KENDALL A. ALMERICO, ATTORNEY AT LAW
CHIEF EXECUTIVE OFFICER

WWW.FUNDHUB.BIZ
KENDALL@FUNDHUB.BIZ

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Via e-mail to rule-comments@sec.gov

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

Re: File No. S7-09-13 - Release Nos. 33-9470, 34-70741
SEC Rule Proposal on Regulation Crowdfunding

Dear Ms. Murphy:

This letter comes to you today with my respectful suggestions as an attorney with more than 25 years of experience of helping to start and grow businesses and also as a nationally recognized authority on crowdfunding. I write this on behalf of the millions of Americans who would like to use the JOBS Act crowdfunding provisions to start or grow a business, and the hundreds of millions of potential investors in those new businesses who do not have the opportunity to otherwise invest in most start-up businesses because they are not accredited investors.

As stated in the SEC's proposed rules, the crowdfunding provisions of the JOBS Act were designed to help provide startups and small businesses with capital by making relatively low dollar offerings of securities less costly. The crowdfunding provisions of the JOBS Act were created to fill an important gap in the funding of businesses. Since 2008, banks rarely lend to new businesses; not even those with a great business plan or innovative concept. Angel investors will rarely lead with seed investments in new businesses, and have moved into the space formerly occupied by venture capitalists by funding businesses that are already revenue producing and who are seeking a second round of financing. The venture capitalists have moved out of the slot now occupied by angels, and rarely get involved with seed rounds, early non-revenue producing startups, or any offering under $5 million.

The JOBS Act was passed in part to fill this very important funding gap where an entrepreneur needs to raise $1 million or less to start or grow a new business. New businesses mean new jobs for the unemployed. With proper financing, new businesses can grow into large businesses. Without funding, however, these small businesses will never exist and never have the opportunity to create jobs and grow into large businesses. Opportunities to spur on the economy will disappear, and the entire purpose of the Title III crowdfunding portion of the JOBS Act will have been thwarted.

As it now stands, some of the SEC's proposed rules on equity crowdfunding under the JOBS Act will make it virtually impossible for most start-up businesses to use the crowdfunding rule to raise capital. The process is simply too expensive as it presently is proposed.[1]

Specifically, the following proposed rules need to be addressed, or there is a strong likelihood that proposed SEC rules will render the crowdfunding rules dead on arrival as a funding tool for most startup businesses. If changes are not made, issuers will be unable to utilize equity crowdfunding due to the extreme cost. How many entrepreneurial business owners are going to spend $15,000 to $25,000 to raise the $100,000 they need to start a business?

Here are my comments, designed solely to help make the equity crowdfunding provisions of the JOBS Act work as Congress intended, and to keep the process affordable so that the law does not die on the vine due to the overwhelming cost of compliance:

1. <u>Request for Comment 1</u>. *"Should we propose that the $1 million limit be net of fees charged by the intermediary to host the offering on the intermediary's platform? Why or why not? If so, are there other fees that we should allow issuers to exclude when determining the amount to be raised and whether the issuer has reached the $1 million limit?"*

Congress enacted the $1 million limit, so despite many public comments asking this to be raised, the SEC has no authority to increase that amount at present, only Congress can do so. However, given the high cost of raising funds under the CROWDFUND Act, Congress should make the amount raised net of all fees and expenses, including funding platform fees, broker-dealer fees, due diligence costs, compliance fees, legal fees and accounting fees. This will allow a business to have full use of up to $1 million in working capital if it successfully crowdfunds the amount it seeks.

2. <u>Request for Comment 8</u>. "*We are proposing to permit an issuer to rely on the efforts that an intermediary takes in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering. Is this approach appropriate? Why or why not? Should an issuer be required to obtain a written representation from the investor that the investor has not and will not exceed the limit by purchasing from the issuer? Why or why not?"*

This is, by far, the most problem fraught provision of the JOBS Act and the proposed SEC rules. There is no possible means, other than the establishment of a mandated filing requirement and governmental (or privately operated) database, to track whether an

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[1] See my article "Has The SEC Made Equity Crowdfunding Economically Unfeasible?" at <u>http://www.crowdfundinsider.com/2013/11/26291-sec-made-equity-crowdfunding-economically-unfeasible</u>

FundHub
4350 West Cypress Street Suite 275
Tampa, Florida 33607
Telephone 813.410.4658 • Fax 813.875.0133

investor has exceeded his or her investment limit as defined by the law. If an investor falsely or mistakenly represents to three different funding portals that he or she is eligible to invest a certain amount based on the limits in Section 302(a)(6)(A) and (B), and then invests three times what the law allows in three different offerings, how are the other funding portals, issuers and broker dealers to know?

Rather than creating more regulation and government involvement, my proposal is simple. Provide the issuer, funding portal and broker-dealer with a safe harbor and immunity from suit or claims as long as they obtain a written or electronic representation from the investor that the investor has not and will not exceed her or her statutory limits by purchasing from the issuer, and a disclosure from the investor as to any previous investments that would limit the amount the investor may purchase of the offered security. This self-reporting and self-authentication requirement would serve two purposes: (1) It provides the issuer, broker-dealer and funding portal with assurance from the investor (who is the person the SEC proposed rules are attempting to prevent from being defrauded or put into an unsuitable investment) that the investor is eligible to invest, and also how much he or she can invest and (2) it lowers the overall cost while giving the issuer, broker-dealer and funding portal assurance they can enact the sale without fear of later being sued for not investigating something that could be impossible to investigate. If an investor lies or misleads the issuer, broker-dealer and funding portal, then the only person who suffers is the investor, who has unclean hands and should not be allowed to sue for his or her own bad acts.

Remember, each investor has to, by law (1) review investor-education information, (2) positively affirm that they understand they are risking the loss of the entire investment, and that they could bear such a loss, (3) answer questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers, (4) answer questions demonstrating an understanding of the risk of illiquidity and (5) *answer questions demonstrating an understanding of such other matters as the Commission determines appropriate*. (emphasis added) Along with this checklist of items an investor must comply with, the Commission should impose as part of this last requirement, a rule requiring the investor to disclose any previous purchase of securities under the crowdfunding exemption for the prior 12 months, the date of such purchase, and the amount of the investment. More importantly, the Commission should provide immunity to the issuer, broker-dealer and funding portal for relying on these representations of the investor.

The only other option is to create a national database and mandatory registration requirement for each and every security sold under the crowdfunding exception. Obviously, this would defeat the purpose of the JOBS Act and would increase the already-significant cost of compliance in many ways.

3. Request for Comment 9. *"Should institutional and accredited investors be subject to the investment limits, as proposed? Why or why not? Should we adopt rules providing for another*

crowdfunding exemption with a higher investment limit for institutional and accredited investors? If so, how high should the limit be? Are there categories of persons that should not be subject to the investment limits? If yes, please identify those categories of persons. If the offering amount for an offering made in reliance on Section 4(a)(6) is not aggregated with the offering amount for a concurrent offering made pursuant to another exemption, as proposed, is it necessary to exclude institutional and accredited investors from the investment limits since they would be able to invest pursuant to another exemption in excess of the investment limits in Section 4(a)(6)?"

The concept behind of giving great investment latitude to accredited investors and institutional investors in all offerings is that these investors, in theory, have a greater sophistication about investing and a greater ability to absorb the losses suffered if an investment goes south. Thus, it makes no sense to limit accredited or institutional investors to a $100,000 limit either per equity crowdfunding offering, or in the aggregate. These same investors are not limited in any other offering under SEC rules exemptions. Why should they be limited for these offerings, which may involve far less money than they typically are asked to invest in other exempted offerings? Clearly, the final SEC rules should provide that whether an offering in reliance on Section 4(a)(6) is aggregated with a concurrent offering pursuant to another exemption or not, accredited investors and institutional investors should not be limited in the amounts they may invest in Section 4(a)(6) offerings.

4. <u>Request for Comment 20</u>. *"Does the exclusion of issuers that do not have a specific idea or business plan from eligibility to rely on Section 4(a)(6) strike the appropriate balance between the funding needs of small issuers and the information requirements of the crowd? Why or why not? Are there other approaches that would strike a better balance among those considerations? If the proposed approach is appropriate, should we define "specific business plan" or what criteria could be used to identify them? How would any such criteria comport with the disclosure obligations described in Section II.B.1.a.i.(b) (description of the business) below?"*

In this case, to effectuate the purpose of the crowdfunding exception, I believe less is more. The law states that an issuer must file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors a laundry list of disclosures that includes all of the relevant information necessary for a potential investor to make an informed decision. One of these criteria is "a description of the business of the issuer and the anticipated business plan of the issuer." I believe the law was not intended to require a "business plan" in the sense of a document prepared by the issuer setting out details of every facet of their operations. Rather, the term "anticipated business plan" was meant to imply a generalized description of what the issuer intends to do with the capital being raised, and what the business will entail. If anything, the Commission should make it clear in their rules that a formal "business plan" is not a necessity. The Commission should simply require issuers to disclose all of the items listed in the statute. If an issuer wants to disclose a formal "business plan" they may, but it should not be required for cost reasons, even though most shrewd issuers will do so to increase their chances of investors participating in the offer. The goal here should be fewer requirements and costs, not more requirements by reading into language with results not intended by Congress.

5. Request for Comment 24. *"Are these proposed disclosure requirements relating to the issuer and its officers and directors appropriate? Why or why not? Should we only require the disclosures specifically called for by statute or otherwise modify or eliminate any of the proposed requirements? Should we require any additional disclosures (e.g., disclosure about significant employees)? Is there other general information about the issuer or its officers and directors that we should require to be disclosed? If so, what information and why? For example, should we require disclosure of any court orders, judgments or civil litigation involving any directors and officers, including any persons occupying a similar status or performing a similar function? Why or why not? If so, what time period should this disclosure cover and why?"*

The law itself requires only the disclosure of the "names" of the officers, directors and 20% shareholders. All of the remaining requirements related to these disclosures in this Request for Comment were added by the Commission and involve additional effort and cost to the issuer. While most of the information the Commission has requested (three years of business experience, etc.) is not burdensome and is easily self-reported, in the Request for Comment there is mention of requiring disclosure of "any court orders, judgments or civil litigation involving any directors and officers." These people are already governed by the "Bad Actor" rules, so certain relevant disclosures along these lines will be required. But, to add a requirement of disclosing "any" litigation whatsoever, not the delineated topics in the Bad Actor rules, would significantly increase the cost of compliance. While in theory, the officer or director would self-report this information, other areas of the rules require steps to be taken by the intermediary beyond self-reporting when it comes to judgments, etc. To impose a requirement as set out in this Request for Comment would require an intermediary to not only ask the officer to self-certify, but also to perform a county by county civil records search in every county in the United States to be sure there was no "court order, judgment or civil litigation involving any directors and officers." This information is not contained in one central data bank anywhere. It would require potentially thousands of dollars paid to private investigators to search county records across the country. Such an addition to the rules would be burdensome, and should not be added. The Bad Actor rules provide enough of a background check to give potential investors a clear concept of the people running the business.

6. Request for Comment 29. *"Are these proposed disclosure requirements appropriate? Why or why not? Should we require any additional disclosures? Should we prescribe specific disclosure requirements about the business of the issuer and the anticipated business plan of the issuer or provide a non-exclusive list of the types of information an issuer should consider disclosing? Why or why not? If so, what specific disclosures about the issuer's business or business plans should we require or include in a non-exclusive list? For example, should we*

explicitly require issuers to describe any material contracts of the issuer, any material litigation or any outstanding court order or judgment affecting the issuer or its property? Why or why not?"

While the last thing I want to do is propose more work for an issuer, this is one area where the Commission has mandated a disclosure requirement, yet given absolutely no guidance as to what to disclose. Perhaps the Commission could create a "safe harbor" list of requirements to disclose that protect the issuer from later regulatory trouble related to the "business plan" requirement. In order to consolidate resources, the disclosures could be the same as those in the statute as well as a few additional disclosures such as material contracts of the issuer, material litigation or outstanding court orders or judgments affecting the issuer or its property.

7. <u>Request For Comment 56</u>. *"Should we require some or all issuers also to provide financial statements for interim periods, such as quarterly or semi-annually? Why or why not? If so, which issuers and why? Should we require these financial statements to be subject to public accountant or auditor involvement? If so, what level of involvement is appropriate? "*

The simple answer is no. The Section 4A(b)(1)(D) requirement for issuers to provide financial statements, reviews and audits in various cases is part of the law, and unfortunately not subject to elimination by Commission rule. This requirement, in and of itself, will price many start-up and young companies out of the equity crowdfunding equation. A company in its early stages cannot afford tens of thousands of dollars to pay to a CPA who is then compelled to follow GAAP and perform a complete audit. Given this expense, the Commission should not impose additional accounting expenses for quarterly or semi-annual financial statements. To do so would be to impose yet another cost on a company that needs to be spending its money on growing its business, and not additional compliance.

8. <u>Request For Comment 64</u>. *"Section 4A(b)(1)(D)(iii) requires audited financial statements for offerings of more than $500,000 "or such other amount as the Commission may establish, by rule." Should we increase the offering amount for which audited financial statements would be required? If so, to what amount (e.g., $600,000, $750,000, etc.)? Please provide a basis for any amount suggested. Should we identify additional criteria other than the offering amount, as one commenter suggested, that could be used to determine when to require an issuer to provide audited financial statements? If so, what should those criteria be?"*

The audit requirement for any offering between $500,000 and $1,000,000 will force most companies to decide to raise less than $500,000, even if their needs are higher. The difference in cost for a CPA to perform a review versus an audit can easily run into tens of thousands of dollars. This is an extreme cost for a startup business to endure.

Given that Congress has offered the Commission the ability to change this law and make the audit standard at any appropriate dollar amount, my proposal would be to either eliminate the audit requirement completely, leaving in place the standard for under $100,000 and applying the CPA review standard for all offerings over $100,000.

9. Requests For Comment 97-104. Text of 104: *The proposed rules would not restrict an issuer's ability to communicate information that does not refer to the terms of the offering. Is this approach appropriate? Why or why not? If not, what limitations should we include on an issuer's communications that do not refer to the terms of the offering and why?*

The collective purpose of my comments to all of the above in Requests 97-104 is to propose ways to ease the restrictions on advertising of these offerings, and to point out that the practical nature of crowdfunding will make the proposed rules, as drafted, unenforceable.

Issuers should be allowed to more broadly advertise their offerings. On Page 109 of the proposed rules, the Commission states that "limiting the advertising of the terms of the offering to the information permitted in the notice is intended to direct investors to the intermediary's platform and to make investment decisions with access to the disclosures necessary for them to make informed investment decisions." But, by both rule and law, the purchase of the securities can only be made through the intermediary's platform, and then only after the intermediary confirms that the investor (1) reviewed investor-education information, (2) positively affirmed that they understood they are risking the loss of the entire investment, and that they could bear such a loss, (3) answered questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers, (4) answered questions demonstrating an understanding of the risk of illiquidity and (5) answered questions demonstrating an understanding of such other matters as the Commission determines appropriate. If an investor cannot purchase the securities from anywhere but the intermediary where these requirements exist, and all information about the investment is available, then why does it matter if the issuer advertises the offering on a television commercial, a park bench, a Facebook page or on a Jumbotron at a packed football stadium? The purpose of the advertisement is to generate interest and drive the potential investor to the intermediary for the sale to be made. If the sale cannot be consummated anywhere else, why should advertisement not be allowed?

This rule also is going to create problems for the general public who are used to the free flow of information about rewards-based crowdfunding projects. On any given day, e-mail inboxes, Twitter accounts and Facebook pages receive numerous communications that are "advertisements" and certainly not "tombstone ads" for various rewards-based crowdfunding campaigns. Most of these are passed along not by the issuer, but by fans of the crowdfunding campaign, other donors to the campaign, friends and family of the issuer, employees of the issuer, and random people who found the campaign through some unknown means, and thought others might like to hear about it.

With equity crowdfunding the same thing is going to happen, whether the Commission, issuers or funding portals want it to, and regardless of any laws preventing advertisements other than "tombstone ads." The first equity crowdfunding campaign to hit a funding portal when these rules become official will spread like wildfire across social media. Links to the intermediary page will proliferate, along with comments, suggestions, Tweets, Facebook posts, e-mails and videos. It is likely that none of these will comply with the proposed "tombstone notice" requirement because people on social media spread news on a daily basis. If a member of the general public finds and equity crowdfunding campaign on a funding portal and decides to share the link on his or her Facebook page, there is no way to stop them. And, if one of their Facebook friends then shares it, the cycle continues. Meanwhile, the issuer and funding portal have no idea this is going on, and have absolutely no way to stop or police it. There is not enough manpower for the Commission to control this, and certainly not enough resources for a small business issuer to prevent it from happening once it starts.

Also, it is standard in the rewards-based crowdfunding for the issuer to make a video promoting the crowdfunding campaign. This will also occur in equity crowdfunding campaigns. These videos are typically posted on YouTube, and are shared through e-mail, Twitter, Facebook and other social media. These videos do not, and will not, comply with the "tombstone notice" requirement. Yet, they are going to be publicly available, and will be spread virally through social media. Again, there is no way to prevent this.

My proposal would be to allow issuers, funding portals or brokers to advertise with "notices" that direct investors back to the funding portal or broker, but that these "notices" may contain any information, photos or videos copied directly from the funding portal's public display of the crowdfunding offering. Given that the crowdfunding portal and the issuer have to follow certain standards and are accountable for what publicly appears on the funding portal, that material should be allowed to be disseminated in the form of advertisements without restriction, but in all cases complying with the requirement from the act that all advertisements must "direct investors to the funding portal or broker" in order to make a purchase.

Finally, if the Commission is unwilling to make this common-sense change to the proposed rules, the rules should be amended to codify the language of Request for Comment 104, which reads "The proposed rules would not restrict an issuer's ability to communicate information that does not refer to the terms of the offering." This is a somewhat expansive reading of the proposed rule, and arguably allows an issuer to promote, advertise and otherwise market their equity crowdfunding offering through any means whatsoever as long as they do not mention "the terms" of the offering. According to the instruction offered in Section 227.204, "terms of the offering" means the amount of the securities offered, the nature of the securities, the price of the securities and the closing date of the offering period. Given this, it appears the Commission intends to allow an issuer to advertise and market their equity crowdfunding offering through any means (not just a tombstone notice) as long as they do not mention amount of the securities offered, the nature of the securities, the price of the securities and the closing date of the offering period.

If this is the case, it should be written in the rule itself. As it stand now, it is not apparent, and only by reading the Commission's notes, comments, requests for comment and instructions can this important rule be determined. To avoid problems that will arise otherwise, the Commission should clarify this matter in the rule itself, and make it clear that advertisement of an offering by an issuer is allowed as long as the amount of the securities offered, the nature of the securities, the price of the securities and the closing date of the offering period are not mentioned. If an issuer wants to mention these "terms of the offering" then they are limited to a tombstone notice directing viewers back to the intermediary's portal.

10. Request for Comment 261. *"Should we eliminate or modify any of the proposed disqualification events? If so, which ones and why? Should additional events be disqualifying events? If so, what should constitute a disqualifying event and why?"*

Request for Comment 263. *"Should we expand or narrow the scope of the coverage of criminal convictions? Why or why not?"*

Request for Comment 272. *In order for an issuer to establish that it had exercised reasonable care, the proposed rules would require the issuer to make a factual inquiry into whether any disqualifications existed. Is this approach appropriate? Why or why not? Should we include in the proposed rules additional guidance on what types of factual inquiries should be undertaken under the reasonable care standard? If so, what should that guidance include? Should we create a cut-off date to apply when issuers make a factual inquiry? If so, what should that cut-off date be?*

I place these three together because they all deal with application of the "Bad Actor" rules. My personal belief is that the Bad Actor rules are, to a certain degree, overkill. However, I understand and appreciate the Commission's concern with keeping known individuals with a propensity to commit fraudulent acts out of the world of equity crowdfunding. I agree that disqualifying real "Bad Actors" makes sense, and is good for the future of equity crowdfunding.

I am concerned, however, with the cost to issuers of fully complying with the rules as stated. As the Commission should be aware, there is no centralized database of information that allows an issuer to determine if someone fits into each of the 23 or so categories of bad actors. This cannot be determined by a simple Google search, or by paying a service to run a basic criminal background check. This "Bad Actor" check, to be done to the letter of the proposed rules and law, will cost thousands of dollars.

For example, the proposed rule § 227.503(1) disqualifies anyone who "has been convicted, within 10 years...of any felony or misdemeanor (i) In connection with the purchase or sale of any security; (ii) Involving the making of any false filing with the Commission; or (iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities. Despite popular belief, there is no centralized database that will run a criminal background check for every felony or misdemeanor conviction in every county of every state. While there are easily obtainable "criminal background checks" that are relatively inexpensive, these do not check the court records of every county in the country for misdemeanor convictions. In order to thoroughly comply with the proposed rule, and issuers would have to hire a private investigator to search county by county for every coverer person, in every county that person ever lived in, or visited. This would require the issuer to spend thousands of dollars on private investigator bills, an amount that would be financially prohibitive for someone trying to raise only $100,000, for instance.

Furthermore, the proposed rule § 227.503(1) disqualifies anyone who is subject to any order, judgment or decree of any court of competent jurisdiction that, at the time of such filing, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice...arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities. Technically anyone in divorce proceedings anywhere in America could be considered to be "subject to (the) order...of any court of competent jurisdiction that...restrains or enjoins such person from ... in any conduct ...arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities" if the divorce judge issued a decree to not sell any marital assets such as stocks or investments. Again, to search civil records on a county-by-county basis would be cost prohibitive for a small issuer.

Another issue that arises is that of convictions of foreign courts. What if an officer of an issuer was convicted of securities fraud in a foreign country? That is not going to show up in any standard criminal background check.

The reasonable care provision that has been proposed is a good one. My suggestion would be to add to the proposed rule that reasonable care is established if the issuer relied upon an outside, unrelated company to perform the Bad Actor compliance and that the third party company certified it followed the criteria established by the Commission.

11. <u>The rules should be amended to explain exactly what disclosure documents are required</u>. At least one experienced securities attorney has publicly questioned whether a 10b-5 disclosure document will be required, despite not being specifically mentioned in the proposed SEC rules or the text of the JOBS Act itself.[2] While the JOBS Act and the proposed rules both seem to say this is not necessary and list the specific disclosure requirements that are required, some very learned securities attorneys believe additional disclosures will be required, and the phraseology of the SEC rules that "Section 4A(b)(1)(I) specifies that

[2] See, e.g. Nancy Fallon-Houle: Nancy Fallon-Houle: "Will Crowdfunding Suffer "Death By Expense?" at http://www.crowdfundinsider.com/2013/12/28994-nancy-fallon-houle-will-crowdfunding-suffer-death-expense.

the Commission may require additional disclosures for the protection of investors and in the public interest " gives many concern that these securities attorneys may be correct.

A simple suggestion to correct this very costly compliance issue is to specifically state in the rules that an issuer is required only to disclose the items delineated in the JOBS Act text itself. Or, create a "safe harbor" provision that gives an issuer comfort that disclosing an enumerated list protects them from later scrutiny. But leaving the open-ended language that the Commission "may require additional disclosures" could lead to future litigation for improper compliance by issuers, funding portals and broker-dealers who followed the letter of the law, but were still forced to defend a lawsuit by a law firm that grabs onto this vague assertion. Certainty in what must be disclosed will make the compliance process more affordable, and fair to all.

I truly appreciate the opportunity to comment and I hope that the Commission will consider my comments as they prepare the final rules for crowdfunding under Title III of the JOBS Act.

Very truly yours,

Kendall Almerico

Kendall Almerico
Attorney At Law
CEO - Fund Hub