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FTC Takes Its First Action Against Crowdfunding Site

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As the ***Federal Trade Commission (FTC)*** targets more FinTech (new and emerging financial technology) under the banner of protecting consumers from deceptive trade practices, the Commission finally turned its attention to the growing movement of "crowdfunding," the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet.

The FTC has brought its first action against a crowdfunding project creator, seeking redress and to deter those who believe that crowdfunding projects are an acceptable way of panhandling while leading contributors to believe their money would be used for a purpose from which they might benefit.

On June 11, 2015, the FTC announced an action against and a settlement with Erik Chevalier (Chevalier), the creator of a crowdfunding project that was claiming to raise money for the creation of a board game. Chevalier used a popular crowdfunding site, Kickstarter.com, to host his campaign. Kickstarter.com is one of many crowdfunding platforms that allow consumers to help innovative thinkers successfully implement projects in exchange for a given reward. While Chevalier claimed that delays in the game's creation and distribution were due to difficulties in obtaining licensing from a nationally recognized toymaker, he was allegedly using the money for personal purposes unrelated to the funding of the project, including a move to Oregon and his rent payments.

When it was learned that Chevalier had used the funds for personal purposes, the FTC took action, citing deceptive practices in violation of the Federal Trade Commission Act (FTC Act). The action was quickly resolved with the entry of an injunction from future misrepresentations, a monetary judgment (which was suspended due to his inability to pay), and an 18-year compliance and reporting requirement.

Background

Chevalier launched a crowdfunding campaign under the username Forking Path, Co. to raise money for the creation, marketing and distribution of a board game. If the campaign reached its goal of $35,000, Chevalier promised contributors that they would receive reward deliverables, including a copy of the board game or figurines, depending on the amount donated. The more an individual donated, the more benefits he or she was entitled to receive. While the campaign far exceeded its initial goal, Chevalier failed to provide any of the contributors with the promised deliverables.

On July 23, 2012, after approximately a year of fundraising, Chevalier stated that production was canceled; while his original goal was to create the board game, “after paying to form the company, for the miniature statutes, moving back to Portland, getting software licenses and hiring artists … the money was approaching a point of no return.” According to Kickstarter’s Terms of Use, a project creator must refund contributors if he fails to deliver promised rewards. While Chevalier acknowledged and accepted these terms, he failed to abide by them.

On June 10, 2015, the FTC filed a complaint against Chevalier pursuant to section 13(b) of the FTC Act, 15 U.S.C. § 53(b), seeking permanent injunctive relief, reformation of contracts, restitution of monies paid, disgorgement of ill-gotten monies and other equitable relief. The FTC also alleged that Chevalier violated section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce. The FTC claimed that Chevalier made misrepresentations when he alleged he would use the money obtained from consumers primarily “for the development, production, completion, and distribution of the board game.”

On June 11, 2015, while Chevalier did not comment on the illegality of his actions, he agreed to a settlement with the FTC, which prevented him from misleading additional consumers on future crowdfunding projects and required him to refund contributors approximately $111,000. The refunds were ultimately suspended due to lack of funds. However, if at any point the FTC becomes aware of Chevalier’s ability to pay, he will be ordered to do so immediately. In addition, Chevalier must engage in compliance and reporting programs for 18 years.

About Kickstarter.com

Kickstarter.com operates on an “all or nothing” standard. This means that if the creator does not reach its projected fundraising goal, he or she is not entitled to *any* of the contributions. Since Chevalier far exceeded the campaign’s projected goal, he was entitled to the money raised, but only to be used for the designated purposes.

To prevent fraud, Kickstarter claims to (1) verify the contact information (including bank account and address) of the project creators, (2) require that the creators provide a concrete and specific start and end date, and (3) verify that the project is indeed a creative one. These requirements serve to ensure that people do not use Kickstarter simply to fund a summer vacation while they claim to be raising money for a completely unrelated but seemingly worthwhile project. Examples of attempted frauds are covered in the November 12, 2013, issue of *Crowdfund Insider* and the June 17, 2013, issue of *Business Insider*.

According to a November 2013 **blog post** in the *Wall Street Journal*, Kickstarter has served as a platform for more than 100,000 projects, and less than a dozen have been canceled due to scams. The aforementioned examples demonstrate that Kickstarter will not hesitate to intervene against companies with falsely advertised campaigns. So, while the action against Chevalier is not the first time project creators have been penalized for alleged fraud, this is the first time the FTC has taken legal action against those who are alleged to engage in unfair business practices and violate Kickstarter’s Terms of Use.

Implications of the FTC Action

It has yet to be determined whether this FTC crackdown will have an impact on future contributors or project creators using platforms such as Kickstarter. While there are inevitable risks in contributing to the creation of a project by an unfamiliar user, consumers can find solace in the fact that those who engage in deceptive business practices may be subject to appropriate legal action. This ruling may cause future project creators to hesitate before engaging in questionable activities and raising money for a false cause. However, was the FTC stern enough? Some question whether the suspension of the reimbursement sent the wrong signal to violators; that is, they will only get a slap on the wrist instead of having to repay all of the money they collected.

As these emerging financial schemes arise within the digital world, it is important for people to remain vigilant and cautious before turning over their funds or personal information. In an article on ***Mashable***, Eric Larson noted that it is the community's responsibility to research the project creator's credibility, the proposed timeline and the project's likelihood of success. If the funder comes across anything suspicious, he or she is expected to submit a fraud report to the "Manager of Trust and Safety."

Kickstarter has guidelines in place to protect consumers from fraud and has successfully suspended the campaigns of those engaging in unlawful business practices. However, it is important that actions are taken preemptively to weed out suspicious and false campaigns.

The FTC has placed crowdfunding project creators on notice that even if the host site or the contributors fail to uncover the fraud initially, the FTC will take action and require lengthy consent injunctions.

Shira Sandler (Summer Law Clerk-New York) assisted in researching and drafting this Alert.

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