

*Law Offices*

KARR · TUTTLE · CAMPBELL

*Founded 1904*

*A Professional Service Corporation*

1201 Third Avenue, Suite 2900, Seattle, Washington 98101  
Telephone (206) 223-1313, Facsimile (206) 682-7100

Mike Liles, Jr.  
(206) 224-8068  
mliles@karrtuttle.com

April 17, 2012

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

RE: SEC Regulatory Initiatives Under the JOBS Act  
File No. JOBS Act Title III — Crowdfunding

Ladies and Gentlemen:

Set forth below are comments that relate to Title III of the JOBS Act. Because I expect that I may provide additional input through Committees of the Business Law Section of the American Bar Association concerning the details of the Commission rules when they are proposed, this letter is restricted to certain comments which I believe may be important to be addressed in the proposed enabling regulations. These comments are mine alone and do not reflect any input from other members of the Business Law Section of the American Bar Association or the Securities Laws Committee of the Washington State Bar Association, nor does it constitute the official position of this firm or any of its clients on the subject.

I commend the Commission's invitation for the public to submit comments before enabling rules for the JOBS Act are proposed, as this should expedite the rulemaking process.

**“Integration” of Rule 506 with Crowdfunded Offerings**

My first comment focuses on the possible interplay between Titles II and III of the JOBS Act as it may affect small business finance planning and structuring. Title II of

the JOBS Act directs the Commission to revise its rules relating to offerings made in reliance upon the private offering safe harbor afforded by Rule 506 of Regulation D under the Securities Act of 1933 to provide that the prohibition against general solicitation or general advertising not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors.<sup>1</sup> This rule revision would allow Rule 506 offerings of any size to be made over the internet by emerging businesses directly to accredited investors. The JOBS Act also amends the Securities Act of 1933 to allow small businesses to raise capital over the internet from the general public in small amounts (“crowdfunding”)<sup>2</sup> to, among others, non-accredited investors through an internet intermediary registered with the Commission and an applicable self-regulatory agency.<sup>3</sup>

A potential problem may exist if a small business attempts an internet financing in reliance upon Rule 506 and one using crowdfunding. The crowdfunding provisions limit the amount a small business may raise for 12 months before and during a crowdfunding transaction to \$1 million,<sup>4</sup> which for a rapidly growing small business may be inadequate. The business therefore may also desire to use Rule 506. Another provision of the JOBS Act, Section 302(b), which amends the Securities Act of 1933 by adding Section 4A(g), states that a company may raise capital by methods other than crowdfunding, but how this relates to the \$1 million crowdfunding limit is unclear. Unless the Commission clarifies and resolves this by rulemaking, if a business were to raise additional amounts of capital over the internet in reliance upon Rule 506, either before or after a crowdfunding round, it would have to wait for six-months<sup>5</sup> in order not to risk destroying both the Rule 506 offering and the crowdfunding offering by virtue of the “integration doctrine,” which would deem both offerings part of a single offering. The Rule 506 internet offering would be disqualified because it may be made only to accredited investors, and integration with the crowdfunding offering would cause the small non-accredited crowdfunding investors to become part of the generally-solicited Rule 506 offering. And the \$1 million in 12 months crowdfunding offering limit might well be exceeded if the Rule 506 offering were integrated with the crowdfunding one. So, unless the implementing Commission rules successfully resolve this dilemma, careful planning

---

<sup>1</sup> JOBS Act, Section 201(a)(1).

<sup>2</sup> JOBS Act, Title III, also known as the “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012,” or the “CROWDFUND Act.” JOBS Act, Section 301.

<sup>3</sup> JOBS Act, Section 302(b), amending the Securities Act of 1933 by adding Section 4A(a)(2). Also, as to funding portals, Section 304(a)(1), amending the Securities Exchange Act of 1934 by adding Section 3(h)(1)(B).

<sup>4</sup> JOBS Act, Section 302(a).

<sup>5</sup> See the discussion of the integration doctrine for Regulation D offerings set forth in Commission Rule 502(a).

would have to surround any use of crowdfunding as a financing strategy lest alternative financing options be curtailed when they may be most needed.

For this reason, I respectfully suggest that in its JOBS Act implementing rules the Commission interpret the “Rule of Construction” of new Section 4A(g), which states that, “[n]othing in this section or Section 4(6) shall be construed as preventing an issuer from raising capital through methods not described under section 4(6),” to mean that crowdfunded offerings will not be deemed to be “integrated” with Rule 506 offerings, irrespective of their respective timings.

### **Lack of Crowdfunding Disclosure Guidelines**

The crowdfunding provisions of the JOBS Act refer briefly to certain disclosures that a small business must make in a crowdfunding offering, including a description of the company’s business and business plan, certified, reviewed or audited financial statements (depending upon the amount of funds to be raised), use of proceeds, the past or prospective compensation received by persons to promote the offering through the intermediary’s channels, the method for determining the offering price of the securities, ownership and capital structure, and risks to investors relating thereto.<sup>6</sup> But these references in the JOBS Act only indicate the subject matter of certain disclosures and are neither comprehensive nor detailed. Securities offering disclosures have been developed and refined by securities laws professionals and regulators over the almost 80 years during which the Securities Act of 1933 has been in effect, and it is unlikely that inexperienced small business owners will be able to prepare a balanced and complete set of disclosures without more detailed guidance. The JOBS Act does not by its terms contemplate a mechanism for preparation of the disclosures by securities professionals or others; however, there would appear to be no reason why the Commission may not do so in its implementing rules.

While the bills that became the JOBS Act were pending in Congress, a committee on small business capital formation of the North American Securities Administrators Association (“NASAA”), the trade association for state securities regulators, developed a proposed Model Crowdfunding Exemption for state securities regulators to use in crowdfunding offerings if the federal crowdfunding legislation did not preempt state regulation. Attached to that proposed Model Crowdfunding Exemption was a fill-in-the-blanks disclosure document modeled after NASAA’s Form U-7 question-and-answer disclosure document for state registration of small offerings that are exempt from federal regulation under Rule 504 of Regulation D. The assumption is that filling in a detailed questionnaire has a better chance of evoking adequate disclosure by a small business than

---

<sup>6</sup> JOBS Act, Section 302(b), amending the Securities Act of 1933 by adding Section 4A(b).

does freewriting. Because state registration of crowdfunding offerings has been preempted by the JOBS Act, NASAA's proposed Model Crowdfunding Exemption and its fill-in-the-blanks disclosure document will presumably never be adopted by NASAA for crowdfunding. However, the Commission's Offering Circular Model A to its Form 1-A Offering Statement under Regulation A is a question-and-answer disclosure document that is modeled upon and virtually identical to NASAA's Form U-7. And NASAA has developed and posts on its website an Issuer's Manual for Form U-7, which provides detailed and reader friendly "how-to" instructions for answering the questions on the Form U-7, which would also apply to the Commission's Offering Circular Model A.

Under the general antifraud provisions of federal and state securities laws,<sup>7</sup> disclosures in connection with the offer and sale of securities must be accurate and complete in all material respects. Any guideposts by the Commission to assist in this should reduce later problems when business failures become manifest. Accordingly, I respectfully suggest that in implementing the crowdfunding provisions of the JOBS Act the Commission reference its Offering Circular Model A as a suggested disclosure aid to crowdfunding issuers. I further respectfully suggest that in implementing the crowdfunding provisions of the JOBS Act the Commission indicate in its rules that use of NASAA's Form U-7 and the corresponding Issuer's Manual for Form U-7 would also make suitable disclosure aids for crowdfunding issuers.

### **Crowdfunded Securities "Held of Record" for Purposes of '34 Act Registration**

The JOBS Act states that securities sold through the crowdfunding process will not be counted as "held of record" by investors for purposes of precipitating registration with the Commission under Section 12(g) of the Securities Exchange Act of 1934,<sup>8</sup> which would otherwise trigger all of the (costly) periodic reporting, proxy, tender offer, short-swing profits recovery and other provisions regulating public companies under that Act. Once sold through a crowdfunding intermediary, the securities would have to be held by the investor for one year unless resold or transferred to the company, an accredited investor, a family member or as the result of death or divorce.<sup>9</sup> The Act is unclear as to whether securities held by the new shareholder upon any such resale or transfer would then be counted as "held of record" for purposes of Section 12(g).<sup>10</sup> The prospect of resales' creating a number of new record shareholders that might trigger '34 Act registration might cause issuers to attempt in some way to restrict resale and transfer of

---

<sup>7</sup> E.g., Rule 10b-5 under the Securities Exchange Act of 1934.

<sup>8</sup> JOBS Act, Section 303.

<sup>9</sup> JOBS Act, Section 302(b), amending the Securities Act of 1933 by adding Section 4A(e).

<sup>10</sup> JOBS Act, Section 303.

the securities once they were sold, even after the lapse of one year, which would be to the detriment of small crowdfunding investors seeking liquidity. For this reason, I respectfully suggest that the Commission in its implementing rules indicate that securities that have been resold after having been initially purchased in crowdfunding transactions be still part of the crowdfunding offering and not be deemed to be "held of record" for purposes of Section 12(g).

### **Use of Crowdfunding Intermediaries in the Resale of Crowdfunded Securities**

It is not clear from the wording of the JOBS Act whether funding portals may serve as intermediaries for the resale of crowdfunded securities after the crowdfunded offering has been completed unless the funding portal registers as a broker-dealer under federal securities laws. If the Commission's rules implementing the JOBS Act do not exempt the funding portal from broker-dealer registration under federal law as to resales of crowdfunded securities, state regulators would not be preempted from requiring them to register as broker-dealers under state securities laws for the resale of securities after a crowdfunding and could require them to register under state securities laws for that purpose. Because the information concerning the crowdfunding offering, the issuer and the investors would already be in the possession of the funding portal anyway, it would appear most efficient if crowdfunding portals could act as intermediaries in the resale of securities previously sold by that portal in a crowdfunding offering. Accordingly, I respectfully suggest that, in promulgating rules for licensing crowdfunding portals under the JOBS Act, the Commission make it clear that the license would allow the funding portal to participate in the reoffering of the securities for which it served as intermediary. In addition, I suggest that the Commission also allow such a licensed funding portal to offer securities of crowdfunding issuers being made by the issuer in reliance upon the safe harbor of Rule 506, as the funding portal would already be geared up to post the securities of the issuer for sale and would only have to make arrangements to qualify prospective investors as "accredited."

I hope that the above comments will prove useful to the Staff and the Commission in developing the proposed rules to implement Title III of the JOBS Act.

Very truly yours,



Mike Liles, Jr.