Testimony of
Catherine Mott, CEO, BlueTree Capital

Senate Committee on Banking, Housing and Urban Affairs
"Legislative Proposals on Capital Formation and Corporate Governance"
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Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the invitation to testify before you today. I am Catherine Mott, founder and CEO of BlueTree Capital and its affiliates, BlueTree Allied Angels and the BlueTree Venture Fund, all based in Pittsburgh, Pennsylvania. I am past Chairman of the Angel Capital Association (ACA), the professional association of active accredited investors across North America.

I appreciate the opportunity to comment on legislative proposals that would make it easier for entrepreneurs and emerging companies to find the capital they need to maintain their role as the engine of American economic growth. I applaud the Committee for addressing these issues so early in this Congress, and for recognizing its critical role in increasing economic growth by removing barriers to capital formation.

The Role of Angel Investors

"Angel" investors are accredited individuals who invest their own money in early-stage companies, helping them achieve success. Angel investors support promising companies in every state of the union. Angels invest approximately $25 billion each year in more than 70,000 startups. Compared to venture capitalists, angels invest in 15 times more businesses, albeit smaller amounts across a greater number of companies.

Angel investors are private individuals writing personal checks. After friends and family, they are the primary source of equity capital for most startup companies, supplying critical funding to companies that are too early and too risky for bank loans, and too small or new for venture capital firms. Without angel funding, these businesses would never get off the ground.

The median angel investment in a startup company is about $850,000, but investments range from $50,000 to $2,000,000. In most cases, multiple angels participate in these investments, with each angel contributing between $5,000 and $50,000.

Money, however, is not all angels invest. Angels provide not only financial capital but human capital — time, expertise, mentorship, and access to our networks of experts, service providers, and potential customers. We tend to invest in companies based in or near our own communities, to support local economic development and make the best use of our specific resources.

Startup companies typically go through several levels of private equity funding. The first layer is "bootstrapping," or the investment of the entrepreneur's own money. The second is capital from friends and family. Angels and angel groups follow (often in multiple rounds of funding), and if the business succeeds, the next stage is venture capital. Angels are often the bridge to venture capital, and angels may build relationships with venture capital firms to help with this transition.

Angel investing is not a low-risk activity. Looking at a typical set of 10 angel investments, three to four break even, five may fail, and one — just one — delivers high-yield results. It is worthwhile, however, because of the opportunities these investments provide for mentoring and making a difference at the ground level of the American economy.

The BlueTree entities have invested more than $50 million in startup companies that meet a list of ten criteria, including an experienced and talented management team; a clear path to cash flow breakeven; a clear strategy for exiting angel funding; and primary operations in targeted, high-growth industries. Our BlueTree Allied Angels network is a group of accredited investors that meets regularly in Pittsburgh to evaluate potential investments. BlueTree Allied Angels has 76 member investors, and we are currently accepting new investors.

The Angel Capital Association, our national trade support organization, comprises more than 14,000 accredited angel investors like me, and 260 angel groups, individual angels, online platforms for accredited investors such as AngelList, and family offices. Our investment portfolios include more than 20,000 entrepreneurial companies, including some of the most iconic names in America, which got their initial startup funding from angel investors. Even Pittsburgh-based Alcoa owes its start to two angel investors, back in 1888. I have attached a short list of successful companies BlueTree angels have helped to fund, to give you some idea of the range of these businesses and industries.

Legislative Proposals to Promote Capital Formation

BlueTree and the other members of the Angel Capital Association are glad to see the Committee return to two bills considered in the last Congress that would clarify investment procedures and expand opportunities for entrepreneurs and investors. These are the "**Helping Angels Lead Our Startups Act**," or **HALOS Act**, and the **Fair Investment Opportunities for Professional Experts Act**. Both are bipartisan, common sense proposals that should not be controversial, and would produce immediate benefits with no real risk to investors or the economy.

Senator Sinema has been a champion of the HALOS Act during her service in the House, and ACA looks forward to working with her and Senator Toomey in this Congress to see it become law.

The HALOS Act would clarify that "demo days" are exempted from the definition of "general solicitation," eliminating market confusion about these events and providing entrepreneurs with better access to capital. While the JOBS Act created general solicitation to allow entrepreneurs to raise capital publicly for Regulation D offerings (called 506C offerings), with requirements for issuers to take additional steps to verify that investors are accredited, the SEC did not change or modernize its own definition of general solicitation. As a result, that definition now effectively includes "demo days," the events in which entrepreneurs pitch their products and companies to potential investors, local economic development officials, academics and other members of the startup ecosystem.

The problem for entrepreneurs is that most accredited investors are not interested in investing in generally solicited offerings because the SEC "safe harbors" for verification require certifications from third parties such as CPAs that are costly, and these certifications last only for three months. Because angels build portfolios for diversification, they would have to be certified 4x a year every year. Accredited investors prefer to avoid this additional burden and instead invest in private (506B) offerings that allow them to self-certify their accredited investor status in significant legal documents.

Demo days have been an essential part of America's startup culture for more than 30 years with thousands of events every year without problem. Some current name brand companies, such as Airbnb and Dropbox, started their journeys in accelerators that hold demo days at the end of their programs. These events have always included the full spectrum of the innovation ecosystem, from university students to seasoned angel investors, venture capitalists, accelerators and incubators, government economic development agencies, and professionals who support entrepreneurs. Demo days have traditionally offered valuable education in entrepreneurship to students, would-be entrepreneurs, new investors and economic development leaders. Entrepreneurs pitch their ideas to a general audience, but engage in capital raising only with accredited investors. The SEC's rules on general solicitation have had the unintended consequence of creating confusion among investors, potential legal liability for entrepreneurs, and a reduction in funding opportunities for startups.

I receive hundreds of invitations for demo days in Pennsylvania every year, and work with my BlueTree colleagues to assign someone to attend as many as possible. Many Pennsylvania demo days have followed local legal advice to remove not only information about the offering, but also descriptions of the companies' business models from pitches. This reduces educational effectiveness — as most investors evaluate companies on how they will create, build and capture value — and it also makes it more difficult for entrepreneurs to get their best information to potential investors.

The Fair Investment Opportunities for Professional Experts Act would modernize the definition of "accredited investor," which was last addressed in the Dodd-Frank Act. ACA applauds the work of Senators Tillis and Cortez Masto in building bipartisan consensus to grow the pool of capital available for new businesses. The bill would codify the current income ($200,000 for an individual/$300,000 for a couple) and net worth ($1,000,000 excluding the primary residence) thresholds for being considered an accredited investor, eliminating regulatory discretion and providing much-needed certainty to angel investors. The bill would also allow certain people with other demonstrated expertise or credentials, such as demonstrated financial sophistication via education or experience of profit and loss responsibility in businesses, to become accredited even if they do not meet these financial minimum requirements.

These changes are common sense ways to grow the pool of accredited investors without excessive risk or disruption. This is especially important in Middle America, where the cost of living is lower and where entrepreneurial activity is desperately needed in areas devastated by losses in manufacturing jobs.

The bill's proposal to index the numerical thresholds for accredited investor status to inflation, with adjustments every three years, raises some concerns. While we recognize the intent to protect accredited investors against potential losses, we fear that raising these thresholds too quickly or too often may shrink the pool of capital available to startup companies. If Congress decides to add these inflationary increases to the financial thresholds, the Committee may want to ensure that any changes allow accredited investors to retain their accreditation through a hold-harmless or "grandfathering" provision. The risk is that the higher thresholds may push accredited investors out of the income or asset minimums, stripping their accredited status and preventing them from continuing to invest in the high-growth startup companies that create innovation and jobs in the US — and that could help boost investors' returns.

I also see people who are financially sophisticated but don't meet the wealth or income thresholds, who could help new businesses start and grow. Some of the young attorneys who develop the deal terms and investment documents for Pittsburgh angels, for example, are not currently accredited investors but know a lot about the companies and investment opportunities. Enhancing the pool of angel investors by a sophistication criteria (i.e. education or profession) can help fund many more companies that are left behind but, given a financial life-line, could deliver meaningful results for the American economy.

Thank you again for taking up these legislative proposals. Your bipartisan commitment to improving access to capital for early-stage startup companies will produce long-term benefits to our economy at both local and national levels. The members of the Angel Capital Association support these efforts and stands ready to provide assistance and expertise as needed toward our common goals of economic opportunity and job creation. Please call on me as a resource as you continue this work.

I would be happy to answer any questions the Committee may have.

Successful Angel Funded Companies

Pittsburgh:

Wombat Security (acquired by Proofpoint Systems, Inc. — remains in Pittsburgh)
Shoefitr (acquired by Amazon)
Fore Systems (IPO, then acquired by Marconi, Inc — remains in Pittsburgh)
GiftCards.com (acquired by BlackHawk Network Holdings, Inc.)
DuoLingo (Unicorn Status)
Pineapple Payments, Inc.

Older and notable:

Free Markets (IPO, then acquired by Ariba, Inc.)
Alcoa, Inc.

Others around the country:

Home Depot
RedHat (acquired by IBM)