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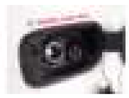
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BY  JOHN VOELCKER | 720 views | Feb 16, 2012

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2012 Fisker Karma EcoChic, New York City, Jan 2012

This is the week when driving impressions of the 2012 Fisker Karma have started to appear, as Fisker invites in waves of automotive journalists for a half-day of driving in and around Los Angeles.

(We'll have our report early next week, but we had a brief drive a few weeks ago, and another with video in December.)

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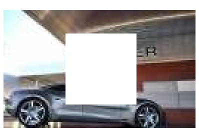

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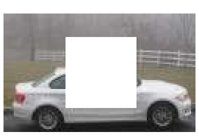

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So, with luck, the press about Fisker Automotive will be about the Karma range-extended electric car--not the lawsuit by an irate investor, nor the ongoing negotiations with the U.S. Department of Energy to renegotiate the terms of low-interest loans under the DoE's advanced-technology vehicle manufacturing program.

So, about that lawsuit.

As reported last week in the *Orange County Register*, an investor named Daniel Wray has sued Fisker Automotive, alleging that the company and the fund through which he invested, Advanced Equities Inc., committed fraud and breach of fiduciary duty when they sold him the stock.

Wray bought roughly $210,000 in preferred Fisker stock from AEI in the 18 months between October 2009 and April 2011. AEI bundled money to invest, in units of roughly $100,000, from high-net worth individuals. In total, it invested $25 million in Fisker over two years.

Last month, Wray got a letter from Fisker saying that due to the company's "urgent need for equity capital, the financing now contains a 'pay to play' provision" that required him to invest an additional $83,900 within nine days.

Wray risked sacrificing several of the benefits of his preferred stock if he didn't invest. They include protection against "dilution" of his share if further stock was sold, a price discount on future stock purchases if Fisker went public, and a preferential position among creditors in any bankruptcy.

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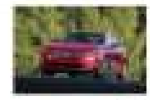

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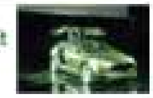

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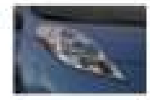

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2012 Fisker Karma EcoSport

That letter was likely part of the company's effort to double the size of its Series D funding round to $300 million. Fisker said at the time it had $243 million already committed.

Wray chose to sue.

His lawsuit seeks restitution from both Fisker Automotive and Advanced Equities, including compensation and punitive damages for making promises he says they knew were false at the time.

To get some perspective on Wray's suit, we spoke to a couple of venture capitalists we know.

Neither would go on the record--the venture capital world is small--and both said they had not read Fisker's prospectus or the letter sent to Wray, so they could only speak in broad terms based on the *Register* article.

But, they also told us that 'pay to play' provisions are far from unusual when a company needs additional capital at an equivalent or lower valuation to prior rounds.

In general, startup companies get financed in successive rounds of capital, taking in only as much as needed to get to specific milestones. That way, the value of the company presumably rises at each milestone, and the shares held by early investors and employees are diluted much less.

But if more capital is needed and the value of the company hasn't risen, then the company has to create an incentive for its owners to continue to invest. The threatened loss of preferential rights--aka 'pay to play'--is such an incentive.

Ray Lane takes delivery of the first Fisker Karma

Whether or not that language is in the original investment documents, the company's controlling shareholders can vote to change the terms later on.

At Fisker, those include famed venture firm Kleiner, Perkins, Caulfield & Byers--whose partner Ray Lane took part in a staged "first delivery" event for the Fisker Karma last July.

At a mere $210,000, Wray is far from a major shareholder in a company with total investments up to $1.4 billion.

In the end, as our friendly neighborhood venture capitalist told us, "This is proof that raising capital for startup companies involves risk."

The 'pay to play' provision, he chuckled, is simply one of those "bumps in the road" of founding and growing a company. "The investors who benefit from success," he said, "are those who help a company during its darkest days."

Those who choose not to re-invest, he said, "no longer support the company."

They "get moved to the back of the bus."

Here endeth today's lesson in venture capital.

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HI-RES GALLERY: 2012 Fisker Karma EcoChic, New York City, Jan 2012

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John Briggs
Posted: 2/16/2012 9:35am PST

Very interesting. I had no idea that is how it worked.

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Eric Loveday
Posted: 2/16/2012 10:55am PST

Sure wish I had an extra $210,000 to invest in an automaker. Can't feel sorry for the extremely wealthy that lose a bit of their wealth due to a poor investment.

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Ramon Leigh
Posted: 2/16/2012 4:08pm PST

"Pay for play" is a euphemism for extortion, pure and simple. Another one of those areas where the law lags woefully behind ethics. Kleiner Perkins has made more than their share of lousy investment recommendations. When they talk, I listen. And then do the opposite.

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