

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2017055183101**

TO: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)

RE: StartEngine Capital LLC (Respondent)
Member Firm
CRD Funding Portal No. 282945

Pursuant to FINRA Rule 9216, Respondent StartEngine Capital LLC submits this Letter of Acceptance, Waiver, and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described in this AWC.

I.

ACCEPTANCE AND CONSENT

- A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

StartEngine is a funding portal that acts as an intermediary for crowdfunding offerings conducted in reliance on Section 4(a)(6) of the Securities Act of 1933 (Securities Act). It is headquartered in West Hollywood, California and has approximately 100 associated persons. It has been a FINRA-registered funding portal since May 2016.

OVERVIEW

At various points in time during the period November 2016 to January 2018, StartEngine included issuer communications on its funding portal website that it knew or had reason to know were false or misleading; posted its own inaccurate counts of the number of investors in the offerings on its portal; and failed to reasonably supervise potentially misleading issuer-prepared content on its website. Therefore, StartEngine violated FINRA Funding Portal Rules 200(c), 300(a), and 200(a).

FACTS AND VIOLATIVE CONDUCT

This matter originated from FINRA's examination program.

1. Background

“Crowdfunding” is a way to raise money using the internet to create a public forum where the “crowd” can discuss, evaluate, and invest in a proposal. Title III of the Jumpstart Our Business Startups Act of 2012 (the JOBS Act) created a new exemption from the registration requirements of Section 5 of the Securities Act for certain crowdfunding transactions. The JOBS Act created an exemption for sales of unregistered securities to investors via crowdfunding intermediaries, which can be either broker-dealers or internet-based platforms, called “funding portals.” Funding portals are required to comply with the relevant provisions of the Securities Act and SEC Regulation Crowdfunding. They are also required to register with FINRA and comply with FINRA’s Funding Portal Rules.

2. StartEngine Included Misleading Communications on Its Website.

a. StartEngine Included Misleading Content on Its Webpage Prepared by Issuers in Two Offerings.

FINRA Funding Portal Rule 200(c) sets forth certain content standards for funding portal communications¹ with the public. Funding Portal Rule 200(c)(3) addresses issuer communications in relevant part as follows:

[N]o funding portal member may include on its website any issuer communication that the funding portal member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

In addition, FINRA Funding Portal Rule 200(a) requires a funding portal member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade. A violation of any Funding Portal Rule is also a violation of Rule 200(a).

i. Issuer A’s Misleading Content Regarding a Home Robot.

From December 2016 through April 2017, StartEngine acted as intermediary for a crowdfunding equity offering in Issuer A. As intermediary, StartEngine, among other things, hosted on its website a page describing Issuer A’s offering, including communications prepared by Issuer A regarding Issuer A’s product, a home robot.

In its communications on the StartEngine offering page, Issuer A exaggerated the robot’s level of functionality. For example, the offering page prominently contained a demonstration video, accompanied by present-tense written descriptions, representing that the robot could independently perform tasks such as waking sleeping family members, smoothly responding to voice commands, teaching a child piano and art,

¹ The Rule defines “funding portal communication” to mean any electronic or other written communication that is distributed or made available by a funding portal member to one or more investors.

projecting a recipe onto a cutting board, projecting a video call onto a wall, patrolling a home for potential intruders, adjusting a thermostat, and playing peek-a-boo with a child. The robot “can do just about anything,” promised the voiceover narration on the video. The video also showed the robot gliding and balancing unassisted on a ball base.²

In addition, in comments posted to the public message board on the offering page, beginning on January 5, 2017, Issuer A’s principal stated that shipping of retail units was imminent.

Beginning in January 2017, StartEngine knew or should have known that the descriptions and video depiction of the robot’s functionality were exaggerated and therefore misleading and that shipping of retail units was not imminent. In January, the firm learned that Issuer A had abandoned attempts to design the robot to roll unassisted on a ball. In March 2017, an eyewitness to a live demonstration of the robot told StartEngine that the robot was unfinished and could not accurately recognize most oral commands users issued to it. Later that month, a different crowdfunding website that had hosted an earlier campaign by Issuer A, not pursuant to the JOBS Act, contacted StartEngine to share doubts about the feasibility of the product and timing for production. Also, in March, StartEngine learned from Issuer A’s contractors and partners that no work had been done, and no payments made, to begin mass production.

Additionally, in April 2017, Issuer A provided a set of progress videos to StartEngine that demonstrated that the prototype robot was not functional or ready for mass production. The videos showed a bulkier, clumsier, and far slower prototype struggling to perform certain of the promised tasks. In those videos, the robot relied on four support legs to balance on its ball, moved so slowly that humans had to pause when walking beside the robot to allow it to catch up, and repeatedly erred in voice recognition, requiring humans to repeat commands. The videos also did not demonstrate that the prototype could perform some of the capabilities demonstrated on the offering page, such as teaching piano, checking the front door, and assessing air quality.

Notwithstanding the foregoing, StartEngine failed to correct any of the false or misleading statements on its offering webpage or remove the promotional video. The offering closed on April 15, 2017, raising approximately \$200,000.

ii. Issuer B’s Misleading Content Regarding Its Basketball League.

From May through September 2017, StartEngine acted as intermediary for a crowdfunding equity offering in Issuer B, a basketball team formed to play in a new professional league. StartEngine, among other things, hosted on its website an offering page for Issuer B containing communications regarding the team and the league. Specifically, in its communications on the offering page, Issuer B claimed that the team

² Although a disclaimer on the offering page noted that the robot was a work-in-progress, it was insufficient to remediate the other misleading representations contained on the offering page.

would play fourteen games between July and August 2017 and then play in an “epic” tournament in September 2017.

By August 2017, StartEngine knew or should have known that this timeline, including the July 2017 start date, would not be met and thus was misleading. In August, based on conversations with Issuer B and another team formed to play in the same league, StartEngine learned that the league had not actually begun to play games in July 2017. In addition, that month, StartEngine became aware through published news articles that the team and the league faced issues with some of its players that threatened the proposed season.³ When StartEngine asked the issuer to respond to these articles, the issuer acknowledged the delays.

Despite the foregoing, StartEngine failed to correct any of the misleading statements contained on the offering webpage regarding the timing of the games. The offering closed in September 2017, raising over \$100,000.

b. StartEngine Posted Misleading Investment Trackers.

FINRA Funding Portal Rule 200(c)(2) provides content standards for funding portal communications. It prohibits funding portals from including “any false, exaggerated, unwarranted, promissory or misleading statement or claim” and omitting “any material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading.” The Rule also provides that “[a]ll funding portal member communications must be based on principles of fair dealing and good faith and must be fair and balanced.”

From November 2016 through August 2017, StartEngine maintained a public-facing tracker on each of its offering pages purporting to display the total number of investors that had committed funds to each offering. The trackers were misleading during this time period because they counted each individual investment as a unique “investor,” even if the same individual made multiple investments. Moreover, in three instances, the counter also included, without further disclosure, investments made by investors who were associated with the issuer, thus creating a misleading impression of outside interest in the offering. After the problems with the tracker were brought to its attention by FINRA, the firm corrected the issue.

Therefore, Respondent violated FINRA Funding Portal Rules 200(c) and 200(a).

3. StartEngine Failed to Reasonably Supervise Issuer Communications Included on Its Website.

FINRA Funding Portal Rule 300(a) requires each funding portal to establish and maintain a supervisory system “reasonably designed to achieve compliance with applicable securities laws and regulations and with the Funding Portal Rules.” As set forth above, one of a funding portal’s obligations is to not include on its website any issuer

³ In fact, no games were ever played.

communication that the funding portal member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

From January 2017 through January 2018, StartEngine failed to reasonably supervise issuer content posted to StartEngine's webpage. Although the firm's WSPs required supervisors to engage in "documented spot-checks" of issuer content, they lacked procedures to guide staff when, in the course of ongoing offerings, the portal received negative information relating to issuers. As a result, the firm failed to respond reasonably to red flags suggesting that existing statements made on StartEngine's platform, authored by Issuers A and B, were misleading. The red flags, as described above, included tips, complaints, messages, and conversations regarding the capabilities and development of Issuer A's robot; and conversations and published reports regarding the timing and viability of Issuer B's basketball team. Without a reasonable supervisory process in place to address these red flags, the firm failed to correct or take down the misleading content.

In May 2017, StartEngine revised its WSPs, including by developing a list of pre-launch "red flags" requiring increased scrutiny of a potential crowdfunding issuer and incorporating the list into its WSPs. Among the exceptions were "extensive claimed experience"; ideas "unrealistic in their claims"; and issuer principals who lacked experience in the relevant industry. Per the new policy, the presence of any of these red flags required escalation to the CEO or CCO, depending on the circumstances, and might lead to the firm rejecting the potential issuer's offering. Despite creating this new policy, the firm failed to implement it in connection with an offering that began in July 2017 by Issuer C.

From July 2017 to January 2018, StartEngine acted as intermediary for a crowdfunding equity offering in Issuer C, an online marketplace connecting merchants and salespersons. StartEngine, among other things, hosted on its website an offering page for Issuer C containing communications prepared by Issuer C regarding the work and life experience of its principal. The communications included statements that Issuer C's principal cured himself of an unspecified illness with a 90% mortality rate and now helps cure others; built an unnamed start-up company from scratch with only a website and a cellphone during the "great recession"; and received 250,000 repeat orders from Fortune 500 companies. Issuer C further stated through StartEngine's website that its technology currently "helps over 165,000 welfare recipients." These claims met StartEngine's criteria for investigation and escalation, but the firm did neither. Issuer C cancelled its own offering prior to reaching the minimum target amount and all funds were returned to investors.

Therefore, Respondent violated Funding Portal Rules 300(a) and 200(a).

B. Respondent also consents to the imposition of the following sanctions:

- a censure;
- a \$350,000 fine; and

- A certification: within 60 days of the Notice of Acceptance of this AWC, Respondent shall certify to FINRA in a submission signed by an officer that, as of the date of the certification, Respondent has established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues identified in this AWC. The certification shall be addressed to Elissa Meth Kestin, Senior Director, FINRA Department of Enforcement, 200 Liberty Street, 11th floor, New York, New York 10281-1003; elissa.methkestin@finra.org. Upon written request showing good cause, FINRA staff may extend the procedural date set forth above.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a complaint issued specifying the allegations against it;
- B. To be notified of the complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made, and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of

FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and
 - 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this statement. This statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA.

STARTENGINE CAPITAL LLC, FINRA MATTER NO. 2017055183101

STATEMENT OF CORRECTIVE ACTION

This Statement of Corrective Action is submitted by the Respondent, StartEngine Capital LLC. It does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA, or its staff.

StartEngine Capital LLC (“StartEngine”) submits this Statement of Corrective Action to accompany the Letter of Acceptance, Waiver, and Consent (“AWC”) it is submitting to FINRA, to set forth some demonstrable steps it has taken to reduce the risk of future compliance deficiencies.

As the AWC notes:

- When the issue with its investor-count tracker/tally was brought to its attention, StartEngine corrected the issue so that only unique investors are counted.
- In May 2017, StartEngine revised its written supervisory procedures (“WSP’s”), including by developing a list of pre-launch “red flags” requiring increased scrutiny of a potential crowdfunding issuer and its offering materials, and incorporating that list into its WSP’s.

With respect to the latter item, the pre-launch due diligence checklist now includes steps to seek to determine if an issuer has conducted a previous crowdfunding campaign in which issues with respect to accuracy of information communicated in the campaign were raised. Also, StartEngine’s WSP’s now include direction with respect to due diligence and disclosures for issuers with pre-production or pre-prototype products or services (disclosure such as “[products] shown in video are prototypes not yet available to the general market”).

StartEngine has continually invested in, built, and improved its compliance function and resources, including strengthening its WSP’s and their implementation. For example:

- StartEngine has implemented a policy for computer generated images, video, or other content posted to an offering campaign page which requires a disclosure such as “this is a computer generated demo version of [product]. Product is currently under development.”

- A Policy for Investor Comments and Complaints, and corresponding WSP provisions, updated and refined from time to time, including a clearly defined process for flagging and reviewing communication channel comments, which includes procedures for contacting outside counsel about such comments when appropriate and processes for identifying key words and phrases in channel posts and for recording removal of channel posts.
- The pre-launch due diligence checklist has been updated from time to time as experience and events dictate improvements, and additional resources have been and are being devoted to pre-launch due diligence.

StartEngine has strived, and continues to strive, with the advice and counsel of outside attorneys, to improve its performance as a gatekeeper for crowdfunding offerings. That process has included upgrading and enhancing its procedures, resources, and training (i) to prevent, correct, or remove any false or misleading statements in issuer communications; (ii) to prevent, correct, or remove any false, exaggerated, unwarranted, promissory, or misleading statements or claims, or omissions of any material fact or qualification, in its funding portal communications, and to ensure that its funding portal communications are based on principles of fair dealing and good faith, and are fair and balanced; and (iii) to reasonably supervise issuer communications included on its website.

StartEngine's corrective actions, and the mitigating circumstances of the events set forth in the AWC, as described in a statement that has been submitted to FINRA, demonstrate StartEngine's continuing commitment to compliance and its efforts to address and to resolve issues as they arise.