LEX Markets
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May 29, 2020

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549

Re: Facilitating Capital Formation and Expanding Investment Opportunities By Improving Access to Capital in Private Markets
Release Nos. 33-10763; 34-88321; File No. S7-05-20

Dear Ms. Countryman,

LEX Markets is a venture-backed company building a marketplace for issuing and trading Regulation A Tier 2 (also called Reg A+ herein) equity interests in individual commercial real estate properties. We believe that, for too long, the best investment opportunities in commercial real estate--which provide stable income and the advantageous tax treatment of pass-through ownership--have been reserved for only the wealthiest insiders. Our mission is to provide an avenue for "Mr. & Mrs. 401(k)" to enjoy those opportunities as well, by making shares of individual properties available for retail investors to create their own customized income-producing commercial real estate portfolios.

LEX Markets selected Reg A+ as the primary vehicle for its offerings. By opening the market to a broader retail investor base, not restricting resales, and then protecting retail investors with ongoing public disclosure requirements, Reg A+ provides an elegant capital raising solution that is uniquely conducive to secondary trading among all the registration exemptions.

But the promise of Reg A+ is today straightjacketed by state law. Despite Reg A+'s clear design to the contrary, Reg A+ securities cannot be secondarily traded without compliance with state Blue Sky laws, dramatically increasing the cost of using Reg A+, as explained below for no good reason.

We write in response to Question 65 in the above captioned rule proposal:

Should we extend federal preemption to secondary sales of Regulation A . . . securities, for example, by expanding the definition of "qualified purchaser"? . . . Should we preempt state securities registration or other requirements applicable to secondary sales of all securities initially issued in a Tier 2 Regulation A offering?

Should we preempt state securities registration or other requirements applicable to secondary trading of securities only of Regulation A Tier 2 issuers that are current in their ongoing reports? . . . What other steps should we consider to improve secondary trading liquidity of securities exempt from registration under Regulation A?

We strongly support extending preemption to secondary sales of Reg A+ securities whose issuers are current in their ongoing reports, for the following reasons.

A. State Filing and Qualification Requirements are Redundant of Federal Reg A+ Reporting and Qualification Requirements

Reg A+ stands apart from other registration exemptions in the robustness of its disclosure requirements, both for initial offerings and ongoing periodic filings. State Blue Sky laws do not add any material investor protections beyond what is already required under Reg A+.

For initial offerings, the information issuers must publicly disclose in a Reg A+ offering circular (Form 1-A) is nearly the same as what registered issuers must publicly disclose in a registration statement (Form S-1), the latter of which also satisfies state law "registration by coordination" requirements. The required disclosures in Form 1-A also contain all of the information required by state law "registration by qualification" rules.

For ongoing periodic filings, the disclosure requirements for Reg A+ issuers in Forms 1-K, 1-SA, and 1-U are far more robust than under any state law rules. Reg A+ issuers undergoing a material change in their business are required to publicly disclose that event in Form 1-U within four business days of the event. No such interim disclosure is required at all under state law.

Acknowledging the above, 25 states and territories now allow filings on Edgar to satisfy a "manual publication" exemption, and in those states a current Reg A+ filer will also be current in their Blue Sky obligations with minimal effort. But the remaining states and territories either require issuers to publish forms in antiquated and expensive manuals to avail themselves of the manual publication exemption, or do not offer such an exemption at all (most notably California).

While the pragmatic approach of counting Edgar filings as sufficient publication is praiseworthy, the approach of the remaining states underscores the need for federal preemption to enable nation-wide Reg A+ offerings.

B. A Recent Academic Study Found that Blue Sky Requirements Stifle Growth

The last major preemption of Blue Sky requirements dramatically boosted the issuance of the covered securities. So conclude Professors Michael Ewens of CalTech and Joan Farre-Mensa of UIC in a current National Bureau of Economic Research Working Paper.* Profs. Ewens and Farre find that the preemption of state filing requirements for Reg D offerings contained in the 1996 National Securities Markets Improvement Act (NSMIA) "played a significant role in changing the going-public versus staying-private trade-off, helping bring about a new equilibrium where fewer startups go public, and those that go public are older."

Prior to 1996, private placements of equity interests to accredited investors were subject to state Blue Sky requirements and their associated compliance costs. This burden on private capital raising made the relative cost of going public and listing shares on a national exchange--listed shares are exempt from Blue Sky laws--less extreme. As between paying lawyers to register an offering and gain access to public investors, or paying lawyers to comply with Blue Sky laws and only have access to accredited investors, many startups picked the former.

But Profs. Ewens and Farre demonstrate that, with Reg D Blue Sky compliance costs removed by the NSMIA, that calculus dramatically shifted: "The passage of NSMIA thus appears to have allowed VC and PE funds investing in late-stage startups--traditional IPO candidates--to raise larger amounts of capital. This and our other results in this section showing that NSMIA has facilitated late-stage startups' access to out-of-state investors and has also allowed them to raise larger funding rounds point to NSMIA as a *positive shock* to the supply of private capital" [emphasis added].

Removing the same shackles from Reg A+ offerings would likely yield a similar "positive shock" to capital raising. Prospective Reg A+ issuers currently confront a regulatory landscape where the alternative avenues of Reg D or full registration with exchange listing are both exempt from Blue Sky requirements, but Reg A+ is only partially exempt. Fully exempting Reg A+ as well would level that playing field and allow Reg A to stand on its merits as a lower-cost method of accessing public markets, fulfilling Congress's intent in authorizing Reg A+ to "help small companies gain access to capital markets without the costs and delays associated with the full-scale securities registration process."**

C. State Securities Regulators' Criticisms of Reg A+ are Unfounded

In a recent comment letter,*** the NASAA pushed for *more* state regulation of Reg A+ offerings, asking the Commission to *rescind* the preemption of primary offerings contained in the current version of Reg A+. The NASAA argued that such a move is warranted because Reg A+ issuers often:

- Lack independent directors or limits on conflicts of interest,
- Broadly indemnify managers or disclaim manager fiduciary duties,
- Do not afford shareholders customary voting rights, or

- Impose mandatory arbitration or forum selection clauses for investor lawsuits.

While we share NASAA's concerns for investor protections, it is possible to both satisfy those concerns and honor Congress' intent to help small companies gain access to the capital markets at lower cost at the same time.

1. Director Independence

Director independence is a critical aspect of investor protection because it can prevent unfair self-dealing by conflicted managers. Not every conflicted transaction is unfair; greater enterprise value can be achieved by allowing companies to proceed with conflicted transactions with mechanisms in place to manage the conflicts than by disallowing all conflicted transactions outright.

The most obvious way to manage conflicts is to recuse the conflicted manager(s) from their regular role in approving a transaction and instead grant approval powers to other unconflicted managers. This concept underlies Section 144 of the Delaware GCL, which shields related party transactions from challenge if they are approved by a majority of disinterested directors.

This mechanism necessarily entails the existence of disinterested – which usually means independent – directors. NYSE and Nasdaq require a majority of independent directors. OTC Markets requires issuers to have at least two independent directors for inclusion on their premium platform.

But requiring full-time independent directors is not the only way to manage conflicts, and Reg A+ is supposed to provide cheaper alternatives to full-scale registration. Small issuers may have difficulty finding suitable people willing to serve as independent directors – and face potential public company shareholder litigation – without paying large-issuer director fees.

Another way to achieve similar results is to provide for an *ad hoc* conflicts committee to form and act only when a potential related party transaction is actually contemplated. Reg A+ already requires issuers to disclose related party transactions in periodic filings, so identifying which transactions require committee approval is easy. In most cases, the committee will never need to be formed, and when it is needed, the ask of its members is less onerous than full-time directorship, and they can be compensated accordingly.

Ad hoc directors will not be familiar with the specific operations of the company, but they should be familiar with how to evaluate a related party transaction. Numerous Delaware professional services firms offer low-cost independent director services, including on an ad hoc basis. Those service providers have traditionally targeted special purpose bankruptcy remote entities for use in secured finance transactions, but they can also be used by Reg A+ issuers to reduce the costs of having public shareholders.

2. Indemnity & Exculpation

Section 102(b)(7) of the Delaware GCL limits the ability of Delaware corporations to reduce director liability below a certain threshold, but there is no such limit imposed on Delaware LLCs, which some Reg A+ issuers are. "State of the art" indemnification and exculpation provisions in privately-held Delaware LLCs routinely reduce the fiduciary duty liabilities of their managers and members to zero, foreclosing most attempts by investors to hold managers accountable for malfeasance.

Some limit similar to Section 102(b)(7) should be required to protect public investors in Reg A+ LLCs.

Most breach of fiduciary duty claims involve some form of conflict of interest, which can be addressed by requiring approval of a conflicts committee as discussed above. Providing a safe harbor from conflicts-based claims when the conflicts committee process is followed – and allowing such claims where the process is not followed – accomplishes the delicate balance of both providing managers with greater clarity as to their potential exposure and providing public shareholders with meaningful protection against unfair self-dealing.

Another common category of breach of fiduciary duty claim is based on a failure to remedy known internal control deficiencies, a so-called *Caremark* claim. These claims are difficult to successfully bring because they require management to ignore known red flags, a hopefully rare occurrence. Merely negligent oversight without proof of a known deficiency is not enough.

An exculpatory clause that tracks the requirements of a *Caremark* claim would again set a nice balance between clearly defining manager exposure and protecting public investors from inexcusable oversight failures. Providing that mismanagement claims are precluded unless damages are caused by a manager failing to remedy a known internal control deficiency would accomplish this.

3. Voting Rights

The pitfalls of dual-class voting rights – where voting rights are retained by founders and withheld from public investors – have been written about at length in recent months, particularly in light of the failed WeWork IPO. Investor advocates have argued that dual-class voting structures insulate management from accountability and market discipline, creating entrenched "corporate royalty." Proponents argue that such insulation is a good thing, allowing managers to execute long-term business plans without interference from short-term investors.

Without taking sides on whether dual-class voting is good or bad, it is sufficient to point out that it is currently permitted and in place at many of the most widely held fully-registered exchange-listed companies, including Google, Facebook, and Lyft, and the exchanges have thus far resisted efforts to ban the practice via exchange listing standards. Imposing a greater restriction on the capital structure of Reg A+ issuers than is required of fully-registered exchange-listed companies is contrary to Congress' intent to lower the burdens of going public with Reg A+.

4. Arbitration & Forum Selection

Another hot topic in corporate governance circles is whether issuers may require shareholders to bring claims in arbitration or in the issuer's preferred court venue. In the last year alone: (a) Delaware Vice Chancellor Laster ruled that companies can only dictate where claims challenging their internal corporate affairs are brought, and that a forum selection clause purporting to limit where disclosure-based claims under federal securities laws may be brought is invalid; (b) SEC Chair Clayton issued a special statement accompanying a no-action letter addressing whether Johnson & Johnson could exclude a shareholder proposal seeking to require arbitration from its proxy materials on the grounds that doing so would violate state law; and (c) J&J shareholders filed suit in federal court to challenge the same no-action ruling.

Whatever the outcome of this unsettled legal topic, it seems unlikely that it will turn on whether the issuer seeking to impose forum restrictions is fully registered or has used Reg A+. In either event, the SEC will need to qualify the offering. If the SEC is uncomfortable with allowing an issuer to impose forum restrictions, it can make that comment just as easily in reviewing a Form 1-A (for Reg A+ offerings) as it can in reviewing a Form S-1. Reg A+ will not be any "worse" than full registration in terms of investor protection in this respect.

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For the foregoing reasons, we urge the Commission to extend federal preemption of state Blue Sky laws to cover all trading in current Reg A+ securities, both primary and secondary.

Very truly yours,

Michael J Friedman
Head of Trading

* Michael Ewans & Joan Farre-Mensa, “The Deregulation of the Private Equity Markets and the Decline in IPOS,” National Bureau of Economic Research, Working Paper 26317, available at https://www.nber.org/papers/w26317

** H. Rept. 112-206, the Small Company Capital Formation Act of 2011, available at https://www.congress.gov/congressional-report/112th-congress/house-report/206/1

*** Comment letter from Christopher Gerold, President of NASAA, on Harmonization of Securities Offering Exemptions, dated October 11, 2019, available at https://www.sec.gov/comments/s7-08-19/s70819-6288085-193367.pdf