GROWTH FOUNTAIN
WHERE CAPITAL FLOWS
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January 7, 2014

Chair Mary Jo White
Commissioner Luis Aguilar
Commissioner Daniel Gallagher
Commissioner Kara Stein
Commissioner Michael Piwowar

U.S Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Proposed Rules for Crowdfunding (Release *No. 33-9470; File No. S7-09-13)*

Dear Chairperson White and Commissioners Aguilar, Gallagher, Stein and Piwowar:

We were pleased to see the Securities and Exchange Commission's long-awaited proposed rules with respect to Article III of the Jumpstart Our Business Startups Act. We are sensitive to the difficulties of the distinct mandates that the SEC must feel of both maximizing the efficient operation of the capital markets while simultaneously minimizing the potential for and the likely severity of any fraud. With this in mind, we hope the SEC will consider our suggestions below as it works to finalize the rules in a manner that is most likely to spur appropriate capital flow in an open and honest environment.

We have presented our thoughts on the SEC's proposed rules in the order by which capital would typically flow in a proposed transaction under the new crowdfunding statute incorporated into the JOBS Act.

The Investor

Investment Limits

The most definitive mechanism for the protection of the investor exists in the rules relating to limitations on allowable investment amounts. For this reason we believe that the limitation on amounts that are specifically set out in the JOBS Act should be interpreted narrowly with respect to individual investors. In particular, in response to the SEC's RFC #6, we believe the most appropriate calculation of the limitations set out in Section 4(a)(6)(B) to be a "lesser of" calculation.

The intent of these limitations is to ensure that should individuals lose money on these investments the amount of such loss would be no more than could be handled by the individual investor's financial situation and this is best achieved through a "lesser of" test. For example, with respect to those who may meet the net worth threshold but not the income threshold, we would hazard that although "widows and orphans" may be somewhat better off financially today than they were 80 years ago there are still millions of Americans who depend on a sizeable and stable net worth in order to deliver a modest and often fixed income. Particularly as the percentage of home owners has deteriorated, such individuals are more and more likely to keep their net worth in generally liquid assets and may therefore be likely to meet the net worth test even though from an objective perspective the amount that they should be able to allocate to "risky" investments should be limited.[1] Where the net worth is sufficiently large, the income will follow. Similarly, in the inverted situation where an individual investor meets the income threshold but not the net worth threshold there is likely to be a significant amount of debt or expenses to which such income is already being applied. In those instances, the best investment is likely to be a pay down of individual debt rather than a more aggressive investment into a relatively new investment vehicle.

On a more pedantic basis, we would highlight that Congress explicitly defined a "greater of" test for investors that have already been deemed to fall under Section 4(a)(6)(B)(i) and that the rule of statutory construction which holds that "expressio unius est exclusio alterius" would argue for a "lesser of" interpretation in each other instance where there is an either/or reference to net worth and income. Since Congress saw fit to insert new threshold amounts into the JOBS Act rather than relying on the various thresholds that already exist in the securities laws this may serve as a method of interpreting congressional intent.

Investment Vehicles and Accredited Investors

Aside from the lower economic end of the potential investor spectrum, we believe the SEC is also right to concern itself with the appropriate approach to the higher economic end of the potential investor spectrum in crowdfunded transactions. We note, for example, the SEC's RFC #9 concerning potentially different limits on accredited investors and institutional investors. We believe that higher limits for accredited and institutional investors are fully appropriate as a mechanism for establishing securities crowdfunding as a significant new source of capital. Accredited and institutional investors currently invest sums well in excess of

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[1] Individuals of this type often generally fall into a category of those more likely to be subject to scams than the average American so that one of the best things that the SEC can do to protect such individuals with respect to crowdfunding rules would be to minimize the advantage that bad actors would gain by preying on such investors.

$100,000 through exempt transactions. If such institutions now want to invest in local businesses through a crowdfunding structure the annual limitation on investments under the crowdfunding exemption would make it impractical, perhaps even impossible, to do so. We see no reason why the rules and regulations surrounding crowdfunding should eliminate such a potentially huge source of investment into new local businesses and other small-scale enterprises. In fact, as further elucidated below, we believe that allowing the restriction to stand without other modifications has the potential to create a dual approach to capital raising that could restrict the benefits of crowdfunding to non-accredited investors and borrowers alike.

Though we believe that higher investment limits for accredited and institutional investors would be appropriate, we recognize that the statutory language of the JOBS Act may limit the SEC's flexibility on this issue. There are, however, other changes that the SEC can make to its proposed rules that would be protective to the interests of both non-accredited investors and crowdfunding issuers. Such other changes, which would be helpful in any event, become more critical in the absence of higher investment limits for accredited and institutional investors.

One such change would be to clarify that limited liability companies and limited partnerships established for the sole purpose of facilitating crowdfunding transactions under the JOBS Act fall outside the definition of an "investment company" under the Investment Company Act of 1940. This may arguably be the case in any event since such companies would be likely to function solely as pass-through vehicles intended to simplify the relationship between a small business and a potentially large number of crowdfunding investors and would not hold themselves out as making investment decisions or actively trading in securities. However, a clear statement in the proposed rules relating to the appropriate use of LLCs and LPs as vehicles for structuring a crowdfunding investment is likely to significantly increase the use of crowdfunding by, among other things, simplifying the regular reporting and communication requirements on individual issuers who may otherwise be overwhelmed by the number of new securities holders they would take on through a crowdfunding transaction.

Without a clearly stated allowance for LLCs and LPs as vehicles for crowdfunding transactions, meaningful investment opportunities are likely to continue to be provided almost exclusively to accredited investors through exempt transactions to the exclusion of (mostly non-accredited) investors in crowdfunded transactions. In fact, the SEC has made clear through two recent no-action letters[2] that similar vehicles may be used by accredited investors in exempt private transactions. These types of investment vehicles are considered beneficial by many issuers because they allow the issuer to interact directly with a limited number of counterparties and so

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[2] See http://www.sec.gov/divisions/marketreg/mr-noaction/2013/angellist-15a1.pdf and http://www.sec.gov/divisions/marketreg/mr-noaction/2013/funders-club-032613-15a1.pdf

avoid the potential of dealing with an overwhelming number of new investors on a day-to-day basis. Given that crowdfunded securities transactions will be significantly smaller than the typical securities transaction, the average infrastructure in place for Issuers to handle investor relations is likely to be minimal and so an allowed mechanism for simplifying this interaction will to spur crowdfunding significantly.[3] It is also possible that by reducing the overall number of investors into a specific issuer it will be easier for issuers to find later follow-on financings.

The Intermediary

The Relationship of Intermediary and Platform

We are not simply concerned that the proposed rules may be advantaging larger, more established investors over smaller, non-accredited investors. We also believe that the proposed rules with respect to intermediaries may serve to advantage pre-existing capital raising structures at the expense of both potential crowdfunding issuers and potential crowdfunding investors.

In particular, we question what appears to be a foundational assumption in the proposed rules that there is no distinction between an "intermediary" and an intermediary's "platform." Leaving aside the proposed rules, there is nothing that precludes a single platform from being used by multiple intermediaries or a single intermediary from using multiple platforms. In fact, as a practical matter numerous broker-dealers may often utilize the same platform for trading activities. Under the proposed rules it is not clear how such platforms might be extended. In these circumstances, the decision to restrict crowdfunding transactions to a single intermediary's platform may have the unintended consequence of prohibiting the development of a single, yet multi-intermediary, platform that would appear to be even more likely to meet the SEC's stated goal for crowd development. Conversely, while the proposed rules note the possibility of non-internet platforms they do not appear to consider the possibility that a single intermediary would establish multiple internet platforms in order to create different criteria for acceptance of crowdfunding transactions or to expand its presence at the expense of a centralized crowd wisdom database.

Even beyond the issues stated above, we are concerned that the SEC's justification for limiting crowdfunding transactions to a single intermediary on an internet-based platform is unlikely to come to fruition. In particular, the SEC highlights the possibility of focusing "crowd wisdom" within the relevant platform. We do not believe, however, that restricting crowdfunding transactions, or even restricting disclosures by a relevant issuer, to a single intermediary's platform is likely to focus

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[3] Although investor relations often constitutes a meaningful expense for SEC-registered issuers no accounting for this cost has been included in the SEC's proposed crowdfunding rules.

crowd wisdom in the manner that the SEC hopes. Ideas have generally proved themselves elusive to the laser effect that the SEC argues will occur through the proposed rules. Limiting an issuer to a single intermediary is unlikely to prevent discussions about significant issuers outside of the confines of that intermediary's platform. What it will do, however, is provide the relevant intermediary with additional pricing power to be utilized at the expense of unwary investors or naïve issuers.

Thus, in response to the SEC's RFC #12, we believe that, contrary to the current proposed rules, the SEC should make clear in the final rules that intermediaries may not enter into an "exclusive relationship" with any debt or equity crowdfunding issuer. An "exclusive relationship," in this context, would be defined as one where the intermediary requires, as a condition of listing on its site, that a business agree to not list or raise funds with another intermediary either simultaneously, or within a certain time period. Clarity from the SEC on the impermissibility of these types of exclusive relationships is critical to ensuring that the market power for equity and debt crowdfunding not become overly concentrated among those intermediaries who are able to gain scale at the expense of other intermediaries, issuers and investors. In response to the SEC's RFC #15, however, we do believe that intermediaries should be allowed to restrict access to their platforms. This is a counter-intuitive assessment since many issuers may be concerned about confidentiality issues in connection with crowdfunding transactions. By allowing intermediaries to modestly restrict access to their platforms the final rules may give greater comfort to potential crowdfunding issuers.

Intermediary Pricing Structures

As noted above, we are concerned that the proposed rules may restrict the potential development of different pricing structures and thereby limit the growth of crowdfunding as a tool for raising capital. The final rules should be made flexible enough to allow for numerous different intermediary financing structures in order for the market to determine the structure most suited for transactions of this type.

In response to the SEC's RFC #122 we believe that the receipt of a financial interest in an issuer (either directly or as carried interest on returns generated in an LLC or LP type pass-through investment vehicle) should be one form of fee arrangement that is available for the market to consider. While the SEC notes concerns over the possibility of promotion, such concerns are mitigated in the case of funding portals by virtue of the fact that funding portals may not give investment advice and by the specific restrictions on outside marketing in crowdfunded transactions. With respect to all intermediaries, promotion concerns may be mitigated through appropriate disclosure and through rules requiring that pricing features of this type be applied equally to all listings on a given intermediary's platform. In fact, we believe that allowing payment in this form would be advantageous to issuers since issuers could use equity as currency to pay intermediary fees rather than using the precious cash issuers need for growth. The approach is also likely to be beneficial to investors as a fraud deterrent since the intermediary will effectively be financially vouching for the issuers on its site. To this extent, an intermediary should also be allowed to invest any commission it receives into issuer equity if it so chooses, since such an investment is likely to further the goal of capital formation.

With or without payment in the form of equity, we recognize that intermediaries are likely to provide many services to issuers beyond the initial crowdfunding issuance. In response to the SEC's RFC #123, we believe intermediaries should be allowed to provide future services even after an acquisition of an interest in an issuer. Since intermediaries may be serving important, ongoing services for issuers, a requirement to cease such services is likely to have a destabilizing effect on both the issuer and the proper maintenance of such issuer's securities. Concerns with respect to such services may be mitigated through proper disclosure. More broadly, we also believe that full disclosure would address the SEC's RFC #124, though in the spirit of ensuring that investors have seen such disclosure, perhaps intermediaries should be required to include a checkbox to the effect that: "I understand that the intermediary owns shares in this entity and may be biased in its recommendation or display."

As a final note towards expansion of the possible offering structures and the growth of crowdfunding transactions we would respond to the SEC's RFC #177 by advocating that the SEC clarify that "qualified third parties" include credit unions, savings & loans and other institutions that offer similar protections to banks. Most credit unions, for example, offer NCUSIF insurance identical to that of the FDIC. Other thrifts and cooperatives that offer similar investor protection should also be categorized as qualified third parties as they provide the same investor protections.

<u>The Issuer</u>

Clarity of Safe Harbors

As noted above, we are concerned that restrictions on crowdfunding investments and the manner in which crowdfunding takes place could have the unintended consequence of creating a two-tiered structure for securities offerings. Such a two-tiered structure would benefit accredited investors and institutionalized practices at the expense of crowdfunded securities issuers and potential non-accredited investors. In addition to the solutions noted above, we believe that an important component in reducing the threat of a two-tiered system is the creation and application of clear safe-harbors with respect to the simultaneous use of crowdfunding and other potential exempt transactions (the most notable being a transaction under Regulation D). Without such a clear safe-harbor, crowdfunding transactions are likely to be in deep conflict with other potential exempt transactions even after the SEC's clear statement that it does not intend to aggregate multiple transactions off-hand. Specifically, since more money can be raised by companies through Regulation D transactions any company that has the opportunity to utilize such a route is likely to take it. Accredited investors, because they are limited in the amount they are able to put to work under the crowdfunding statute, are also likely to continue to rely on Regulation D and, with no further modifications, there is likely to continue to be a "dual system" of investing where more sophisticated investors remain behind closed doors likely receiving a different (better) class of security than the securities offered to non-accredited investors through crowdfunded transactions. In a very literal sense, the SEC runs the risk of establishing an ingrained "class structure" for the distribution of capital in America. It is not enough, therefore, for the SEC to simply say that it is not integrating crowdfunding transactions with other exempt transactions. The SEC should instead lay out clear guidelines -- a safe harbor -- where issuers could know that they could utilize crowdfunding with other forms of exempt transactions without running the risk of tripping a registration process. One such approach, in fact, may be to include a requirement that certain simultaneous transactions be conducted on simultaneous terms. Thus, in answer to the SEC's RFC #3, the SEC should seek to maximize the degree to which offerings under 506(c) and Section 4(a)(6) can be done together on similar terms. Under such an approach non-accredited public investors are more likely to receive the benefit of the more "sophisticated" investors that have been investing in transactions of this type to date.

Modified Disclosure Requirements

In several RFC's the SEC asks the reviewer to consider the appropriate level of disclosure for issuers in a crowdfunding transaction. In response to these RFCs we would like to highlight one example of differing disclosure requirements. Attached as Exhibits A and B are two different types of disclosure with respect to related products. In both cases, the disclosure amounts to the most sophisticated simplification of the mandated disclosure rules and yet one form is utilized by the general public on a daily basis while the other form is generally limited to a relatively small group of professionals and non-professional enthusiasts. The SEC has long noted, rightly, that the omission to state a material fact is no less misleading than the statement of a false fact. On a similar note, the SEC should focus on the fact that over-disclosure is no less opaque than under-disclosure.

We believe that the SEC and the investing public would be best served by utilizing an 'if/then' approach with respect to disclosure under the statute. With the exception of statutorily mandated disclosure requirements, the SEC should take a light touch with respect to required disclosure but should hold that to the degree any disclosure is made such disclosure must conform to regulations set out by the SEC. In this manner, the SEC is likely to allow for the greatest variety of businesses to utilize the crowdfunding mechanism for raising capital. In fact, as the SEC itself notes in its proposed rules, "[the SEC believes] that many issuers engaging in crowdfunding transactions in reliance on Section 4(a)(6) are likely to be at a very early stage of their business development and may not have an operating history. In many instances, these issuers will have no more than a business plan for which they are seeking investors to help fund." In such cases, the level of disclosure currently proposed seems a bit of an overkill and an approach of the type described above would be more conducive to an efficient market.

Potential for Individual Issuers

As one final note, we would like to highlight a point that the SEC mentions only briefly in its RFC #59; specifically, the ability of individual persons to utilize the statute as issuers. While there is no specific prohibition against individual persons as issuers it is not apparent how an individual would be able to meet the requirements of the statute. We believe, however, that the statute has brought upon an extremely fine gradation since many provisions that had previously been considered on a business entity level must now be considered on an individual level. For example, the SEC defines "issuer" under proposed rule 100(c) of Regulation Crowdfunding to include all entities under common control of the issuer or its predecessor. This certainly makes sense in the context of complicated corporate structures with numerous subsidiaries, affiliates, and joint ventures, etc., but we urge the Commission to consider in the crowdfunding case the prospect of a serial entrepreneur who, perhaps, decides that they may want to start both a battery company and a transportation company at the same time. Though the two firms may have very different ambitions, and may utilize different staff and decision-making techniques they would nevertheless be consolidated for purposes of SEC crowdfunding analysis. The statute also clearly requires further delving into individual finance levels for all investors to a degree that had previously only been required by a limited subset of individuals seeking additional access to the capital markets (e.g., accredited investors, traders in derivatives, etc.). Given the overall purpose of disintermediation and the average levels of outstanding debt in America (roughly $30,000 for student loans, roughly $15,000 for credit cards) we believe the SEC should reconsider the prospect of individuated issuers in the capital markets.

Conclusion

We would like to thank the Commission and the staff of the SEC for considering our proposals listed above. We believe firmly in the potential for crowdfunding for both investors and borrowers and trust that the SEC will achieve a great result. Should you wish to contact us about any of the matters discussed above we can be reached at info@growthfountain.com.

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