



ANGEL CAPITAL ASSOCIATION

July 14, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-21-11
Disqualification of "Bad Actors" from Rule 506 Offerings

Dear Ms. Murphy:

We write to offer comment on the Commission's proposed "bad actor" rules, to be part of Rule 506 of Regulation D. We strongly support "bad actor" disqualifications in order to protect the integrity of private offerings under Rule 506, but urge the Commission to implement this reform so that issuers may comply in the same way they currently observe the "accredited investor" standard. This will make compliance practical for the new firms that receive angel investment.

The Commission is required to implement a "bad actor" disqualification because of Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Angel Capital Association actively supported Section 926. In fact, together with Section 412 of Dodd-Frank, which amended the "accredited investor" definition, Section 926 was a key accomplishment of the Angel Investor Amendment, which was designed to make sure that startups and young companies were not caught in the crossfire over Wall Street reform. The bi-partisan amendment was supported by ACA and a number of pro-growth organizations.

We believed at the time of Dodd-Frank, and continue to believe, that offerings under Rule 506 are almost always preferable to offerings that go "underground" and rely instead on Section 4(2) or other exemptions which are less transparent, require no filings, and offer far less guidance to entrepreneurs and angel investors. We think angel investing is healthier and more likely to thrive with a workable Rule 506 in place.

We are concerned that the Commission's rules, if implemented as now proposed, will backfire and will harm the viability of Rule 506 for startups and angel investors.

Consider the issuer's standard today for determining whether or not a prospective investor is accredited. Here is how current Rule 501(a) reads:

"Accredited investor shall mean any person who comes within any of [certain specified] categories, or who the issuer reasonably believes comes within any of the [the specified] categories, at the time of the sale of the securities to that person."

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Contrast that with the standard the Commission proposes for identifying bad actors. An offering won't be disqualified for involving a bad actor, the proposed rule states:

"If the issuer establishes that it did not know, and in the exercise of reasonable care could not have known, that a disqualification existed."

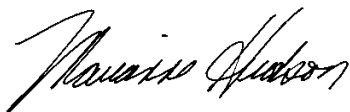
Such a rule would arguably require issuers to independently investigate the backgrounds of its officers, directors and investors. This is not practical, particularly not for entrepreneurs who should be using precious seed capital to get businesses off the ground. For companies that raise financings in increments over a period of high growth, the Commission's proposed rule could arguably require continuous (and expensive) monitoring of all stakeholders. The last thing the Commission should want should be to require startups to now hire private investigators to establish compliance with bad actor rules.

With respect to an issuer's obligations under Rule 506, we think the Commission's rules should state that the issuer's burden will be the same it undertakes today under Rule 501(a): does the issuer reasonably believe that no persons involved in the offering are "bad actors?"

In honoring the accredited investor standard, issuers typically seek representations and warranties from potential investors, and many require investors to complete questionnaires to verify their accredited status. We suggest the Commission offer guidance to issuers, to the effect that they will be presumed to have demonstrated reasonable belief if they require questionnaires from appropriate persons and otherwise have no actual knowledge of problems. Though we don't propose any particular form of questionnaire be mandated by rule, for the sake of illustration we enclose with this letter a proposed form of "bad actor" questionnaire that we think should satisfy a "reasonable belief" standard. Moreover, to discharge its duty with respect to prospective investors who may potentially own 10% or more of any class of the issuer's equity securities, we think an issuer should be able to take the substance of a "bad actor" questionnaire and include it within the existing questionnaire the issuer uses for establishing accredited investor status.

The purpose of the Angel Investing Amendment was to ensure that Regulation D would continue to facilitate the flow of angel capital into the startup and emerging companies that drive almost all of America's job growth. We urge the Commission to remember the progeny of Dodd-Frank's reforms to Regulation D, to reject rules that skirt Congressional intent, and to make sure that Rule 506 remains safe, workable, and reliable for startups and angel investors.

Sincerely,



Marianne Hudson
Executive Director

Enclosure: Example form of "bad actor" questionnaire