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Crowdfunding

Mark Methenitis

Evan Fitzmaurice

Ryan Barrett

Patrick Holleman

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SYMPOSIUM PANEL II

Panelists
Mr. Mark Methenitis, MetroPCS Wireless
Mr. Evan Fitzmaurice, Selman Munson & Lerner P.C.
Mr. Ryan Barrett, Sandswept Studios
Mr. Patrick Holleman, The Game Design Forum
Mr. Holt Foster, Thompson & Knight L.L.P.
Mr. Zack Karlsson, Capcom

Professor W. Keith Robinson:[1]

The topic of our second panel is crowd funding. I am sure most of the audience has heard about Kickstarter[2] and know of some of the campaigns that have been successfully funded through it. The panel we have assembled today is going to talk about crowd funding with respect to video games, specifically some of the risks, the potential rewards, and whether it is a viable model going forward to fund and finance games. I will introduce the moderator of the panel and let him introduce his panelists.

Mark Methenitis is our moderator.[3] He is corporate counsel at MetroPCS and was instrumental in helping plan the conference.[4] Without further ado, I would like to introduce Mark.

Mr. Mark Methenitis:

My name is Mark Methenitis, and I am a MetroPCS Wireless attorney and co-chair of Dallas International Game Developers Association Board of Directors.[5] We have a great panel here today to discuss crowd funding and Kickstarter. With that, I am going to let each panelist introduce himself and say why he is here. Evan?

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1. Walter Keith Robinson- Profile, SMU DEDMAN SCHOOL OF LAW, http://www.law.smu.edu/Faculty/Full-Time-Faculty/Robinson.aspx (last visited Mar. 19, 2013).

2. KICKSTARTER, http://www.kickstarter.com (last visited Mar. 19, 2013) (Kickstarter is a platform used to raise funds for creative projects through crowd funding.).

3. Mark Methenitis—Profile, IGDA DALLAS, http://igdadallas.com/people/mark-methenitis/ (last visited Mar. 26, 2013); *see also* SMU Program Participants: Mark Methenitis, GAME BUSINESS LAW 2013 INTERNATIONAL SUMMIT, http://smu.edu/gbl/speakers.html#nix (last visited Mar. 26, 2013).

4. *Id.*

5. *Id.*

Mr. Evan Fitzmaurice:

Thank you, Mr. Methenitis. My name is Evan Fitzmaurice.[6] I am an attorney in Austin at Selman Munson & Lerner.[7] I am predominantly a corporate securities lawyer. I do public offerings, private offerings, mergers and acquisitions, and the like. I spent five years in Los Angeles doing entertainment law and digital transactions. I have spent the last year and a half, or so, as the film commissioner for Texas; so I just got out of government service and back into private practice.

Mr. Ryan Barrett:

Hi, my name is Ryan Barrett.[8] I work for Sandswept Studios, which is actually a virtual studio.[9] I work by myself in Austin out of my own home, doing technical animation. The rest of the Sandswept team is located all over the world. I am an SMU alumnus; I graduated from the Guildhall[10] program in 2009. I am also part of a company that had a successful Kickstarter called *The Dead Linger*,[11] which I will be talking about later.

Mr. Patrick Holleman:

Hi, my name is Patrick Holleman.[12] I run a website called The Game Design Forum.[13] Thanks to Kickstarter, we have been working on a series of textbook, chapter-length articles about what we call "reverse designs," or reverse engineering of classic games. The full scope of our project covers all of the design decisions that went into *Final Fantasy VI*,[14] *Chrono Trigger*,[15] *Super Mario World*,[16] *Half-Life*,[17] *Final Fantasy VII*,[18] and *Diablo II*.[19] I will talk about how we got money for our project and the miracle of Kickstarter.

6. Evan E. Fitzmaurice—Profile, SELMAN MUNSON & LERNER, http://www.selmanmunson.com/evan-fitzmaurice.html (last visited Mar. 19, 2013).

7. *Id.*

8. Ryan Barrett—Profile, SANDSWEPT STUDIOS, http://www.sandswept.net/inside/meet-the-team (last visited Mar. 19, 2013).

9. SANDSWEPT STUDIOS, http://www.sandswept.net/ (last visited Mar. 19, 2013).

10. SMU GUILDHALL GAME DEVELOPMENT EDUCATION, http://guildhall.smu.edu/ (last visited Mar. 19, 2013).

11. THE DEAD LINGER: BLOG, http://www.thedeadlinger.com/ (last visited Mar. 19, 2013).

12. Patrick Holleman—Profile, LINKEDIN, http://www.linkedin.com/pub/pat-holleman/a/801/aaa (last visited Mar. 19, 2013).

13. THE GAME DESIGN FORUM, http://thegamedesignforum.com/ (last visited Mar. 19, 2013).

14. *Final Fantasy VI*, RPGAMER, http://www.rpgamer.com/games/ff/ff6/ff6.html (last visited Mar. 19, 2013).

15. *Chrono Trigger*, SQUARE ENIX, http://na.square-enix.com/ctds/ (last visited Mar. 19, 2013).

16. *Super Mario World*, IGN, http://www.ign.com/games/super-mario-advance-2-super-mario-world/snes-6885 (last visited Mar. 19, 2013).

Mr. Holt Foster:

My name is Holt Foster.[20] I have been in the video game business for almost twenty years, both as a lawyer and as an investor. I have represented publicly-traded developers, startup developers, and publishers. I was also one of the founders of a video game publishing company called Gathering of Developers,[21] which ultimately sold to Rockstar Games.[22]

Mr. Zack Karlsson:

My name is Zack Karlsson.[23] I am currently the Vice President of Business Development and the General Manager of Digital Platforms for Capcom.[24] I have been in the video games industry for about fifteen years. I am one of those people that started out making nine dollars an hour as a temp, and I have since worked my way up. My first project was a game called *EverQuest*,[25] which I worked on for a number of years. Prior to this, I was Vice President of Business Development and Finance at Double Fine Productions,[26] which ran one of the first successful Kickstarters, a game called *Double Fine Adventure*.[27] I was not there during development of the game, although the project did start while I was there. Funding through Kickstarter was not my idea. I can talk a little about the discussions we had, but my largest contribution to that particular effort was saying that we would never raise enough money. So, I am not a "prophet." Before working at Double Fine Productions, I was head of Business Development at NAMCO

17. *Half-Life*, STEAM, http://store.steampowered.com/app/70/ (last visited Mar. 19, 2013).

18. *Final Fantasy VII*, SQUARE ENIX, http://finalfantasyviipc.com/us (last visited Mar. 19, 2013).

19. *Diablo 2*, BLIZZARD ENTERTAINMENT, http://us.blizzard.com/en-us/games/d2/ (last visited Mar. 19, 2013).

20. Holt J. Foster III—Profile, THOMPSON & KNIGHT, http://www.tklaw.com/holt-foster/ (last visited Mar. 19, 2013).

21. Gathering of Developers (a.k.a. God Games), IGN, http://www.ign.com/companies/ gathering-of-developers-aka-god-games (last visited Mar. 19, 2013).

22. ROCKSTAR GAMES, http://www.rockstargames.com/ (last visited Mar. 19, 2013).

23. Zack O. Karlsson, Sr., CAPCOM, http://www.zoominfo.com/#!search/profile/ person?personId=706369999&targetid=profile (last visited Mar. 19, 2013).

24. CAPCOM, http://www.capcom.com/ (last visited Mar. 19, 2013).

25. EVERQUEST, https://www.everquest.com/ (last visited Mar. 19, 2013).

26. DOUBLE FINE, http://www.doublefine.com/ (last visited Mar. 19, 2013).

27. *See Double Fine Adventure*, KICKSTARTER, http://www.kickstarter.com/ projects/doublefine/ double-fine-adventure (last visited Mar. 19, 2013).

Bandai.[28] I have developed independent startups twice, and sold both companies to Sony, which I will discuss later.

Mr. Mark Methenitis:

In case anyone is behind, Wikipedia defines crowdfunding as "the collective effort of individuals who network and pool their money, usually via the Internet, to support efforts initiated by other people or organizations."[29] Basically, it is a way to raise money, where everybody is putting in a small amount that ultimately leads to funding of a bigger project. It has ultimately grown as a result of a website called Kickstarter,[30] which the audience generally seems to be familiar. There are a number of other sites providing similar services. Basically, a person will preorder something, or give money, to get a reward. A more interesting model that Mr. Fitzmaurice will get into is the larger potential for crowdfunding, where the backer is actually making an investment in the company, rather than in the project, and receiving an ownership stake.

In 2012, Kickstarter had a substantial number of backers giving a substantial amount of money that funded over 18,000 projects.[31] This has been particularly interesting to the games industry because the most funded category of 2012 was Games, $83 million of the $319 million total funds raised last year.[32] There are a number of projects I assume are familiar to people. These are just the Top Eight: *Ouya*, which was the small Android-based console—$8.59 million; *Project Eternity*—$3.98 million; *Double Fine Adventure*—$3.33 million; *Wasteland 2*—$2.93 million; *HomeStruck Adventures*—$2.48 million; *Planetary Annihilation*—$2.22 million; *Star Citizen*—$2.13 million; and *Shadowrun*—$1.83 million.[33]

Of course, raising funds is not necessarily a guarantee of success, and part of what we will be discussing is whether a couple of recent project failures are an ill omen for future project success. In particular, *Haunts: The Manse Macabre* raised $28,739, which is of course on the smaller end of the Kickstarter project list compared to some of the more substantial successes, but it may never be completed since the group appears to have run out of

28. NAMCO BANDAI GAMES, http://www.namcobandaigames.com/home (last visited Mar. 19, 2013).

29. *Crowd Funding*, WIKIPEDIA, http://en.wikipedia.org/wiki/Crowd_funding (last visited Mar. 19, 2013).

30. *See* KICKSTARTER, *supra* note 2.

31. *Best of 2012 Overall Category Stats*, KICKSTARTER, http://www.kickstarter.com/year/ 2012?ref=footer#category_overall (last visited Mar. 19, 2013).

32. *Id.*; *Best of 2012 Overall Pledged Stats*, KICKSTARTER, http://www.kickstarter.com/year/ 2012?ref=footer#overall_pledged (last visited Mar. 19, 2013).

33. *Most Funded Games*, KICKSTARTER, http://www.kickstarter.com/discover/categories/games/ most-funded?ref=more#p1 (last visited Mar. 19, 2013).

money and programmers.[34] *Code Hero* raised almost $200,000, but is similarly out of money.[35] The studio has claimed they will still deliver the game, but I think it is really still up in the air at this point.[36] It seems like a good time to turn it over to Mr. Barrett, who will talk about his project.

Mr. Ryan Barrett:

Thank you, Mr. Methenitis. Like I said before, I am an independent developer. I want to talk a little bit about the company I work for, Sandswept Studios.[37] I mentioned earlier that Sandswept is a worldwide company. We are largely located around the United States, but we also have one employee in Argentina and one employee in Norway. We do all of our work and communication in a Skype room.

The first game Sandswept made was called *Detour*,[38] available on Steam right now.[39] I was not with Sandswept when *Detour* was being developed. I was actually brought on in January, 2011. At that time I was basically working for free, just trying to do my best to get into the industry.

A year after I started with Sandswept, I was told about the Kickstarter project for *The Dead Linger*, which is a first person, open-world zombie survival game.[40] Our goal is to allow players to do anything they want, at any time, without any limitation whatsoever. The players basically do their own thing and make their own goals. I assume the crowd is familiar with *Minecraft*.[41] If not, in *Minecraft*, players basically are free to do whatever they want. The only predetermined objective is to survive. We operate under the same premise, but we are much more realistic.

The Dead Linger is also similar to *Minecraft* in that the game is 100% procedurally generated, which means that the entire game is generated through algorithms and there are no predesigned levels. We also allow play-

34. Nate Garun, *Failed Kickstarter Game is a Cautionary Tale in Crowd Funding Project Development*, DIGITAL TRENDS (Oct. 22, 2012), http://www.digitaltrends.com/gaming/failed-kickstarter-game-provides-lessons-for-over-anticipating-project-development/ (describing the failed Kickstarter campaign for *Haunts: The Manse Macabre*); *Haunts: The Manse Macabre*, KICKSTARTER, http://www.kickstarter.com/projects/2066438441/haunts-the-manse-macabre (last visited Mar. 19, 2013).

35. Jessica Conditt, *Code Hero: The Dangers of a Kickstarter Success Story*, JOYSTIQ (Dec. 13, 2012 2:45 PM), http://www.joystiq.com/2012/12/13/code-hero-the-dangers-of-a-kickstarter-success-story/.

36. *Id.*

37. SANDSWEPT STUDIOS, *supra* note 9.

38. *Detour*, STEAM, http://steamcommunity.com/app/92100 (last visited Mar. 19, 2013).

39. STEAM, http://steamcommunity.com/ (lasted visited Mar. 19, 2013) (an online video game download service for PC, Mac, and Linux).

40. *See* THE DEAD LINGER: BLOG, *supra* note 11.

41. MINECRAFT, https://minecraft.net/ (last visited Mar. 19, 2013).

ers to barricade. Freeform barricading allows players to keep the zombies at bay. We also allow online play; right now we can have up to sixteen people playing together. We have not yet determined our maximum number of online players, but we do anticipate it to increase.

I would like to discuss our Kickstarter campaign. Basically, in March of last year, Sandswept wanted to make a game they wanted instead of "filling a niche." Their previous game, *Detour*, was a niche game, and after its release they realized they were going about game development the wrong way. They wanted to put all their effort into a game they could truly be passionate about. *The Dead Linger* was going to be that game. It was in preproduction before I even joined the Sandswept team. The director and my boss, Geoff Keene basically had the idea for *The Dead Linger* when he was fifteen years old, and he had been actively developing the idea in the preproduction phase ever since.[42] When Geoff and his father Richard Keene,[43] who was also the Chief Technology Officer, first discussed the Kickstarter for *The Dead Linger*, it was intended to fund the development of that project only. This was why the initial goal was only $60,000.[44] That $60,000 was for a goal of about six months of development for the two of them alone, and all of the employees on the team understood that. We decided to work on it anyway.

The timing of the Kickstarter was perfect. We launched on March 30, with an end date of April 29. In that thirty-day period, we received almost $155,000.[45] We were very excited during that time and we reached our initial goal of $60,000 in a little over a week.[46] By the time our funding project ended, we made more than 258% of our goal.[47] That surplus actually allowed me to get paid and start working on the game.

The success of *The Dead Linger* has been 99.9% word of mouth. We have not reached out to do any advertising at all. We have done very little online advertising and there have been a few online news articles, but that has always been the result of people coming to us. Otherwise, our success has been word of mouth; it has come from forums, from people talking on YouTube, and from people talking amongst themselves.

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42. NateRios, *Exclusive Interview with The Dead Linger Design Director Geoff Keene*, FPSGENERAL (Nov. 26, 2012 6:21 PM), http://www.fpsgeneral.com/news/the-dead-linger/22476-exclusive-interview-with-the-dead-linger-design.

43. *See* Meet the Team, SANDSWEPT, http://www.sandswept.net/inside/meet-the-team (last visited Mar. 19, 2013).

44. *See The Dead Linger*, KICKSTARTER, http://www.kickstarter.com/projects/sandswept/the-dead-linger (last visited Mar. 19, 2013).

45. *The Dead Linger* Tracking, KICKTRAQ, http://www.kicktraq.com/projects/sandswept/the-dead-linger/ (last visited Mar. 19, 2013).

46. *Id.*

47. *Id.*

Mr. Mark Methenitis:

Mr. Barrett, for those who are unaware, what is Kicktraq?[48]

Mr. Ryan Barrett:

Kicktraq is an alternate website to Kickstarter that actually tracks a campaigner's funding progress for them.[49] If campaigners want to check out the analytics while using Kickstarter, they go to Kicktraq. The Dead Linger is actually still available for viewing on Kicktraq.[50] It provides a number of different analytics, including pledges or backers by day, projection rate, and trending. Those familiar with Kickstarter know most projects have a funding trend: they usually have a lot of funding in the early stages, a big decline in the middle, and then a lot of funding near the end. Almost all Kickstarters work this way. However, we were very lucky. Our trend was almost a straight line going up, so we received funding fairly consistently during the open period. It was amazing how that turned out. So, Kickstarter works!

On October 31, 2012—Halloween—we released *The Dead Linger* in Alpha.[51] Typically developers are wary of releasing games in beta. Companies generally do not release Alpha, but we did. Since then we have been constantly updating the game. We have released six builds since then; we just released our latest build last Tuesday, January 15. I am working on Build Seven as we speak. When we first released the game, it was $24.99. We have since reduced the price to $19.99. One of the incentives we offered during the Kickstarter was to let people get an in-game backpack. When players use the backpack, they will see it on their character, and it will show others who was a backer for the game. Some other incentives for backing our game on Kickstarter were to allow backers to get their name in the game, or have a prop or build named after them. After we released the game in Alpha, we continued to offer pre-order incentives to get more people to buy it. These incentives lasted up until the beginning of December. Among these preorder incentives was the gas mask, which is a useful in-game item. If a zombie bites a player in the game, they become infected; but the gas mask reduces infection.

We also do not have a non-disclosure agreement for the game. Basically, this means anyone can make and record a video of gameplay and put it on YouTube or elsewhere on the Internet. A good number of YouTube videos showing people playing *The Dead Linger* and enjoying it exist. This has been great for us because they are basically our testers, and we hear what they like, and what they dislike, about the game.

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48. KICKTRAQ, http://www.kicktraq.com/ (last visited Mar. 24, 2013).

49. *Id.*

50. *The Dead Linger* Tracking, *supra* note 45.

51. John Walker, *Dead Linger Has a Playable Alpha*, ROCK PAPER SHOTGUN (Oct. 31, 2012 4:00 PM), http://www.rockpapershotgun.com/2012/10/31/dead-linger-has-a-playable-alpha/.

We have also learned how important it is to keep fans interested at all times. It is very important to be really intimately engaged with the company or game's community; building that community is pretty much everything. We have learned that if the developer respects the community's time and answers their questions, they will repay the company by endorsing the game to others. We have incredible fans that I never imagined we would have.

Mr. Patrick Holleman:

I write about game design professionally. I have also consulted for a number of other Kickstarters local to the Philadelphia area, a hotspot for indie gaming. Some video game companies are involved in strange indie projects, such as board game video games.

I have consulted for three Kickstarter projects . One of the groups I assisted with had a very tight budget. It consisted of two developers living in a one-bedroom apartment, making $20,000 a year with substantial credit card debt. The other two Kickstarters I worked with were basically starting from scratch. This includes my own Kickstarter. We had no market profile, no fans, and no followers—nothing. So, we basically created this product and tried to market it. In some instances, I created a product—as they had not created a product yet—and we tried to sell something that was not even finished, to a market we did not even have. When the product is not even finished, it can be very difficult to market; there is no way to tell potential consumers much about it.

So, the product I created is a progressive textbook. Essentially, we started with one chapter that completely reverse-engineered the design of *Final Fantasy VI*.[52] We put this chapter out on the Internet free of charge and told our viewers that we were going to do a Kickstarter campaign to fund additional chapters. We told our potential backers, "These are going to be the games we will cover. If our funding passes our basic goal and meets our stretch goals, we will reverse-engineer additional games."

We were ludicrously under-budgeted—that is, we set our Kickstarter funding goal way too low—which I think is a running theme on Kickstarter. It is true that not everyone exceeds initial goals, but everyone definitely hopes for it. Typically, people are going to under-budget because they do not want to ask for too much money, which is logical. Some of the bigger names here would probably agree that under-budgeting is a particularly widespread issue in most games projects. Even TripleA,[53]—who has a full market forecast—under-budgets because they still do not estimate all the right factors that go into their projects. In effect, under-budgeting is sort of a necessity in

52. *Reversing the Design: Final Fantasy 6*, THE GAME DESIGN FORUM, http://thegamedesignforum.com/features/reverse_design_ff6_1.html (lasted visited Mar. 24, 2013).

53. TRIPLEA, http://triplea.sourceforge.net/mywiki (last visited Mar. 9, 2013) (describing itself as s "a turn based strategy game . . . [that] comes with multiple games and over 100 more games can be downloaded from the user community").

Kickstarter, and campaigners just hope to get more than they budgeted or asked. Achieving those stretch goals, therefore, is very important.

As a general rule, if a campaigner has a marketing budget, they probably should not be Kickstarting. This is not as big of an issue for gaming students who are beginning careers in gaming development, but it is important to remember. As soon as a campaigner starts to put a budget towards marketing and spreading word on the Kickstarter, people show up on their Kickstarter wall, saying "Is there a marketing budget to try to gain donations? The money should just be put in the project."

People on Kickstarter are actually rather shrewd. If campaigners spend their money in "too TripleA-a-way," people will start to get suspicious about the actuality of their need and may not fund those projects.

It is important to remember that crowd funding is very much about communities. Remember that communities fund projects, not individuals. Some of these communities are virtual; like Mr. Barrett's studio Sandswept, it could exist across the entire world. But whether virtual or physical, they are still very much a community and understanding this fact is important.

We regularly observe something in Kickstarter that I call the "Guru Effect,"[54] which basically demonstrates how many projects get funded. In a nutshell, the Guru Effect says that there is a single decision maker for a virtual community who can then tell everyone in that community to make a purchase and they will.[55] This is substantially different from, for example, Tom Cruise advertising for Acura. People know that Tom Cruise is paid and that he may have no personal feeling about Acura. People are aware that he is a spokesperson shilling a corporate message. Gurus are different. For example, for my Kickstarter for the Game Design Forum, we had a voice actor named Jessie Cox. He has a booming YouTube channel business where he talks about games for a living. He makes more money than we do writing about games. He was a Guru for a very large community, and he got on his "Total Biscuits" podcast and said, "Fund this guy." We immediately rocketed over our funding goal in just one week. And then the funding kept going.

In retrospect, I wish we had extended our funding longer. We set our funding for thirty days, just like Sandswept for *The Dead Linger*. However, I have advised everyone with whom I have consulted since to leave their Kickstarters open for the maximum amount of time possible. There is no downside; people will continue to fund the project. This is almost always the case. It is my first rule of Kickstarter: if campaigners are going to start a project, go for the maximum amount of time and do not cut opportunities short. Kickstarter is like TEDtalks: the most popular ones are often the longest ones.

54. *See generally* Dan Sperber, *The Guru Effect*, REVIEW OF PHILOSOPHY AND PSYCHOLOGY, 583–92 (Mar. 6, 2010), *available at* http://www.dan.sperber.fr/wp-content/uploads/guru-effect.pdf (explaining the Guru effect and how people often follow the Guru's authority without much thought).

55. *Id.*

Similarly, the most popular Kickstarters are often the ones that are available for the longest amount of time.

Tim Schafer of Double Fine Productions was an anomaly to the Guru Effect.[56] He was advertising for himself, but, despite that, people still trusted him as their Guru. Not long before Double Fine Productions launched their Kickstarter for *Double Fine Adventure*, Schafer hosted the Game Developers Choice Awards. Tim is very charismatic; he has this larger-than-life presence. During the awards ceremony, Tim was on stage, making a number of funny faces, and, of course, people were snapping pictures. This actually became the subject of a number of articles, including one called The Many Faces of Tim Schafer.[57] His exposure from the event was incredible and widely positive. A lot of people who may not have known who Tim was suddenly did. "Oh, he was the guy with the monkey. . . Psychonauts, okay!"[58] They now knew that Tim Schafer was behind the Kickstarter for *Double Fine Adventure*, that there was this person whom they trusted involved in the project.

Double Fine Productions[59] is a great company, but companies change personnel. Tim Schafer, though, is his own brand. Knowing the guy who they perceived to be the origin of all these great games was at the helm of this Kickstarter, Tim was able to market a product that did not yet exist in any real physical form. Those who have studied marketing know that marketing a product based only on an idea is incredibly difficult. But what really happened was, instead of marketing the idea of a game, Tim marketed himself. He said, "I am going to be in charge here. I promise we are going to make this game that will be great. I can be trusted because I am Tim Schafer." People did know him; they did trust him; and they gave him about $3.3 million.[60]

The important takeaway is that Tim Schafer was the face of the Kickstarter, and Tim was marketing Tim. Double Fine Productions, by extension, was also Tim, but he was marketing himself by saying, "Trust me." And that was the kind of remarkable brand loyalty companies cannot buy. We have found, in every section of Kickstarter, especially gaming, campaigners hope

56. Tim Schafer—Profile, DOUBLE FINE PRODUCTIONS, http://www.giantbomb.com/tim-schafer/3040-2860/ (last visited Mar. 19, 2013).

57. Kirk Hamilton, *The Many Faces of Tim Schafer*, PASTE MAGAZINE (Mar. 4, 2011 12:27 PM), http://www.pastemagazine.com/articles/2011/03/the-many-faces-of-tim-schafer.html (last visited Mar.19, 2013).

58. Double Fine Action Shop—*Psychonauts*, DOUBLE FINE, http://shop.doublefine.com/collections (last visited Mar. 19, 2013).

59. DOUBLE FINE PRODUCTIONS, http://www.doublefine.com/ (last visited Mar. 24, 2013).

60. *See Double Fine Adventure* by Double Fine and 2 Player Productions, KICKSTARTER, http://www.kickstarter.com/projects/doublefine/double-fine-adventure (last visited Mar. 19, 2013).

for a trusted Guru who says, "This is worth it, and I am not being paid to say this," because, if a Guru tells their community to buy it, they buy it. As such, even though it may be difficult to do, it is very important to target, meet, and network with people who have communities at their disposal.

The news cycle alone is not enough to allow projects to achieve their fundraising goals. There are generally two surges for a project's fundraising program. First, there is an initial surge, which is followed by a lull period. Later, there is often a second and final surge. For example, when I consulted for Cipher Prime's Kickstarter for *Auditorium Duet*,[61] their fundraising and awareness campaign went through various stages. First, we set them up with a big campaign at Joystiq to help with their initial surge.[62] The initial surge picked up from the news cycle during the first week of that campaign, after which all the other stories picked it up. As was the case for the Auditorium Duet campaign, this news cycle can yield tremendous results.

Not all Kickstarter campaigns reach their fundraising goals, though. Before a news cycle begins, the people who are going to adopt the project, no matter what, adopt it. Later, the people who are exposed to the news cycle will adopt the project. Sometimes these two groups will not contribute enough. For *Auditorium Duet*,[63] the lull between the initial and final surge lasted until near the end of the campaign, and, at the time, it looked like the campaign might not reach its fundraising goal. At the very end of the campaign, however, an online community wiki organization called GiantBomb[64] gave the *Auditorium Duet* campaign the final surge it needed to reach its goal. Basically, the Guru within the GiantBomb community encouraged the community to rally around the *Auditorium Duet* project. Suddenly, money came pouring in from GiantBomb's forum members, and Cipher Prime was consequently able to exceed its fundraising goal.[65] As seen from this instance, community Gurus can have a huge impact on whether a crowd funding project succeeds. Communities such as GiantBomb often react and make collective decisions as a result of the Guru Effect. Often, giant community groundswells arise to support a project simply because a well-respected member of the forum, the "Guru", tells the community that a certain project needs to get done.

Crowd funding vehicles such as Kickstarter do not market to individuals. Rather, they market to a very tangible, if virtual, community that is very responsive to Gurus. Likewise, crowdfunding campaigns rely heavily upon

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61. *Auditorium 2: Duet* by Cipher Prime, KICKSTARTER, http://www.kickstarter.com/projects/761471459/auditorium-2-duet/ (last visited Mar. 19, 2013).

62. JOYSTIQ, http://www.joystiq.com/ (last visited, Mar. 19, 2013).

63. *See Auditorium 2: Duet, supra* note 61.

64. Harry McCracken, *50 Websites That Make the Web Great: Giant Bomb*, TIME (Aug. 16, 2011), http://www.time.com/time/specials/packages/article/0,28804,2087815_2087939_2087927,00.html.

65. *See Auditorium 2: Duet, supra* note 61.

the community manager—who is probably more important than the project's marketer—because the community manager knows the Guru.

Kickstarter campaigns are also inherently personal. Crowdfunding mostly revolves around how well a company sells itself. The company is the brand, and people want to trust the company to make a good product. It is hard for investors to buy into the video game projects themselves because the games often change radically from the time fundraising begins to the time the final projects are completed. Consequently, investors buy into the individual companies that make the games. Kickstarter crowd funding campaigns involve both marketing the company and marketing how well it can complete the projects as promised. To that end, establishing the company's trustworthiness is very important. Generally, the more these indie video game studios expose about their hobby culture to the public, the more success their Kickstarter campaigns tend to enjoy. Even human-interest stories and interviews unrelated to the actual fundraising campaign will tend to generate more Kickstarter success.

Mr. Evan Fitzmaurice:

There are important developments going on in equity-based crowd funding. The major focus of equity-based crowdfunding efforts is how to get around the general rules and regulations imposed by the Securities Act of 1933.[66] Registering with the Securities and Exchange Commission ("SEC") is super expensive and very onerous.[67] Most people try to avoid it, if at all possible. Many companies try to find a way around these restrictions and find an exemption for their securities option. The crowdfunding community is thus very concerned with what rules the SEC is going to create to regulate new equity-based crowdfunding markets under the Jumpstart Our Business Startups Act (the "JOBS Act").[68]

One general focus is § 4(a)(2) of the Securities Act of 1933, which applies to sales "not involving a public offering."[69] Regulation D was later promulgated by the SEC to supplement § 4(a)(2) and provides certain safe-harbor protections for companies raising funds through private offerings.[70] Regulation D has a component called Rule 506, which allows companies to do two important things. First, it allows companies to sell unlimited amounts of equity to accredited investors.[71] Second, Rule 506 allows companies to sell equity to a certain number of non-accredited investors if they satisfy certain filing requirement.[72] Basically, Rule 506 removes private offerings

66. 15 U.S.C. § 77a (2012).

67. *See id.*

68. JOBS Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

69. 15 U.S.C. § 77d(a)(2).

70. 17 C.F.R. § 230.506 (2011).

71. § 230.506(a); *see also* § 230.501(a) (defining "accredited investor").

72. §§ 230.502(b), 230.506(b)(2)(ii).

from the general scope of § 4(a)(2).[73] The SEC is not particularly concerned with private offerings and placements, so Rule 506 allows companies some freedom to raise money privately.[74]

Solicitation and advertising are also important issues addressed in the JOBS Act.[75] Prior to the JOBS Act, general solicitation and general advertising were prohibited for a Rule 506 offering by Regulation D.[76] This means, in order to make an exempt offering under § 4, the company could not have solicited the public or advertised their offering in publications such as The Dallas Morning News[77] or the Dallas Observer.[78] The current advertising and solicitation limitation of Regulation D is a very important part of satisfying the conditions of a Rule 506 offering. Despite the visibility of huge, popular IPOs such as those made by Facebook[79] and Ebay,[80] registered offerings are not the norm;[81] so the solicitation and advertising rules really limit a lot of companies' fundraising efforts.

The JOBS Act, which President Obama signed into law in April of last year, addresses some of the barriers in securities law that often prevent entrepreneurs from raising capital.[82] The tight economy of the present has created a need to make it easier for business creators—in this case video game startups—to create jobs, create value, and create wealth without being overly hindered by securities laws. One of the main things the JOBS Act did in Title

73. *See generally* § 230.506.

74. *See id.*

75. *See* JOBS Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

76. § 230.502(c).

77. Dallas Morning News, http://www.dallasnews.com (last visited Mar. 19, 2013).

78. Dallas Observer, http://www.dallasobserver.com (last visited Mar. 19, 2013).

79. *See* Timothy Stenovec, *Tech IPOs: How Facebook's Big Move May Compare to Other Huge Tech IPOs*, Huffington Post (Feb. 2, 2012 11:25 AM),http://www.huffingtonpost.com/2012/02/01/tech-ipo-facebook-apple-google-_n_1247832.html?ncid=edlinkusaolp00000003.

80. *See* Shelly K. Schwartz, *eBAY: Return of the IPO*, CNN Money (Sept. 24, 1998 5:05 PM), http://money.cnn.com/1998/09/24/technology/ebay/.

81. Tanya Prive, *Inside The JOBS Act: Equity Crowd Funding*, Forbes (Nov. 6, 2012 11:57 AM), http://www.forbes.com/sites/tanyaprive/2012/11/06/inside-the-jobs-act-equity-crowd funding-2/ (In 2011, for example, $895 billion was raised through Rule 506 offerings compared to the $984 billion raised through registered offerings).

82. Remarks on Signing the Jumpstart Our Business Startups Act, 2012 Daily Comp. Pres. Doc. 201200249 (Apr. 5, 2012).

II is focus on the "accredited investor" concept.[83] "Accredited investors" are those with the greatest wealth and sophistication. Securities laws provide these sophisticated individuals greater freedom to fend for themselves in the markets. The tests for qualification as an "accredited investor" are an asset test and an income test. An "accredited investor" satisfies the income test if he or she made over $200,000 in each of the two previous years.[84] The asset test, which now excludes your home, is satisfied if the investor possesses assets in excess of $1,000,000.[85] These income and asset threshold levels were initially intended to target the wealthiest 1% of the population. The definition for "accredited investor" has not changed over time, though; so, as inflation has occurred and incomes have increased, "accredited investors" now define about 7% of the population.

The JOBS Act aims to further facilitate how accredited investors participate in securities offerings. Title II of the JOBS Act now allows general solicitation and advertising.[86] These rules are not final yet, so "accredited investors" must still wait.[87] The JOBS Act, when it takes effect, should allow "accredited investors" to go online and to be solicited and advertised to as long as the ultimate buyers in those stock offerings are only "accredited investors."[88] A good example of this sort of activity was seen during Facebook's pre-IPO period, wherein private online portals were set up for "accredited investors" to sell and trade, to each other, their privately held Facebook shares before the IPO occurred.[89] This whole process was done very secretively and outpaced the law's regulatory efforts to allow this type of trading. The SEC will hopefully allow these types of online "accredited investor" portals with the changes it is making, with regards to advertising and solicitation. The SEC's decisions will have important implications on crowd funding, as the new rule will create a broader and wider field of investors who might want to buy equity in these projects.

Crowdfunding is the major revolutionary piece of the JOBS Act. There is a lot of internal drama at the SEC with regards to crowdfunding. It has been difficult for regulators to figure out how to facilitate securities trading

83. JOBS Act, Pub. L. No. 112-106, sec. 201, § 77d, 126 Stat. at 312 (amendment to 15 U.S.C. § 77d Note).

84. 17 C.F.R. § 230.501(a)(6) ($300,000 if filing jointly with spouse).

85. § 230.501(a)(5).

86. § 77d, 126 Stat. at 312 (amendment to 15 U.S.C. § 77d Note).

87. *Information Regarding the Use of the Crowdfunding Exemption in the JOBS Act*, SEC (Apr. 23, 2012), http://www.sec.gov/spotlight/jobsact/crowdfunding exemption.htm.

88. § 77d, 126 Stat. at 312 (amendment to 15 U.S.C. § 77d Note).

89. Zoran Basich, *SEC Brings Charges In Wake Of Facebook Pre-IPO Feeding Frenzy*, WALL ST. J. (Mar. 4, 2012 5:26 PM), http://blogs.wsj.com/venture-capital/2012/03/14/sec-brings-charges-in-wake-of-facebook-pre-ipo-feeding-frenzy/.

while still preserving the safeguards that protect investors from fraud. The SEC was notably formed during the Great Depression, when there was a lot of securities fraud and theft.[90] There still remains the same type of regulatory culture at the SEC today. State regulators also have their own state laws that parallel these regulatory SEC safeguards. Investor protectionism, however, must be balanced today with other concerns such as the need to facilitate trading and boost the economy. Practitioners, businesspersons, and regulators are currently struggling to combine the countervailing philosophical and regulatory principles into practical law.

The Internet has changed everything. It has created an efficiency in the market that allows individuals to communicate much more easily and permits them to raise equity from all corners of the United States. Many investors will highly value rules that allow them to tap into this efficiency. The SEC has yet to figure out a good way to open the markets without eliminating current protections against securities fraud. The SEC takes this problem incredibly seriously, as they should. The SEC's struggle to release rules for the JOBS Act are also currently exacerbated by the fact their Chairwoman, Mary Schapiro, just stepped down several months ago.[91]

The JOBS Act was clearly a congressional and presidential edict to the SEC to change their laws to allow crowdfunding. There are many crowdfunding incentives that the SEC must balance, and account for, that are causing some delay in getting these rules out. The SEC rules need to allow people to invest and get equity, preserve Guru-centric fundraising, and allow investors to see a realization from their investments. The rules were due on December 31, and regulators have already missed the first deadline.[92] The equity-based crowdfunding community is very eager for these rules to come out. This eagerness can be seen in the news, where, for example, the New York Times has covered the SEC's delay—twice already in the last sixty days—in lengthy pieces.[93] This delay is causing problems because issuers need to start preparing to be portal service providers for these "accredited

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90. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml (last visited Mar. 24, 2013).

91. Press Release, SEC Chairman Mary Schapiro to Step Down Next Month, U.S. SECURITIES AND EXCHANGE COMMISSION (Nov. 26, 2012), *available at* http://www.sec.gov/news/press/2012/2012-240.htm.

92. Eric Blattberg, *Crowdfunding Leaders to Press SEC JOBS Act Rules*, CROWDSOURCING (Feb. 19, 2013), http://www.crowdsourcing.org/editorial/crowdfunding-leaders-to-press-sec-on-jobs-act-rules/23989.

93. Amy Cortese, *The Crowdfunding Crowd Is Anxious*, N.Y. TIMES (Jan. 5, 2013), *available at* http://www.nytimes.com/2013/01/06/business/crowdfunding-for-small-business-is-still-an-unclear-path.html?pagewanted=all; Robb Mandelbaum, *'Crowd Funding' Rules Are Unlikely to Meet Deadline*, N.Y. TIMES (Dec. 26, 2012), *available at* http://www.nytimes.com/2012/12/27/business/

investor" online trading portals. Most people think the rules will come later this year. After the rules are released, there will be a comment period, and then, hopefully, by the end of 2013, equity-based crowd funding will be legal.

The SEC must reform its rules to be able to enforce the new laws from the JOBS Act. Previously, § 5 of the Securities Act of 1933 required registration unless an exemption was available.[94] Title 3 of the JOBS Act, however, creates a new crowdfunding exemption in § 4 of the Securities Act.[95] Section 3 will allow $1,000,000 to be sold in a twelve-month period by an issuer to all investors if the sales are "conducted through a broker or funding portal."[96] The JOBS Act keeps the distinction between "accredited investors" and "non-accredited investors," and still uses an income test to distinguish the two. The JOBS Act permits solicitation and advertising to "accredited investors," so long as the issuer uses reasonable steps to verify. The issuer will have to follow some detailed rules in order to verify that its investors are all accredited.

The JOBS Act also makes special rules for "non-accredited investors." There are two different levels of tests depending on whether the investor has $1,000,000 or more in net worth or annual income. If either the annual income or the net worth of the investor is less than $1,000,000, then that individual will be able to invest the greater of $2,000 or 5% of his or her annual income or net worth with that one securities issuer.[97] Investors that fall above the $1,000,000 threshold may invest a maximum of $100,000 and no more than 10% of their annual income or net worth.[98] Congress established these investment threshold limitations for "non-accredited investors" in order to provide some protections for the inherent lack of knowledge of this investor class. The JOBS Act, therefore, allows "non-accredited investors" to invest in a project they really believe in, without allowing them to fall subject to too much risk.

As previously stated, the SEC missed the deadline to create the rules for the enactment of the JOBS Act crowdfunding provisions. There are many issues the SEC must wrangle with to create these rules. We generally do not have any idea how expensive or otherwise workable the SEC rules will cause equity-based crowdfunding to become. There are considerable problems with how to balance investor protections versus easing access to capital. The SEC does not want to quickly release rules that allow inexperienced investors to

smallbusiness/why-the-sec-is-likely-to-miss-its-deadline-to-write-crowdfunding-rules.html?pagewanted=all&_r=0.

94. *See* 15 U.S.C. § 77d-e.

95. JOBS Act, Pub. L. No. 112-106, sec. 302, § 77d, 126 Stat. at 315.

96. § 77d(a)(6)(A)-(C), 126 Stat. at 315.

97. § 77d(a)(6)(B)(i), 126 Stat. at 315.

98. § 77d(a)(6)(B)(ii), 126 Stat. at 315.

pour their money into these new crowdfunding portals without adequate protections in place. A huge consumer fraud early on could be a huge black eye on the efforts of lawmakers to really make this Act work. So, the SEC has taken a little more time than Congress thought they would need; much to the consternation of some of the chairmen of the committees in Congress. If the SEC does not get this right—for example, if there is too much regulatory oversight—then investors will likely ignore the equity-based crowdfunding market and continue to use alternative fundraising methods such as Kickstarter campaigns.

The drafting of the JOBS Act presents another issue: fund-raising more than $500,000 requires part of the disclosure to investors to be audited financials.[99] This section of the JOBS Act may pose a problem because audited financials can become very expensive to produce. This process involves hiring an auditor such as Ernst & Young[100] or PwC,[101] paying certain legal fees, and generally owing additional banker fees. The more expensive equity-based crowdfunding becomes, the more it will start to resemble a public offering. This is a problem. So, we should keep an eye on the audited financial issue.

Large funds face additional problems when trying to utilize the equity-based crowdfunding model. First, large funds generally have many investors, spanning various levels of income and sophistication, around the country that can often be very difficult to contact to get approval. Dividing equity through private portals only exacerbates this problem. There is a concern that equity-based crowdfunding will disrupt the management structure of these companies, as well as damage later stages of equity financing.

Equity-based crowdfunding also presents liquidity concerns. Liquidity is a real issue because, unless the company gets bought or goes public, there is no guarantee that the company will have monetization. To ameliorate this issue, some people want preferences or superior rights built in that will continue to incentivize investors. The concern is that investors will throw common shares into a privately held company that will never have an IPO, might never get acquired, and might never have an obligation to pay a dividend. Therefore, you can see how such liquidity concerns may easily become a disincentive to participate.

Depending on what rules the SEC releases this year, crowdfunding will likely place considerable burdens on issuers at the funding portals as well. For example, as previously discussed, the issuer, and seemingly only the issuer, will be responsible to make sure individuals do not buy securities in excess of the "non-accredited investor" limitations set forth in 15 U.S.C.

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99. § 77d-1(b)(1)(D), 126 Stat. at 316.

100. Ernst & Young, http://www.ey.com/ (last visited Mar. 19, 2013).

101. PricewaterhouseCoopers LLP, http://www.pwc.com/ (last visited Mar. 19, 2013).

§ 77d(6)(B).[102] This may be too difficult a burden for some; many issuers may not want to contend with such hurdles from the JOBS Act.

However, if the SEC is somehow able to successfully navigate through all these challenges, these crowdfunding portals could become something huge. To achieve this, they must figure out how to facilitate capital formation while maintaining enough investor protection to make everyone feel comfortable about this new investment model. These investment portals may also have particularly exciting implications for video game creators. It is definitely possible that there will be special portals just for the video game community and its related offerings.

There will likely be some portals that get a bad name early on and are shut down by securities authorities. While there will likely be many portals that open up when the rules go through, this large group of issuers will probably be winnowed down to a smaller group of the most successful portals. The best portals will be the "gold standard," and they will have really good track records. Unfortunately, at the beginning of this winnowing process, there will likely be some high profile cases of abuse that may potentially tar the business.

There are some really exciting developments in equity-based crowdfunding, and I think we all hope this works out well. The SEC and state regulators are really trying to create something that is going to provide enough investor protection, but also make it easy and cheap enough for people to make use of this funding source. The Internet has brought great efficiency to the American economy already, as well seen with the Indiegogo and Kickstarter campaigns.[103] The Internet will continue to play an important role for equity-based crowdfunding in the development of these portals. The most immediate concern, though, is whether the SEC rules can strike the right balance. This funding source needs to be economical enough for companies to use without becoming overly burdensome. We do not want the equity-based crowdfunding process to resemble the public offering process because it will cause people to revert to older sources of fundraising.

Mr. Mark Methenitis:

This is the discussion portion of the panel. If anyone in the crowd has questions or comments, please raise your hand at any time. Your questions may very well be better than mine. I want to start with Mr. Foster and Mr. Karlsson to see if they have any comments based on what we have heard so far.

Mr. Zack Karlsson:

It is really important that we understand how the model has shifted. There was a question that was asked regarding the roles of publishers, and

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102. *See* JOBS Act, Pub. L. No. 112-106, sec. 201, § 77d, 126 Stat. at 312 (amendment to 15 U.S.C. § 77d Note) (requiring "the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors").

103. *See* Indiegogo, http://www.indiegogo.com/ (last visited Mar. 20, 2013).

there was some response that the old model is dead. Patrick Hudson mentioned that the use of publishers has decreased. Obviously, I have a vested interest in this as I represent a publisher, but I have also been a developer. The reality is that the value right now is in eyeballs, people, communities, and getting users to discover and play your game—not in distribution, which was historically the business of publishers.

Also, game developers are moving away from Facebook.[104] The question is, "Why?" In many cases, the cost of acquiring users is too high. Most developers are ill equipped to compete with many of the big brands.

In assessing cost, there are two relevant measurements in the industry: cost per install ("CPI") and expected lifetime value ("ELV"). When ELV is less than the cost to acquire customers, or CPI, there is a problem. As long as the ELV is greater than the CPI, the game is worth funding. With Facebook, the model has shifted such that, in most cases, developers cannot make enough money to offset the cost of acquiring users.[105] For example, here is some actual math: a fully qualified user on a mobile platform—meaning someone who has installed games and has monetized previously—is going to cost about $3 per user to acquire.[106] An unqualified or incentivized user—meaning one offered a discount on a product or service that he or she currently uses as a reward for installing the game—is considered to be worth less money because those users are getting something in exchange for having done the behavior. The response is Pavlovian: ring the bell and get them to do something. Those users cost between $0.90 and $1.50 to acquire. Therefore, if the users playing the game generate $2 per user, and it costs $1.50 to acquire the user, then it is financially viable. On the other hand, if it costs $3 to acquire a user and each user generates $2 on the backend, then the game is losing $1 for every acquired user; and that is a problem.[107]

With regard to crowdfunding scenarios, such as Kickstarter, many companies come in under budget because they do not think about the cost of having to acquire users. Kickstarter is not a marketing platform; nor is it a user acquisition platform. Rather, it is a platform for developing funding. The problem then arises from cash flow implications. For example, a developer may decide he needs $1,000,000 to finish his game. That may be true, but finishing the game is not the only cost involved. He will also need to spend

104. Zach Walton, *Game Developers Met with Zuckerberg to Discuss The Future of Facebook Gaming*, WebProNews (Dec. 3, 2012), http://www.webpronews.com/game-developers-met-with-zuckerberg-to-discuss-the-future-of-facebook-gaming-2012-12.

105. *See id.*

106. Zoya Street, *CPA Hits All-Time High*, Games Brief (Feb. 1, 2012), http://www.gamesbrief.com/2012/02/cpa-hits-all-time-high/.

107. *See, e.g.*, David Skok, *Startup Killer: The Cost of Customer Appreciation*, For Entrepreneurs (Dec. 22, 2009), http://www.forentrepreneurs.com/startup-killer/.

$1 per user to get users to discover the game, assuming they have not partnered with someone to do that part of the business, and play it. This creates a cash flow implication on a monthly basis that could be an additional $100,000 or $200,000. Sometimes developers do not recover that money for thirty, sixty, or even ninety days. At that point, there is a total cash flow implication of possibly half to the entire Kickstarter budget that no one planned for. The project is then way off target, even assuming that the developer has the expertise necessary to acquire users; which includes knowledge of how to build an ad, how to contact an ad network, and how to integrate a shoot-to-kill type video game. But the reality is that most developers have no experience with, nor have even thought about, how to do all of that work. For most of them, games are a pet project.[108] So, for a very small project, Kickstarter can be a valid funding platform.

However, let us assume that a developer got $160,000 in a Kickstarter campaign. The average game developer's time is measured in man-months.[109] In the United States, man-months include benefits, overhead, and rent among other things.[110] The cost for one man-month is about $10,700 according to Game Developer Magazine.[111] One hundred sixty thousand dollars divided by $10,700 is roughly sixteen man-months. If there are five developers, that is three and one-fourth months of development time.

In the case of a passion project—like those so often crowdfunded with Kickstarter—this math does not apply because the developers are not pooling, do not have an office, and are drawing only a small salary. Rather, these costs only apply when a game hires traditional developers who have no emotional connection to the game. People tend to view Kickstarter not as a speculative platform where they invest in an idea and may, at some point, get something out of it. Instead, consumers tend to think of it like Amazon, where they can order something digitally, and it merely has a very long de-

108. *See* Jeff Toll, *Pet Projects: Never Stop*, NET MAGAZINE (Oct. 16, 2012), http://www.netmagazine.com/opinions/pet-projects-never-stop.

109. Man-Month, BUSINESSDICTIONARY.COM, http://www.businessdictionary.com/definition/man-month.html (last visited Mar. 20, 2013)(defining "man-month" as a "[u]nit of work representing the productive effort of one person in a [four]-week period"); *see, e.g.*, Manuel Ravago, *Game Development Outsourcing*, THOLONS, *available at* http://www.gameshastra.com/docs/Game_Development_Outsourcing.pdf (last visited Mar. 20, 2013) (demonstrating that game developers commonly use man-months as a standard unit of time measurement).

110. *See, e.g.*, *Function Point Analysis: Effort Estimation*, FREDOSAURUS, http://www.fredosaurus.com/notes-softeng/technology/fpa/fpa-effort.html (last visited Mar. 20, 2013) (illustrating that the man-month calculation will include, inter alia, benefits, overhead, and rent).

111. *Game Developer Salary Survey 2012*, GAMECAREERGUIDE (Aug. 9, 2012), http://www.gamecareerguide.com/features/1108/game_developer_salary_survey_2012.

livery. I predict that 2013 and 2014 will be the year of failed Kickstarter projects.

Many of the Kickstarter projects do not work because making games is hard. Shipping games is hard. Both are a lot harder than people think. And, if having one publisher is difficult, having 13,000 publishers is really difficult. Everyone has an idea about what kind of game it should be and each person is very passionate; people feel very connected. Part of the success of the Kickstarter model is that it allows developers to connect to those people. However, in really big projects, everyone wants to have an opinion, and each person is entitled to one because that person gave the developer money. If the developer does not have a mechanism to handle that, or was not ultimately clear in the vision for the product, the developer will end up with disappointed customers as evidenced by *Code Hero*, wherein the creator of that game got sued.[112]

Kickstarter is a useful platform for very few people, in my opinion. For some of those people, it is brilliant and meets an exacting need. But, for most people, it is not a long-term play. For me, it is not a viable alternative to conventional funding for a variety of reasons.

Mr. Mark Methenitis:

Does the JOBS Act change your mind with regard to Kickstarter being a viable alternative to conventional funding?

Mr. Zack Karlsson:

No.

Mr. Holt Foster:

I am not as optimistic about the crowdfunding portion of the JOBS Act because there are so many hurdles. If a developer gets $1,000,000, that person has to do accounting and hire lawyers. The problem is that the developer will need to raise $1,000,000 to develop a game that costs $300,000-$400,000. Because of that, the game will be upside-down on cash flow versus assets. There may be an even larger impact because of the modification of Rule 506 that allows for general solicitation.[113]

I think that people may use Kickstarter or other reward-based crowdfunding as the seed capital for companies. For passion projects, it is unbelievably beneficial. It lets people with a love and an attainable goal get access to the market, and it can create a platform for the success of smaller projects. But, you will also see savvy people use Kickstarter for two reasons: seed money and marketing.[114] If developers can get a Guru to sell their prod-

112. Andy Chalk, *Code Hero Kickstarter Goes Bad—UPDATED*, THE ESCAPIST (Dec. 13, 2012, 9:45 AM), http://www.escapistmagazine.com/news/view/121069-Code-Hero-Kickstarter-Goes-Bad-UPDATED.

113. 17 C.F.R. §230.506 (2011).

114. *See, e.g.*, Alyson Shontell, *How a Guy with a Mason Jar Raised $30,000 in 4 Days on Kickstarter*. BUSINESS INSIDER (July 27, 2012), http://www.businessinsider.com/how-to-raise-a-lot-of-money-on-kickstarter-marketing-tips-2012-7.

uct and exceed the Kickstarter goal, they can create a market buzz and generate a following in the Kickstarter community. After that, they can then utilize the Rule 506 exception and do a general solicitation that allows a developer to advertise, market, and tell the world about all the success he or she had on Kickstarter. The next step is to make sure that only the "accredited investors" invest after that point. I am really skeptical regarding the SEC's version of crowdfunding for equity, in that I think it is going to be too cumbersome.

Mr. Evan Fitzmaurice:

To that point, many Kickstarter campaigns, not including these gentlemen who were incredibly successful because they brought in a huge amount of money, are a part of the branding effort from a marketing standpoint. The reason could be companies that do not need the money, as Mark was talking about at the beginning, but are doing it for the viral benefits. Companies that use the 506 strategy to do a general solicitation or credits and have the credibility, which Kickstarter and Indiegogo[115] definitely exude, have a greater chance of being successful than would be possible if either strategy were not used. When people are involved, it becomes a kind of package that brings in some real dollars.

Mr. Zack Karlsson:

I do not view Kickstarter as a marketing platform. On games projects in 2012, 30% of the total funding of successfully funded projects came from "tier-one" contacts.[116] Tier-one contacts include people the developer or the project proposer actually knew personally. It is a method to get those people excited; it is not a method to just go out there and hope. Developers should not wing it.

That statement is obviously generalized. In some cases, you can utilize a Guru. A Guru should be someone who can be an evangelist. Tim Schafer is a good example of a Guru.[117] I know him reasonably well because we have worked together for a number of years. Tim did not achieve "Guru Status" because he tells funny jokes; although that helps. Rather, Tim is successful because he is good at what he does, not because of luck. I hope this is not the quote that they put in the blurb, but most game developers are more lucky than good. Our egos make it difficult to accept this truth, but success is often due to timing. Yet we like to think it is because of our own skill, especially when we have worked on big, successful projects. However, most of the people who have done that will tell you their success was mostly a result of chance than their hard work.

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115. INDIEGOGO, *supra* note 103.

116. Kickstarter Stats, KICKSTARTER http://www.kickstarter.com/help/stats (last visited Mar. 20, 2013).

117. Adam Barenblat, *How to Get to the Next Level*, FAST COMPANY (June 2012), http://www.fastcompany.com/most-creative-people/2012/tim-schafer (profiling Tim Schafer as number thirty-nine in its list of 100 Most Creative People in Business in 2012).

As I said before, Tim is more good than lucky. In fact, he is good and *unlucky*. He has had brilliant ideas that have had bad marketing and timing or had a publisher change. But it is evident through merely talking to him that he is good at what he does. When sitting, talking to him, and looking him straight in the face, it becomes exceedingly clear that he is better at his job than you are at your own. There is no doubt about it. It shows when he pitches his projects, in that it is evident that he understands something about what he is doing that you do not. It is extremely powerful.

Other examples include Chris Taylor[118] and the doctors who were at Bioware—Ray and Greg,[119]—who are also more good than lucky and have always built quality products. Therefore, if you want to use the Guru strategy, you have to find a Guru who is like that; and there are very, very few who can inspire at that level.

Mr. Patrick Holleman:

A Guru has to be really charismatic because a community is still a community of human beings. So, the Guru has to not only be good, but also charismatic.

Audience Member 1:

You are saying that 30% of money comes from tier-one sources that the person already knew. To me, that means that 70% of the money is coming from people that the developer does not know. Do you have any additional breakdown of those numbers?

Mr. Zack Karlsson:

No. That statistic comes from someone I knew at Kickstarter who I met at a bar once, so I do not really know much more than that. That is a statistic that has been released publicly,[120] so I do not know where else that money goes or how else it breaks down.

Mr. Patrick Holleman:

It is true for me. Thirty percent of my money came from people with whom I was acquainted.

Mr. Mark Methenitis:

Mr. Barrett and Mr. Holleman, you guys have both heard about the potential for equity crowdfunding. Since you have both run previously successful Kickstarter campaigns, does equity seem like something that would be appealing to you or would you rather stick with what you did via Kickstarter?

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118. *See* Chris Taylor—Profile, GiantBomb, http://www.giantbomb.com/chris-taylor/3040-7137/ (last visited Mar. 20, 2013).

119. David Their, *Bioware Co-Founders Ray Muzyka and Greg Zeschuk Retiring*, Forbes (Sept. 18, 2012), http://www.forbes.com/sites/davidthier/2012/09/18/bioware-co-founders-ray-muzyka-and-greg-zeschuk-retiring (last visited Mar. 20, 2013).

120. Kickstarter Stats, *supra* note 116.

Mr. Patrick Holleman:

I would say, if the developer has a prototype, then equity funding might be best. But pre-prototype, equity is suicide.

Mr. Ryan Barrett:

Unfortunately, I cannot speak on behalf of the company since I do not run the company. Sorry.

Mr. Patrick Holleman:

We worked for free to do the first chapter, and then everybody knew what they were getting after that. But, if a developer does not have a prototype, that developer does not have anything—unless the developer you have is Tim Schafer. In which case, he or she has Tim Schafer. Otherwise, the prototype is the cornerstone of everything.

If you have a prototype, people play it, and it is fun. Then it has legs, and equity would be a great idea because there is a reasonable expectation of success. Also, equity gives partial control. If a party has enough equity, that party could say, "These people are completely incompetent at marketing their game, but at least I know what I am doing. And I can bring my marketing firm, or I can tell someone else to get some equity and we can have enough equity to shape the marketing vision for this product that we know has legs." Again, without a prototype, people are just guessing.

Mr. Mark Methenitis:

That is something that has even shifted on the Kickstarter site: physical products require an actual prototype now to even start a campaign because Kickstarter had so many projects that were just renderings on the physical product side, as opposed to the game side where they would say, "This is our rendering and it may not ever come to pass."[121]

Mr. Patrick Holleman:

Right. There are certain investments that are so low that people do not expect to get equity. Nobody wants five dollars in equity, right? Not many people at least.

Mr. Mark Methenitis:

Does anyone on the panel want to predict how successful or unsuccessful that the top twenty Kickstarter games are going to be in 2013?

Mr. Zack Karlsson:

I think some will be wildly successful. I do not mean to be all doom and gloom, but being a developer is difficult. Being a publisher is hard as well, as illustrated by a scenario where, when hitting milestones, the developer tells an investor, "We appreciate the $10,000,000 you have already invested, but it is going to be another $10,000,000 to get out the door. I am sorry about that."

121. Mike Masnick, *Kickstarter Introduces New Rules to Try to Limit Disappointment*, TECHDIRT (Sep. 21, 2012 2:31 PM), http://www.techdirt.com/articles/20120921/ 13281620462/kickstarter-introduces-new-rules-to-try-to-limit-disappointment.shtml.

Mr. Patrick Holleman:

Do you think *Wasteland* is going to be the first one done?[122]

Mr. Zack Karlsson:

That is the first big one, right?

Mr. Patrick Holleman:

Yes, $1,700,000.[123]

Mr. Zack Karlsson:

I think there are going to be some great games that come out of Kickstarter that I will play. I have backed a lot of games personally; I am a PC gamer. I love the idea of Kickstarter. I use Kickstarter, Indiegogo, and even Kiva,[124] which delivers microloans to developing countries. I am a big fan of that model, but it is not going to take many wild misses where the developer comes up short, spends all the money, and has nothing to show for it before it has an absolute chilling effect on the market. People do not like throwing away money for nothing. This is particularly true when it is a passion project and an investor is really excited about it. The investor gave the developer the money because he or she is excited about this product being developed, a product that he or she has always wanted that is amazing. Except, the developer fails after having already taken an investor's money.

Mr. Patrick Holleman:

A person can totally lose Guru status that way too.

Mr. Zack Karlsson:

And people will.

Mr. Patrick Holleman:

Gurus cannot get that back.

Mr. Zack Karlsson:

No. Once it is gone and that trust has been broken, it is broken. There is no coming back from that. So, to restate: it is not going to take very many who missed to have a really negative effect on the market.

Mr. Zack Fitzmaurice:

Whereas on the securities side, there is not only disappointment but also potential liability for §10b–5 material misstatements.[125] When the Fried Model misses, people get frustrated and they run out of the house angry.[126] If

122. *Wasteland 2*, KICKSTARTER, http://www.kickstarter.com/projects/inxile/wasteland-2 (last visited May 21, 2013).

123. *Id.* (funding exceeded $2,900,000 at the close of its funding period, April 17, 2013).

124. KIVA, http://www.kiva.org/start (last visited Mar. 20, 2013).

125. 17 C.F.R. § 240.10b–5 (2013).

126. *See* Dick Olsher, *Floor Loudspeaker Reviews: Fried Model G/3 loudspeaker*, STEREOPHILE, (Dec. 22, 2009), *available at* http://www.stereophile.com/floorloudspeakers/ fried_model_g3_loudspeaker/index.html (originally published Nov. 22, 1986).

the securities model misses, the JOBS Act is very clear regarding the many causes of action ranging from business failure—a risk companies almost always face—to misrepresentation, where something was said but not done.[127]

Mr. Zack Karlsson:

I would like to underscore the point that for many of these games that are super niche, it is not as big of an issue. But the ones that cost $4 million, $5 million, or $6 million, there is no marketing built into that. I do not want to speak for Steve Nix,[128] who was on the panel before, but they did not buy Kongregate[129] because of the tech—they bought it because of the community. It is an amazing community with a lot of content that has all of these people already viewing it, and it allows them to expand their business in some really interesting ways. It is about having those built-in customers and access to an audience. A game cannot get the big numbers through Kickstarter alone. If the goal of the game is to get $100,000, $200,000, or $300,000, and the whole audience basically consists of the people who funded the game. But when the game is $6,000,000 in, and the developer used Kickstarter for seed funding and the rest of the money is coming from sweat equity, angel investments, or the developer's own pocket, it can be a problem. That model is upside-down if the game does not have marketing, a community of users, or even a pre-determined mechanism to solve the discoverability problem. This is an area where the whole project can come apart.

Audience Member 2:

A lot of people look at Kickstarter as a place to start marketing and create a buzz despite the fact that the company has enough money to develop the game. Where does that fall off? I heard someone on the panel say you cannot use this for marketing alone because people will get upset.

Mr. Patrick Holleman:

Right. As soon as a company loses Kickstarter's users' trust by showing that it has more money or reach than it pretended, it is, "Goodbye!" That is it.

Mr. Zack Karlsson:

I will give you an example of a situation that I am in currently. We are a massive company—we measure our revenue in billions, not millions. As an example of the challenges we face, I cannot make the profit and loss work on a well-loved, older intellectual property I own because the intellectual property has not been to market in a long time. I would love to use Kickstarter as

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127. Keith Paul Bishop, *Crowd Funding—There Will Be Investor Losses*, CALIFORNIA CORPORATE AND SECURITIES LAW (Apr. 4, 2012), http://calcorporatelaw.com/2012/04/ crowdfunding-there-will-be-investor-losses/.

128. SMU Program Participants: Steve Nix, GAME BUSINESS LAW 2013 INTERNATIONAL SUMMIT, http://smu.edu/gbl/speakers.html#nix (last visited Mar. 26, 2013).

129. KONGREGATE, http://www.kongregate.com (last visited Mar. 20, 2013).

a tool to measure the interest of others. Ideally, if others were interested, they could preorder it.

I do not need the cash. Rather, I just need to know that people are going to buy it when it comes out. But, the challenge is that our company has money. If I show up on Kickstarter as a company that has money and I then ask people for money before I have built the product, they will burn me at the stake.

Mr. Patrick Holleman:

One of the things we found is the average Guru really knows his stuff. It is usually someone who is really smart, has a college degree, and is in the industry. On top of that, he or she is on a first name basis with most people in the industry. Many times, if a campaigner who has money tries to use a Guru for the type of Kickstarter that Zack described, someone will know the Guru and will out the campaigner.

Audience Member 3:

I have two questions. First, I have seen many projects on Kickstarter that are really cool and I am willing to gamble $5, $10, or $15 to see it happen. However, there is a certain limit to the number of products to which I am willing to give money but will not see for a year. What effect do you think this has on projects making money on Kickstarter? My second question is regarding a given game that gets put up on Kickstarter in a prototype-stage and fails. Does that game have a stigma attached to it that it might not have had if it had used other methods of raising funds?

Mr. Zack Karlsson:

If you fail on Kickstarter, do not pitch it to me. I am not interested.

Mr. Patrick Holleman:

To answer the first question, Kickstarter fatigue seems to be cyclical.[130] I knew at least one person who was running a Kickstarter at all times last year. The two of us who did it right after Christmas had no problem, and we had no valley. Instead, we had an exponential upward curve. It was a small amount of money because the curve started very low, but Kickstarter fatigue can be avoided if you target it correctly.

We found that the summer was the best time to start a Kickstarter campaign. I do not know if that was unique to last summer when Kickstarter was the hot thing to do or if people simply spend more money in the summer.

Mr. Mark Methenitis:

You are talking about life cycle fatigue as opposed to cyclical fatigue.

Audience Member 3:

I was talking about fatigue from the investors' standpoint. For example, there are only a certain number of role-playing-games from the 1980s and 1990s that I want to see remade. There are only a few I would put $10 toward—Kickstarter is very risky. So, I am curious whether or not the timing

130. *See, e.g.*, Joe Brown, *We're Done with Kickstarter*, GIZMODO (Mar. 29, 2012 12:30 PM), http://gizmodo.com/5897449/were-done-with-kickstarter.

of the release of a company's Kickstarter affects the money it makes. What if people who would normally invest had just invested in another, similar game right before, then decide they do not want to invest in the new game because of the previous investment?

Mr. Patrick Holleman:

My thought on this, and I cannot prove it with enough data, is that Kickstarter is also tied to the market cycle of regular games. People have discretionary funds that they can spend on games or Kickstarters. One of the reasons we think that the first quarter is so good for us is that there is almost nothing groundbreaking that is for sale in a traditional video game store in the first quarter. So, developers can get away with taking the market share of discretionary funds via a Kickstarter campaign rather than in a Gamestop[131] because there is nothing to buy at Gamestop in February.

Mr. Zack Karlsson:

I do not see Kickstarter fatigue as being much of an issue. Although, anecdotal evidence tells me that my own buying habits are curbed when I feel like I have funded enough of those. Many times I want to see how some of these come back, and maybe I will do it again after that return. I also think there is some learned behavior. The last panel was talking about how important Steam[132] sales were. I found my own behavior starting to shift with regard to this type of purchase. I thought it was interesting, so I went to work and pulled all of our internal data to see if my change in behavior was mirrored across the industry.

What is interesting is that frontline pricing has dropped on Steam, in terms of the volume of units, because we have started to teach people to wait for the sale. Now, because everyone knows it is coming, the revenue is still there, but it is distributed in some really different ways. Unless people have to purchase the game immediately, they will just wait for it to go on sale for 75% off. The next big sale is not that far away—it is going to happen, and when it happens, all those games are going to be on sale.

I have a sneaking suspicion that the same thing happens with Kickstarter. If an investor thinks that he or she is overextended a little bit, that person can wait until the Kickstarter goal is almost met and fund it then. That is why most projects have a surge at the end. It is also the reason that many projects exceed their goal: people are more willing to invest if they know the project is definitely going forward. Even though Kickstarter does not collect the money until after the project has successfully met its goal, most people do not want to put money in if the project is only at 60% of its goal because then that investor has wasted that money. It is weird psychology.

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131. GAMESTOP, http://www.gamestop.com (last visited Mar. 20, 2013).

132. STEAM, *supra* note 39.

Mr. Patrick Holleman:

You get your money automatically back if the project does not meet its fundraising goal, but people are still unsure.[133] They do not trust it.

Mr. Zack Karlsson:

Right. I personally do not trust it. I do not know why.

Mr. Patrick Holleman:

Definitely true.

Mr. Ryan Barrett:

I feel like the great success of our Kickstarter all had to do with timing, and, if we had pitched the game again this year, it might not have happened. Last year was just insane. It seemed like every news, online, or gaming site article was about Kickstarter. People were jumping on the Kickstarter bandwagon. I am not saying we were responsible for that response, but I feel like our success had to do a lot with the timing of the proposal. I am already feeling the fatigue, and I do not care about other projects right now; I do not want to fund them. With everyone is jumping on the Kickstarter bandwagon, I do not know if it is going to come back.

Mr. Zack Karlsson:

To me, it is analogous to a gold rush. People can choose to chase the gold rush and be out there, but it is not a long-term business strategy. If you want to be on the cutting edge and try to reap the benefits of the site while it is hot, that is fine. But that is not a long-term business strategy. I am not pivoting my business model to Kickstarter-funded projects because I do not think it will work in the long term.

Mr. Patrick Holleman:

I think Kickstarter reached its high when David Fincher, the director of Seven, and Charlie Kaufman, who did various movie adaptations, decided to Kickstart their movie projects to get out of the studio system.[134] The indie communities revolted and claimed that Kickstarter was designed, not for big names like David and Charlie, but for the indie community as a whole. In that way, you can sense the top being hit in the market. Video games are unique in that the fundraising success these guys have had is absolutely tremendous. That has not happened in other industry sectors, and it says a lot about the grassroots support and enthusiasm of the game community. Hopefully, the community will sustain that since it seems to be unique to video gaming.

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133. *But see FAQ*, KICKSTARTER, http://www.kickstarter.com/help/faq/kickstarter%20basics (last visited Mar. 20, 2013).

134. Jesse David Fox, *Academy Award-Nominated Director David Fincher has Started a Kickstarter*, VULTURE (Oct. 12, 2012 12:45 PM), http://www.vulture.com/2012/10/david-fincher-turns-to-kickstarter-for-animated-film-the-goon.html.

Mr. Mark Methenitis:

We are out of time. Thank you everyone. Perhaps we will have you all back next year to either talk about the bubble bursting or talk about the second year of wild success in crowdfunding.