

TWENTY-FIFTH ANNUAL

SEC Government-Business
Forum on
Small Business
Capital Formation



FINAL REPORT

NBA

2006
Washington, DC

NBA

2006 Annual SEC Government-Business Forum
on Small Business Capital Formation

FINAL REPORT

The SEC hosts the annual Government-Business Forum on Small Business Capital Formation, but does not seek to endorse or modify any of the Forum's recommendations. The recommendations are solely the responsibility of the Forum participants from outside the SEC, who were responsible for developing and prioritizing them. The recommendations do not necessarily reflect the views of the SEC, its Commissioners or any of the SEC's staff members.

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SUMMARY OF PROCEEDINGS

Background

As mandated by the Small Business Investment Incentive Act of 1980, the U.S. Securities and Exchange Commission hosts an annual forum that focuses on the capital formation concerns of small business. Called the “SEC Government-Business Forum on Small Business Capital Formation,” this gathering has assembled every year since 1982. A major purpose of the Forum is to provide a platform for small business to highlight perceived unnecessary impediments in the capital-raising process and address whether they can be eliminated or reduced. Each Forum seeks to develop recommendations for governmental and private actions to improve the environment for small business capital formation, consistent with other public policy goals, including investor protection. Prior Forums have published numerous recommendations in the areas of securities and financial services regulation, taxation and state and federal assistance, many of which have been implemented.

The 2006 Forum, the 25th, convened at the SEC’s headquarters at 100 F Street, N.E., Washington, D.C., on Friday, September 29, 2006. This was the first Forum to convene at the new SEC headquarters office.

Planning and Organization

Consistent with the Commission’s statutory mandate in the Small Business Investment Incentive Act of 1980, the Commission’s Office of Small Business Policy, Division of Corporation Finance, invited other federal and state government agencies and leading small business and professional organizations concerned with capital formation to participate in planning the 2006 Forum. The individuals who participated in planning the Forum, and their professional affiliations, are listed on pages 3 and 4.

The planning group recommended that this year’s Forum be held in Washington, D.C. and that it remain focused on securities regulation and taxation, as has been the case in recent years. The members of the planning group also assisted in preparing the agenda and in recruiting speakers and moderators.

Participants

The SEC’s Office of Small Business Policy worked with members of the planning group to identify participants for the 2006 Forum. Invitations were sent to participants in previous Forums and to members of various business and professional organizations concerned with small business capital formation. The SEC issued two press releases announcing the time, date, location, and Internet Webcast address of the Forum.

Approximately 100 participants attended this year’s Forum in person, including 11 roundtable panelists, moderators and SEC staff. The video Webcast of the Forum received 405 hits on the day of the Forum, indicating that many individuals participated by watching or listening over the Internet.

Proceedings

The agenda for the 2006 Forum is reprinted starting at page 5. The Forum began with a video recording of opening remarks by SEC Chairman Christopher Cox. Chairman Cox's remarks were followed by two morning roundtable discussions. SEC Commissioner Annette L. Nazareth attended part of the morning roundtable discussions. Peter J. Wallison, Resident Fellow at the American Enterprise Institute and former Counsel to President Ronald Reagan, gave the luncheon address.

The afternoon proceedings included a workshop on private placement broker-dealers and breakout groups designed to elicit and discuss recommendations for government and private actions to improve the environment for small business capital formation. Approximately 60 participants attended the afternoon proceedings.

Brian A. Bussey and Kristina Fausti, both of the Office of Chief Counsel of the SEC's Division of Market Regulation, moderated the first hour of the workshop on private placement broker-dealers. The workshop participants then formed a breakout group moderated by Gregory C. Yadley, Faith Colish and Ralph V. DeMartino to develop securities law recommendations in the area of private placement broker-dealers. John D. Hogoboom and Charles L. Bennett each moderated a separate breakout group to develop securities law recommendations in areas other than private placement broker-dealers. A fourth breakout group discussed tax issues. The discussions of the breakout groups resulted in recommendations on federal securities law topics and on tax law topics.

After the Forum assembly on September 29, the five securities law breakout group moderators, Charles L. Bennett, Faith Colish, Ralph V. DeMartino, John D. Hogoboom and Gregory C. Yadley, compiled a list of 14 securities law recommendations based upon the discussions in their respective breakout groups. All participants who attended the afternoon sessions were then given an opportunity to vote by e-mail on the recommendations and their order of priority. The 14 securities law recommendations, in the order of priority established by the vote, are set forth beginning on page 11. The tax law recommendations were compiled by Marc Lumer, the tax issue breakout group moderator.

Records of Proceedings

Video recordings of Chairman Cox's opening remarks at the 2006 Forum and of the two morning roundtable sessions of the Forum are available for viewing through the SEC's Web site at <http://www.sec.gov/info/smallbus/sbforum.shtml>. The written text of Chairman Cox's remarks is reprinted beginning at page 8. The text also is available in the official Record of Proceedings of the Forum, which is available at <http://www.sec.gov/info/smallbus/sbforum.shtml>. The Record of Proceedings also contains the text of Peter Wallison's luncheon address and transcripts of the morning roundtable sessions.

PLANNING GROUP

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AGENDA

2006 SEC Government-Business Forum
on Small Business Capital Formation
Washington, D.C.
September 29, 2006

9:00 a.m. Call to Order

Gerald J. Laporte, Chief, Office of Small Business Policy,
SEC Division of Corporation Finance

Introductory Remarks

John W. White, Director, SEC Division of Corporation Finance

Opening Remarks

SEC Chairman Christopher Cox (videotaped)

9:15 a.m. Roundtable on Interactive Data and Smaller Public Companies

Moderators:

John W. White, Director
SEC Division of Corporation Finance

Gerald J. Laporte, Chief, Office of Small Business Policy
SEC Division of Corporation Finance

Panelists:

Greg D. Adams, Director, Chief Operating Officer and Chief Financial Officer,
EDGAR Online, Inc. (Norwalk, Connecticut)

Brian R. Balbirnie, Chief Executive Officer, My EDGAR Inc. (Cary, North
Carolina)

Deborah Allen Hewitt, Professor of Economics and Finance at the Mason
School of Business at the College of William & Mary, and member of the
Investment Committee of the Virginia Retirement System (Williamsburg,
Virginia)

James Lucier, Senior Vice President and Research Analyst, Prudential Equity
Group, LLC (Washington, D.C.)

Malcolm C. Persen, Chief Financial Officer, Radyne Corporation
(Phoenix, Arizona)

R. Christopher Whalen, Senior Vice President and Managing Director,
Institutional Risk Analytics (Hawthorne, California)

10:45 a.m. Break

11:00 a.m. Roundtable on Hot Topics in Small Business Capital Formation

Moderators:

Martin P. Dunn, Deputy Director
SEC Division of Corporation Finance

Marc H. Morgenstern, Partner
Sonnenschein Nash & Rosenthal (San Francisco, California)

Panelists:

John D. Hogoboom, Member, Lowenstein Sandler PC
(Rosedale, New Jersey)

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Corp. (New York, New York)

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Anna T. Pinedo, Partner, Morrison & Foerster LLP (New York, New
York)

Byron Roth, Chairman and Chief Executive Officer, Roth Capital Partners,
LLC (Newport Beach, California)

12:30 p.m. Break

12:45 p.m. Luncheon

Speaker: Peter J. Wallison, Resident Fellow, American Enterprise Institute,
and former Counsel to President Ronald Reagan

2:15 p.m. Breakout Groups to Develop Recommendations

- **Workshop on Private Placement Broker-Dealers**

Moderators:

Brian A. Bussey, Assistant Chief Counsel
Kristina Fausti, Special Counsel
Office of the Chief Counsel
SEC Division of Market Regulation

- **Federal Securities Law Breakout Group A**
- **Federal Securities Law Breakout Group B**
- **Tax Breakout Group**

3:30 p.m. Break

3:45 p.m. Continuation of Breakout Group Discussions

4:45 p.m. Plenary Session to Develop Next Steps

Moderators:

Faith Colish, Counsel
Carter, Ledyard & Milburn, LLP (New York, New York)

Gerald J. Laporte, Chief, Office of Small Business Policy
SEC Division of Corporation Finance

Gregory C. Yadley, Partner
Shumaker, Loop & Kendrick, LLP (Tampa, Florida)

5:30 p.m. Networking Reception

**OPENING REMARKS
OF
CHAIRMAN CHRISTOPHER COX**

SEC Government-Business Forum on Small Business Capital Formation

September 29, 2006

Good morning, and welcome to the SEC's Government-Business Forum on Small Business Capital Formation. This is the 25th annual convening of this Forum, but the first time we've met in the new SEC headquarters on Capitol Hill, right next to the historic Union Station in Washington D.C.

I hope all of you here in person feel welcome in our new home, and to all of you participating via Webcast, we very much appreciate and welcome your virtual presence. This annual Forum is at the heart of the SEC's mission, because our mandate to do this each year comes explicitly from Congress, in statute. Not only does the SEC have the statutory mission to promote capital formation, but very specifically, we are directed to conduct this Forum by the Small Business Capital Formation Act, signed into law 26 years ago.

Today's 25th anniversary event is a significant milestone. For a quarter century, we've been working together to help promote capital formation for small business, and to underscore its importance to our economy. Just how important is small business to America's anything-but-small economy? Well, for starters, there are no fewer than 23.6 million small businesses that represent more than 99.7% of all employers in the United States.

In terms of jobs, small business makes up more than half of the nation's private-sector workforce. Even more astonishing is that small business creates nearly 80% of all new jobs. And as for America's \$12 trillion GDP? Not surprisingly, small business creates over half of it.

For the entirety of my professional career, I've taken a very personal interest in small business. As a Member of Congress for 17 years, I saw overwhelming evidence that small business is the lifeblood of our nation's economy. As a securities lawyer in private practice, I had first-hand experience working with venture-backed and early stage public companies.

And as an entrepreneur back in the 1980s, I started a small business with my father, called Context Corporation, that translated the Soviet Union's leading newspaper, Pravda, into English and sold it in 26 countries around the world. I'd like to think that a small business, by giving free people the opportunity to read Communist propaganda designed for the Russians themselves, did its part in hastening the collapse of the Soviet Empire.

All of this experience with small businesses has contributed to my unshakeable conviction that small business is the critical engine of growth in the United States. Small business really does drive innovation. So I can assure you that I and the other SEC Commissioners look forward to the discussions at today's Forum, and to reviewing any recommendations that result.

You'll have two very timely roundtable discussions this morning. The first will focus on smaller public companies' use of interactive data, in SEC filings and elsewhere—and on how this can get small companies better coverage by research analysts, and lower their cost of capital. The second roundtable will spotlight several "hot topics" in small business capital formation.

Since becoming Chairman I have been actively advocating the use of interactive data to file financial information with the SEC. Interactive data is the plain-English way to say XBRL, which stands for Extensible Business Reporting Language. It's a freely available, open source computer language for financial reporting.

Using interactive data can make it easier for companies to analyze their own information, share it with others, and file it with the SEC. It will work across all software formats and technologies. It will permit investors and analysts to download a company's financial information into spreadsheets, personal financial software, or sophisticated corporate analysis software. It will allow data to move more freely and usefully over the Internet.

I am very glad to see this Forum focusing on the benefits that using interactive data can bring to small business, and on how we can help these benefits start to flow. One of the things that's most exciting about the introduction of interactive data for smaller companies is that it can improve their analyst coverage.

By permitting analysts to cover more companies more efficiently, interactive data will help companies with little or no coverage today to improve their overall visibility to investors. Better research analyst coverage, in turn, should help smaller companies raise capital at a lower cost.

Another way that interactive data can help smaller companies is by improving their internal controls, while at the same time reducing their compliance costs. That, in turn, can help attract qualified directors who will be more content with the risk profile of the firm.

All of these areas are tremendous challenges to many smaller companies. In our second roundtable this morning, we'll look at issues such as when and how small companies should go public. Answers to these questions have become more complicated in recent years, with the addition of new regulatory requirements for public companies, most notably the Sarbanes-Oxley Act.

We're very interested in discussing areas where regulations can be reduced or modified without compromising investor protection.

Finally, I want all who are listening to this to know that the Commission is working to implement the important recommendations from the SEC Advisory Committee on Smaller Public Companies last April. In particular, we have adopted the Committee's recommendation on Sarbanes-Oxley Section 404, that unless and until a framework for assessing internal control over financial reporting for smaller companies is developed that recognizes their characteristics and needs, smaller companies will get relief from Section 404.

We're busy, and the PCAOB is busy, working on an extensive rewrite of Auditing Standard 2 that led to such high costs in the initial application of 404 to larger companies. And we've postponed smaller company compliance until that work is done. We're keenly

aware that the problems we have experienced with Section 404 arise from the implementation of the second half of this provision: the part that requires an auditor evaluation of management's assessment.

The Advisory Committee's Final Report focused on this as well, and so we're working to fix the process so it can work for smaller companies. The continued health of small business depends upon it.

Since the beginning of our country, small businesses have been the backbone of the American economy. It's a continuing marvel that even today, in the 21st century—in the midst of globalization and globe-straddling technology, small business creates more jobs than anyone else. Daring and inventive startups, often just operating out of a garage, often get their first capital from the investment of a single entrepreneur, or a single family—and that investment often represents everything those people have in the world.

Small businesses pump billions into the economy. They are, in many ways, what makes America great. It's the SEC's job to see to it that small business has better access to cheaper capital on the most competitive terms possible, and we aim to do just that. We're on your side—and we're proud to be your partners. Thanks for all that you do, and best wishes for a great Forum.

RECOMMENDATIONS*

Set forth below are the recommendations of the 2006 Government-Business Forum on Small Business Capital Formation. The taxation recommendations follow the securities regulation recommendations.

Securities Regulation Recommendations

The following 14 securities law recommendations were developed in three Forum breakout groups on the afternoon of September 29, 2006. Five breakout group moderators worked together after that date to compile the recommendations and edit them for clarity and to eliminate overlaps.† The recommendations were then sent out to the participants in the breakout groups for a vote. The recommendations are set forth in the order of priority established as a result of the participants' voting.§

- 1. Adopt the recommendations of the SEC Advisory Committee on Smaller Public Companies as soon as possible, or advise the public why, in the view of the Commission, such recommendations should not be adopted.**
- 2. Spearhead a multi-agency effort to create a streamlined NASD membership application process for finders, M&A advisors and institutional private placement practitioners in accordance with the Report and Recommendations of the ABA Section of Business Law Task Force on Private Placement Broker-Dealers and the SEC Advisory Committee on Smaller Public Companies.**
- 3. Develop a limited registration exemption for business brokers and M&A advisors involved with the purchase and sale of a whole business or business unit where the buyer is personally involved in the management or operation of the acquired business. The SEC should coordinate this effort with the states, which would provide primary regulatory oversight.**

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† The five moderators were Charles L. Bennett, Faith Colish, Ralph V. De Martino, John D. Hogoboom and Gregory C. Yadley.

§ The participants were asked to rank the 14 securities law recommendations in order of priority by assigning a number to each of the recommendations on a scale from 1 to 14 (1=highest priority, 14=lowest priority), using each number from 1 to 14 only once. The participants also were instructed that they need not rank all recommendations, but that failure to rank a recommendation would be equivalent to a "no" vote on any unranked recommendations.

In tabulating the votes, each recommendation ranked first by a participant was assigned 14 points, each recommendation ranked second was assigned 13 points, each recommendation ranked third was assigned 12 points, etc. Unranked recommendations were not assigned any points. The order of priority of recommendations was then determined by adding up the number of points assigned to each recommendation as a result of the voting of the participants. The recommendations are prioritized in the order of points assigned to them, from highest to lowest.

- 4. Amend the Securities Exchange Act of 1934, and SEC and NASD rules and regulations to permit a registered broker-dealer that is a member of the NASD to retain, supervise, and compensate finders who structure and present the broker-dealer with investment banking opportunities, without requiring the finders to become associated persons of the member.**
- 5. Amend the holding periods under Rule 144 so that holders of a company's securities may resell within six (6) months under 144(d), and 12 months under 144 (k), of the initial investment.**
- 6. Create a regulatory framework to allow for the development and operation of a private placement market (like a Rule 144A market without the requirement that buyers be qualified institutional buyers) open only to institutional accredited investors.**
- 7. So as to avoid the current requirement to file a post-effective amendment, revise Form S-1 and SB-2, similar to Form S-3, to permit forward incorporation by reference of subsequent 1934 Act periodic reports for any offerings made in reliance upon Rule 415, by all registrants that, at the time of filing: (i) have filed at least one annual report on Form 10-KSB or Form 10-K; and (ii) are current with their periodic reporting obligations.**
- 8. The Staff of the SEC should either (i) clarify and determine whether an offering is "by or on behalf of the registrant" for purposes of registering an offering on a continuous or delayed basis in reliance on Rule 415(a)(4) by examining the circumstances of the issuance of the shares being registered and the nature and type of the selling stockholders, and not the amount of shares being registered by the issuer in relation to the amount of shares outstanding, or (ii) request the Commission to promulgate proposed rules interpreting Rule 415(a)(4) as applied to resale registration statements and allowing interested persons to comment on those proposals, instead of taking the position that any resale offering of more than 30% of the public float is an offering "by or on behalf of a registrant" without notice or an opportunity for comment. Alternatively, the Commission should consider amending Rule 415(a)(4) to allow "at the market offerings" by any issuer that has been public for at least one year, regardless of whether the issuer qualifies to use Form S-3 or Form F-3 for a primary offering. The Commission and the Staff should be aware of the chilling effect that the Staff's interpretation of Rule 415(a)(4) is having on the ability of smaller public companies to raise capital.***
- 9. Streamline or eliminate the restrictions imposed by the SEC regarding subsequent private placements by an issuer when that issuer has a "resale" registration statement (not a primary offering) on file that is not yet effective.**

* The Staff's interpretation of Rule 415(a)(4) was briefly discussed privately at a pre-conference meeting of the participants of the roundtable on "Hot Topics in Small Business Capital Formation" held the morning of the Forum. It was not discussed at length, however, in any of the Forum afternoon breakout sessions, primarily because the public was not generally aware of the interpretation. In light of the significant impact that the interpretation has had on capital raising by smaller public companies subsequent to the meeting and the amount of discussion that the recommendation has fueled, the five Forum securities law breakout group leaders believe that this recommendation should be considered by the Commission and the Staff.

10. Analyze the historical trends in the costs of going and remaining public with the goal of seeking ways to streamline the process in recognition of the fact that higher costs create barriers to entry for small businesses.

11. Revise the SEC Website to make it more user-friendly, including:

- allowing individuals to “opt in” to receive automatic e-mail notification of matters of interest to them;
- improving public outreach and publication of SEC events;
- publicizing Sarbanes-Oxley Section 404 developments and compliance time lines; and
- advising the public about Staff “hot buttons” and areas of current regulatory scrutiny/interest.

12. Provide a simplified and codified discussion, guidance and examples on accounting for financing instruments, including equity, debt, warrants, options and other instruments which should include an analysis of embedded features that determine proper accounting. This should not address derivative instruments related to hedging activity, which should be separately addressed and not commingled.

13. Make the SEC comment process more consultative.

14. Modify the NASD mark-up rule to better correlate risk with reward and allow greater mark-ups for smaller issuers.

Tax Recommendations

The Forum tax breakout group developed and prioritized the following recommendations for Congress.

1. Expansion of the “domestic production activities deduction” under IRC Section 199

Issue: In general, the amount of the “domestic production activities deduction” for any taxable year shall not exceed 50% of the Form W-2 wages of the employer for the taxable year under Internal Revenue Code Section 199. Should this deduction limitation based upon 50% of Form W-2 wages be expanded to include non-W-2 compensation too?

Discussion: Most small businesses are organized as sole proprietorships, S-corporations, limited liability companies and partnerships. For these types of organizations, worker/owner compensation is not reported on Form W-2. If the Section 199 deduction limitation of 50% of Form W-2 wages were expanded to include also non-W-2 compensation, then the allowable deduction limitation would increase along with worker/owner compensation.

Recommendation: We recommend that Congress amend Section 199(b) to expand the deduction limitation to be based upon not only Form W-2 wages paid but also to include self-employment earnings of worker/owners.

2. Overreliance on IRS data

Issue: Whether Congressional findings that rely on agency reports and are not supported by included documentation should be required to list their sources and be subject to minority or contrary views and opinions? If such review and comment are not permitted, should any resulting Congressional report state that it should not be considered an official finding of the Congressional committee or of Congress?

Discussion: Recent Senate hearings on IRS non-filers and non-compliers imply that small businesses represent the major source of the federal “tax gap” problem because of unchallenged IRS data and reports. Other studies found significant areas of non-compliance by larger corporations and partnerships, as well as in connection with off-shore transfers, individual tax returns and illegal activities. Based on these studies, such non-compliance appears to be independent of business size. Moreover, as a result of the IRS’s positions in this area, enforcement pressure and resources are often allocated to pursuance of non-compliant small businesses with attention to minutiae and in a far-reaching way. At the same time, audits of large businesses are terminated prematurely because further information collection is too time consuming. While small businesses are an “easy hit” for the IRS—as small businesses will generally comply rather than fight a finding—audits of larger corporate targets are more difficult, and as a result, transferred or unreported overseas income, deductions, etc. often go unaddressed and uncollected.

Recommendation: Congressional reports should not simply rely on agency “data” and research to support Internal Revenue Service or any other agency findings that sanction or promote new requirements on small businesses without independent comment and review. Congressional committees should not be misled by agency studies that produce facts and results that conform to that particular agency’s suggested point of view. With respect to all agency studies, Congress should set the standards for checking and accepting the agency’s data and soliciting testimony that may present alternate views.

3. Costs in implementing new tax legislation and reporting requirements

Issue: Small business must increasingly allocate their limited resources to comply with new tax legislation.

Discussion: This required allocation takes away from creating jobs and expanding small businesses, which creates a ripple effect from the local economy up to the national economy. We agree that “fine tuning” of the tax laws is important but not at the cost of the health of small business and the economy as a whole. As an example, the tax benefits that small businesses have gained from recent changes in the Code have been mitigated in certain states that have not integrated them into their state tax laws. Due to the economic climate, certain states no longer have adopted the current Code provisions as the starting point for determining their state taxation. This is causing small businesses to utilize capital to keep and maintain two separate sets of tax records to comply with the tax requirements of both the federal government and the state government.

Recommendation: Federal and state legislatures should acknowledge the difficulty small businesses have in keeping track of varied tax laws and jurisdictional requirements and keep in mind these difficulties when passing new tax legislation or approving new recordkeeping and reporting requirements.

4. Simplifying tax filings for very small businesses

Issue: Simplification of tax filing requirements is needed for very small businesses that are home-based or just starting up. It is in our national interest to make start-ups and new business expansion as simple as possible.

Discussion: Simplification is provided for individual filers who opt for the standard deduction on IRS Form 1040 and have no other deductions from gross income. The simplification caused by the increase in the standard deduction and the personal exemption has been a boom for both “small filers” and the IRS. No corresponding provision exists for small businesses, although many forms have been proposed.

Recommendation: We propose that small businesses be granted a “standard deduction” of a fixed amount for business expenses and a “personal exemption” for each full time employee or full time equivalent, plus each self-employed owner, in lieu of reporting expenses. The deductions and exemptions could be subject to a phase-out in the same way that the individual statute provisions work. This has the added benefit that it gets the new business “on the government books” in a simple and effective way.

REGISTERED FORUM PARTICIPANTS

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