August 18th, 2013

Ladies and Gentlemen of the SEC,

My comments are made in the context of having had considerable experience in startups. I have founded and worked in seed financed startup companies, have mentored voluntarily hundreds of startups, and finally have invested in multiple seed stage ventures as an angel investor. This expertise therefore makes my views and perspective only applicable to financings usually less than $5M; my comments may not be so well informed for anything in private equity or Venture Capital financings where the deals are considerably larger in dollar terms.

I'm a successful entrepreneur who became an Angel for all the reasons listed in the subsequent paragraph. I belong to several angel groups all of whom are members of the Angel Capital Association. I relish my privacy and try to prevent Google and others indexing my activities, thus I have not used my real name in this note. (I can always be reached by the email provided.)

General Commentary

Angels don't have to invest. Unlike Venture Capitalists it is not our job or livelihood. We elect to support the entrepreneurial eco system for three primary reasons 1) have fun with people of like mind and learn new technologies, business models, and industries, 2) do some good, usually in our regional communities, and 3) make money. Many of us have multiple alternatives for spending our time.

Currently, the largest pain in doing deals with entrepreneurs is usually the deal terms themselves, the due diligence on the entrepreneurs and their companies (and sometimes on fellow investors unknown to us), and motivating fellow angels to step up.

What I see emerging in the new SEC rules is a huge pain threatening to make the Angel processes and due diligence much more difficult. The result will be exactly the opposite of the intent of the JOBS Act – I and other Angels will simply decide not to invest (remember it is not our job) and thus the $20 to $30 Billion invested by Angels each year will be at risk so harming the entire entrepreneurial eco system in the country. I strongly support the premise of allowing general solicitation; the rules and implementations proposed are just much too burdensome for the startup.

Let me elaborate on how I perceive the issues with the current proposed rules.

On the one hand, outwardly 506(b) essentially still allows us to operate as we do now. However, it would appear that since you have now provided a general solicitation category – 506(c) – you may be much stricter on enforcing rules of general solicitation where in the past you have turned a blind eye. Overt mass (e)mailings, tweets, promotional web sites and the like have always been obviously out of bounds but there has always been the gray area of pitch events, demo days, accelerator events, venture forums and even applying to angel groups for financing on web sites like GUST.com. Many startups raising money participate in such events in person and virtually. An easy solution then is to better define general solicitation to **not** include the gray area events I just listed, maybe also including some guidelines of how the event operators should operate without being hugely restrictive. It works pretty well now – that presumably is why you have turned a blind eye.

By the way, how many “bad actor” events in the true startup area have the SEC investigated in, say, the last 15 years? Very few I suspect.

On the other hand there is 506(c) which allows general solicitation. On the face of it, it would seem that all entrepreneurs should use this form and investors should insist on it to avoid any issues of inadvertent general solicitation with its consequences. However, the burden, and penalties placed on entrepreneurs for failure to comply with the rules, is enormous. Legal fees will mount, the potential for mistakes of full disclosure of solicitation collateral and the like will be huge, as will the burden on Angels’ due diligence. A startup’s business plan, executive summary, pitch, business model, etc., are all living documents that evolve very quickly in the early days – do you seriously want to burden the startup with filing every version? Has anyone at the SEC gone into a two person startup environment to see what really goes on each 20 hours/day? And now you want to add to their burden with multiple filings – the attorneys will love it, before they run out of startup clients.

On the Angel side, the extra due diligence work required by 506(c) and/or legal costs will cause Angels to become disengaged. Verification that Angels are indeed accredited is an issue of privacy for Angels, and I know the Angel Capital Association (ACA) are actively working on how that can be accomplished, but they have a strong angel group emphasis (their members). Nevertheless, if it is burdensome, costly, and invasive then again there will be disengagement.

Further, the ACA only represents the minority of Angels who are in organized groups. According to the report from the University of New Hampshire (http://paulcollege.unh.edu/sites/default/files/2012_analysis_report.pdf) there were >268,000 active angel investors in 2012. Of these only about 20,000 (300+ groups and say 60 members per group) are in angel groups which the ACA represents. The majority are therefore impacted by the verification of income and/or net worth. Not every Angel is a multi-millionaire so those with modest or marginal millions (probably the majority) may not have all their assets with a single broker, may not have a CPA, etc., thus making verification a real burden by compiling verification information from multiple sources.

Please recognize that if there is a hiccup in angel activity either because of the uncertainty of the ultimate rules or their burdens, individuals will disengage, and angel groups may disband pretty quickly; it will take several years to restart them and grow again. Don’t underestimate the effort required to run and maintain an angel group – it is really hard work often by volunteer angels with no paid help. There is a continual search for new members (money) while existing members wait an average of about seven years to see any return, often more than that. Mess with that eco system and it will take years to heal.

The startups and angels of which I speak are almost exclusively dealing with companies that raise funds in the seven figure, or less, dollar range. They have no or few customers, few employees, and limited resources. Any higher raise is usually for private equity or venture capitalists. So maybe the SEC should consider breaking out the startups from the other, higher capital, financings you are trying to cover. The VCs and private equity investors involved in those higher raises are usually established businesses and have the financial means and staff to deal with more bureaucratic requirements (it’s their job), as do the companies raising money since they are often ongoing businesses with customers.

One other consideration is the impact that experienced angels (usually those found in angel groups) have in addition to investing. They usually have great business and/or startup experience and can therefore become valuable mentors and advisors to startups. Without them, fewer startups will succeed no matter how much money they raise from inexperienced accredited investors. ***I am sure that the majority of experienced angels would prefer to work with and invest in 506(b) companies providing the gray areas I have discussed above are better defined and allowed.*** That's not to say there is not a place for 506(c) companies; they will just be less preferable to experienced angels given the filing requirements, verifications, and penalties and the fact many experienced investors may resist having inexperienced co-investors co-invest since they could exert influence on company decisions and financings downstream in a non-prudent way.

Some other thoughts: the more rules and procedures you put in place the more people the SEC will need to monitor activities and you will never have enough people for the startup segment and their numbers. Why create rules you cannot adequately enforce?

When you look at all the comments to the rules try to determine the sector each comment represents. Angels and entrepreneurs will have different views to private equity, venture capitalists and more mature companies. Service providers like lawyers and CPAs might see opportunity of increased fees to assist companies meet compliance.

The USA has one of the best and efficient startup entrepreneurial systems in the world. Why make it more cumbersome and think about who you are trying to protect in a system that has evolved and is still evolving extremely well.

Suggestions

First have a subset of rules specifically for startup fund raising which is typically less than $10M in size. Within this subset, I make the following suggestions:

1. *For 506(b)*: The SEC should define general solicitation more definitively. You should make those "gray" area events listed above permissible, while still restricting overt advertising such as mass (e)mailing, and website content promoting a deal. You could allow pitching at those events but limit the number and frequency of invitations the event holder can make to a single event and/or the number of people that can attend a physical event to 500 or view a virtual event to 100 people, thereby eliminating the "Shark Tank", and en masse webcasts and the like.
2. *For 506(c)*: Remove the requirement that companies file **all** promotional materials but leave the requirement to add short legends etc., on materials. Perhaps companies could file their solicitation materials every 90 days (and when their financing round is closed) and limit the materials required to an executive summary, a pitch deck, and any written materials circulated to more than 250 people within the previous 90 days.
3. *For 506(c)*: Remove the 15 day waiting period after filing, and the harsh penalties
4. *For 506(c)*: Allow investors to self-qualify as accredited as they do now and remove all requirements for the company (issuer) to "validate" the investor. The SEC should reserve a right to inspect those self-qualifications. You could mandate that a self-qualification form has a warning about false statements and the legal implications of any false statements.
5. Clarify what happens if a company starts under 506(b) and then for whatever reason (inadvertent or otherwise) has to transcend to 506(c).