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Informal capital-raising consultation responses
Enterprise Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

12 April 2004

Dear Sirs

We are a private equity services firm providing strategic, financial and funding advice to early-stage technology related companies. Our client base is primarily in the USA and Europe and we raise early-stage high risk equity funding from High Net Worth Investors (“HNWs”), Sophisticated Investors (“SIs”), Venture Capital Firms and Strategic Corporates around the world.

I personally wear two hats as CEO Europe for MCC Energy Group, Inc. in which role I particularly focus on the alternative/renewable energy sector in the UK and as a Director and the Compliance Officer of our FSA regulated business in the UK – Moore, Clayton & Co. (UK) Limited. I am also a certified HNW and SI in my own right and active early-stage business investor.

At the moment we are attempting to encourage new investors into the relatively new area of alternative/renewable energy. This is a sector identified by the UK government as of strategic priority through the White Paper last year and reinforced by the recent DTI innovation review in February. As practioners at the cutting edge of encouraging private investors to invest in a sector that is forecast to require £10 billion of funding by 2010 in the UK alone, **we find the current FPO unworkable and completely unhelpful** in achieving that objective. We very much welcome the opportunity, therefore, to comment on the proposed changes to the FPO which **we strongly support**.

Q1: Are the current exemptions allowing appropriate numbers of HNW’s and SI’s to become certified?

No

Q2: If no to Q1, is this posing a problem for smaller firms seeking to raise capital via unlisted equity for investors?

Yes

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In the alternative/energy sector as an embryonic industry with no history of investment there is a crucial management/commercial skill shortage. A key attribute of angel investing is that investors are able to bring to the party smart money with skills and contacts. Under the current rules we cannot approach certain individuals i.e. Head of Global Energy and Utilities at a magic circle law firm or CEO of major energy company unless **we have checked their HNW/SI certificate without having given them any information** on the potential investment (strictly speaking not even the name of the company) and even if we believe that the balance of probability is that they would **overwhelmingly satisfy the certification requirements**.

The requirement to check/see somebody's HNW/SI certificate before any information is given defies all Human norms, behavior (particularly English) and common sense and is highly likely to solicit a deservedly rude response. **It is totally impractical/unworkable**. This is a timing issue. The normal process is to call a known individual by phone, give a brief thumbnail sketch of the potential investment opportunity then **if an interest is shown** send them a 4-6 page executive summary. If at that point the **potential investor chooses** to find out more about the investment opportunity they could then sign a self-certified certificate as a HNW and SI together with a HNW/SI declaration and the usual confidentiality letter before seeing any further information. At present if intermediaries do not follow the correct procedure they are open to **personal unlimited liability** as breach of the FSA/FPO rules cannot be insured against. Not surprising when your own home and life savings are on the line **it strongly discourages any contact with HNWs or SIs** at all.

Q3: Do you agree that promotions should be allowed on the basis of a reasonable belief that an individual is either a certified HNW or SI?

No/Yes if on the correct basis

The correct basis would be that there is a reasonable belief that they would **qualify** as an HNW or SI **not** that they have the certificates. The reality is that most qualifying HNWs and SIs do not have certificates as they either regard them highly skeptically as just another excuse for their Accountant to charge them more fees, just too much hassle or are not aware of the need for them. That does not mean that they would not be prepared to sign such a certificate if it was self-certifying.

This means that the current draft needs to be altered as follows:

SCHEDULE 1

48 (1)(b) is made only to an individual whom the person making the communication believes on reasonable grounds to **qualify** as a certified high net worth individual;

50A (5)(a) is made only to an individual whom the person making the communication believes on reasonable grounds to **qualify** as a certified sophisticated investor

Of course self-certified HNW/SI certificates and declarations could be sought **once the initial contact has been made** and **after an executive summary has been sent** to the potential investor prior to any further information being provided. The timing for this only really becomes relevant at the point at which the investor invests i.e. when any potential loss of



investment can arise. This would therefore set the most sensible backstop date. Clearly, it would be important that the potential investor was made aware from the outset that copies of both the certificate and declaration would be required prior to any investment.

Obviously, the approach set out above (without the requirement for seeing the certificates or receiving signed declarations) is in line with that adopted in the US. In this case companies and advisors are exempt if they offer their or their clients securities “to accredited investors or to any person who they reasonably believe comes within the definition”

Q4a: Should potential investors be able to self-certify as HNW individuals? Yes

Q4b: Do the majority of sophisticated investors already meet the high net worth criteria?

Yes but not all

Q4c: Should the self-certification exemption replace or be introduced alongside the current HNW exemption?

It should replace it - this is just money for old rope for accountants.

Q5: Should the net assets test for self-certification by HNW investors be increased from £500,000, remain at £250,000 or be set at another level?

It should remain at £250,000 liquid assets i.e. excluding value of main residence and other pension/insurance benefits. 10% of £250,000 is £25,000 which is a typical angel investment size which should be the appropriate minimum benchmark.

Q6: Do you think that the test for self-certifying as a sophisticated investor should be introduced alongside the current regime?

Yes

Q7: Do you agree with the proposed criteria for sophistication? What changes would you make and why?

I agree with the first two tests. The third test should be amended as follows:

“the size of the investors securities portfolio exceeds £100,000”

The requirement for transaction frequency is at odds with the nature of early-stage investments which are highly illiquid and have typically very long term timeframes i.e. 4 to 7 years. This type of investment has nothing to do with the day-trader mentality.

Q8: Do you think self-certifying as a sophisticated investor without detailed criteria to test against should be introduced?

No



Q9: Out of models 1,2 and 3, which do you think provides the most appropriate balance between investor protection and facilitating investment in SMEs, and why?

Model 2 is best as it allows self-certification for both HNWs and SIs whilst unambiguously setting the requirements to qualify. If investors choose to sign these certificates without qualifying then they only have themselves to blame.

Q10: Should amendments equivalent to those made to the Financial Promotion Order be made to the CIS Order?

Yes

Q11/Q12/Q13/Q14 Nothing of material significance.

Miscellaneous

Early-stage private equity investments are by their nature high risk/high reward investments not for widows and orphans but vital to the health of innovation and the economy in the UK. Many investors frequently lose all or most of their investments. It is much better to recognize this and approach such investments with appropriate caveat-emptor health/wealth warnings within a pragmatic regulatory system than pretend that a bureaucratic system somehow further protects investors and encourages investment.

As advisors in this sector we are only too aware that we operate in a high risk investment sector with legislation that currently does not work where we are personally liable on an unlimited basis.

The system currently does not work and needs to be changed!

If you have any further questions on the above responses, please do not hesitate to contact me as set out below.

Yours faithfully

Charlotte Moore

Director

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