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100 F Street, NE
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File No. S7-09-13
Proposed Regulation Crowdfunding

Dear SEC Commissioners and Staff,

We sincerely appreciate the opportunity to comment on the proposed rules establishing Regulation Crowdfunding ("Reg. CF"). We understand that ensuring investor protection and maintaining the efficiency of the capital markets are the primary objectives that the United States Securities and Exchange Commission (the "Commission") seeks to balance with Reg. CF. As such, we have framed our comments in a way that addresses these two objectives within each suggestion. Our goal is to have a functional body of rules that provide investors with understandable, transparent investment alternatives and small and startup businesses with access to much needed capital, all with the appropriate degree of investor protection. If not workable, Reg. CF serves no one, undermines the intent of the Jumpstart Our Business Startups Act of 2012 (the "Statute") and most importantly represents a wasted opportunity to advance the capital markets of this country.

Below we have set forth what we see as the potential roadblocks that could make Reg. CF underutilized and provided workable solutions within the confines of the Statute's framework. We are available to address any questions or concerns you may have at the contact information provided below.

All section references are to the Statute unless otherwise specified.

Issuer Level Liability for Funding Portals

We begin with the "issuer" standard of liability faced by funding portals ("Funding Portals") that intend to register as under Section 3(a)(80) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We feel this creates an unwarranted barrier to entry to otherwise diligent Funding Portals. Furthermore, the type of diligence historically conducted to establish the "due diligence defense" may be of limited value with respect to small and startup businesses.

Section 4A(c)(3) defines an issuer, for purposes of the liability provisions of Section 4A, as including "any person who offers or sells the security in such offering." On the basis of this definition, the Commission has proposed that intermediaries, including Funding Portals, should be considered issuers for purposes of Section 4A(c). We do not believe that Funding Portals will "offer or sell" securities and disagree with the Commission's position which likens Funding Portals to underwriters in an underwritten transaction under the Act. The comparison of a Funding Portal to an underwriter is inapt. Under Reg. CF, the Funding Portal would not take possession of the securities, would not custody funds, would not receive a similar level of compensation, would be prohibited from receiving equity compensation (as discussed in further detail below) and most importantly, will not offer or sell securities. The role of a Funding Portal should be more closely analogized to the role of a finder, which plays matchmaker to issuers and investors, but does not offer or sell securities nor provide substantive contributions to the offering process. Instead of a true intermediary, proposed Reg. CF positions the Funding Portal as a virtual guarantor of each transaction.

Moreover, by attaching liability to "a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer," Reg. CF positions the officers and directors of the Funding Portals as personal guarantors of each transaction conducted on the website. Even officers and directors of underwriters do not bear such personal liability for the transactions their related companies take part in, highlighting the imbalance between the level of liability assigned and the transaction size and services being provided by a Funding Portal. Subjecting Funding Portals and their directors and officers to this kind of risk will prevent the type of thoughtful and risk averse parties we should be encouraging to participate in crowdfunding from entering the market, and may have the unintended consequence of causing less diligent Funding Portals, who do not appreciate (or care about) the significance of such liability, to enter the market instead.

The proposing release for Reg. CF discusses how intermediaries could take steps in exercising reasonable care in light of the proposed liability provision including, establishing policies and procedures that are reasonably designed to achieve compliance with the requirements of Reg. CF, and conducting a review of the issuer's offering documents before posting them to the platform, to evaluate whether they contain materially false or misleading information. While it is true that a Funding Portal should review the offering materials prior to posting them on its website, the language of the proposed liability standard for Funding Portals is analogous to the existing liability standard under Rule 10b-5 of the Exchange Act, and suggests that a much higher level of diligence is required to provide comfort of compliance than merely reviewing offering documentation. The implied level of diligence suggests that of an underwriter in an underwritten transaction under the Act.

Case law and no-action letters have provided a framework establishing the "due diligence defense" that underwriters must undertake in order to insulate themselves from 10b-5 liability. These measures are intensive and include months of documentary and on-site diligence. The expense incurred to conduct such diligence efforts is cost prohibitive, especially considering the volume of issuers per portal and low offering amounts contemplated by both the proposed rules and the market. Furthermore, Funding Portals are not market actors the way underwriters and placement agents are and will not have the opportunity to generate fees from the provision of other services to issuers.

Additionally, it is not clear that the full blown due diligence procedures as historically conducted by underwriters would be effective in ferreting out fraud in a Reg. CF scenario. Many small businesses are operated out of homes and in garages and as part time endeavors, so on-site visits may not provide much insight. For small and startup businesses, many aspects such as customers, suppliers and revenues may still be in the idea phase and requiring a Funding Portal to diligence an idea without running afoul of providing investment advice is a difficult proposition. Small and startup businesses are built on ideas and the personal integrity of their founders and traditional documentary and physical diligence does not seem appropriate to capture that information. Of course there is risk in these types of transactions that cannot be eliminated, however, that risk is mitigated by limiting the amount people can invest and should not be addressed with near guarantor liability applied to Funding Portals and their employees.

We envision a more routinized diligence process, which requires a Funding Portal to take reasonable steps to diligence the issuers using its website and provides a non-exhaustive list of steps deemed reasonable, rather than virtual strict liability of the Funding Portal. Similar to the strategy for complying with accredited investor verification under Rule 506(c) of the Act, the list of reasonable steps could include background checks of officers and directors and vetting their resumes, sample customer and/or supplier calls to the extent the issuer has either, review of the offering materials against basic information provided by the issuer including organizational documents and a review of the financial statements and business plan. Once the Funding Portal conducts these or similar routine procedures that can be standardized, it should receive a presumption that it exercised reasonable care and could not have known of any misstatement or omission, rebuttable only upon a showing that the Funding Portal had actual knowledge to the contrary. This solution both protects investors, as it standardizes a set of checks that screen for potential fraud, and gives Funding Portals the peace of mind that as long as they follow the established procedures they will be free from liability.

This modification is not intended to apply to entities who "offer and sell" securities such as a broker-dealer. Furthermore, since broker-dealers already have significant experience in the traditional due diligence methods and can provide services other than simply playing intermediary to Reg. CF transactions, the currently proposed standard of liability has the presumably unintended effect of favoring broker-dealers over Funding Portals without providing meaningful investor protection. Additionally, Funding Portals are at a distinct disadvantage to broker-dealers since Funding Portals, unlike broker-dealers are not allowed to prohibit certain issuers from using their websites based on subjective criteria yet they bear liability for such issuer's behavior while on their websites.

Section 3(a)(80) of the Exchange Act and proposed FINRA rules for the registration and regulation of Funding Portals are predicated on Funding Portals playing a less extensive role in the offer and sale of securities than a broker-dealer registered under Section 3(a)(4) in connection with a traditional private placement. The proposed liability standard for Funding Portals under proposed Reg. CF is inconsistent with the reduced role that the regulatory regime expects that such Funding Portals will play in the offering process under Reg. CF. In addition, there is a risk that imposing such a high liability standard on Funding Portals could cause investors to infer the endorsement by a Funding Portal of the securities on its website. We believe the Commission staff should be concerned about adopting rules that would bolster market perceptions that the rules were directly intended to prohibit.

Portal Curation

As mentioned above the Commission has taken away a significant tool in preventing losses and lawsuits by denying Funding Portals the ability to restrict access to its platform based on subjective criteria. The Statute states that a Funding Portal may not "offer investment advice or recommendations." Directing potential investors to select one investment over another on its platform falls squarely within the " investment advice or recommendation" portion of the prohibition. However, the initial selection of an individual issuer prior to any investor awareness or the availability of a potential investment in such issuer is not investment advice, as there is no offering, no security and no potential investor at that point. The Funding Portal should have the opportunity to decide who it will and will not provide its services to, especially considering the liability it bears with respect to the actions of such issuers. Otherwise, Funding Portals will be forced to assume the liability of anyone with an idea that needs financing, unlike underwriters who can pick and choose who they will and will not represent. A high liability standard coupled with no ability to restrict access creates a Hobson's Choice for Funding Portals. More importantly, even with a lower liability threshold, curation is an essential tool for investor protection.

Section 4A(a)(5) requires intermediaries to take measures to reduce the risk of fraud with respect to transactions conducted on its website. The inability to use subjective criteria when onboarding issuers severely inhibits a Funding Portal's ability to perform such a gatekeeper role. Limiting a Funding Portal to denying access only in the case of suspected fraud prevents Funding Portals from considering a questionable management team, business model or prospects, which are equally as likely to lead to a loss of investor funds as actual fraud. We suggest that Funding Portals be allowed to determine which issuers may use its website based on its own subjective criteria, similar to any other service provider doing business, but once issuers are listed on the Funding Portal website, the Funding Portal may not subjectively favor one over another. In addition, the Funding Portal should be restricted to organizing issuers based on objective criteria such as "trending," nearing target date, industry, location, offering size, type of security, etc. Thus, when communicating with the potential investor, no advice, favoritism or high-pressure sales tactics are allowed, but a Funding Portal should be able to make the threshold decision regarding the potential liability it is willing to assume from any one issuer prior to posting it on its website.

Audit Requirement (including ongoing disclosure)

Many have noted the time and expense component with respect to the audit requirement and the crippling effect it will have on issuers. We concur that this is a significant and potentially overwhelming burden for a small or startup business, especially considering the amount of capital being raised, and urge you to review the discussion and data presented by the other commenters on this topic. We would also like to point out that it is highly likely that the information produced by such an audit will not be helpful to investors and not further the Commission's aim of investor protection through disclosure and education. Audited financials of companies with limited or no revenue and/or assets are practically useless as an analytical tool and are certainly no more helpful than reviewed or certified financials. In fact, many venture capital firms stipulate in their investment documents that the companies they invest in shall not provide audited financial statements as they do not want corporate funds being diverted to audit fees and the production of useless documents. We would also like to point out that under Regulation A and Rule 504 of Regulation D, pursuant to the Act and as currently in effect, issuers may raise up to $5 million (well over the Reg. CF limit of $1 million) and $1 million, respectively, from unaccredited investors with no investment limits without providing audited financial statements. This undue burden on Reg. CF issuers will unnecessarily deny access to legitimate and deserving issuers who do not have the upfront capital to provide useless documentation.

The Statue requires that issuers raising "more than $500,000 (or such other amount as the Commission may establish, by rule)" must provide audited financial statements, meaning the Commission has the authority to raise the threshold. Whether the Commission would choose to raise the threshold to above or equal to the overall Reg. CF limit of $1 million is a laden question. However, we would counsel for such a threshold, as we do not feel either of the Commission's aims are served by requiring audited financial statements and instead a significant hurdle has been placed in the way of the efficacy of Reg. CF. Our position remains the same with respect to any ongoing requirement of audited financial statements, as we feel such a requirement belongs in the aspirational domain of public company issuers and not Reg. CF.

Test the Waters

The Statute requires that an issuer "not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the Commission may establish), make available to the Commission and to potential investors" the disclosures required by the Statute and regulations thereunder, but the Statute does not specify *when* those disclosures must be made available in relation to an offer or an acceptance of that offer. Reg. CF requires the " information be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, *during which time the intermediary may accept investment* *commitments*." We support proposals set forth in other comment letters to Reg. CF that encourage the Commission to allow an issuer to offer securities through an intermediary in a "prospect mode"[1] to gauge if there is interest before spending scarce resources on the preparation of a Form C. This practice would be similar to the "testing the waters" activities permitted under Regulation A and in connection with IPOs by emerging growth companies and would not create a firm commitment from a potential investor nor would any funds be submitted to the issuer by a potential investor.

The Commission could maintain the rule as proposed and clarify that a mere pledge during prospect mode would not be deemed a "commitment" and that all potential investors would have to affirmatively commit and could only authorize the release of any funds previously submitted to an escrow account, if applicable, after the requisite disclosure materials (Form C) were made available on the intermediary's website for the requisite amount of time. This practice would preserve an issuer's ability to go back to the drawing board if their business model or concept did not resonate with the crowd without depleting the capital needed to try again. Additionally and equally important, this will allow for a higher quality of actual offerings for which investments may be accepted and give the crowd the opportunity to assist even further in the vetting process of crowdfunding issuers.

Compensation to Portals

The primary and often only currency of a small or startup business is its equity. Often this is the sole consideration it can provide when paying its employees, vendors and service providers. The Statute says an intermediary must "prohibit its directors, officers, or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services." We think it is important that the language specifically omits the intermediary itself while listing the individuals that may not receive a financial interest in the issuer. Congress uses the word intermediary frequently throughout the Statue and could have easily included "intermediary" in the list, but chose not to. Congress likely understood that one of the major hurdles facing small and startup businesses in America is initial liquidity, and therefore knew that to require extensive upfront fees would stop this new mode of financing before it could start.

Rather than charge a significant upfront fee or take a portion of the offering proceeds (which is inimical to the policy rationale of Reg. CF), an intermediary could receive a stake in the issuer, thereby aligning its interests with those of the investors. By analogy, underwriters, broker-dealers, attorneys, trade creditors and others are allowed to take equity stakes in the businesses they serve, so why cut out a crucial service provider from similar compensation at a company's most vulnerable stage? Simply put, equity compensation reduces upfront costs for issuers and aligns an intermediary's interests with investors.

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[1] See comment letter from Kiran Lingam, Esq., General Counsel of SeedInvest, LLC, dated as of January 22, 2014.

Appropriately, Reg. CF contains provisions prohibiting a Funding Portal from favoring or featuring one issuer over another so it cannot give preferential treatment to an issuer in which it has a stake. Moreover if the intermediary's means of compensation is taking an equity stake in all of the issuers on its site, all issuers are on an even playing field. Importantly, the securities issued pursuant to Reg. CF are not freely tradable and are restricted from transfer for one year, making the infamous pump and dump by the intermediary scenario unlikely. Furthermore, pursuant to Reg. CF, Funding Portals cannot provide a secondary market, thus fears of market manipulation should be allayed.

Thus, by removing an upfront cost and incenting an ongoing relationship between the intermediary and the issuer, equity compensation for intermediaries fulfils the Commission's twin aims of efficient capital markets and investor protection.

Conclusion

We believe these proposals will assist in making Reg. CF workable, efficient and safe. We hope that you agree and thank you again for the opportunity to provide our comments.

Very truly yours,

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cc

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