PRIVATE CLIENT

LEGAL SERVICES

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November 4, 2013

U.S. Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549-1090
Attn: Ms. Elizabeth M. Murphy, Secretary

Re: Proposed Rule Amendments to Regulation D, Form D and Rule 156 Under the Securities Act; File No. S7-06-13

Dear Ms. Murphy:

Thank you for the opportunity to provide comments to the Securities and Exchange Commission on its proposed amendments to Regulation D under the Securities Act of 1933, and Form D. Additionally, because so many of the issues raised in this latest set of proposed regulations relate to matters in the earlier set of regulations (particularly those involving verification of accredited status), I ask the Secretary's permission to comment on those as well.

As means of background, I own and operate Private Client Legal Services (PCLS), a boutique law firm in San Francisco. PCLS assists accredited investors, successful entrepreneurs, technology executives and engineers with their financial transactions, including their investments in early stage privately held technology startups that are raising capital under Rule 506. I also serve as outside general counsel to angel funds, assisting with their funding transactions. Prior to founding PCLS, I served as in-house general counsel to technology startups, including Pure Digital Technologies (Flip Video), Trulia, AdBrite and reddit, and I also spent six years as Senior Counsel at PayPal. I co-founded 2 companies, raised several rounds of start-up capital and handled successful exits through mergers and an IPO. I also spent several years as a technology journalist. In sum, over the past 2 decades, I have been a part of the community of job creators and startup innovators that Congress intended to empower with the JOBS (Jumpstart Our Business Startups) Act, and I speak from first-hand experience with these matters.

The good news, from my perspective, is that the JOBS Act already has made a positive impact. The lifting of the general solicitation ban, the raising of the 500 holder rule to 2000, and the imminent prospect of crowd funding already have increased the flow of investment capital to companies that otherwise would have had trouble getting off the ground. This capital has created new businesses and jobs. Things seem to be going according to plan.

The bad news, however, is that the Commission appears to see a darker picture, rife with risk rather than with reward. Through its proposed (and some already finalized) regulations, the SEC risks turning back the progress the JOBS Act has made. I write this letter today to urge the Commission to rethink the proposed regulations, because they are, as I explain more fully below, both counterproductive and harmful to the very stakeholders that the SEC seeks to protect.

As many of my colleagues in the high tech community already have stated eloquently, the proposed requirements for Form D under 506(c) are logistically difficult at best, and logically impossible at worst.[1]

Previous comments have explained, for example, that startups are constantly raising money, which means that it is difficult for them to file a Form 2 weeks before an unexpected investment springs from, say, a casual conversation at an industry conference or social event. We talk shop a lot here in the Bay Area. And shoptalk sometimes does lead to shop investments.

Additionally, startups update their websites and Facebook pages on a daily, sometimes even on a real-time basis; they send emails and tweets, and revise (quite frankly) their business plans on-the-go, rendering it close to impossible to keep the SEC as up-to-date as the company's Facebook Fans and Twitter followers are. More importantly, the fact that these materials are publicly accessible for 506(c) companies makes the SEC's updating requirements bizarrely irrelevant. After all, the Commission, like prospective investors, need only check the company's Twitter page or blog for updates and archives. The Commission will not convince the technology industry that posting on a government-maintained website is the best way to create a reliable, trustworthy permanent record.

Perhaps most dangerous, as other comments have argued, is the Commission's unprecedented proposal to punish startups that accidentally fail to comply with these filing requirements -- and believe me, if the regulations are finalized as proposed, every startup raising money under 506(c) is certain to fail to comply -- by banning them from raising capital under the only way they know how: Rule 506. If they cannot raise money under Rule 506, the startups will die. When the startups die, they will not create jobs. This is not what Congress intended.

Secretary, please understand that startups raising money under 506(c) cannot afford a compliance attorney. After all, the companies are *not yet funded* and lawyers charge for their services. Founders

[1] See, e.g. http://www.sec.gov/comments/s7-06-13/s70613-453.pdf, http://www.sec.gov/comments/s7-06-13/s70613-151.pdf (both showing the angel investor POV); http://www.sec.gov/comments/s7-06-13/s70613-37.pdf (AngelList (general solicitation platform) perspective); http://www.sec.gov/comments/s7-06-13/s70613-400.pdf (founder and issuer perspective).

and early employees of pre-funded startups often forego salaries and benefits. Put plainly: they are broke, but hopeful. General solicitation -- aka, public fundraising -- was intended to empower these broke, hopeful, optimistic creative people by providing a low-cost way to getting the word out that they need help. For founders without direct ties to institutional capital or wealthy relatives, general solicitation gives them a more equal playing field.

By imposing verification and filing requirements only on these public fundraisers, the Commission destroys that equal playing field, and instead levies the largest costs and penalties on the people who can afford them the least.

Even more ironically, by imposing an artificial requirement to send updates to the SEC only in cases where startups are already publicly distributing their fundraising materials, the SEC transforms a business incentive for transparency (in order to reach the largest possible market) into a compliance risk towards secrecy (in order to avoid accidentally violating the filing requirements and thereby be sentenced to death by starvation of funding). Given that, for Americans, television remains the only source of news that still surpasses the Internet, including Facebook and Twitter, it is baffling that the SEC still holds onto the stillborn fantasy that filing updates with Edgar is the best way to inform the public about issuer updates and shareholder information. Pushing information away from Twitter and towards closed boardrooms, deprives investors of access to deals, and issues from access to capital, harming startups and investors alike.

Meanwhile, the already-finalized requirement to “verify” the accredited status 506(c) investors similarly eviscerates Congress’s intentions by raising costs to the issuers who present the fewest risks to investors because their funding materials are online and can be double-checked or disputed. As the SEC knows, greater transparency reduces fraud[2]. Being able to access materials online paves the way to double-checking them. Investors need more information, not less; they need more data points, not fewer. The fact that fraudulent issuers may also solicit capital online does not change the fact that public channels provide a better way to weed them out.

For the vast majority of issuers -- who are not fraudulent -- public solicitation empowers them to verify and authenticate their identities and accomplishments, to connect investors with professional references, and to provide evidence of projects in process.[3] For the good guys, it’s a great way to connect with fans and supporters. For the bad guys, it’s a great way to get caught. I submit to the Commission that you would rather have the criminals posting their false claims online than by continuing to do what they already do: make direct phone calls, emails, and door to door solicitation. Instead of interfering with honest entrepreneurs from soliciting publicly, the SEC should invest in public education to inform the less savvy that the man who says that he has a million dollars for them waiting in an account in Africa does not.

[2] http://www.sec.gov/about/whatwedo.shtml

[3] Many companies and websites currently use LinkedIn, Facebook and Twitter profiles to authenticate the identity of a user trying to post a comment or join an online community.

Instead of education, the Commission chose obstruction. Through the already finalized regulations (which I implore the SEC to reconsider), only accredited investors who are willing to reveal their tax returns, bank statements and credit reports -- a standard much higher than any that came before -- are allowed to buy shares in companies that solicited publicly, rather or not these investors learned about the investment opportunities by means of a public channel.

Without any basis, the SEC has concluded that (1) companies that raise money via public channels inherently pose greater risks to investors; and (2) the best way to reduce these risks is to ensure that only the really, truly accredited investors may own shares in these companies.

As discussed above, there is no reason to conclude that public fundraising presents bigger risks; in fact there are reasons to conclude the opposite.

And, as to the accreditation verification requirement, as so many others have pointed out in so many ways for so many years, <u>greater wealth and larger income do not, by themselves, make an otherwise unsophisticated investor better at investing.</u> Truth be told, most sophisticated accredited investors recognize that some of the greatest knowledge comes from unaccredited individuals, including Ph.Ds. in economics and engineering, whom many funds hire as consultants and advisors whose research informs their investment decisions. One wonders if the SEC's own in-house research staff, on whose conclusions the Commission relies, qualify as sophisticated investors under the Commission's current definition of market worthiness.

The American people deserve better than this farcical regime that prevents highly educated experts from investing in the companies that need them most simply because these experts have incomes under $200,000/year. This outdated approach harms not just issuers raising money, but investors as well.

Issuers want "smart money" -- investment capital that comes from a source that can advise them on their business strategies and product roadmaps. Allowing a technology startup to take funding from Hollywood celebrities like Ashton Kutcher, but prohibiting it from taking a check written by a Ph.D. candidate across the country that is writing a dissertation in a related field, helps neither the startup nor the educated investor who can help the startup succeed.

At the same time, preventing the vast majority of Americans (like these Ph.D. candidates) from participating in appropriately vetted investments that fall within their knowledge base only deepens the divide between the wealthy and poor by depriving regular people of the most profitable (albeit risky) investment opportunities.

Additionally, by focusing on the accredited status of the investors, the Commission ignores its real job: to prevent fraud, rather than ensure that fraud impacts only those who can afford to lose their investments. I submit to the Commission an idea that should not be controversial: rich people deserve to be protected from crime just as much as their less-wealthy counterparts do. And, as the Commission should know, the deepest pockets make the best targets. Rich or poor, investors deserve a market free of fraud the same way they deserve a city free of street crime. Locking most people out of the market -- or city -- does not stop the crooks from finding a way inside.

Put plainly: issuers suffer no harm if their investors turn out to be unaccredited. Both unaccredited investors and issues suffer actual harm by being kept apart financially and artificially by SEC regulation alone.

And, while the SEC's regulations make it harder for 506(c) startups to connect with smart money, they at the same time impose a new tax on doing business: the cost of complying with the regulations' verification requirements. These verification requirements, for those who seek to follow them precisely, although in effect for less than a month, have already sprouted a cottage industry of "accredited investor verification services"[4] that charge as much as $500 per investor to verify accreditation. Given that there are approximately 300,000 angel investors who are potentially impacted by this rule,[5] one verification per investor adds up to $150 million in unnecessary expenses. Then, given that this "safe harbor" verification system lasts only 3 months, requirement 4 verifications annually in order to maintain the right to operate as an angel investor, this regulation alone may cost investors and issuers **$600 million dollars** a year, just in towards credit report and tax return checking. **<u>Congress could not have intended that result</u>** -- a result created entirely by the SEC's counterproductive rules.

I ask the Commission to consider these costs and reconsider its former decision.

Together, these burdensome regulatory requirements levied solely on companies fundraising under 506(c) risk fostering an atmosphere of fear and confusion among startups that want to keep raising money under 506(b) rather than 506(c). These startups rely (and have always relied) on events such as demo days, startup boot camps, pitch competitions, accelerator meetups, venture forums and websites directed to accredited investors like GUST.com to secure their funding under 506(b).[6] Those regular channels, however, may possess qualities (like website announcements) that could conceivably be considered "general solicitation" under the regulations. Given the huge difference in consequence for noncompliance for 506(c) and 506(b) (where an investor's signature constitutes sufficient verification of accredited status, and where Form D compliance doesn't require an ability to foresee the future, upon penalty of death for missing a deadline or making a typo), the Commission has created incentives that run directly counter to those intended by Congress: the regulations as proposed, seem certain to drive investments further underground, where they cannot be monitored. Additionally, the proposed regulations would discourage investors from investing in even the most viable companies under 506(c)

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[4] Second Market (www.secondmarket.com) has already launched such a service, as have numerous other companies. See, e.g., a google search for "accredited investor verification services" - https://www.google.com/search?q=third+party+accredited+investor+verification&oq=third+party+accredited+inv&aqs=chrome.1.69i57j0.9373j0j4&sourceid=chrome&espv=210&es_sm=119&ie=UTF-8#es_sm=119&espv=210&q=accredited+investor+verification+services

[5] http://paulcollege.unh.edu/sites/default/files/2012_analysis_report.pdf

[6] See, e.g., http://www.sec.gov/comments/s7-06-13/s70613-151.pdf, an excellent commentary on this process.

out of fear that their new portfolio company will be cut off from essential funding due to accidental non-compliance, and thereby unable even to make payroll. There simply is no bright side to these proposed regulations, and I urge the Commission to discard them.

As a reminder, Congress passed the JOBS Act in order to create jobs by means of increasing startups' access to public capital markets. Congress correctly recognized the importance of access to capital markets. It can mean life or death to early startups. Similarly, access to these companies that are seeking financing makes all the difference to investors who know what they are looking for, and want to get in on the ground floor.

These benefits go even farther. With more access to capital, issuers can demand better terms. With more access to deals, non-institutional investors can compete directly with institutional investors, who used to enjoy exclusive access to much of the deal flow. Perhaps best of all (thanks to the JOBS Act lifting of the 500 holder rule), startups can accept investments from multiple non-institutional sources without worrying that soon they will have to file registration statements with the SEC because they have too many shareholders. Now that the 500 Holder Rule is the 2000 Holder Rule, a startup raising $5 million can forego one large check from an institutional investor (that usually comes with strings attached) in favor of 100 string-free $50,000 checks from individual experts and advisors, all of whom can, and will, provide help.

This empowerment of non-institutional investors has transformed the process of fundraising for startups in immeasurable, positive ways.

For historical context, prior to the JOBS Act (and the emergence of the angel investment community), startups had very few choices in raising capital. Given the ban on public solicitation, they had to keep their efforts quiet, because, they were advised, any public mention of their fundraising could jeopardize the outcome. Most often, founders (in Silicon Valley, at least) that lacked wealthy friends and family were directed towards Venture Capital firms. To the extent that the venture capitals agreed to hear their pitch (an honor bestowed only upon the few), and then to the extent that the venture capitalists decided to invest (an even rarer occurrence), startups were thrilled to take in funding on any terms whatsoever -- even if those terms included liquidity preferences multiple times the size of their investments, preferred shares that not only converted but also participated in the proceeds (doubling the size of their payoff), board seats to keep a close eye on matters and influence executive decision-making, information rights that surpassed other stakeholders and often placed an administrative burden on the executives, voting rights to veto any corporate event that they perceived as harmful to their interests, and other rights that had a direct, material, tangible, powerful influence on the future prospect of the startup's survival, including, usually, the right to drop all support of a startup if it was not close enough to liquidity upon nearing the fund's 7-10 year maturity date. Although some "rock star"[7] startups could demand more friendly financing terms, most startups felt fortunate to be funded, even with these costs.

[7] See, e.g., Facebook Founder & CEO Mark Zuckerberg.

From the VC perspective, however, these costs were unavoidable. Their business model involves risk, and these types of funding terms were necessary for them to fulfill their obligations under their partnership agreements, and ensure that their own investors (their limited partners, which often included college endowments and pension funds), experienced a sufficient rate of return.[8]

Those constraints, while unavoidable in the world of institutional VC, are wholly absent in the world of non-institutional, friends-and-family, angel investment. Angel investors do not have any obligation to invest. It is not their job, and they have no timeline to follow. Rather, they invest for reasons including the fact that they connect with a team and/or idea on a personal level. They choose to be involved with that team and/or that idea because they care about that team and/or idea, and they can and will provide help. Or, angel investors invest because they feel grateful for the success they have achieved in their careers so far, and they seek to contribute to the next generation of innovation and successful entrepreneurs. Their motives are diverse, but one thing is consistent: their incentives are more closely aligned with those of the entrepreneurs, if for no other reason that they have no limited partners demanding larger returns, no financial model that limits their profitability by means of a carry and management fee, and no timer that runs out in 7-10 years. Their success depends on the success of the company, no matter the size of that success, plain and simple.

For those reasons, and because angel investors often invest in a number of companies at the same time, while also sometimes working a day job and/or spending time with their families, non-institutional investors rarely demand board seats -- which they sometimes perceive as a logistical burden -- and they rarely require information rights, because they know that they CEO views them as a friend and advisor and will take their phone calls. They rarely demand liquidity preferences that go beyond repayment of their investment, and they trust the founders to make decisions, rather than demand voting rights that allow their judgment to trump that of the team they entrusted with their money. Although these do receive the same terms as VCs when they participate in the same rounds of financing, they usually stay away from the bargaining table. In all of these ways, the interests of the angel investors remain perfectly aligned with those of the issuers.

By granting non-institutional investors access to these deals (via general solicitation), and by granting issuers access to non-institutional investors (by raising the 500 holder rule), the JOBS Act has increased the flow and decreased the price of capital for startups -- which is what Congress intended. When institutional capital has to compete with non-institutional angel investment money in this way, startups are able to demand better terms, whether they go with angels or with VCs. Better terms for their capital means that startups have more liquidity available to do what Congress intended: grow and create jobs. From the entrepreneur's point of view, non-institutional investment sources like angel funding are invaluable means of optimizing growth, profitability, innovation, and jobs. It's a win-win.

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[8] Some people may argue that the fees that venture capitalists charge their limited partners, including carry interest as high as 30%, and management fees as high as 3-4%, actually create the need for these funding terms, but that is a debate for a different day.

BUT, if the Commission insists on imposing unnecessary regulatory roadblocks on entrepreneurial and non-institutional investors -- including verification requirements, filing requirements and harsh penalties for noncompliance -- the Commission risks undoing the beneficial impact that the JOBS Act has already had on startups seeking capital and creating jobs.

In conclusion, I request that the Commission consider the following:

1. Remove the requirement that 506(c) issuers verify the accredited status of investors -- and do not add any similar requirements to 506(b). Best of all: don't require that all 506(c) investors be accredited.

2. Alternatively, lower the threshold for accredited investor status. Wealth is not always linked to market sophistication. Consider removing the requirement altogether. Investing is always risky.

3. Focus less on catching unaccredited investors, and focus more on catching fraudulent issuers.

4. Modify the Form D requirement so that it conforms to the requirements for 506(b), and require disclaimers only where deal terms are actually stated.

5. Remove in its entirety the one-year ban on fundraising for startups that fail to comply. Killing startups will destroy jobs, not create them.

I appreciate your consideration.

Sincerely,

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