



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

August 13, 1996

MEMORANDUM TO ELAINE KAMARCK

FROM:

Philip Lader *PL*

RE:

REGO/Gore Announcement Idea --
SBA's New Internet Venture Capital Financing
for Fast-growth Businesses

Now with the SEC's "blessing," let me again offer this SBA initiative -- the "Angel Capital Electronic Network," (ACE-NET), an internet means of venture capital financing for fast-growth small businesses -- as an opportunity for the Vice President to demonstrate

- * the Administration's REGO achievements,
- * its innovations on facilitating access to capital, and
- * the very tangible benefits of such a public-private partnership for America's economy.

I think this could have considerable September-October media coverage in business media.

The attached materials, providing further detail, have also been sent to those persons noted below so that they might be aware of the initiative and in the event they have alternate presentation ideas.

Just let me know if and how you want us to proceed.

cc: Don Baer
Jack Gibbons
Kitty Higgins
Ron Klain
Mack McLarty
Mike Nelson
Bruce Reed
Greg Simon
Gene Sperling
Barry Toiv



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

MEMORANDUM

TO: Albert Gore, Jr., Vice President

THROUGH: Philip Lader, Administrator, SBA

FROM: Jere W. Glover, Chief Counsel

DATE: 8 August 1996

SUBJECT: Advocacy Initiative: Angel Capital Electronic Network
(ACE-NET)

INTRODUCTION

As you know, one of the President's directives to this Office and SBA has been to solve the credit crunch for small businesses. The SBA has made great strides in expanding loans to small business. However, loans do not provide all of the answers; for growing companies additional equity investment is needed to ensure financial stability.

The equity investment needs of the vast majority of small businesses fall below the range of interest of the institutional venture (VC) firms. Therefore, their needs are served by the "angel investors" -- business-savvy, wealthy individuals. These angels annually fund over 30,000 small businesses (compared to 1,000 for institutional venture firms), and provide five to ten times as much funding overall as the VCs.

For the past year we have been working on an initiative to make it easier and less costly for angels to find investment opportunities in innovative small businesses, particularly high-tech firms, via a national electronic network. The initiative will also accelerate and expand angel investments in growth companies. ACE-NET brings together university-based local angel/entrepreneur networks, SBA, and federal and state securities regulators in a re-invention of the angel marketplace that permits a low-cost free flow of information.

We believe the initiative will be of interest to you, given your long-standing commitment to the technology sector and to innovation in government services and regulation. **More importantly, it is an initiative we would like you to announce.**



BACKGROUND

In the next ten to thirty days, Advocacy will be ready to announce a unique new service that brings information technology and securities regulations together to:

- * improve the capital formation climate for small innovative/technology companies;
- * use the National Information Infrastructure (NII) (in this case, the Internet) to solve capital market inefficiencies and small business equity capital needs economically;
- * create a unique partnership between government, industry, universities and private citizens; and
- * address the single most important item of the 1995 White House Conference on Small Business (WHCSB) - capital formation. This topic received about 25% of the total votes cast.

The specific WHCSB recommendation that our initiative covers was to:

"Develop new public markets and instruments for small-firm securities," a sub-set of recommendation #406 entitled: "Investment Initiatives for High-Tech Firms."

It ranked number thirteen out of the total of sixty recommendations forwarded to the President.

THE INITIATIVE - ANGEL CAPITAL ELECTRONIC NETWORK (ACE-NET)

The Angel Capital Electronic Network (ACE-NET) is to be a nationwide Internet linking of small innovative companies seeking equity capital with "angel" investors. The network will improve the capital climate for small technology and innovative companies that need equity investments in the order of \$250,000 to \$1,500,000. This level of investment is above the limit of personal investments for most founders. Of particular significance, it is below the level of investment interest to institutional venture capital (VC) funds. The average VC investment in 1995 was \$6.5 million, far above the range of these small start-ups.

"Angel" investors are those sophisticated, accredited investors who are the primary sources of seed and start-up venture funding in the United States. They have filled the \$250,000 - \$1,500,000 investment gap for years, primarily through informal personal networking (word-of-mouth, and financial forums). [See attachment #4 for a detailed description of angel

investors.] However, the growth of the technology sector in the past years has out-paced the ability of these investors to investigate ALL of the companies that would interest them. The benefit of the ACE-NET is that it will permit "angels" to expand their search, using a secure password-controlled Internet link, and a powerful search engine especially designed for this task.

Investors and companies will access the ACE-NET through local university-based non-profit organizations (Network Participants). The nine Network Participants included in the inaugural program were selected on the following basis:

- * they are non-profit organizations that have been successfully engaged in the introduction of angels to entrepreneurs for more than five years;
- * they are under the jurisdiction of a major university or state agency that ensures a careful peer review of the business plans; and
- * they have high quality education programs that teach entrepreneurs how to approach the financial community and angels how to work with entrepreneurs.

The network will be managed by a board of directors which will include a representative of each of the inaugural Network Participants, the Chief Counsel for the Office of Advocacy or representative, and probably one or more representatives from venture capital organizations. One of the goals of the network is to add Network Participants from the other 42 states as soon as qualified ones can be added (with their state approvals).

A pilot demonstration of the ACE-NET was funded by the Office of Advocacy and is hosted on a server at the University of New Hampshire, managed by the Center for Venture Research (CVR-UNH). CVR-UNH was selected because they have a twenty-year track record of research in angel investments and have a long-standing commitment from their university leadership to support this effort. They will maintain the longitudinal data-base on the ACE-NET transactions. The pilot demonstrator is in the final debug stage and can be viewed on the Internet at:

<http://rccwww.unh.edu/angel/>

Initial User ID: wsbe
Initial Password: xbz1d

Search User ID: angel
Search Password: demo

Based on this pilot demonstrator of the ACE-NET we estimate the initial budget for the entire project is on the order of \$400,000 to \$500,000 for the first year, dropping to about \$250,000 the second year. We expect it to be entirely self-funded in the remainder of its operation. The Office of Advocacy and the DoD SBIR program have each committed \$50,000 to assist in the initial funding. The rationale for DoD support is that ACE-NET will facilitate the commercialization of product development of the Small Business Innovation Research (SBIR) program. We are meeting with other SBIR agencies and expect to receive more than half of the start-up funding from federal government agencies with SBIR or other small business technology programs. We expect to obtain the remainder of the funds from major corporations and financial institutions.

SECURITIES AND EXCHANGE COMMISSION

We have been working extensively with the Securities and Exchange Commission (SEC) staff and management and we received favorable final comments from them this week on the attached draft letter requesting that the agency take no action against the network as currently designed. Chairman Levitt and Administrator Lader have been personally briefed on this subject. (We also briefed Bob Stone and Greg Wood at NPR as part of the discussion on the U.S. Business Advisor program that we supported.)

STATE SECURITIES REGULATORS

The working regulations that govern each of the transactions between angels and entrepreneurs are defined by the state in which the company (and the angel) reside. We have also been working with the state regulators directly and through their North American Securities Administrators Association (NASAA) to ensure that the program will receive the appropriate support from them. We expect to have support from at least two of the state securities commissioners from the states covered in this pilot program before announcement. (Formal approval is not required, but we have worked to ensure that active support is obtained.)

We have also been working with a number of states to encourage them to develop reciprocal agreements to permit interstate sales of securities. Under these reciprocal agreements, the home state of the company would review the adequacy of the securities information filed and would issue a permit to sell stock. Other states would accept the adequacy of this review and would not require the company to submit additional information in order to issue a permit to sell stock in their state. New Hampshire has developed and passed model legislation that would allow reciprocity. Missouri and Kansas

have also passed legislation that permits reciprocity between their states. Similar legislation is currently under consideration in other states.

PUBLIC ANNOUNCEMENT

The ACE-NET will be ready for public announcement as soon as SEC responds to the final "No Action" request letter--we expect this within two weeks. Their letter of response will be a public document and we want to be ready for announcement when this is received. The proposed agenda for public announcement is as follows:

August Washington

Initial announcement of the service; SEC concurrence (as indicated by a "No-action" letter from them); initial two Network Participants (probably Pennsylvania and Massachusetts); New Hampshire as host of the ACE-NET.

Participants: Vice President
SEC - Levitt
SBA - Lader & Glover
Congressional reps from PA, MA and NH
University of New Hampshire, Center
for Venture Research

After the initial announcement, the following activities are planned:

August-Sept. Local events in states as the Network Participants come online.

Texas, California [Irvine, San Diego], Georgia, Kansas, Missouri and North Carolina

Sept. 26-27 Washington

SEC Government and Business Forum on Small
Business Capital Formation (annual SEC Forum)

Late Sept. Washington

State and Federal Technology Partnership Forum being organized by the Office of Science and Technology Policy (Dr. John Gibbons, The Assistant to the President for Science and Technology), Dept. of Commerce (Dr. Mary Good, Under Secretary for Technology), and National Governors' Association (Jay Kayne, Director, Economic Development and Commerce Policy Studies) with support from SBA and others.

CONCLUSIONS

The ACE-NET brings together key departments of the Administration, state securities regulators, and experienced university based angel/entrepreneur networking organizations to provide a creative low-cost and effective solution to the problem of equity capital formation for small technology and innovative companies. It fills a gap in the capital formation structure that will multiply the effectiveness of other Administration efforts in this area.

We would be pleased to provide additional details to you or any members of the Administration staff.

cc: Philip Lader, Administrator, SBA
Elaine C. Kamarck, Senior Policy Adviser
for the Vice President
Bob Stone, NPR
Greg Wood, NPR

ATTACHMENTS

1. Draft request to SEC for ACE-NET approval, Advocacy letter, July 1, 1996
2. One page summary of program
3. Seven page outline of program
4. "Creating New Capital Markets for Emerging Ventures," Report by Center for Venture Research, University of New Hampshire, June 1996, prepared for the U.S. Small Business Administration, Office of Advocacy, under Contract No. SBAHQ-95-M-1062.



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OFFICE OF CHIEF COUNSEL FOR ADVOCACY

IMPROVING THE ANGEL CAPITAL MARKETPLACE--DETAILS

I. White House Conference on Small Business Capital Formation recommendations:

- NCRA # 5: Pensions and 401(k) Investment in Small Business
- NCRA # 9: Banking Industry Regulation Reform
- NCRA # 14: Secondary Capital Markets
- NCRA # 20: Small-Business Investment
- NCRA # 24: Small Corporate Offering Registration
- NCRA # 25: Small-Business Loan Guarantee Programs
- NCRA # 28: Financial Institution Performance Under the Community Reinvestment Act
- NCRA # 31: Community Reinvestment Act
- NCRA # 91: Pension Reform
- NCRA #129: Pre-Export Financing
- NCRA #139: Small Business Relief Fund
- NCRA #161: 8(a) Program Reforms
- NCRA #242: Capital Gains Tax Treatment
- NCRA #390: Capital Gains Taxes
- NCRA #406: Investment Incentives for High-Tech Firms

II. The Office of Advocacy has investigated the capital needs of small companies over the 20 years of its existence. Specific recent studies include:

- A. Banking Studies of Commercial Lending Practices of all 10,000 banks in the U.S. (1994 and 1995).
- B. Pension Investments
- C. The Third Millennium: Small Business and Entrepreneurship in the 21st Century
- D. Capital Needs for Innovative Small Businesses and Entrepreneurship in the 21st Century.

The results of these studies show that access to capital for small business is still problematic in many areas:

- A. Short-term capital (callable bank loans, trade accounts payable, and finance company loans make up 46% of the measurable financing of U.S. small businesses).
- B. Long-term loans for small businesses are almost all mortgages and are collateralized by the brick and mortar of the buildings used by the businesses. Mortgages represent 47% of the small business measurable financing.



- C. Equity capital for small businesses is only 7% of the measurable financing of these businesses and includes the NASDAQ SmallCap listings (3%) and venture capital institutional investments (4%). Very little institutional venture capital goes into start-up and seed investments--typically fewer than 100 deals per year.
 - D. SCOR offerings to the public have not yet provided a significant source of capital to small businesses.
 - E. Angel (business-sophisticated, wealthy individual investors) have provided the major source of start-up and seed capital for "non-life-style" companies that are beyond the capability of founders and friends to finance.
- III. The Angel market is a "hidden" market, with very little hard information on the size and characteristics of the market or players. In order to better understand the market and its dynamics the Office of Advocacy undertook the following since the 1995 WHCSB:
- A. Contracted with the Center for Venture Research at the University of New Hampshire to develop an objective and thorough analysis of the market, its dynamics and characteristics of the players and structure. The principal investigators for this project are:
 - William Wetzel, Director Emeritus, CVR
 - Dr. Jeffery Sohl, Director, CVR.
 - B. Held focus groups to better understand the players, issues, dynamics, structure and integration of this market into the overall financing of small businesses. These focus groups were held as follows:
 - Boston--Angels, venture capitalists, The Capital Network-MIT
 - Providence--(in conjunction with the SEC Small Business Capital Formation Forum)--Angels, state economic development agencies, accountants, small business owners, state securities regulators, angel networking organizations
 - New York--Corporate securities attorneys specializing in small business offerings
 - Washington--State securities regulators
 - Menlo Park (CA)--(3000 Sand Hill Road)--Leading venture capital institutions, angels, state economic development agencies, angel networking organizations

Palo Alto (CA)--Leading corporate securities attorneys and accountants for Silicon Valley companies, security litigation plaintiff's attorneys

Irvine (CA)--Angels, venture capital firms, SCOR organizations, banks specializing in small entrepreneurial businesses, angel networking organizations, state economic development agencies

San Diego--Angels, venture capital firms, state capital formation leaders, university-based angel and venture capital network organizations

- C. Continued communication with the WHCSB Issue Implementation Chairs for Capital Formation and for Technology and Information Revolution.
- D. The conclusions and recommendations from these meetings, studies and discussions are summarized as follows:
1. The angel marketplace is an inefficient market for the following reasons:
 - a. State securities regulations prohibit the free flow of information on opportunities, completed deals and competing businesses.
 - b. Except for Silicon Valley and the Route 128 region, each transaction is structured as a unique event, with appropriately high costs.
 - c. Except for Silicon Valley and the Route 128 region, each transaction has high liability insurance costs.
 2. The education process for entrepreneurs and angels is very expensive, and is currently primarily an "on-the-job" training exercise with the new taught by the old. Only a few universities have developed solid programs to teach entrepreneurs how to develop business plans and how to approach investors. Even fewer have good programs to teach budding angels how to analyze business plans and how to develop portfolio strategies.
 3. A new generation of wealthy, self-made potential angels has developed and they are interested in investing in entrepreneurial deals. They are generally limited by their lack of experience, lack of connection into the existing "good-old-angel network," and lack of access to deals.

- IV. The robust angel and venture capital network of Silicon Valley and the Route 128 region have developed some "unwritten rules of the game" that have helped to make these regions rich in start-up and seed capital. These include:
- A. Angels perform a valuable mentoring function for small start-up and seed companies. The angels are generally experienced CEOs and senior executives of previous companies and a part of their compensation for being an angel is the satisfaction that comes from mentoring.
 - B. Venture capital firms develop long-standing relationships with angels and will often follow them into solid deals. A good angel on the Board of Directors or Advisors can often mean the difference between a small company obtaining institutional venture capital or not.
 - C. Angels don't litigate when the deal goes bad. They expect that some of their investments will not succeed--that's the nature of risk investment. When they recognize they have a bad investment, their action typically is to try to recoup as much as possible by selling the products or assets to other companies.
 - D. Angels use very standard terms and conditions of the stock sale. Venture capitalists, angels and experienced corporate securities attorneys generally spend very little time and expense on working special terms. The primary time and effort of the angel is spent in analyzing the business validity of the transaction.
- V. The Center for Venture Research has documented that the angel investors are a much larger factor than institutional venture investors in funding small start-ups and seed companies. The angels are fundamental to the "farm-league" process that graduates companies to the large venture firms.
- VI. The primary findings of the effort by the Office of Advocacy to date and the recommended actions are as follows:
- A. An electronic network that permits established university-based, angel-networking organizations to share information would bring considerable value to the economic climate of the U.S. with little or no downside. The characteristics of a specific recommendation for this network are as follows:

1. Establish a pass-word controlled electronic network at the University of New Hampshire that would link the following initial organizations:

The Capital Network--MIT, Massachusetts
Advanced Technology Center--Georgia Institute
of Technology, Georgia
Accelerate SBDC--University of California at
Irvine, California
UCSD-CONNECT--University of California at
San Diego, California
The Enterprise Network--University of Santa
Clara, Silicon Valley, California
The Texas Capital Network--University of
Texas, Austin, Texas
KTEC--Topeka, Kansas
Ben Franklin Partnership, Philadelphia,
Pennsylvania
North Carolina Biotechnology Center, Research
Triangle Park, North Carolina

as the experienced leaders in this angel and entrepreneurial networking and education process.

2. Permit the accredited investors working with these organizations to view transactions in other states. (Accredited investors would meet the criteria of the state of residence.)
3. Only U.S. based companies that have filed with their state of primary place of business for sale of securities would be permitted to place their listings on the network.
4. No transaction fees would be permitted for these listings--only listing fees.
5. The university-based organizations would be required to offer their education programs for entrepreneurs and angels to other organizations on the network.
6. The network would be governed by representatives from the networked organizations and the chair of the governing board would be the Chief Counsel of the SBA Office of Advocacy (or designated representative).
7. Other university-based organizations would be encouraged to participate when they meet the requirements of educating and networking of angels

and entrepreneurs established by the governing board. The goal would be to have one or more from each state.

- B. State securities regulators would be encouraged to develop regional or national reciprocity agreements with other states to permit the sale of securities to accredited angels when they have been permitted in the home state of the offering business. [New Hampshire has led the nation in developing the framework for this, and Kansas and Missouri have developed a reciprocal agreement.]
- C. Standardized terms of sale for the securities are in the process of being developed for the SBA Office of Advocacy by experienced corporate attorneys and law schools for use by investors and entrepreneurs. No individual or company would be required to use these standard term sheets, however, they will help guide the parties to standard terms used by most parties.

[DRAFT 7/1/96]

Catherine McGuire, Associate Director
and Chief Counsel
Division of Market Regulation
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Jack W. Murphy, Associate Director
and Chief Counsel
Division of Investment Management
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Ms. McGuire and Mr. Murphy:

On behalf of the Angel Capital Electronic Network (Network), we request confirmation from the Division of Investment Management that the staff would not recommend enforcement action against the Angel Capital Electronic Network (Network) and the Network Participants (Network Participants) if the Network and the Network Participants do not register as "investment advisers" under Section 203(a) of the Investment Advisers Act of 1940, as amended, (Investment Advisers Act).

In addition, we also request confirmation from the staff of the Division of Market Regulation that it would not recommend enforcement action against the Network and the Network Participants if the Network and the Network Participants do not register as "brokers" or "dealers" under Section 15(b) of the Exchange Act of 1934, as amended, (Exchange Act), and if the Network and Network Participants do not register as "exchanges" under Section 6 of the same Act.

BACKGROUND

The Office of Advocacy of the U. S. Small Business Administration has the statutory responsibility to represent the interests of small businesses within the federal government. Related to this, the Office is working to implement the recommendations from the 1995 White House Conference on Small Business.

Access to capital was one of the top issues at the 1995 White House Conference on Small Business. Fifteen of the top 60 recommendations were related to capital formation. These recommendations received 24% of the total votes, more than any

[DRAFT 7/1/96]

other issue topic. At the conference, many small business owners voiced their frustrations with seeking capital through the equity markets. Access to the equity markets appeared to be even more troublesome for owners of small innovation- and high technology-based businesses.

In the past year, the Office of Advocacy held over nine focus groups across the country with small business owners, venture capitalists, angel investors, attorneys, accountants, capital formation leaders, academicians, state securities regulators and state economic development agencies to discover the problems small businesses confront when seeking to issue securities.

In addition to the focus groups, the Office of Advocacy contracted with the Center for Venture Research, University of New Hampshire, to study the contributions of accredited investors to the capitalization of small firms.

We found that the greatest obstacles a small corporation confronts are: 1) a limited exposure to experienced, accredited investors and 2) the high transaction costs of soliciting and/or obtaining equity capital.

Based upon the recommendations of the 1995 White House Conference on Small Business, the issues raised by the focus group meetings, and the findings from our completed research, we believe that the creation of an electronic bulletin board available through the Internet listing small corporate stock offerings will facilitate small companies' access to accredited investors.

PROPOSAL

It is our intention to create the Angel Capital Electronic Network (Network), an electronically connected electronic bulletin board system run by participating universities and non-profit entities and/or their non-profit subsidiaries (Network Participants) for the purpose of listing small corporate offerings. The electronic bulletin boards, available through the Internet, will allow accredited investors to access a listing of small corporate stock offerings and to download offering circulars.

We are currently in discussion with the following universities and non-profit entities as potential Network Participants:

Center for Venture Research
Whittemore School of Business and Economics
University of New Hampshire
Durham, New Hampshire

[DRAFT 7/1/96]

The Enterprise Network
Silicon Valley Capital Network
Sunnyvale, California

Accelerate Technology Small Business Development Center
Graduate School of Management
University of California, Irvine
Irvine, California

UCSD-CONNECT
Extended Studies and Public Service
University of California, San Diego
San Diego, California

Business and Technology Development
North Carolina Biotechnology Center
Research Triangle Park, North Carolina

Ben Franklin Technology Center
of Southeastern Pennsylvania
Philadelphia, Pennsylvania

Technology Capital Network at MIT
Cambridge, Massachusetts

KTEC-Kansas Technology Enterprise Corporation
Topeka, Kansas

Economic Development Institute
Advanced Technology Development Center
Georgia Institute of Technology
Atlanta, Georgia

The Capital Network, Inc.
Austin, Texas

The primary mission of these university-based and non-profit entities is to help start and sustain new enterprises through capital, technology, technical and training assistance.

The Network will have one central computer system, operated by the Center for Venture Research, University of New Hampshire, and will be electronically connected to each of the Network Participants. In turn, each of the Network Participants will establish its own independent electronic bulletin board.

Small companies will be allowed to list their securities offerings on the Network through their local Network Participant. Small companies will be assessed a nominal fee to list their corporate offerings on the Network.

[DRAFT 7/1/96]

Listings on the electronic bulletin boards will consist of small corporate offerings exempt from federal registration under Regulation A or Regulation D, Rule 504. Accredited investors registered with the Network Participants will be able to access through the electronic bulletin boards a small corporation's "tombstone" advertisement, Regulation A Form 1-A and/or the Small Corporate Offering Circular Form (SCOR Form or Registration Form U-7). In addition, "solicitation of interest documents" pursuant to Regulation A may be listed on the Network. These documents will be prepared by the small corporation. It will be the responsibility of the small corporation to be in full compliance with the appropriate filing and registration requirements of federal and state securities laws and regulations.

Access to the Network will be available only to "accredited investors" through a pass-word system. Each investor will be required to certify that the investor is an "accredited investor" within the meaning of Rule 501 of Regulation D under the Securities Act of 1933. If a sales transaction occurs, it will be the responsibility of the small company to ascertain before completion of the sale whether the investor meets the criteria of an "accredited investor" within the appropriate jurisdiction.

Investors who have registered with their local Network Participant will be able to access the electronic bulletin boards and review the lists of companies. The investor may then download the publicly filed Form 1-A's or SCOR Forms of the listed companies. If an investor wishes to purchase stock from a small company listed on the bulletin board, the investor must contact the small company directly.

No trading will take place on the Network and no Network Participant will participate in any sales transaction.

As the Network will contain a data base of investors and small corporations, the Center for Venture Research, University of New Hampshire, will have all propriety rights to the data base that is created from the Network system. Precautions, however, will be taken to ensure the confidentiality of the investors and small companies. The Center for Venture Research will be permitted to use aggregated statistical data generated from the data base for teaching and research purposes relating primarily to entrepreneurship.

The Network Participants are to select at their option an Advisory Board for the Network. The Advisory Board will establish the electronic bulletin boards' specifications, Internet access specifications, and overall Network operating procedures.

[DRAFT 7/1/96]

Funding for the Network will be obtained from a nominal fee charged to the participating small companies. This fee will cover administrative costs. Additional funding may be sought from federal and state governmental agencies, foundations and from corporate and individual sponsors.

As for the latter, a sponsor of the Network will be allowed a box located on the screen of the Network's "homepage" and the Network Participants' homepage which will contain either advertising information furnished by the sponsor and/or will connect the viewer to the sponsor's homepage (very much like what is currently available on the World Wide Web portion of the Internet). Sponsorship of the Network will not grant a sponsor either special access to the Network's listings or decision making authority over the Network. Small corporations that are listed on the Network will be ineligible to become a sponsor.

DISCUSSION

The Investment Advisers Act of 1940

The Network and the Network Participants do not believe that they are required to register as "investment advisers" as set forth under Section 203(a) of the Investment Advisers Act of 1940.

The Network and Network Participants will not be engaged in the business of advising others concerning the advisability of investing in the small companies listed on the electronic bulletin boards nor will they be in the regular business of issuing or promulgating analyses or reports concerning securities.

Neither the Network nor the Network Participants will make any recommendations concerning any offering of securities listed on the Network. The Network and Network Participants will not (i) advise any entrepreneurs or investors on the merits of any investment opportunity, (ii) participate in negotiating the terms of any investment, (iii) hold themselves out as providing any securities-related services other than a listing service, (iv) provide information as to how the investor and the entrepreneur would complete a transaction, or (v) handle funds or securities involved in completing the transaction. In addition, no fees, other than a nominal listing fee to cover administrative costs, will be assessed or made contingent upon the completion of a sales transaction.

Network officials, participants, and employees and participating university officers, directors and employees with direct operating or supervisory control over Network Participants will not participate as entrepreneurs or investors in any company

[DRAFT 7/1/96]

listed on the Network.

The Securities and Exchange Act of 1934

The Network and the Network Participants do not believe that they are required to register as a "brokers" or "dealers" under Section 15(b) of the Exchange Act of 1934. In addition, it is believed that the Network and Network Participants are not required to register as "exchanges" under Section 6 of the same Act.

While a "broker" is defined in Section 3(a)(4) of the Exchange Act as a person engaged "in the business of effecting transactions in securities for the account of others," and a "dealer" is defined in Section 3(a)(5) of the Exchange Act as a person engaged "in the business of buying and selling securities for his own account," the Network and Network Participants neither effect the transactions in securities listed on the Network nor are in the business of buying and selling securities listed on the Network.

Specifically, the Network and the Network Participants will not: (i) provide advice about the merits of particular opportunities or ventures, (ii) receive compensation from program participants other than the nominal fee to cover administrative costs, (iii) participate in any negotiations between the investor and entrepreneur, (iv) handle funds or securities involved in completing a transaction, or (v) represent or hold themselves out as providing any additional securities-related services to investors or entrepreneurs other than a listing service.

The Network and the Network Participants will not receive compensation other than a nominal fee to cover administrative expenses. No other fees, commissions or compensation will be due from the investors or the entrepreneurs. The fee will be unrelated to the outcome or completion of transactions in securities listed on the Network.

With regard to the registration of the Network and the Network Participants as "exchanges" under Section 6 of the Exchange Act, the Network and the Network Participants do not believe that they are required to register. The Network will not perform the functions commonly performed by a stock exchange. The Network will only be a listing service for small corporate stock offerings and will not effect any transaction in a security nor report any such transaction for companies listed on the Network. Once an accredited investor decides to invest in a company listed on the Network, the investor must contact the small company directly.

[DRAFT 7/1/96]

CONCLUSION

- 1) The Network and the Network Participants should be exempt from registration under Section 203 of the Advisers Act since the Network will not be engaged in business of dispensing advice to investors on the worthiness of small corporate stocks listed on the Network.
- 2) The Network and the Network Participants should be exempt from registration under Section 15(a) of the Exchange Act. The Network and the Network Participants will not be engaged in the business of effecting securities transactions nor will they be engaged in the business of buying and selling securities.
- 3) The Network and the Network Participants should not be required to register as exchanges under Section 6 of the Exchange Act. The Network is solely a listing service and does not effect any transactions in securities or report any such transactions to third parties.

ACTION REQUESTED

We respectfully request that the staff of the Commission confirm that it will not recommend enforcement action against the Network and/or the Network Participants.

Thank you for your consideration of this matter. If you need clarification or have any questions concerning the establishment of the Network, please contact me at (202) 205-6533 or Gregory Dean, Jr, Assistant Chief Counsel for Banking and Financing, of my staff at (202) 205-6951.

Sincerely,

Jere W. Glover
Chief Counsel for Advocacy