

Farrell Fritz: Joining in the effort to build Long Island's innovation economy

A partner in Farrell Fritz's corporate department, Alon Y. Kapen leads the firm's emerging companies & venture capital practice group. Although this focused practice area was formally branded at Farrell Fritz three years ago, Kapen has been handling deals involving entrepreneurs, public and private emerging growth companies and the venture capital funds, angel investors and investment banks that finance them since graduating from law school in 1987.

"It's a unique space and those companies and their investors are best represented by firms with a dedicated practice group focused on those deals," Kapen said.

The development of Farrell Fritz's emerging companies & venture capital practice group coincided with several developments, including efforts to reform regulations that affect capital raising, as well as initiatives on Long Island and in New York City to build a meaningful, robust innovation ecosystem, Kapen said.

As a young lawyer, Kapen began his career—along with many internet entrepreneurs—in New York City. After the dot.com bust in 2000-2001, New York City's tech community took a step back, he said. Years later, in the aftermath of the 2008 financial crash, NYC Mayor Michael Bloomberg made a bet on technology in an effort to replace the thousands of jobs lost in the financial sector. Recognizing New York City would need a world-class engineering school if it was to be considered a serious technology hub, Bloomberg dedicated City property and invited some of the world's top engineering and research universities to bid on its operation.

In 2011, Bloomberg partnered with Cornell University and Technion-Israel Institute of Technology to build a two-million-square-foot, 11-acre applied science and engineering campus on Roosevelt Island. The selection of the Cornell/



Farrell Fritz Emerging Companies & VC Team

Technion consortium furthered the City's Applied Sciences NYC initiative designed to increase its capacity for applied sciences, transform its economy and create tens of thousands of jobs.

"Over the last five years, New York has leapfrogged over Boston as a solid No. 2 in technology—particularly digital, information technology and media—after Silicon Valley," Kapen said.

On Long Island, there has been a similar process of strategic thinking and effort to move the area in the direction of technology, he said. "Other regions are also trying to build a robust innovation ecosystem, but they have a fraction of the assets we have here on Long Island," Kapen said, noting Long Island's five world-class research institutions, including Cold Spring Harbor Laboratory, Brookhaven National Laboratory, Stony Brook University, Hofstra University, and the Feinstein Institute. "The hope is that these institutions will encourage their researchers to spinout—make discoveries and seek to commercialize them through startups," he said.

The trend toward capital markets re-

form, which gained steam about five years ago, also coincided with Farrell Fritz's determination to brand a focused practice group on emerging companies & venture capital. "In the aftermath of the financial meltdown, there was a growing sense that many regulatory laws from Congress and the SEC that may have been intended to protect investors were no longer current and were unnecessarily impeding capital formation by smaller companies, especially in light of the emergence of the internet," Kapen said, adding the majority of capital raising rules had been written in the 1930s. "Many advocates for reform, including me, identified specific impediments to capital raising among private companies."

The most serious barrier was the prohibition on general solicitation in private offerings, he said. Under the old rules, "if you were a company doing a private offering and you sent out a mass mailing, advertisement or some other general solicitation about your raise, that would blow your private offering exemption," Kapen said.

Three years ago, under enormous pressure and in recognition of the number

of jobs generated by small companies and start-ups, Congress passed the JOBS Act (Jumpstart Our Business Startups Act), reforming some of those critical rules, he said. Since then, the SEC has been issuing rules on the JOBS Act, including proposed rules on crowdfunding which have been somewhat controversial. “Despite its being legislated as Title III of the JOBS Act, generic equity-based crowdfunding is still illegal in the United States because the SEC hasn’t passed final rules, unless you do a purely intrastate crowdfunding raise in one of the handful of states that adopted their own rules. New York is not among them,” Kapen said. There are, however, two variations on crowdfunding which allow general solicitation through the internet and that were part of the JOBS Act and final SEC rulemaking: under the first method, companies may sell only to accredited investors and must use reasonable steps to verify accredited investor status; the second requires a scaled disclosure filing with the SEC as a mini-public offering, he said.

In creating a practice area in this space, Farrell Fritz determined to offer focused representation to the major players—researchers, entrepreneurs, emerging companies, and the angels and VCs that invest in them. “There are a lot of issues to grapple with if an entrepreneur is still an employee of a research institution,” Kapen said, noting the institution owns intellectual property created in its lab and typically imposes restrictive covenants on its employees. “We work to sift through everything.”

The next step is generally helping the entrepreneur with entity formation. If the company has two or more co-founders,

Farrell Fritz’s team will help them enter into important arrangements among themselves, primarily regarding their equity. “These companies have unique attributes as growth companies. Chief among them is that they need capital. They make enormous investments in research and development in the early years. Also, their products are scalable and so they require significant investment to scale up.” Selling securities to outside investors is heavily regulated, and an exemption from registration with the SEC must be satisfied.

In many deals, Farrell Fritz will represent the investors, including venture capital funds or high-net-worth “angel” investors. Once company founders have formed a company and maxed out their credit cards, it’s time to bring in outside capital, Kapen said. “When we were doing these deals 10 to 15 years ago, that first outside investment would have been a multi-million-dollar round from venture capital funds,” he said. “Today, the cost of launching a start-up is a fraction of what it was because of emerging new technologies.” The result has been the emergence of seed funding in the range of \$150,000 to \$1.5 million with a stripped-down version of a typical VC Series A round.

“We represent all of these different players in the space,” Kapen said. He spends one day every week on-site at early-stage VC fund Canrock Ventures, surrounded by start-ups incubating at the fund. “We represent their portfolio companies. We believe we add a great deal of value to the startups and it’s very rewarding,” he said.

In addition to offering focused representation, Farrell Fritz provides thought

leadership, keeping people informed about regulatory developments and deal trends. Two years ago, Kapen started a blog, New York Venture Hub, as a resource for entrepreneurs, emerging companies, the investors who invest in them and the professionals who serve them. Additionally, Managing Partner Charles Strain has been involved with and has served on the board of Accelerate Long Island since its inception.

Farrell Fritz has assumed a leadership role in significant initiatives to build a robust innovation ecosystem on Long Island and promote the commercialization of Long Island-originated technology. The firm’s attorneys have also taken active roles in advocating for private and public capital markets reform to make it easier for emerging companies to raise capital in the private markets and ultimately go public.

Moving forward, Kapen believes efforts to reform capital markets will continue on pace. “There’s still a lot of work to do,” he said. “Crowdfunding has enormous potential.” Companies are only beginning to learn legal methods for raising capital on the internet, including through the hundreds of emerging accredited investor-only crowdfunding platforms, he said. Governing rules are still being hashed out; few people understand them. “They are being developed as the industry is growing,” Kapen said, noting he suspects there will be some abuses. “This is the Wild West of the capital formation industry right now,” he said.

“We’ll be poised to represent the companies, the investors and the intermediary platforms,” Kapen said.



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