ANGEL CAPITAL ASSOCIATION

November 4, 2013

Elizabeth Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: File No. S7-06-13, Amendments to Regulation D, Form D and Rule 156

Dear Ms. Murphy:

Thank you for the opportunity to provide comments to the Commission on its proposed amendments to Regulation D and Form D. The Angel Capital Association is the leading professional and trade association supporting the success of accredited angel investors in high-growth, early-stage ventures. Our members are among the angels that invested an estimated $22.9 billion in 67,000[1] early-stage investments in 2012, with companies located in every state in the country.

Our comments today are in support of the nation's startup entrepreneurs, those who create the majority of net new jobs in the country[2] and many of the innovations that improve the quality of life throughout the world. It is vital that promising startups continue to attract angel capital, for their own growth and for the American economy as a whole. The purpose of the Jumpstart Our Business Startups (JOBS) Act was to enhance access to capital for job-creating startups. Lifting of the ban on general solicitation was one of the ways to provide more options for capital formation for entrepreneurs, and ACA wants to add our voice to many others in the startup ecosystem advocating for a regulatory environment that supports the goals of the JOBS Act.

The proposed rule's goals of investor protection and building data on general solicitation practices are admirable, but we do not believe the proposed rule would actually do a better job of investor protection than current regulations. In addition, the proposal would unfortunately create a considerable burden on small startup companies, could result in the death of many of these startups, and drive away angel investors. This result is exactly opposite of the intent of Congress when it approved the JOBS Act.

Key concerns identified by ACA and many other commenters to the proposed rules include:

1. Filing Form D 15 days prior to any general solicitation imposes particularly heavy costs and regulatory burdens on startup companies, and forces early stage entrepreneurs to navigate a minefield of potential regulatory sanctions when making any type of public comment if they are even contemplating a future offering.
2. Requiring early stage entrepreneurs to electronically furnish copies of each item of general solicitation no later than the date of first use also imposes fatal burdens of cost and

[1] Center for Venture Research, University of New Hampshire, https://paulcollege.unh.edu/research/center-venture-research/cvr-analysis-reports
[2] John Haltiwanger, Ron Jarmin, and Javier Miranda, Jobs Created from Business Startups in the United States, 2008

complexity on issuers who can least afford it, without achieving relative benefits in terms of regulatory oversight.

3. Lengthy legends and other standard disclosure requirements in advertising materials would increase costs of general solicitation for issuers, and would be unlikely to be read by most interested individuals.
4. The penalty for non-compliance, including prohibiting an issuer from using Rule 506 for an offering for one year, are draconian and unnecessary, and would effectively grind to a halt the flow of capital to startups under Rule 506(c). Many startups would go out of business with this penalty, with most non-compliance expected to be inadvertent. As written, it does not appear that there are mechanisms for due process for startups that receive the penalty.

We understand it is important for the Commission to develop rules that balance the need for capital formation with investor protection. Unfortunately, it is unclear how and if the proposed rules would really add more protection for investors, and whether the costs to small businesses, particularly to startup businesses, were truly considered as part of any perceived benefits.

Given the current broad definition of "general solicitation" it appears that a large number of small issuers will fit within Rule 506(c) and would be subject to the requirements of this proposed rule if it became final. This is especially unfortunate particularly for those startup issuers whose only use of general solicitation is a demo day at their college or university or similar event such as one led by their local community economic development authority. In this case, considerable new requirements would be forced on them for using a method they have used for decades without incident.

We believe the best solution is to withdraw the rules as proposed. If, however, the Commission chooses to move forward with the proposed rules, we suggest several ideas to improve them. First, it is important to understand critical issues that underlie our comments and concerns.

Proposed Rule Doesn't Address Startup Financing Perspective

It appears that the proposed rule has been developed more for larger types of offerings than for small businesses and startups, despite the fact that the median Regulation D offering is modest in size: approximately $1.5 million.[3] As noted in a previous, comprehensive response letter,[4] the proposal "manifests a lack of understanding of the operational realities facing small issuers in complying with technical requirements of securities law." We see the same kinds of startups as Mitchell Kapor[5] and Naval Ravikant[6] in their letters – cash-flow negative early startups that do not have in-house attorneys or compliance personnel, do not use Private Placement Memorandums (PPMs), do not work with investment advisors or securities broker-dealers, and that make substantial changes to their business plans and terms as they talk with and learn from potential investors.

While the proposed rules might be workable for large issuers with resources, they are difficult and expensive for small businesses and startups. For a startup that is inadvertently out of compliance, the penalty of not being able to raise a Rule 506 offering for a year effectively puts them out of business.

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[3] Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption, Vlad Ivanov and Scott Bauguess, July 2013

[4] John Fahey and Wayne Whitaker, Whitaker Chalk Swindle & Schwartz PLLC, September 30, 2013

[5] Mitchell Kapor, Kapor Capital, letter submitted September 4, 2013

[6] Naval Ravikant, AngelList, letter submitted August 12, 2013

They have no cash or revenues to begin with and would not be able to operate for a year without financing.

The range of issuers and offerings included in Regulation D is quite wide and a "one size fits all" approach may not be appropriate for this particular rule. As Catherine Mott wrote in her comment letter,[7] "Main Street investments (by regional angels) have to be differentiated from Wall Street investments."

Cost-Benefit Analysis of Proposed Rules on Startups and Small Businesses

When the proposed rules were announced, the first thought of many ACA members was that startups and small businesses would bear heavy burdens, and that the requirements and penalties could be devastating for many honest startups who could not keep up with these complex potential rules. That impression has only grown as we have discussed the proposed rules with entrepreneurs and the startup support community. We believe the Commission extended the comment period because so many comments underscored this point, and appreciate that extension.

The question is whether the Commission has yet done a thorough cost-benefit analysis of these proposed rules as they relate to small businesses. The Office of Advocacy of the Small Business Administration believes additional analysis is needed.[8] As the Office wrote, "Small business owners, entrepreneurs who have participated in small business startups and investors in small business have all been in contact with Advocacy to discuss the proposed rule. Based upon this input from small business representatives, Advocacy is concerned that the Initial Regulatory Flexibility Analysis (IRFA) contained in the proposed rule lacks essential information required under the Regulatory Flexibility Act (RFA). For this reason, Advocacy recommends that the SEC republish for public comment a supplemental IRFA before proceeding with this rulemaking."

Put another way, the proposed rule does not include economic analysis of the negative impact on small issuers who are disqualified from raising a Rule 506 offering for a year and go out of business or in the best cases are unable to expand and hire additional employees. The potential impact on job creation and economic growth for the company could be quite negative and more understanding of this potentiality is important.

It is also important to fully understand the costs of compliance for startups, in terms of financial outlays and loss of time in operating and growing their businesses. Most early-stage financings are small – less than $1 million and often less than $500,000. We have heard that the cost of filing under current Regulation D Rule 506 (now b) is $5,000 to $10,000. The new rules will lead to soaring legal fees for these firms, and also redirect their time from developing their products and acquiring customers to regulatory compliance.

How Does Advance Form D Protect Investors?

ACA believes it is important to have rules that protect investors from fraud. However, it is unclear how Advance Form Ds protect investors. We agree with the comments of Whitaker Chalk[9] that investors do

[7] Catherine V. Mott, Chair Emeritus Angel Capital Association, letter submitted October 24, 2013.
[8] Office of Advocacy, Small Business Administration, letter submitted September 12, 2013.
[9] Fahey and Whitaker (note 4)

not receive Form Ds and that it is not clear how an advance filing protects investors. The form does not (and should not) include information that a reasonable investor would ever base their decision on – it "does not describe the issuer's business prospects and trends, number of employees, operations, financial statements, market segment, management background or any of the other information that investors would typically consider in determining whether to invest."

The 15-day advance requirement further holds back important activity for startup companies. Many opportunities for fundraising are chance meetings and activities that don't come with 15 days of advanced notice.

Definition of General Solicitation is Very Broad

All of these concerns would not be so high if the current description of general solicitation were not so broad, as essentially to include the large majority of angel-like offerings, and unfortunately to include some practices that have been in use for more than a decade without problems or fraud. If the proposed rules become effective, many startups will have a whole new regime of rules, filings, and penalties for doing the very same thing as thousands of entrepreneurs before them. These particular startups are not getting new avenues for advertising their offerings and expanded access to capital – they're just getting many more rules.

Of particular concern is whether or how events such as demo days, venture forums, and business plan contests are considered to be part of 506(c) or 506(b). We have seen a wide variety of interpretations in the market about whether these events are general solicitation or not, but it appears that most of these events are general solicitation as they are meetings whose attendees have been invited by any general solicitation or general advertising.

It would really help the startup ecosystem if the Commission provided more clarity on the definition of general solicitation, particularly related to these events. ACA notes that a large number of these events are hosted or sponsored by federal, state, and local government agencies, universities, non-profits that receive government funding, and law firms for the purposes of economic development and education – and that a number of them have been presented for many years.

These events are important to many sophisticated angel investors, and ACA members have been involved as coaches, mentors, and judges in them. The companies that participate in the events are the ones angels want to invest in, and these exact activities are great sources of deal flow for angels. As such, they should not be considered general solicitation. These are events where investors, service providers, mentors, and other experts who are all knowledgeable about the innovation ecosystem – and critically important to the startups in finding experienced people to help them succeed. The participating investors are not unknowing retirees who are unwittingly being solicited.

New and Proposed Rules Add Risk to Already Risky Asset Class, Reducing Capital Formation for Small Businesses

Sophisticated angel investors recognize the inherent risks in investing in startups and early-stage businesses – research has found that angel investors lose money in more than half of their investments.[10] New Rule 506(c) adds additional risk through the requirement for issuers to verify that

[10] Returns of Angels in Groups, Robert Wiltbank and Warren Boeker, published by the Kauffman Foundation, 2007.

all investors are accredited. As Golden Seeds noted in their comment letter,[11] "We cannot understand how our members or funds can prudently make an investment in any company issuing securities under Rule 506(c) if the cure for an issuer's failure to verify that all investors are accredited is that the issuer must offer all purchasers the right to rescind their investment. This in effect exposes our members and funds to a potentially open-ended risk that a disgruntled investor could bring, or threaten to bring, action against a company, just by challenging the issuer's verification process."

This proposed rule adds even further risks for investors, with many chances that issuers could be out of compliance and the penalty would cause their portfolio company to go out of business. This is particularly true for companies that try to sell "quiet" 506(b) offerings, but a communication is disseminated beyond the intended audience without the issuer's knowledge or consent. For instance a reporter could learn of a company in a quiet fundraising process and publish a story about it without the company's permission.

We have heard from some investors and organizations that they are concerned about these additional risks and that they will stop or hold off making angel investments because of their concerns. For example Ralph Mayer,[12] chairman emeritus of Tech Coast Angels, wrote that he would retire from angel investing if the new rules took effect as currently written. Similar decisions by many angel investors would be devastating to capital formation and job creation, as in virtually all cases angel capital is the only source of financing available to a startup entrepreneur. Driving angel capital from the marketplace will lead to a significant reduction in company and job creation across America, the antithesis of the objectives of the JOBS Act.

Does the Commission have the Technology and Resources to Effectively Receive and Use Materials?

The proposed rule's temporary requirement for issuers to submit all materials related to general solicitation activities would encompass a wide range of materials and file types. As CrowdCheck pointed out in its comment letter,[13] a robust and well-designed system will need to be developed to take in nearly every type of electronic file that exists, including presentations with heavy graphic content and videos, some with very large file sizes. Significant resources will need to be dedicated to effectively build such a platform. In addition, should the Commission not have the resources to review the filed materials, the benefits of having the materials are greatly reduced and it is harder to justify why every material must be submitted.

Recommendations

As stated earlier, ACA believes it would be best if the proposed rules were not enacted.

If, however, the Commission decides to go forward with these rules, we believe the following changes would greatly improve the rule both in terms of capital formation and investor protection:

- **Remove harsh penalties for non-compliance**. Not only is the penalty severe, but the rule deprives issuers of due process. There are too many chances that an offering intended for

[11] Jo Ann Corkran, Loretta McCarthy, Peggy Wallace, and Vanessa Wilson, Golden Seeds LLC, letter submitted August 9, 2013.
[12] Ralph Mayer, Board Member of Angel Capital Association and Chair Emeritus, Tech Coast Angels, letter submitted August 21, 2013.
[13] Sara Hanks, CrowdCheck, Inc., letter submitted July 18, 2013.

506(b) becomes a generally solicited 506(c) without the choice or knowledge of the issuer. If an issuer is to be disqualified, they need an opportunity to appeal the penalty.

- **Remove the requirement for submission of Advance Form Ds** 15 days before general solicitation activities. It is not clear that any significant additional investor protection comes from this requirement.

- **Allow for parts of Form D to remain confidential to the public.** For instance, some startups prefer not to reveal the amounts raised in their offerings for competitive reasons. Compliance in filing Form Ds would increase from current practices if issuers were able to request that portions of their filings were not made public.

- **Require legends or disclosures only when terms are included in materials and/or in the legal documents at the close of the offering**.

- **Form working groups from Commission advisory boards to monitor and study 506(c) materials, rather than requiring the submission of all materials**. As suggested by CrowdCheck,[14] these "advisory bodies and working groups in the small business and investor protection area … could report back to the Commission and Staff on a regular basis, with anonymized examples."

- **Clarify the meaning of "general solicitation," and consider carving out certain types of communications that should not trigger application of Rule 506(c).** As noted by the Milken Institute,[15] "The definition of 'general solicitation' remains ambiguous, especially when applied to modern forms of communication, including social media and websites, and when applied to practices that have become commonplace, particularly in entrepreneurial circles, such as pitch contests, accelerator competitions, and demo days." The Institute further noted, "The Commission should provide clear examples of what it deems to be a general solicitation, and consider adopting for private markets the same advertising safe harbors that apply to companies pursuing a public offering. The Commission should also consider the types of solicitation that invoke the greatest concern over investor protection, and consider carve-outs where those concerns are not implicated."

The proposed rule also asked for comment on the **Accredited Investor definition**. ACA will comment on this issue separately, except to say that we do not believe any increases should be made to the financial thresholds. Increasing them to adjust for inflation would lead to considerable reductions in early-stage capital. In addition, it is not clear that the original net worth and income numbers set in 1982 were based on any serious analysis of wealth versus sophistication or that the thresholds were the "right" numbers to begin with. Given that new investment and wealth creation in the exempt markets now exceeds new capital formation in the public markets,[16] it would be a tremendous disservice to further exclude the limited slice of the American public now permitted to invest in such offerings. Further, the

[14] Hanks (note 13)

[15] Daniel Gorfine, Milken Institute, letter submitted September 23, 2013.

[16] Ivanov, Bauguess (note 3), indicates that in 2012, $900 billion was raised under Reg D in 31,471 offerings , versus approximately $240 billion newly raised in 954 public equity offerings (Figure 4).

current thresholds often represent the top tier of income and net worth across the United States, especially in the Main Street communities where the majority of ACA's 10,000 plus member angels invest. We encourage the Commission to address this important issue via separate rulemaking.

We appreciate the Commission's review of all comments related to this proposed rule, and are available for further discussion on our concerns and recommendations. We hope that the final rules will allow for general solicitation to work as intended by the JOBS Act.

Regards,

Marianne Hudson
Executive Director