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November 10, 2010

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

Re: Accredited Investor Standard, Title IV Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, File No. DF Title IV – Accredited Investor

Dear Ms. Murphy:

Thank you for the opportunity to provide comments concerning the “accredited investor” definition under Regulation D. We understand that the Commission is exercising its discretion to review the definition, as permitted by the Dodd-Frank Act, and may determine later to proceed to rule-making to amend the definition. We applaud your efforts to encourage public participation in the Commission’s deliberations on this subject, and especially your decision to make the review process accessible and transparent on the Web.

We provide a description of who we are and the circumstances that inform our perspective in the latter part of this letter. First, however, we present our comments.

1. We ask that the Commission clarify that it has no intention at this time to adjust the annual income thresholds set forth in the accredited investor definition.

As you likely know, early drafts[1] of the Senate bill that became the Dodd-Frank Act proposed to increase the annual income standard under the accredited investor definition. The increases proposed were to track inflation since the standard was first set almost 30 years ago. Ultimately, however, the Senate acted to strip this proposal from the bill, just before the bill passed the Senate and went on to the House-Senate conference committee.[2]

The Senate acted deliberately, transparently and decisively in rejecting an inflation-based increase in the annual income standard. Senator Dodd himself co-sponsored the amendment

[1]See for example S. 3217, “Restoring American Financial Stability Act of 2010.”
[2]Note: there was no provision in the original, corresponding House financial reform bill calling for changes to the accredited investor definition.

that was passed by voice vote on the Senate floor. A press release heralding the Senate's action remains available, as of this writing, on the website of the Senate Banking Committee.[3]

As the record reflects, the reason the Senate acted was to save "angel investing."

Angel investing is the means by which technology and other startup ventures in America raise initial seed capital *directly* from accredited investors (a/k/a "angels") in private transactions, using no broker-dealers, no placement agents, no finders, and no middlemen. "Seed" capital is that early financing that actually precedes investment by venture capital firms, without which venture capitalists would not have companies in which to later make larger investments.

By striking draconian increases proposed for the annual income standard, the Senate did more than simply preserve the eligibility of upwards of 50% of active angel investors to back startups.[4] Because all net job growth in America is the result of startup activity, and because angel investing is not plagued with fraud or abuse, the Senate's passage of the "Angel Investing Amendment" was actually a bold and prudent act to protect and strengthen America's innovation economy.

Although the record is clear that the Senate rejected an increase in the annual income standard, and in particular any increase to either the net worth or annual income standard based on inflation, we raise this point based on our concern with the letter recently submitted to the Commission by the North American Securities Administrators Association (NASAA), dated November 4, 2010. NASAA's letter makes reference to "adjustment of the current thresholds set forth in the accredited investor definition for inflation." NASAA knows better: an inflation adjustment was expressly rejected by the Senate, and NASAA itself supported the compromise that resulted in the final provisions of Dodd-Frank on the subject.[5]

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[3] See http://banking.senate.gov/public/index.cfm?FuseAction=Newsroom.PressReleases&ContentRecord_id=a8a93650-936c-1e68-27b0-a38401ac9619

[4] Precise data is not available but the most widely respected estimates of the impact of changes to the accredited investor definition on the pool of eligible angel investors comse from Scott Shane. See, for example, http://www.businessweek.com/smallbiz/content/mar2010/sb20100318_367600.htm.

[5] See the Senate Banking Committee press release cited in footnote 3, final paragraph ("The bipartisan Bond-Brown-Cantwell-Warner amendment is strongly supported by the U.S. Chamber of Commerce, the Angel Capital Association, the Financial Services Roundtable, the North American Securities Administrators Association, Private Equity Council and several other pro-growth organizations.")

2. The Commission has been charged by Dodd-Frank to take the public interest and the state of the US economy into account when considering changes to the accredited investor definition.

The standard for the Commission's review of the accredited investor definition is set by Dodd-Frank. Under the Act, the Commission should "determine whether the requirements of the definition . . . should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy."[6]

Some may regard these three Congressionally mandated aims to be in tension. But at least with respect to the direct investments angels make in technology startups, all three aims are perfectly aligned. The fact of the matter is, direct angel investing in innovative startup companies is almost completely free from fraud or abuse. We think the Commission's review should consider what may explain this phenomenon. It is all the more amazing when you consider that, in real terms, the annual income and net worth standards of the accredited investor definition have actually been declining for the last three decades. More and more angels participate, more and more startups are launched, more and more US jobs are created. There is something right with this picture, and we should be acting to support it, or at least do no harm when entertaining changes to Reg D.

We do not doubt that NASAA sees fraud and abuse in Reg D "private placement" offerings and we respect that state securities administrators toil on the front lines every day to try to bring scammers to justice. But we request that the Commission sift through the patterns and find means of redress and reform specifically tailored to the protection of investors who need the protecting. In the rare case where a bona fide angel investment is tainted by issuer fraud, the startup ecosystem and investor remedies under federal and state law are more than adequate to punish the bad actors. We submit that all systematic abuse of Reg D can be tied to rogue broker-dealers, finders and other promoters who use Reg D to shield themselves from scrutiny and from regulation. It would be far better to simply exclude such middlemen from participating in exempt offerings under Reg D, than to permit a concern for their bad behavior to gut a regulatory framework that is working to enable the American Dream.

3. The Commission should consider adding an "opt in" alternative standard for satisfying the accredited investor definition.

We submit that the Commission's review of the accredited investor definition should focus, not on further restricting who may be eligible, but how the successful, ongoing expansion of the pool of angel investors might be accelerated without compromising the essential integrity of Reg D

[6] Section 413 of the Dodd-Frank Act, Public Law No. 111-203.

for direct "seed' investments in startup companies. With respect, we think that the Dodd-Frank review standards of the public interest and the state of the economy *require* such consideration.

We think that both the public interest and the state of the economy might be well served by the addition of an alternative, "opt-in" basis for determining accredited investor status. Many in the startup community think wealth is a poor proxy for investor sophistication. Many citizens in general feel that, as a matter of principal, it is not fair to exclude all but the wealthy from participating in America's innovation economy. At the same time, we continue to expect the Commission to discharge its central mission of protecting investors. Might the Commission consider what elements would be appropriate for an "opt-in" alternative means of satisfying the accredited investor definition? We believe that if educated investors are willing to acknowledge that they accept the risk, in full, that they may lose their entire investment in a startup, they ought to permitted to invest in a startup. Perhaps successful completion of a course of study and/or certification could be part of the process. It should be possible to serve liberty, support the American Dream, and protect investors, all at the same time.

A word about who we are.

We are two lawyers from different firms based in Seattle, Washington, who represent dozens of startup companies, serial entrepreneurs and angel investors. We have each been practicing long enough to be amazed at how well the Reg D exemption works for the startup technology ecosystem. As it becomes easier and easier for innovators to start new businesses with less and less capital, particularly in the Internet, software and information technology arenas, it becomes ever more critical to keep legal costs and regulation proportionate with the investments at stake and the sophistication of those involved. The system is working. It is a national treasure, if all too secret.

We care passionately about this issue and blog about it, respectively, at http://wac6.com and http://www.startuplawblog.com/.

Very truly yours,

/s/ William Carleton *Joe Wallin*

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