

**From:** Catherine Mott  
**Sent:** Saturday, October 29, 2011 10:34 PM  
**To:** Stephen Graham; Christine Jacobs  
**Cc:** Laporte, Gerald  
**Subject:** SEC Advisory Committee - Oct 31  
**Attachments:** Crowdfunding - Benchmark Criteria 10-27-11 (2).doc

Dear Stephen, Christine and Gerry,

I do regret not being able to attend our first advisory council meeting. As promised, I am sending some notes your direction regarding the topics of our agenda. Primarily, my comments are focused on Crowd Funding.

On Friday, the public policy committee of the Angel Capital Association discussed the Crowd funding legislation – attached is the **DRAFT** document we discussed without arriving to definitive conclusions. We believe we have more research to conduct in order to firmly comment. In general, we are supportive, but there are areas of concern.

The attached draft document includes three key concepts I personally would want to promote to the SEC: If the legislation doesn't address these issues, perhaps the SEC should:

- 1) provide a maximum amount of funding the issuers can raise via crowdfunding (\$1 million, or if possible a smaller amount like \$500K),
- 2) allow for release of funds to the issuer only once 60% - 70% of their requested funding has been committed, and
- 3) protect the entrepreneurs by ensuring that the platform provides them important services like putting all of the commitments into one funding vehicle (i.e LLC) so that entrepreneurs don't have to deal with so many investors on their cap table.

In addition, these deals shouldn't have to provide any more reports than are needed for Reg D 506 deals. (We've seen notes from Senate staff requiring that issuers file Form Ds to the SEC and to the home state of the issuer. This likely imposes greater legal costs for struggling start-up companies.)

Once again, I regret not being able to attend this Monday. Our Angel Capital Association Leaders' Conference and Board Meeting conflict with this time and as Chairman of the Board of the Angel Capital Association, I can't be absent. I look forward to meeting all of you at the next advisory council meeting.

Very best regards,  
Catherine Mott



Catherine V. Mott | CEO / President

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**Crowdfunding Legislation**  
**Benchmark Criteria**

The Angel Capital Association believes any crowdfunding exemption must balance the real need entrepreneurs have - for access capital to alternative sources of capital -with protection of investors against fraud.

The Angel Capital Association is uniquely positioned to appreciate this important balance. Angel investors are the primary source of equity capital for the entrepreneurial small businesses that create jobs and innovation in the United States. In fact, new businesses funded by angel capital have been responsible for all net job growth in the United States for the past \_\_ years.

While angel financing is growing, it remains virtually free of fraud or abuse. The secret of this success is that the right balance has been struck. Angels must be “accredited investors.” Incentives are in place for angel financing to be essentially self-policing. Issuers, promoters and investors who “act badly” are not welcome to participate in the startup financing ecosystem.

With this backdrop in mind, we offer support for the right crowdfunding exemption. America’s entrepreneurs who found innovative and high growth startups will be well served by a clear and transparent framework for another “entry point,” if you will, into capital markets. Even modest amounts of crowdfunding will help entrepreneurs prototype new products and services, test markets with new entrants and new ideas, and conduct “trial runs” to validate experimental concepts. A clear and explicit crowdfunding exemption may even come to replace the “friends and family” conundrum that has no actual exemption supporting it.

In addition, we recognize that many American entrepreneurs are not looking to build the next big tech giant. Instead, many small businesses are looking to serve their local communities and provide jobs for their neighbors. For these entrepreneurs, as well as individuals who espouse the ethos of socially responsible investing, crowdfunding may be a means of seed capital that frankly would not be available to them from venture capital investors.

But in all events, a crowdfunding exemption must not do more harm than good. Make no mistake: the first and foremost beneficiaries of striking the right balance, of providing an exemption that does not invite fraud and abuse, are the very entrepreneurs needing the seed or micro-financed capital and providing the new jobs. Investors who are swindled will not back the next entrepreneur, and are less likely to later develop into active angel investors themselves. High growth entrepreneurs and startups victimized by fraudsters will find themselves “damaged goods,” making it difficult to raise the necessary angel and venture capital for further growth downstream.

We think H.R. 2930, the Entrepreneur Access to Capital Act, as amended and approved by the House Financial Services Committee on October 26, 2011, is a promising start. But it needs more work. Specifically, we are concerned with (1) the lack of sophistication of potential investors with respect to investing in startups, and (2) administrative and liability implications of large numbers of shareholders for startups.

ACA recommends that the crowdfunding legislation incorporate the criteria listed below. Please note: we take as our baseline the markup of H.R. 2930 approved by the full committee. That markup addressed many prior concerns we had had with the bill.

1. **\$1,000 cap on individual investments** – For unaccredited investors individual investment limits should be capped at \$1,000 per year per issuer, with an annual aggregate cap of the lesser of \$10,000 or 10% of annual income. Issuers should be required to confirm (a) whether or not an investor is an accredited investor based upon criteria to be established by the Securities and Exchange Commission (SEC or the Commission) and (b) annual income in the case of unaccredited investors.
2. **Lifetime cap on use of exemption** – We recommend a simple \$1,000,000 aggregate, lifetime cap on all amounts raised by a given issuer under this exemption. The aggregate offering cap should not be reset on an annual basis. Doing so could result in difficulties with respect to valuing the business if and when it seeks angel or venture funding, lead to an infinitely large and unmanageable shareholder population for a private company, and frankly end the day of reckoning for businesses that the market has determined should fail. Crowdfunding should be a way to get a start or get a leg up; it should not be a life support system.
3. **Small businesses** – Only small businesses should be permitted to issue securities via a crowdfunding exemption. Larger businesses have greater access to capital and should not see this an alternative to going public in an effort to avoid disclosure requirements. Small businesses which put crowdfunded capital to good use and growth will be that much more attractive to angel and venture capital fund investors downstream.
4. **Prohibition on broker or finder's fees** – No broker's commissions or finder's fees should be permitted to be paid in connection with offerings of crowdfunded securities. Fees or commissions paid to authorized intermediaries (discussed below) should be exempted from this prohibition.
5. **Online intermediaries** – Offerings via crowdfunding to unaccredited investors may only be permitted through regulated online intermediaries, which will essentially take the place of due diligence, negotiating leverage, and legal documentation on the part of the individual investor. General advertising or solicitation should only be permitted to unaccredited investors on the internet or through the intermediaries.
6. **Services to be performed by intermediaries** – Intermediaries should be required to (a) perform a minimum level of due diligence on issuers and potential investors; (b) monitor offerings, including confirming that minimum required information is provided to investors; (c) facilitate communications with respect to fraud; (d) prohibit those determined to have been engaged in fraud from participating in any offerings whether as an issuer or investor; and (e) monitor funding of offerings. Intermediaries should be permitted to (a) require standard legal documentation with regard to how the issuer is organized and how the crowdfunded transaction is conducted; (b) serve as stock transfer agent to the issuer; (c) serve as an administrative agent of the shareholders in order to facilitate communications to

shareholders and facilitate shareholder voting; and (d) collect reasonable fees or commissions, expressed to investors as a percentage of the offering amount.

7. **Evaluation** – Within 1 year of the implementation of crowdfunding legislation a study of its effectiveness, costs, and benefits should be commenced, and such study should be completed within 2 years of implementation of crowdfunding legislation. The results of such study should be delivered to the SEC with a requirement that the Commission evaluate crowdfunding as a method of capital raising against its purposes of facilitating capital formation and protecting investors while maintaining fair and orderly markets.