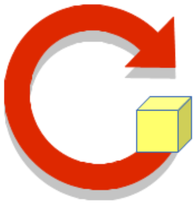

PUBLIC STARTUP COMPANY, INC.
https://www.publicstartup.com
2360 Corporate Circle, Suite 400
Henderson, NV 89074-7739

November 13, 2014

To: Mary Jo White, Chair
Elizabeth M. Murphy, Secretary
Charles Kwon, Office of Chief Counsel,
Division of Corporation Finance
Securities and Exchange Commission
100 F Street, NE, Washington, DC 20549-1090
CC: rule-comments@sec.gov

From: Jason Coombs, Co-Founder and CEO
Public Startup Company, Inc.
http://twitter.com/JasonCoombsCEO
http://JOBS-ACT.com/Coombs.Jason
http://facebook.com/publicstartup/info
http://linkedin.com/in/jasoncoombs
http://facebook.com/JasonCoombsCEO

Re: Release No. 33-9416; Release No. 34-69960; Release No. IC-30595; File No. S7-06-13
JOBS Act legislation URL http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf

On February 15, 2008 the SEC implemented a revision to Rule 144 that perpetually prohibits restricted securities from being deemed free-trading securities unless the securities in question are of a class of securities **registered** with the Commission, **and** the holder of the securities intends to sell them to the general public in the near future, **and** the issuer is current in its Exchange Act reporting requirements.

See: http://www.sec.gov/rules/final/2007/33-8869.pdf

For registered issuers who deregister with the Commission by filing Form 15 to cease all Exchange Act reporting requirements, the revision to Rule 144 enacted on February 15, 2008 poses a serious problem. Unregistered issuers who have never registered their securities, and who started out small, the way that nearly every startup company does, may be deemed legally to have been a "shell" previously by virtue of the ambiguous wording of revised Rule 144. I believe the SEC must clarify the intent of Rule 144 in order for people to know that securities issued by startups that register, then later deregister, will **never** end up being deemed to be perpetually-restricted due to the SEC's "former" shell company prohibition.

The plain language meaning of the revised Rule 144 could not be any more clear in its explicit support for shareholders' right to resell unregistered securities after a 12-month holding period. Quoting here: **"Restricted securities of issuers that are not subject to the Exchange Act reporting requirements will continue to be subject to a one-year holding period prior to any public resale"** (Rule 144 page 1)

However, the Commission created Rule language that was ambiguous with respect to "former shell" company eligibility to rely on the revised Rule 144. Although the Commission has reiterated many times that the Rule 405 definition of "shell company" is not meant to cover startups or small companies the Commission has chosen to leave the ambiguous meaning and uncertain impact of its new Rule 144 language unclear, so that securities lawyers cannot even agree as to what the difference is between a small startup and a "non-reporting shell company" for purposes of later eligibility for Rule 144. It does make rational sense, and it is good regulatory policy, for the SEC to impose special requirements for additional reporting by registered shell companies under circumstances such as when they cease to be shell companies. It also makes rational sense and is good regulatory policy to impose a reasonable period of disqualification from reliance on Rule 144 when a startup with nominal non-cash assets and nominal operations deregisters, whether or not the company was ever technically a "shell", but a new provision "Treatment of Securities Issued by 'Reporting and Non-Reporting Shell Companies'" in 2008

introduced a bizarre "scarlet letter" or "evergreen" prohibition on the use of Rule 144 by any company that was ever, at any time, previously a "shell company" as defined by Rule 405, or was ever, at any time, a newly-devised class of previously-undefined issuer, known as a "non-reporting shell company."

This scarlet letter prohibition went into effect on February 15, 2008, and since this time it has been necessary for every company, whether registered with the Commission or not, to be able to prove to its securities lawyer that the company has not, at any time, ever previously had "nominal" non-cash assets and "nominal" operations. Any company, whether registered or not, that has ever had only a small amount of non-cash assets and a small amount of operations (i.e. a startup that only has seed capital, or a startup that hits a funding air pocket and ceases to "operate" above "nominal" scale while searching for its next round of capital, or perhaps even companies that only "operate" seasonally, and so on) is presently vulnerable to being labeled a "non-reporting shell company" previously. (Rule 144, §II.F.6)

The definition of "shell company" prior to, and also still outside of, the revised Rule 144 is as follows:

See: http://www.law.cornell.edu/cfr/text/17/230.405

"Shell company. The term shell company means a registrant, other than an asset-backed issuer as defined in Item 1101(b) of Regulation AB (§ 229.1101(b) of this chapter), that has:
(1) No or nominal operations; and
(2) Either:
(i) No or nominal assets;
(ii) Assets consisting solely of cash and cash equivalents; or
(iii) Assets consisting of any amount of cash and cash equivalents and nominal other assets."

Unfortunately, when the SEC introduced its revision to Rule 144 it also created this new idea that extra regulation was needed for any company that has ever been a "non-reporting shell company" previously but that now has shareholders who wish to rely on Rule 144 to resell the company's securities publicly.

Quoting from page 21 of the final Rule 144: **"As discussed below, we are codifying the staff's current interpretive position that Rule 144 cannot be relied upon for the resale of the securities of reporting and non-reporting shell companies."**

Quoting from pages 46-48: **"On January 21, 2000, the Division of Corporation Finance concluded in a letter to NASD Regulation, Inc. that Rule 144 is not available for the resale of securities initially issued by companies that are, or previously were, blank check companies. In an effort to curtail misuse of Rule 144 by security holders through transactions in the securities of blank check companies, we proposed to codify this position with some modifications. First, we proposed to modify the staff interpretation to address securities of all companies, other than asset-backed issuers, that meet the definition of a shell company including blank check companies. The category of companies to whom the staff interpretation was proposed to apply is broader than the Rule 405 definition of a "shell company," however, as it would apply to any "issuer" meeting that standard, whereas the Rule 405 definition refers only to "registrants." For purposes of the discussion in this release only, we call these companies, *"reporting and non-reporting shell companies." [emphasis added]* Under the proposed rule, a person who wishes to resell securities of a company that is, or was, a reporting or a non-reporting shell company, other than a business combination related shell company, would not be able to rely on Rule 144 to sell the securities."**

Rule 144 explicitly requires registration under the Exchange Act for all non-reporting issuers that had "nominal" non-cash assets and "nominal" operations at any time previously. ***This must be eliminated.***

This language of the revised Rule 144 clearly captures every company that at any time previously had “nominal assets other than cash and nominal operations” – even a company that was not meant to be captured by the meaning of the word “shell” initially. The small size of non-cash assets and operations may be the result of being a small business or a startup, rather than the result of being an empty shell or “blank check company” that has no real purpose to exist in the economy and therefore requires special regulation by the Commission to help prevent deception and abuse of the public financial markets.

There has been interpretive guidance issued by the Commission related to this question of former shell companies and the implications of the revised Rule 144 which went into effect on February 15, 2008:

http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm

Section 137. Rule 144(i) — Unavailability to Securities of Issuers with No or Nominal Operations and No or Nominal Non-Cash Assets
Question 137.01
Question: If an issuer had previously been a shell company but is an operating company at the time that it issues securities, is the Rule 144 safe harbor available for the resale of such securities if all of the conditions in Rule 144(i)(2) are not satisfied at the time of the proposed sale?

Answer: No. Rule 144(i)(1) states that the Rule 144 safe harbor is not available for the resale of securities “initially issued” by a shell company (other than a business combination related shell company) or an issuer that has “at any time previously” been a shell company (other than a business combination related shell company). Consequently, the Rule 144 safe harbor is not available for the resale of such securities unless and until all of the conditions in Rule 144(i)(2) are satisfied at the time of the proposed sale. [Jan. 26, 2009]

A company with a billion dollars in the bank and nominal operations may still be deemed a “shell” by the SEC's current rule. A billion dollars of cash with nominal operations and nominal non-cash assets implies a non-operating shell company that is nothing more than a pool of money seeking a business purpose for the capital. The dictionary definition of “nominal” according to Merriam-Webster is: *adj.* “very small in amount” – in other words, a small company or startup **ALWAYS** meets the dictionary definition of **“nominal”**. This is true both in terms of assets and operations. The SEC acknowledged that its rule language and use of the word “nominal” was not meant to capture startups or other small businesses merely by virtue of being small, but a shell company is still a shell, legally, even if it has non-cash assets and operations far greater than any startup or small business, if the shell exists as a business in name only, “nominally” for the purpose of reverse merger with an operating company. The meaning of the word “shell” in the Commission's Rules has always focused on regulating deceptions and fraud surrounding the creation of the appearance of a legitimate business structure or entity whose only purpose is to trick people into perceiving market value for securities where no value truly exists.

However, instead of empowering the securities lawyers and accountants who provide services to small businesses and startups to affirmatively declare that the company exists for a legitimate purpose and is not engaged in any shell company deception or fraud, the Commission's ambiguous Rule language for its Revised Rule 144 created a duty for securities lawyers to affirmatively declare that the company has never in the past possessed “nominal” assets other than cash and “nominal” operations. No securities lawyer can ethically say such a thing about any company that started as a small business, and unless the clients of a securities lawyer keep the lawyer informed of its substantive non-cash assets and significant operations on an ongoing basis (even when there is no need for the lawyer's ongoing services) there is no way for any lawyer to know whether the non-cash assets and operations became “nominal” at some

point in time, such as during a catastrophic global economic meltdown like the one that coincidentally started the same year the SEC enacted its revised Rule 144 and that is, in my view, still ongoing today.

Fully-reporting registered issuers can easily describe operations in quarterly and annual reports that are substantial enough to demonstrate that they were not a shell company during a given time period in the past, but that does not mean the company still has more than “nominal” non-cash assets and operations in the present. Where there is some doubt about this, securities lawyers can require their clients to file their next quarterly or annual report prior to issuing new Rule 144 opinions, which serves to document via recent EDGAR filing that the issuer had not become a shell company in the latest reporting period.

But for purposes of the JOBS Act (except in Title I) we are primarily talking about unregistered issuers. Imposing periodic reporting requirements for eligibility to raise capital under Title III or Title IV may address this issue adequately, if the “shell company” prohibition of Rule 144 were limited to companies that have nominal non-cash assets and nominal operations in the present, but unfortunately Rule 144 as it exists today requires securities lawyers to verify that any company, whether registered fully reporting company or not, ***never*** had “nominal” non-cash assets and nominal operations ***at any time in the past***.

The Commission is well-aware that it is impossible for securities lawyers to verify such a thing in most cases. Permitting securities lawyers to rely on statements made by the issuer itself doesn't solve this problem, either, because deceptive issuers will tell lies and honest issuers will not be able to swear that their company was never a “nominal” startup unless the business started with substantial non-cash assets and has, ***at all times since inception***, maintained substantial non-cash assets and operations. In my opinion, the SEC should eliminate its policy of regulating by “scarlet letter” political punishment. On October 1, 2008, attorney David Feldman submitted a petition for rulemaking to solve this problem.

See: http://www.sec.gov/rules/petitions/2008/petn4-572.pdf

On July 1, 2005, the Commission's revision to the definition of “shell company” expressly permitted former shell companies to use Form S-8 after the shell company ceased to be a shell company. Since only registered issuers can use Form S-8, this did not create any problem for unregistered issuers. If a company that was formerly a shell company wishes to make use of Form S-8 the first thing they must do is register a class of securities. Nobody should be forced to register securities to rely on Rule 144. However, issuers **should** be required to file **at least** once with the Commission, such as filing a Form D when shares are issued, for issuers' shareholders to be allowed to rely on Rule 144 without registration.

See: http://www.sec.gov/news/press/2005-99.htm

“permit former shell companies to use Form S-8 once they become operating companies and 60 days have passed since they filed with the Commission the information about the operating company that they will be required to provide if they were filing a registration statement under the Exchange Act;”

Companies that were never formerly shell companies can compensate employees and others with equity, and after the required Rule 144 holding period the shares can be resold publicly through a broker if there is a public secondary market for the shares. The availability of Rule 144 for companies that are not registered with the Commission is important for the thousands of unregistered public companies that exist today, and it will be important for the thousands of new public companies that will be created after raising capital with the help of JOBS Act Rules. The Commission must alter Rule 144's “former non-reporting shell company” restriction so that all non-reporting issuers are deemed eligible.

See: http://www.sec.gov/info/smallbus/secg/rules144-145-secg.htm