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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

File No. S7-09-13

Dear Securities and Exchange Commission:

Here are my comments on the proposed Crowdfunding regulations:

Summary

- The SEC needs to protect public investors in unregistered companies. Unregistered companies should be encouraged to adhere to a series of best practices that would promote ongoing disclosure and good corporate governance in return for a safe harbor.
- Disclosures should be separated into two parts: An industry-standard educational document with all of the boilerplate, and an issuer specific document with only the relevant information about the issuer.
- The crowdfunding rules should be issued as temporary rules to force the Commission to review and refine them soon.
- Portals should be allowed to use common sense and refuse offerings for companies that they think will fail.
- Portals should be required to display track records of all previous deals and their performance.

- The rules should be simplified even more.
- The SEC should set an example of clear disclosure and improve the writing quality of its rule filings.

Background

The SEC has long had broad authority to craft its disclosure rules to streamline the capital raising process for smaller ventures. Yet it has consistently failed to do so successfully, despite constant requests and reasonable proposals such as those found in File No. 4-605, an earlier crowdfunding petition. As is often the case when the Commission fails to exercise its authority, Congress steps in with something far worse than what the Commission could have done with its existing authority. Congress shoved crowdfunding down the SEC's throat with the JOBS Act. Congress, being dimly aware that it does not properly fund the SEC, delegated first level regulation to the newly created regulatory bucket of crowdfunding portals.

The Commission, under previous leadership, dragged its feet and missed the statutory deadline for issuing the crowdfunding rules. The Commission thus signaled, whether intentionally or not, a continuing hostility to the idea that smaller businesses should be able to raise capital with a level of oversight appropriate to smaller businesses. This will undoubtedly create a climate in which Congress will see fit to meddle over and over again in matters that are best left to a properly functioning and properly funded SEC. And a Congress upset over a Commission that seeks to subvert Congressional intent will be highly unlikely to give the Commission the budget it needs to do its job properly.

Many other comment letters have provided useful suggestion on the details of the crowdfunding proposal. Their comments on the burdensome nature of many of the proposals should be heeded. The proposing release rightly asks for input on many of the details, but spends relatively little discussion on how the information will be presented to the investors. I will begin my remarks on two less discussed but nevertheless extremely important problems, how to make the information usable to investors, and how to provide ongoing investor protection for the public investors in unregistered companies.

I. Investor Protection

<u>The SEC needs to protect public investors in unregistered companies.</u>

The JOBS Act will have the impact of substantially increasing the number of public shareholders in companies that are exempt from the usual SEC registration requirements. These provisions include crowdfunding, the increased size of Reg A offerings, and the increase in the number of shareholders "of record" that triggers registration requirements. These will all increase the number of companies that do not have to formally register with the SEC, and thus the number of shareholders in these companies. These unregistered companies are not exempt, however, from the anti-fraud and other provisions of our securities laws. The SEC has a statutory duty to protect investors in those companies as well.

It is a sad fact of life that many unregistered companies attempt to suppress the public markets in their shares to the detriment of their minority public shareholders. This suppression is sometimes done to avoid going over the shareholder limit that would trigger costly registration with the SEC. This is a paradoxical side effect of our securities laws that are designed to "protect" investors: Lawyers sometimes advise firms to provide no public information about company financial results so as not to encourage more shareholders to acquire the stock and thus increase the number of shareholders of record.

Such companies thus provide not only no public financial information, but often no information of any type. This lack of information clearly harms the investors who own the shares as they have little ability to monitor the ongoing results of the company. This lack of information and evidence of management hostility to shareholders scares away potential investors. When shareholders need to sell, the only buyers are those with connections inside the company who know what is going on. This problem has become more acute with the growing numbers of firms that have "gone dark" by filing Form 15 to deregister from the Commission. Shareholders who invested in SEC-registered companies with the legitimate expectation that they would continue to receive adequate information about their investments suddenly find themselves deprived of vital information regarding their investments.

Sometimes these shareholder suppression campaigns are part of conscious manipulation attempts to force minority shareholders to sell out at prices below the intrinsic value of the shares. By refusing to provide public information, the company insures that no sane outside investors will be willing to buy into such a company. The only buyers are insiders who understand the true value of the company, and they pick up the shares at a bargain price.[1] The antifraud rules under Section 10b of the 1934 Act clearly apply to such manipulations, whether such stocks are registered with the SEC or not. Indeed, large parts of our corporate and securities laws have developed as a result of attempts to expropriate companies from the minority shareholders.

Sometimes it appears as if the SEC wishes that these unregistered companies would just go away and not have any publicly traded shares. [2] The large number of small companies just creates more enforcement headaches for the underfunded Commission. Unfortunately, Congress is moving in the opposite direction. The SEC has made the cost of compliance so high for SEC registrants that Congress is exempting more and more companies from the burden of SEC registration. This creates more and more shareholders whom the SEC theoretically protects through its administration of the rest of our federal securities laws.

One of the good things in the proposed crowdfunding rules is the requirement for some basic ongoing disclosure. That is fine as far as it goes, but what about important material events in between annual

[1] Such a campaign appears to be going on now with the preferred shares of W2007 Grace Acquisition I, the successor in a buyout of Equity Inns. The Goldman Sachs controlled company deregistered the preferred shares, refused and still continues to refuse to provide any public financial information, halted payment of the preferred dividends, and failed to fill director seats belonging to the preferred shareholders. The company not only deregistered the shares from the SEC, it even made the shares not eligible for electronic transfer at DTC, forcing shareholders to revert to paper certificates to transfer shares. In the meantime, another Goldman-controlled company has been quietly buying up the shares while in the possession of material nonpublic information regarding W2007 Grace Acquisition I. See SEC File 81-939 http://www.sec.gov/comments/81-939/81-939.shtml for more details. The lack of timely enforcement despite the SEC's knowledge of these manipulations is scandalous and seriously damages the SEC's reputation as an entity capable of enforcing our securities laws.

[2] This hostility to public markets can be seen in the Division of Corporate Finance's No Action Letter regarding the Motors Liquidation Company GUC Trust (OTC:MTLQU). (The Motors Liquidation Company GUC Trust contained some shares and warrants of the new General Motors that would be spun off to creditors of the old General Motors once the uncertainties regarding claims were resolved.) After noting In the no-action letter that there were thousands of likely claimants, the staff dictates: "None of the GUC Trust Parties nor the GUC Trust Parties' Affiliates will: (1) do anything to facilitate or promote a trading market in the Units; or (2) take any action to facilitate or otherwise encourage any trading in the Units or any instrument or interest tied to the value of the Units, such as trading in due bills for the Units;" http://www.sec.gov/divisions/corpfin/cf-noaction/2012/motorsliquidation052312-12g.htm It is well known in financial markets that more liquid securities are more valuable. By making these securities less liquid, the SEC reduces the value that the long suffering GM bondholders, many of whom are retail investors, receive if they have to sell these units before the final distribution of GM securities. By the way, the units have an average daily trading volume of over 200,000 shares.

filings? What about corporate governance issues? What about public investors in other firms that have issued shares through other channels and that have no ongoing disclosure requirements? The SEC needs to address these issues.

<u>The SEC should issue a concept release on shareholder protection in unregistered companies.</u>

First, the SEC needs to understand that a problem exists and then begin the public debate on what to do about the problem. A staff study and concept release would be a good place to start. This would document the extent of the problem and potential solutions. The comments received would help to shape Commission policy going forward.

<u>The SEC should promulgate a series of voluntary best practices for unregistered companies.</u>

One solution is to promulgate a series of best practices for investor protection for public investors in unregistered companies. Adherence to these practices would provide a safe harbor against various Commission enforcement activities.

These best practices would include:

1. The company posts regular financial results on its web site in a timely manner and leaves them up for at least five years.
2. The public financial statement should be audited, if audited financial statements are available. If not, the company need not spend the money on a professional audit, but must post copies of its tax returns. Tax returns are even more credible than audited financial statements, as companies are highly unlikely to exaggerate profitability to the IRS.
3. The company takes no steps to inhibit the public market for the shares. If the shares are quoted in the OTC market, the company takes the appropriate steps to make the shares DTC eligible.
4. Important company information is promptly disseminated through postings on the company web site or social media such as Twitter. Anything that would merit an 8-K filing for a larger company should be either tweeted, Facebooked, or emailed to a distribution list of interested investors and posted on the web site, such as a link to the Twitter or Facebook page.

5. The company will provide size-appropriate investor relations activities for its shareholders, including appropriate answers to reasonable questions about the company's business. Stonewalling investor questions as a matter of policy is not permitted.
6. The company will have a policy to prevent preventing officers, directors, affiliates and employees from engaging in improper insider trading in the company stock.
7. The company will provide adequate information to shareholders regarding the background and qualifications of candidates for the board of directors.
8. The company will follow standard good corporate governance practices.

Companies would have an incentive to adopt these practices as a safe harbor against various SEC enforcement activities:

1) By providing reasonable amounts of public information, officers, directors, employees, and affiliates can appropriately trade in the shares with less fear of being the target of an insider trading prosecution. If the firms are not providing adequate public information, then all of the insiders in the company are in perpetual danger of trading with the public while in the possession of material nonpublic information.
2) The SEC could use its Section 36 exemptive authority to exempt companies from SEC registration if their shareholder base grows beyond the 12(g) threshold for registration as long as i) they do not issue new shares, and ii) they adhere to the best practices.

II. Disclosure

<u>There is a difference between disclosure and communication.</u>

As in the movie, *Cool Hand Luke*, “What we’ve got here is a failure to communicate.”

The main thrust of the proposed rules regarding disclosure has to do with what details are disclosed. The result will be disclosure documents filled with fine print but that do little to communicate the important information to the investor. However, from an investor protection perspective it is important that investors actually **understand** the disclosure. As communicators and marketers well know, in order to get a message across it has to be simple and it has to be repeated. Let me repeat for emphasis: Just disclosing details does not protect investors. The important messages have to be communicated in simple terms and repeated often enough that they get the message.

<u>The educational materials should be industry-standard documents that contain much of the information often included in repetitive boilerplate in registration statements.</u>

The Commission is on the right track with its approach to educational materials. There is a need to educate consumer-investors with simple materials that describe the basics of investing in crowdfunding. There should be an industry standard disclosure document on the benefits and risks of crowdfunding investments. This would be similar to --but hopefully better executed than --the standard document delivered to investors who trade in options. This would be contained in the educational materials contemplated in this release.

This disclosure document would be aimed at an investor with a high school level of education. It would describe how crowd funding works, how shares are bought, and it would emphasize that very many new ventures fail quickly. It would provide a basic education in what to look for, and what to look out for.

Such a standard document would achieve three objectives: First, it would reduce the cost to issuers of the continual re-inventing of the wheel that goes on now with standard registration statements. Second, an industry standard document would provide a safe harbor to issuers and portals that they are providing proper educational materials. Third, by removing repetitive boilerplate from disclosure documents, it would make the disclosure provided by the issuer that much more informative.

Current disclosure documents have too much useless repetition and boilerplate.

One problem with current "disclosure" documents for registered companies is that they are filled with repetitive boilerplate that is similar from one company to next. Risk factors such as "The company is dependent on key personnel." or "The company faces fierce competition." are not unique and are widely known. Having these generic risk factors in the industry standard educational materials will help focus the company specific disclosure on the factors that are most important.

Wading through all of this redundant low-value "disclosure" is time consuming and costly, and it obscures the really important information that gets buried in the fine print. Important red flags such as "**A**ndrew S. Fastow, Executive Vice President and Chief Financial Officer of Enron, is the managing member of LJMI's general partner. The general partner of LJM1 is entitled to receive a percentage of the profits of LJM1 in excess of the general partner's proportion of the total capital contributed to LJM1, depending upon the performance of the investments made by LJMI." should not be buried deep in the fine print on page 25 of the proxy statement.[3]

Important information should be graphically emphasized.

The proposing release spends a great deal of time asking about what details should be included, but spends little time discussing the form of the disclosure, and how to emphasize the most important points. Not all points are of equal importance. The Commission should devote serious effort not only to the content, but also to the form by which the content is displayed.

My belief is that most of the crowdfunding ventures will be high-risk Angel-type investments providing seed capital for startup ventures. From an investor protection perspective, the most important thing is

[3] http://www.sec.gov/Archives/edgar/data/1024401/0000950129-00-001279.txt

that investors understand that the level of risk is very, very high. A large cigarette-style warning label should be prominent in the educational materials as well as all of the disclosure documents:

Crowdfunding investments are high risk investments. You may lose some or all of your investment. Do not invest any money you cannot

afford to lose.

Another important risk is that the secondary market will be problematic.

You may not be able to sell the shares at a fair price when you want to sell.

Finally, the ongoing quality of the information may not be as extensive as for SEC registered companies:

The financial information you get will not be as complete as for other companies.

But too many warning boxes will just create clutter. We don’t need a warning box that the customer may get a paper cut if they print out a hard copy of the disclosure document.

III. Other Comments

Rules should be issued as temporary rules.

As crowdfunding is a new area for the SEC, it is highly likely that the rules will need to be refined in practice. To make sure that this refinement takes place in a timely manner, the new rules should be issued as temporary rules with a finite expiration date. This will give the Commission time to learn from experience, and the expiration date creates a deadline that will force the Commission to reexamine the results of the rules when coming out with a final rule.

Permit portals to refuse bad offerings.

The proposed requirement in Rule 402(b) that portals not limit the offerings using criteria "based on the advisability of investing in the issuer or its offering" because doing so just might possibly be deemed <gasp> "impermissible investment advice" is absurd. The logic behind requiring crowdfunding to go through regulated portals is that the portals would be gatekeepers to keep the fraudsters out. This same consumer protection logic also applies to keeping the really stupid ideas out.

For example, suppose that an honest but starry-eyed would-be entrepreneur with a clean regulatory history proposes to start a company to grow Christmas trees on the planet Mars in a crowdfunded offering. Such a preposterous venture is almost certain to fail and inflict losses on the investors. Even if the crowd is smart enough not to fund the venture, its mere existence as an offering on a portal will damage the reputation of all other offerings on the portal. Such failures will damage the reputation of crowdfunding in general, and deter other investors from investing in any crowdfunding deals. Portals should be permitted to use common sense to snip such losses in the bud by refusing to carry such offerings.

Congress intended for the portals to be gatekeepers, and the SEC should permit them to use their good business judgment in what offerings to accept on their platforms. Forcing portals to become the equivalent of common carriers that have to take every offering, no matter how foolish, will make crowdfunding more likely to fail. Or is that what the SEC wants, to set up crowdfunding so it is doomed to fail so it can say "We told you so!"?

“Investment advice” should be defined narrowly to permit portals to convey useful information.

Similarly, there is no reason at all why crowdfunding portals themselves should not be allowed to convey useful information and opinions about various offerings on their platforms without it being deemed “investment advice.” Indeed, merely listing a proposal is an implied statement that the proposal meets certain regulatory requirements. Investors will be faced with the task of analyzing hundreds or thousands of potential offerings, and they will search for solutions to help them find appropriate offerings. The portals themselves will have superior experience and knowledge and should be permitted to share this knowledge without fear of breaking this stupid prohibition. It is far better for the portals to provide information than for investors to invest based on tips from their in-laws.

The SEC should define “investment advice” narrowly for funding portals so that they can provide useful information. As long as the information or opinion is about the offering and does not specifically recommend its purchase, then that information or opinion should not be deemed “investment advice.” For example, a portal could post articles on its web site about various offerings as long as the articles clearly pointed out that they were not conveying advice about the suitability of a particular investment for a particular investor and not predicting future financial performance. Rankings of risk would be very useful to this investor, as long as they were based on a reasonable objective basis.

Portals should be required to post track records.

Speaking of reputation, it is important for investors to know the performance of past crowdfunding deals. This will help investors to understand the risks involved in crowdfunding deals in general and also the history of deals through a specific portal. Portals should be required to post a list on their web site of all previous offerings, showing the target amount, the actual amount raised, if any, and information about the current status (if known) of the crowdfunded venture, and payouts to the investor. Such a track record could look like this:

Offering Number	Closing date of offering	Name (with hyperlink to more details)	Target Amount	Amount raised	Current Status	Return to investor
1	1/2/15	Jim's Martian X-Mas Tree Farm	$500K	$500K	Firm Defunct	-100%
2	1/3/15	Amy's 3D Printshop	$400K	$600k	Still operational	Not yet known
3	1/4/15	Elizabeth's Artworks	$100K	$200K	Firm acquired 6/1/2015	50% return
4	1/5/15	William's D&D Factory	$600K	$0	Offering not completed	Not applicable

Look for ways to simplify the proposed rules further.

As many of the other commenters have pointed out, the overly burdensome nature of the proposed rules is contrary to the intent of Congress to provide a simple and cost-effective ways for small businesses to raise small amounts of capital. The proposed rules appear to be written with an "S-1" mindset, an attempt to make the crowdfunding process look like regular SEC registration. Here are a few suggestions for simplification:

Makes the entire filing process of Form C be a simple online form.

I like the part about having the cover page of Form C be an XML form. The Commission should go even further and make the entire Form C be an online web submission, rather than go through the usual cumbersome Edgar submission process.

Permit electronic signatures in accordance with the ESIGN law.

Footnote 244 is an example of how cumbersome the proposed rules are:

> "An issuer that does not already have EDGAR filing codes, and to which the Commission has not previously assigned a user identification number, which we call a "Central Index Key (CIK)" code, would need to obtain the codes by filing electronically a Form ID [17 CFR 239.63; 249.446; 269.7 and 274.402] at https://www.filermanagement.edgarfiling.sec.gov. The applicant also would be required to submit a notarized authenticating document as a Portable Document Format (PDF) attachment to the electronic filing. The authenticating document would need to be manually signed by the applicant over the applicant's typed signature, include the information contained in the Form ID and confirm the authenticity of the Form ID. *See* 17 CFR 232.10(b)(2)."

The issuer has to provide a notarized form that is manually signed! Why does it have to be notarized? Why can't it be electronically signed? The requirement for a manual signature flies in the face of Congress' intent in passing the Electronic Signatures in Global and National Commerce Act in 2000, over a decade ago.[4] Requirements for unnecessary and redundant paperwork like this increase the workload for the Commission as well as for the issuers. Other federal government agencies do not require anywhere near this amount of overkill to get online access. An employer can quickly establish an online account to upload confidential earnings information to Social Security with far less fuss. Any concerns about verifying the actual identity of the issuer would have been picked up by the crowdfunding portal when it did the background checks.

The time estimate of .15 hours (9 minutes) to fill out Form ID on page 435 is absurdly low and demonstrates a lack of comprehension of what it takes for someone to comply with new government rules for the first time. First, the entrepreneur has never seen the form before and has to figure out what is involved and educate him or herself on the process (10 minutes). The form itself is five pages with instructions. The notarization part is in the fine print of the instructions and there is no indication on the form itself of the notarization part. As a startup entity, the entrepreneur probably does not have a notary on site and will have to travel to the office of the notary (30 minutes).[5] The form needs to be filled out, including typing the name on the form (10 minutes). The notarization alone will take several minutes, more if there is a wait at the notary (5 minutes). Chances are the entrepreneur may have signed the form

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[4] Public Law 106-229

[5] This assumes that the notary is actually there. The last time I needed a notarized form, the notary was out for the day and I had to come back later.

before even noticing the notarization requirement. The notary therefore requires him or her to sign over again, perhaps on a fresh form, in the presence of the notary. Then the document needs to be scanned and the entire form put into a pdf and submitted, for another 15 minutes unless the scanner jams. Thus, it could clearly take about 70 minutes –over 700% more time than the SEC's estimated time of nine minutes for this one "simple" task. Many of the other compliance obligations are likely to be similarly underestimated, much as the compliance costs for Sarbanes-Oxley §404 were drastically underestimated.

The writing in the proposal is still unnecessarily repetitive.

The SEC, as an agency with a mandate to provide disclosure to investors, should be a model of clear communication. Once again, an SEC rule filing is filled with redundant and repetitive verbiage that makes it difficult to separate the important points from the pointless repetition. For example, the Economic Analysis on page 315 states "As discussed in detail above, we are proposing Regulation Crowdfunding to implement the requirements of Title III.": As if someone who has made it to page 315 of the 585 page document hasn't figured this out??? Indeed, the phrase "as discussed" appears 48 times in the document. This redundancy obfuscates the important details, wastes staff time to write and proofread, murders trees, wastes the reader's time and does no good whatsoever. Such badly written documents tarnish the reputation of the agency. I urge the Commissioners to send the next such poorly written document back for a plain English re-write before inflicting it on the general public.

Respectfully submitted,

James J. Angel, Ph.D., CFA