive and burdensome than Washington's.

Cuzdey filed to use the state's law in August. Since then, his Lacey company, Cuz-D Industries, was able to attract a \$3 million investment from its manufacturer in the form of engineering and tooling. The investment – announced in January – did not require use of the crowdfunding law. The company still needs real money, though, to get off the ground.

Too hard to use

Congress passed the federal law in 2012 to make it easier for entrepreneurs to raise money. Instead of relying on a few investors to take the leap and invest large sums, the so-called Jumpstart Our Business Startups Act allows entrepreneurs to take small amounts from many investors.

Crowdfunding is similar to crowdsourcing sites like Kickstarter or Indiegogo, but investors receive equity in a company instead of gifts

or products. Investors risk smaller amounts of money on new ventures, and entrepreneurs have greater access to capital.

Implementing the federal law was slow. Years went by as entrepreneurs waited for the U.S. Securities and Exchange Commission to issue rules with no end in sight. So in 2014, Washington lawmakers passed a state version of the JOBS Act. It's been more than two years, and only two startups have started the process to register securities. None have succeeded so far.

"It's a huge economic waste that we make it so hard on them," said Seattle startup attorney [Joe Wallin](#), who was an early crowdfunding advocate and provided the first draft of Washington's law.

The version lawmakers passed, Wallin said, makes it too expensive and difficult for startups to raise money. Entrepreneurs must be pre-approved by the state in order to use the crowdfunding law. The state's crowdfunding gatekeepers say the process will become easier with time. Right now, though, it's a months-long process. Cuz-D Industries has clocked as many as 30 hours with an attorney working on this issue.

"That's the real shame of this thing," Wallin said. "Smart people are in a garage somewhere building something spectacular. But instead of being able to stay in the garage, they have to take six or nine months out of the year raising money."

Nearly four years after Congress passed the JOBS Act, the federal law is finally set to go into effect. But Wallin said the new mechanism provides little hope for small businesses.

The federal law's biggest barrier, he said, is a requirement for entrepreneurs to pay a fee to a registered broker or portal. The Securities and Exchange Commission speculates the fee will be between 5 and 15 percent, meaning if entrepreneurs raise the maximum allowed amount of \$1 million, they'd have to pay a third party

as much as \$150,000 to conduct the offering.

State laws are still the best hope for entrepreneurs looking to sell equity to a small group of investors.

A 'vast experiment'

Cuz-D Industries is still going back-and-forth with the state Department of Financial Institutions on its paperwork.

"We're appreciative of the state, but we're frustrated," Lunde said.

Washington DFI's securities administrator Bill Beatty said crowdfunding is still a "vast experiment" for the state. He expects the process will get easier as more entrepreneurs use the mechanism. In order for that to happen, the state needs to provide more support for outreach.

The DFI is responsible for regulating banks, credit unions, mortgage brokers, payday lenders and consumer loan companies. Within Beatty's securities division alone, a small team has to license broker-dealer investment advisers, regulate administering the Franchise Act, the Business Opportunity Act and the Commodities Act. Crowdfunding is just a small part and while Beatty said it's an important part, DFI's mission is to serve as a regulator, not a marketer.

"We try to be as helpful as we can, but are we a small business incubator?" Beatty said. "No, we're not."

Why Oregon's rules work

The Oregon department in charge of crowdfunding is a small business incubator.

The nonprofit organization, called Hatch, pushed the state's rule-change through and serves as an economic engine to help companies access crowdfunding. So far, 17 companies have used Oregon's crowdfunding mechanism to raise a total of \$417,000.

Oregon modeled its crowdfunding system after Washington's, but Hatch founder and executive director Amy Pearl said the state made a few key changes.

Instead of asking entrepreneurs to file documents and wait for the state's review, Oregon requires companies to review business plans with a free consultant called a Business Technical Service Provider – usually a staff member through the state's small business development centers or economic development districts.

After the review, companies file securities through a clearly outlined filing, pay a fee, wait a week and can start crowdfunding through Hatch's online portal. Any bad deals will be weeded out by the crowd and flagged. So far, Pearl said, no deals have been flagged.

The trade-off is companies can't raise as much money – \$250,000 compared to Washington's \$1 million. The lower threshold means the mechanism is more accessible for companies. It's how the state avoids what's proven in Washington to be a months-long scrutiny process that has tied up businesses and resulted in mounting legal fees.

“The range is intentional to make it easier to file,” Pearl said. “You can raise more money in Washington, but when we were taking a stab at doing this, we realized you also need to be able to use the law.”

What's next

State Sen. Cyrus Habib, the Kirkland Democrat who is running for Washington's Lieutenant Governor in 2016, sponsored the state JOBS Act passed in 2014. He admits the law has flaws, and is evaluating potential changes.

Wallin has many suggestions for improving Washington's law, but chief among them is axing the pre-approval requirement. Startups offering less than \$250,000, Wallin said, should be able to skip the back-and-forth and instead file a form, pay a fee and wait a week – just

like in Oregon.

Washington also needs to do a better job of outreach, he said.

Meanwhile, entrepreneurs want to change a provision in the law that requires companies to disclose their financial information annually. The rule almost prevented Cuz-D Industries from pursuing crowdfunding. Lunde worries making the information available to the public compromises his ability to compete with private competitors who don't have to share any information.

Until the state makes changes, Cuzdey and anyone else considering crowdfunding in Washington will have to wait.

Cuzdey wouldn't call it that, though. Nothing about being an entrepreneur, he said, feels like waiting – he's constantly benching one problem to try and solve another. His need for funding, though, always seems to crop back up.

"The people who work for us, they look at us and assume we're going to be here tomorrow," Cuzdey said. "Meanwhile, Mark and I are in the back office wondering how the hell we're going to do this."

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