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June 7, 2016

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C.

Dear Chairman Hensarling and Ranking Member Waters:

I write to you in support of HR 4855, the *Fix Crowdfunding Act*. I speak from the background and perspective of a securities attorney in private practice since 1978, and one who has been an active participant in post-JOBS Act rulemaking and advocacy on behalf of small and medium enterprises.[1] I am pleased that the House Financial Services Committee continues to demonstrate the quality and vigor of bi-partisan Congressional leadership that is essential for our country to continue on a path of economic growth and prosperity for all Americans from all walks of life. It is my hope that HR 4855 will receive enthusiastic bi-partisan support and will be enacted into law without further delay.

Undoubtedly echoing the sentiment of many, the Jumpstart Our Business Startups Act of 2012 was monumental, opening up new and diverse paths of capital formation, its provisions singularly focused on our economy's most important source of job creation: small and emerging businesses. However, aligning our complex federal securities regulatory system with both pressing economic needs and rapid technological change is a daunting task which remains very much a work in progress – and as such can be expected to evolve, and pivot.

This evolution will require, among other things, ongoing Congressional oversight – and further legislation - with the input of key market participants, including the business community, federal and

[1] I served as President of the Crowdfunding Professional Association in 2015 and have participated extensively in rulemaking activities implementing the JOBS Act, including multiple public letters of comment submitted in connection with Title III SEC rulemaking. I have been cited twice by former SEC Commissioner Daniel M. Gallagher in public speeches in 2014 and 2015 as a thought leader in JOBS Act reforms and as a small business advocate, including Title III reforms and a proposal ultimately resulting in a bill unanimously passed by the House Financial Services Committee and the House of Representatives, H.R. 3848, to create the SEC Office of Small Business Advocate. For further biographical data, see Appendix I to this letter.

state regulators, securities professionals, and economists, among others. HR 4855 is an important and necessary step in that direction.

Some have argued, as regards Title III of the JOBS Act, that more data, and study, is necessary before any additional legislative measures can and should be implemented. Though this proposition is, on its face, understandable, it ought not be a mantra to delay the curing of what I and others in the crowdfunding industry view as glaring deficiencies in the current Title III structure, as implemented by final SEC rulemaking.

## THE DATA IS IN ON THE KEY PROVISIONS OF HR 4855

As regards the current proposed legislation, HR 4855, ***the data is in*** for those who care to examine the current record. And if anything, in at least one important respect, existing data, as well as established practices in other securities markets, suggest that *HR 4855* ***does not go quite far enough***, even in this very early stage of the Title III marketplace. As discussed below, I respectfully submit that HR 4855 would benefit by the addition of a provision allowing "off portal" issuer solicitation and advertising during a crowdfunding campaign, with the appropriate investor protection measures suggested below.

### INCREASING OFFERING LIMITS TO $5 MILLION

*The United Kingdom*

Currently Title III limits the amount an issuer can raise under Title III to $1 million in a 12 month period. HR 4855 proposes to increase this limit to $5 million.

The United Kingdom presents perhaps the richest data set, with regulated investment crowdfunding in operation for a number of years. The UK has ***no*** offering limits; the European Union, in turn, sets a limit of EUR 5 million for "non-prospectus" offerings.

*The State of Georgia*

Georgia was an early mover in the U.S., enacting investment crowdfunding through regulations promulgated by its Secretary of State in 2011. The initial offering limit was $1 million. In late 2015 the Georgia legislature raised the offering ceiling from $1 million to $5 million at the behest of the Georgia Secretary of State.

*The State of Illinois*

The offering limit for intrastate crowdfunding in Illinois was initially set at $4 million.

*Rewards Based Crowdfunding*

Rewards based crowdfunding, largely unregulated, and outside the purview of federal and state securities laws, has no campaign dollar limits. Data going back to 2007 reflects the minimal occurrence of fraud, especially in larger offerings – which tend to draw the watchful eyes of a larger crowd. Though

some might be skeptical of the so-called "wisdom of the crowd," there is truly strength in numbers for fundraising which occurs in the transparency of the internet.

**EXEMPTION OF "SPECIAL PURPOSE VEHICLES" FOR THE PURPOSE OF INVESTING IN A SINGLE ISSUER**

This provision would reinforce existing investor protection measures already embedded in Title III. Importantly, providing this exemption would allow the formation of investor "syndicates" which include non-accredited investors, thus allowing unaccredited investors to be represented by sophisticated lead investors and encouraging investment diversification.

*The Data*

Failure to include this provision in the original JOBS Act Title III can fairly be viewed as an oversight. Unfortunately, history records that the Securities and Exchange Commission was largely absent from the legislative table when Title III traversed the legislative process in 2011 and 2012. Indeed, it is fair to say that if it were up to the Commission, as then constituted, there would have been no table at all. With new leadership at the Commission, one would expect the SEC could only be supportive of this very useful investor protection. Indeed, the House Financial Services Committee need only inquire, if it has not done so already.

**TESTING THE WATERS**

***Pre-Campaign Publicity***

Title IV of the JOBS Act, allowing for raises of up to $50 million, expressly provided for "testing the waters," a process by which companies could both measure the potential level of interest in their company as well as generate awareness at little or no cost. These provisions were entirely absent from Title III and are an important component of a vibrant investment crowdfunding ecosystem. Absent new legislation such as HR 4855, even reaching out to one's extended social network, often in the dozens or hundreds, would run afoul of SEC doctrines which generally prohibit broad advertising or solicitation in regards to a proposed offering.

*The Data*

There have been numerous studies in the area of rewards-based crowdfunding, as well as a great deal of anecdotal data, concluding that one of the most important ingredients for a successful crowdfunding campaign requires generating momentum *before* a campaign officially commences, hence increasing the likelihood of a large number of early participants. Campaigns which are unable to generate substantial interest in the initial stages of a campaign have a high likelihood of failure. Early success breeds success: and lackluster interest at the outset of a campaign more often than not is the kiss of death for what

could otherwise be a successful campaign. Current U.S. securities laws preclude an issuer from generating any significant pre-campaign interest.[2]

***Off Portal Campaign Publicity – A Proposed Addition to HR 4855***

A basic tenet of Title III offerings is that all offering activity must take place on an "intermediary" (*i.e.* a registered broker-dealer or SEC/FINRA registered funding portal). Similarly, Title III prohibits advertising of a Title III offering by an issuer. Though the SEC through rulemaking has provided a limited exception, allowing off-portal "notices," limited to a brief description of the business and the terms of the offering (SEC Rule 204), as interpreted informally by the Staff of the SEC, this rule would not even allow issuers to inform the public of the progress of the offering off of the portal.

This limitation on offering publicity is in stark contrast to leeway afforded to issuers in Title IV Regulation A offerings as well as in registered public offerings, where "free writing" is permitted so long as these materials are filed with the SEC.

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[2] The need for wide publicity and early momentum is supported by both academic research and statistics compiled by major rewards-based crowdfunding platforms. A summary compilation of some key studies, with citations to the original sources, may be found at *"How Likely is Your Crowdfunding Campaign to Succeed*,"Canada Media Fund http://crowdfunding.cmf-fmc.ca/facts_and_stats/how-likely-is-your-crowdfunding-campaign-to-succeed Following is a pertinent summary of some of this data:

> **Momentum**
> One of the key success factors for a crowdfunding campaign is achieving and maintaining the right amount of momentum behind the campaign, especially in the early post-launch days. Indeed, according to statistics reported by Kickstarter, once a campaign raises over 20% of the initial funding goal, the project has an 80% chance of successfully reaching its total funding goal. Seedrs reports that once a campaign hits 30% of its funding goal the success rate climbs to 90% (compared to only 50% after a campaign reaches the 5% mark). And the faster the momentum is gained the better: campaigns that reach the 30% mark within the first week have a higher rate of success. To-date, Seedrs has seen a 100% success rate for projects once they raise 35% of their funding goal.
>
> That said, the turning point for a campaign does vary by the size of the funding goal, according to analysis conducted by Professor Ethan Mollick and blogger Jeanne Pi. Not surprisingly, the larger the funding goal, the higher the turning point will be. For example, projects with a funding goal of $100,000 or more need to reach 65% of their funding goal in order to increase their chances of success to 80%, whereas projects with a funding goal of $10,000 or less only need to reach 15% of their funding goal to increase their chances of success to 80%.
> **Exposure**
> Figures confirm the assumption: the more exposure your campaign receives, the higher the chances of success. And one of the best ways to get word out about your project is through social media. Mollick and Pi report that an average project with a social network of only 10 friends or followers would have a 9% success rate, whereas a project owner with a network of 1,000 friends or followers would increase that success rate to 40%.

There is no compelling reason why startups ought not to be afforded the same ability to draw attention to their campaigns off of the portal, especially through social media and the internet, albeit with some protective measures. These protective measures could be as simple as filing these materials with the SEC and making them available on the intermediary hosting the campaign – with a link to the campaign on the licensed intermediary's site.

*The Data*

Common sense tells us that limiting the ability to publicize an offering will have the negative impact of reducing its likelihood of success. Common sense is borne out by academic and industry studies in the area of rewards-based crowdfunding.[3]

Besides, most startups can ill afford the cost of hiring a seasoned securities lawyer to engage in a round of seed financing. Even those who may dot all of their "I's" and cross all of their "t's" with their SEC required disclosures may inadvertently run afoul of the current SEC prohibitions on off-portal publicity.

Anecdotal data is already available as to these inadvertent "foot faults," which can not only derail an offering, but also create a statutory right of rescission by the investor against both the issuer and its "control persons."

Witness the headline of an article which appeared in *Forbes* on May 31, 2016, entitled "*Will S.E.C. Crowdfunding Rules Cripple Equity Crowdfunding?*[4] detailing an interview by a Title III issuer during its Title III crowdfunding campaign, with the consequence of potentially invalidating the availability of the statutory crowdfunding exemption from SEC registration even before it reaches completion. Nor is this an isolated example. Witness an interview with another crowdfunding company which recently graced the pages of *The New York Post,* with the somewhat ironic title of "*Hipster Startup Found the SEC Loophole,"* (May 28, 2016), http://nypost.com/2016/05/28/startup-looks-to-take-advantage-of-crowdfunding-with-new-loophole/.

Likewise, this issuer too may have inadvertently invalidated its Title III crowdfunding exemption simply by engaging in a public interview during the offering – something allowed in Regulation A and registered offerings.

**EXEMPTION OF TITLE III SECURITIES FROM EXCHANGE ACT REPORTING THRESHOLDS**

The failure of Title III to explicitly exempt all Title III securities from counting towards the Securities Exchange Act Section 12(g) requirement triggering public reporting was an oversight with unintended, and untoward consequences. Failure to legislatively mandate this exclusion will certainly have the unintended effect of discouraging our most promising startups, including so called "gazelles," from utilizing Title III crowdfunding. And for those startups oblivious to the pitfall of prematurely becoming a

[3] *Id.*

[4] http://www.forbes.com/sites/robbmandelbaum/2016/05/31/s-e-c-rules-limit-ads-for-equity-crowdfunding/#32d6fd177f8f.

fully reporting company, they will be prematurely burdened with the obligations of seasoned, fully reporting companies.

HR 4855 cures this omission, with minimal impact on investor protection. In this regard, Title III mandates ongoing disclosures which are right-sized for startups and early stage companies.

**CONCLUDING THOUGHTS**

This country witnessed the birth of what has proven to be the greatest economic startup in history - the U.S. economy. History records that its inception was heralded in part with a public cry back in 1775: *"The British are coming."*

Today the British are not coming. Rather, they are staying home - building their entrepreneurial economy and leading the world by example – with a "light touch" regulatory scheme for investment crowdfunding that has proven to be a model of success.

Let us hope that after more than four years following the passage of the JOBS Act our lawmakers do not make the mistake of waiting until *all* the data is in to make limited, necessary reforms. The stakes are too high. And we are already behind the curve.

Thank you again for considering this critical legislation to ensure that this country's entrepreneurs and small businesses have access to the capital they require. I look forward to supporting you in this legislation.

Respectfully submitted,

Samuel S. Guzik
Guzik & Associates

cc: Representative Patrick T. McHenry

## Appendix I

**Samuel S. Guzik** has more than 35 years of experience as a corporate and securities attorney and business advisor in private practice in New York and Los Angeles, including as an associate at Willkie Farr and Gallagher, a major New York based international law firm, a partner at the law firm of Ervin, Cohen and Jessup, in Los Angeles, and in the firm he founded in 1993, Guzik & Associates. Mr. Guzik has represented public and privately held companies and entrepreneurs on a broad range of business and financing transactions, both public and private. Mr. Guzik has also successfully represented clients in federal securities litigation and SEC enforcement proceedings. Guzik has represented businesses in a diverse range of industries, including digital media, apparel, health care and numerous high technology based businesses.

Guzik is a recognized authority and thought leader on matters relating to the JOBS Act of 2012 and the ongoing SEC rulemaking, including Regulation D Rule 506 private placements, Regulation A+, and investment crowdfunding. He has been consulted by Congressional members, state legislators and the U.S. Small Business Administration Office of Advocacy on matters relating to the JOBS Act and state securities matters. He is a frequent blogger on his blog, The Corporate Securities Lawyer Blog (www.corporatesecuritieslawyerblog.com), addressing developing corporate and securities laws issues.

Mr. Guzik has twice been cited by former SEC Commissioner Daniel M. Gallagher in public speeches as a thought leader in JOBS Act reforms and as a small business advocate: *"Grading the Commission's Record on Capital Formation: A+, D, or Incomplete?* (Note 19), March 27, 2015, https://www.sec.gov/news/speech/032715-spch-cdmg.html; *"Whatever Happened to Promoting Small Business Capital Formation,"* (Note 36), September 17, 2014, https://www.sec.gov/News/Speech/Detail/Speech/1370542976550

He has published two major commentaries on JOBS Act rulemaking in The Harvard Law School Forum on Corporate Governance and Financial Regulation: the first article, entitled "Regulation A+ Offerings – a New Era at the SEC," discussing the SEC's proposed regulations implementing JOBS Act Title IV Regulation A+ (also published in the Fall 2014 issue of the Texas Journal of Business Law); the second article is entitled "SEC Crowdfunding Rulemaking under the JOBS Act – An Opportunity Lost?" addressing deficiencies in the SEC's proposed Title III investment crowdfunding regulations. Mr. Guzik also authors a regular column on Crowdfundinsider.com, The Crowdfunding Counselor, addressing JOBS Act issues affecting entrepreneurs, small and emerging companies, investors and Internet-based funding portals. His articles have been cited in national business publications on issues relating to federal securities regulation, including The Economist, Forbes, Bloomberg's Businessweek, Compliance Weekly and Equities.com, as well as by SEC Commissioners.

Mr. Guzik has also been a regular speaker on federal securities matters, including leading government, academic and trade association forums. He also served as President of the Crowdfunding Professional Association in 2015. Mr. Guzik is also a founding member of The Heritage Foundation Securities Regulation Working Group, focusing on federal regulatory issues affecting small businesses and emerging growth companies, including ongoing JOBS Act and Dodd-Frank SEC rulemaking.

He received a B.S. degree in Industrial and Labor relations from Cornell University and is a graduate of Stanford University Law School. He is admitted to practice in both New York and California.