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July 10, 2012

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

Re: SEC Regulatory Initiative Under the JOBS Act
Title IV Small Company Capital Formation[1]

Ladies and Gentlemen:

Title IV (Small Company Capital Formation) of the JOBS Act, sometimes referred to as "Regulation A+," has great potential to increase capital formation for smaller companies if the Commission adopts suitable rules to implement the benefits Congress intended in amending the Securities Act to add Section 3(b)(2). It is well known that small companies are an engine for job creation (the impetus behind the JOBS Act),[2] but have great difficulty raising capital in a cost-efficient manner. Regulation A+ could serve a much-needed middle ground for companies needing to raise substantial capital at earlier stages before they are able to take on the full panoply of compliance and expense needed to become and remain a reporting company under the Exchange Act.

By increasing the annual offering cap to $50 million for Regulation A+, the JOBS Act removes a major impediment. A company can now realistically anticipate that transaction costs will be moderate relative to gross proceeds, which was not the case with the old $5 million cap. But that increase only makes the Section 3(b)(2) exemption attractive if the Commission's rules address three critical matters:

1. <u>Define "qualified purchasers" to facilitate creation of "covered securities"</u>. The requirement to comply with "blue sky" law in each state where the "old" Regulation A offerings occurred added much uncertainty, time and expense to

[1] The views expressed in this letter are solely those of the author, and do not constitute the official position of McCarter & English LLP.

[2] See, e.g., Rutheford B. Campbell, Jr., "Regulation A: Small Business' Search for a 'Moderate Capital,'" 31 <u>Del. J. Corp. L.</u> 77 (2006) 84-86.

these offerings.[3] By increasing the scope of "covered securities" under Section 18(b)(4) of the Securities Act to include those offered and sold in Regulation A+ offerings to "qualified purchasers," Congress expressed its intention to enable removal of state regulation of these mini-public offerings.[4] The investor protection goal of federal securities law would not be undermined by adopting standards for "qualified purchaser" that are less restrictive than those for "accredited investor" as defined in Regulation D. Accredited investors are deemed to have sufficient financial sophistication to fend for themselves and, accordingly, Regulation D does not prescribe any offering disclosure for private placements limited to accredited investors. By comparison, a purchaser in a Regulation A+ offering would have the benefit of SEC-reviewed offering statement that cannot be used for purchases until cleared by the Commission. In addition to initial regulatory review, investors would receive protection from the ongoing risk by subsequent reporting requirements (see 2 below).

Adoption of a "qualified purchaser" standard that is the same or more demanding than that of "accredited investor" would only encourage ever greater reliance on Rule 506 private placements limited to accredited investors, to the detriment of Regulation A+. Given transaction costs and regulatory uncertainty, statistics show[5] that companies elect Rule 506 which, so long as purchasers are accredited, allows them to raise unlimited amounts without prescribed disclosure in an offering exempt from state regulation.

Use of Regulation A+ will benefit from an objective test for "qualified purchaser," as is now the case for accredited investor, which for natural persons is based on

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[3] A recent survey of state review procedures is contained in the July 2012 U.S. General Accountability Office's Report to Congressional Committees entitled "Securities Regulation – Factors that May Affect Trends in Regulation A Offerings". The GAO Report also noted that the continued state regulation may deter use of Regulation A+ even with its increased annual cap.

[4] This is consistent with the recommendation of the SEC's 2011 annual forum on small business capital formation. New Securities Act Section 18(b)(4)(D) defines "covered securities" also to include Section 3(b)(2) shares that a company lists on a national securities exchange. One may question whether this route to avoid state regulation is a practical alternative for a company that has chosen to raise capital via Regulation A+ rather than in a registered public offering. Even if a company could meet the initial listing standards, the continued listing requirements, especially the quantitative the bid price and stockholder equity requirements, present special challenges for small companies. NASDAQ's daily list of non-compliant companies confirms how often small companies encounter these listing deficiencies.

[5] See Rutheford B. Campbell, Jr., "The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions," The Business Lawyer (August 2011) 919 – 942.

income and net worth standards. An objective test for qualified purchaser could be, e.g., a percentage of the accredited investor standard or subject to an investment maximum as in the case of Crowdfunding (Section 4(a)(6)(B) of the Securities Act). This avoids the difficulty of a subjective determination, as is now the case for "sophisticated purchaser."

Defining "qualified purchaser" so as to make Regulation A+ attractive for capital formation has the additional benefit of enabling companies to undertake "follow-on" Regulation A + offerings in subsequent years at reasonable expense. Smaller reporting companies, especially those that are not listed on a national securities exchange, encounter significant difficulties when they attempt to use a short-form prospectus enabled by Form S-3 for registered offerings.[6]

2. Facilitate creation of a secondary "resale" market. Insofar as Regulation A+ securities are freely tradable, the key, as a practical matter, to making an investment in these securities attractive would be the availability of a secondary or resale market so purchasers can "exit" their investment.[7] The Commission can facilitate this development by adopting rules that require ongoing disclosure without the level of compliance needed for the admittedly robust reporting requirements of the Exchange Act, perhaps accompanied by required risk factors (see below). Securities Act Section 3(b)(2)(F) requires filing annual audited financial statements, and the Commission is authorized under Section 3(b)(4) to adopt rules requiring "periodic" filings. The key word, of course, is "periodic," meaning a report perhaps based on Forms 10-K and 10-Q (with "scaled" disclosure now permitted to "smaller reporting companies"), or the standards in Exchange Act Rule 15c2-11. The Commission may, of course, recommend companies adopt a more robust disclosure standard, e.g., "real-time" Form 8-K reports, and presumably the more complete and current the reporting, the more likely a vibrant resale market will develop, but that should be left in the issuer's discretion. Because Form 8-K reports are event driven rather than "predictable" as in the case for periodic reports, compliance with 8-K-like reporting rules will be burdensome for non-public companies, as it often is now for many smaller but fully reporting companies. The Commission might recommend, but not require, current reporting of clearly definable 8-K events related to, for example, material agreements, financial

[6] E.g., A company that does not meet the $75 million public float requirement of Form S-3 cannot qualify under Instruction I.B.1 of Form S-3, and, if not listed, cannot rely on Instruction I.B.3 for secondary transactions (commonly used for PIPEs), or Instruction I.B.6 for limited primary offerings.

[7] Rule 506 of Regulation D, which requires issuance of "restricted securities," necessitates an offering to patient investors willing to hold their securities until they can be resold under the Rule 144 safe harbor or the occurrence of some other corporate "liquidity event".

obligations, unregistered sales of securities, change of accountants, changes in and compensation of directors and officers, and charter amendments. In its comments on the new rules, the Commission could also refer to (without recommending) the Alternative Reporting Standard developed by OTC Markets Group.

In order to reduce the risk that investors do not recognize that the periodic reporting of Regulation A + companies is not as complete or current as those that comply with the Exchange Act, the Commission could mandate certain risk factors to be included in the offering statement and each periodic report (or posted on the company's website). These might include, for example, that the company is an early-stage company; it has not elected to be subject to Exchange Act requirements such as Form 8-K current reports and proxy rules, and its annual reports and financial statements are not subject to periodic review by the Commission; its financial statements do not necessarily meet the standards of Regulation S-X; its principal executive and financial officers are not required to certify review of reports and publicly disclose an evaluation of disclosure controls and procedures and internal control over financial reporting; its insiders are not required to report, or be subject to short-swing profit recovery with respect to, transactions in company securities; it is not required to meet the governance standards required for Exchange Act reporting companies and those listed on a national securities exchange.

3. Permit confidential submission of the offering statement. For the reasons that "emerging growth companies" under the JOBS Act are permitted to submit a draft registration statement to the Commission, companies electing to rely on Regulation A+ should have the same benefit. Following review by the Commission, and presuming a company intends to go forward with the Regulation A+ offering, but before accepting any investments, it would file the offering statement with the Commission as required by Section 3(b)(2)(G)(i). That approach is consistent with "test-the-waters" approach of Section 3(b)(2)(E) allowing for solicitation of investor interest before filing an offering statement.

I hope these comments will be helpful to the Staff and the Commission in considering and adopting rules to implement Title IV of the JOBS Act so as to enable it to meet the capital formation objectives sought by Congress.

Very truly yours,

JC Guest

Jonathan C. Guest

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