ANGEL CAPITAL ASSOCIATION

October 17, 2019

Mr. Thomas Feddo
Assistant Secretary for Investment Security
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: Comments on proposed regulations to implement the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), relating to the authorities of the Committee on Foreign Investment in the United States (CFIUS)

Dear Assistant Secretary Feddo:

Thank you for the opportunity to provide comments to the Department on its proposed rules implementing FIRRMA & CFIUS. We very much appreciate your leadership in finding the right balance between legitimate national security concerns and the needs of the commercial sector who are investing in the creation of jobs and the growth of our country's economy. The proposed rules include many interesting ideas and have the potential to provide much needed clarification about how the commercial sector should conduct its affairs in compliance with FIRRMA & CFIUS. However, the Angel Capital Association has several concerns about these proposed rules and is therefore grateful for the opportunity to alert you to these concerns.

The Angel Capital Association (ACA) is the leading professional and trade association supporting the success of accredited angel investors in high-growth, early-stage ventures. Our 14,000 members are among the angel investors who invest an estimated $25 billion in 70,000[1] early-stage investments every year, with companies located in every state in the country. Our comments today are in support of both angel investors and the nation's startup entrepreneurs, those who create nearly all net new jobs in the country[2] and many of the innovations that improve the quality of life throughout the world. It is vital that promising startups continue to attract angel capital, for their own growth and for the American economy.

This letter addresses some of the key concerns ACA sees with the proposed rules, particularly in relation to:

(i) the potentially significant negative impact on vitally needed direct and indirect foreign investment in benign US technologies and job creators;

(ii) the potentially significant negative impact on the liquidity of existing domestic investments by existing domestic investors, without which liquidity those investors cannot recycle and reinvest those funds in new technologies and job creators, thereby increasing the already critical shortage of needed capital; and

[1] Center for Venture Research, University of New Hampshire, https://paulcollege.unh.edu/center-venture-research/research
[2] Kauffman Foundation, 2015 https://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/the-importance-of-young-firms-for-economic-growth

(iii) the potentially significant chilling effect such uncertainty about liquidity would have on US domestic investors investing in benign US technologies and job creators.

Specifically, we are concerned about four main issues:

(A) the extremely broad scope of potential industries covered (the precise boundaries of which are very difficult to discern with any certainty whatsoever),

(B) the significant burden of verifying compliance with the new rules in connection with routine investment transactions;

(C) the rules' express statement that companies and investors may not seek any judicial review of decisions by the United States President to suspend or prohibit transactions; and

(D) the potential for sizable high fees which could be very burdensome in the context of the young startups and early stage financings in which the Angel Capital Association's members are involved.

We directly address these issues below.

(A) Broad Scope and Uncertain Boundaries

Given (i) how many industries and technologies are potentially covered by CFIUS jurisdiction, (ii) how low the threshold of potentially "controlling" behaviors a foreign investors are forbidden to undertake (many of which, such as the right to appoint directors, give management advice, or receive confidential investor updates, are absolutely standard parts of every early stage risk equity investment), and (iii) the fact that no list of friendly companies or other safe harbor mechanisms have been published, it is virtually impossible to determine with any certainty whether a particular routine start up investment presents CFIUS risk and therefore should be avoided by a potential investor.

(i) Technologies covered. The ACA believes the number of covered industries, potentially covered uses of technologies, and potentially covered data collection behaviors greatly exceeds the scope of what is necessary to protect our country's national security, and further feels that there is tremendous ambiguity in relation to many categories of goods and services, depending on which supply chain or use case in which they become ensnared.

For example, a maker of 18" diameter steel pipe might not be covered by CFIUS in the context of selling to domestic municipal sewer systems, but might well be covered if the pipes are used in the contest of strategically vital oil and gas exploration. Similarly, a maker of computer chips might not be covered in the context of their chips being used in domestic home-wi-fi routers, but might be covered if their identical chips were used by a defense contractor in relation to a piece of surveillance or security gear. Similar ambiguity relates to routine behaviors with respect to data collection necessary to deliver next generation machine learning and artificial intelligence solutions.

How is an investor supposed to determine with any certainty whether there is CIFUS risk when evaluating either of those companies? What level of scrutiny is required with respect to co-investors in every deal? If virtually any company can be covered, then logic dictates that extreme scrutiny is required on every potential investment transaction. This is impractical and will chill both domestic and

needed foreign investment. Clarity is required in the form of a narrowing of scope, safe harbors or the like to help investors define "safe" company investments.

(ii) Low Threshold for "Control" Behaviors. The ACA believes the proposed rules fail to appreciate the manner in which risk equity is typically invested in the United States. Because of the extremely high risk of this type of investment, combined with the relative inexperience of most startup founding teams, significant levels of control and protection are typically afforded to early stage risk equity investors. And these controls and protections are automatically applied by the structure of the deal to every investor investing in the class of stock being issued. Examples of nearly universally applied controls and protections include the right to appoint board directors and board observers, the right to receive confidential management updates, the right to approve major transactions by the company and the right to consult and advise the management team as necessary.

Since these controls are standard in virtually every deal, and virtually any high tech company could become subject to CFIUS jurisdiction by indirect involvement in a sensitive supply chain, this means that the prudent investor will not invest in any company where there is any foreign direct or indirect investment of any kind. Finding out whether such foreign investment is present will be impractically burdensome, so the default will be to seek a "no foreign money" clause in every termsheet, meaning that promising and potentially job-creating US startups will be even further challenged by a critical need for capital than they already are.

(iii) Lack of Clear Guidance or Safe Harbors. The ACA believes the intent of the proposed rules is very important and beneficial. ACA further believes that creating a national culture of compliance with these rules is vitally important. However, when rules present a very high burden for compliance and no clear guidance or safe harbors to ensure safety of a given transaction, a risk/benefit calculation is required for every potential transaction and such a risk/benefit calculation is the antithesis of a culture of compliance. To ensure broad compliance, the Department should provide safe harbors and/or some mechanism for seeking quick no-action letters with respect to specific companies and technologies so that there can be bright lines and reduced risk taking.

(B) Significant Burden of Compliance

Early stage risk equity investment rounds of the type the Angel Capital Association's members routinely undertake are typically small in size, small in budget and very fluid and dynamic in terms of the roster of individuals and funds who end up participating in a given round. Often, for example, it is necessary to make a "soft-circle" commitment to a round well before all of the investors have been identified. Further, these companies typically experience significant changes in strategies, markets and even vertical industries in their first few years of operation.

If it is necessary, before honoring your initial "soft-circle" commitment by making an actual investment, to do a deep and thorough review of both the scope of all of the company's possible future strategies, as well as the nationality of every other investor who may have soft-circled, as well as the nationality of every limited partner in any funds which may have soft-circled, most investors would simply refuse to invest. Or they would insist on a representation and warranty that the company is not and will not participate in any vital CFIUS-covered industries or take any money from foreign investors.

Given the complex and fact-specific nature of making an assessment of whether CFIUS jurisdiction applies, the burden of ensuring compliance is extremely high. Since there are many startups from which investors can choose, startups attempting to address vital gaps in sensitive and data intensive industries will naturally face great difficulty securing needed capital. A similar issue is already occurring with respect to life sciences companies in the US. Because of the risk, burden and uncertainty of receiving FDA approval, many high potential life science, medical device, therapeutic and diagnostic companies struggle terribly to raise needed financing and rely increasingly on NIH and NSF grants. This chilling effect would be a national disaster if it extended to the huge swath of vital technologies and industries potentially covered by CFIUS.

(C) Inability to Seek Judicial Review

Determinations that a specific investment or acquisition must be suspended or reversed for national security reasons has massive economic consequences for the company, the investors and the potential buyers. Best case, it is a significant business setback or financing crisis. Worst case it could lead to the failure of the company if another buyer or source of financing cannot be found.

Given the severity of the economic impacts from a mandate of suspension or reversal, and the nuanced nature of the analysis in terms of whether national security is involved, affected companies and investors ought to have a right to appeal to judicial review of complex cases. The fact that the statute and rules do not provide such right of judicial review, and, in fact, require some filings to include a stipulation that parties expressly waive the right to challenge any determination, exposes companies and investors to dire economic consequences without any means of redress or equitable relief.

(D) Fees And Costs

In addition to the indirect costs of compliance, the fee structure permitted by the proposed rules (lesser of 1% of transaction or $300,000) is burdensome for startup companies. As noted previously, the companies and investment rounds the members of the Angel Capital Association invest in are very small rounds, often as little as $300,000-$500,000 in total. Typically, these rounds provide little more than 12 months of operating expenses. Significant legal expenses associated with compliance combined with a filing $5,000 fee on a small $500,000 seed round is a significant burden for a company already giving away significant ownership just to raise one year's worth of operating expenses.

Conclusion & Request for Relief

In conclusion, the Angel Capital Association, on behalf of its 14,000 members, thanks the Treasury Department for its commitment to finding the right balance between legitimate national security concerns and the needs of the commercial sector who are investing in the creation of jobs and the growth of our country's economy, and further thanks the Department for this opportunity to comment and raise concerns.

We believe the economic impact of our investments is absolutely vital to the health of the US economy and we are deeply concerned about:

(i) the potentially significant negative impact on vitally needed direct and indirect foreign investment in benign US technologies and job creators;

(ii) the potentially significant negative impact on the liquidity of existing domestic investments by existing domestic investors, without which liquidity those investors cannot recycle and reinvest those funds in new technologies and job creators, thereby increasing the already critical shortage of needed capital; and

(iii) the potentially significant chilling effect such uncertainty about liquidity would have on US domestic investors investing in benign US technologies and job creators.

Additionally, and very importantly, the Angel Capital Association suggests that angel-backed small investments, such as a transaction where the total investment is less than $5 million, or any company that is below $2.5 million in annual revenues, be exempt from CFIUS jurisdiction and review.

We urge the Department of Treasury to review the specifics of our concerns and make every effort to address them so that the vital job we do of creating new professions can continue.

Respectfully,

Patrick Gouhin, CEO
Angel Capital Association

Linda Smith, Chair Emeritus and Public Policy Chair
Angel Capital Association