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Submitted electronically to rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File Number S7-11-13: ***Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act***

Dear Ms. Murphy,

Thank you for the opportunity to comment on the Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act (the "Proposed Rule" or the "Regulation A Proposal"), which was recently issued by the Security and Exchange Commission (the "Commission" or "SEC"), as required by Title IV of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Acts").

While I commend the Commission's efforts to carefully revise and modernize numerous key aspects of Regulation A in order to make it more useful to small companies seeking to raise capital, like many others who have submitted comments on this proposed rulemaking, I have several concerns regarding the lack of sufficient investor protections included therein.

Although I support many of the Commission's proposed modifications to Regulation A, which I will address in greater detail in my comments set forth below, I have great apprehensions regarding one significant aspect of the Proposed Rule: the

Commission's proposal to exclude states from participating in the regulatory review process through the proposed preemption of state securities laws ("blue sky" laws).

My comment will proceed in the following order. Section I will briefly outline the key components and purpose of the Commission's Regulation A Proposal, including considerations regarding its statutory authority, the legislative directive from which this rulemaking stems, and the presence of a compelling public need. Section II will provide specific comments detailing my concerns regarding the proposed preemption of state securities regulations. Section III will outline my comments relating to the Commission's analysis regarding the economic effects of the Proposed Rule and its consideration of alternatives. Section V will provide my concluding remarks and expand upon my key recommendations for improving the Regulation A Proposal, which focus on the avoidance of adopting a preemptive approach.

I. Overview

The JOBS Act and Revisions to Regulation A

On January 23, 2014, the Securities and Exchange Commission (SEC) issued its Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act. As statutorily directed by Title IV of the Jumpstart Our Business Startup Act of 2012 (the "JOBS Act"), which amended the Securities Act of 1933 by adding section 3(b)(2), the SEC's Proposed Rule seeks to expand Regulation A, an existing registration exemption for small companies offering or selling up to $5 million in public securities during a twelve-month period. Per the explicit directive outlined in Title IV, Section 401, the Commission was required to increase the annual Regulation A offering threshold from $5 million per year to include companies offering an aggregate of up to $50 million in securities per year.

The Commission has proposed to implement the expansion of the Regulation A exemption by creating two "tiers" of securities offerings. While Tier 1 would include those offerings previously covered under Regulation A (not exceeding $5 million in a twelve-month period), Tier 2, as proposed, would consist of offerings of up to $50 million in a twelve-month period. Notably, for offerings of $5 million or less, the company may select the tier (and associated requirements) under which they would like to offer their securities.[1]

In addition to increasing the Regulation A exemption limit, the JOBS Act also directs the Commission to: (1) review the offering limitation amount every two years and increase the exemption amount as it deems appropriate; (2) require that companies offering or selling securities under this exemption prepare and file with the SEC an audited financial statement on an annual basis; and (3) that issuers, prior to filing an offering statement, may "test the waters" (advertise) to gauge interest in the offering. The JOBS Act further mandates that securities offerings covered under this exemption:

- may be offered and sold publicly;
- may not include "restricted securities" within the meaning of federal securities laws and regulations;
- will be subject to the civil liability provisions of Section 12(a)(2) of the Securities Act; and
- will be limited to equity securities, debt securities, and debt securities convertible into or exchangeable for equity interests, including any

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[1] Proposed Rule Amendments for Small and Additional Issues Exemptions under Section 3(b) of the Securities Act, 79 Fed. Reg. 3926 (proposed Jan. 23, 2014) ("Proposed Rule") at 3927.

guarantees of such securities.[2]

As a complement to the requirements explicitly outlined by Congress, the JOBS Act also authorized the Commission to exercise its discretion as necessary in furtherance "of the public interest and for the protection of investors."[3] While Congress specifically delegated authority to the Commission to determine (1) whether to require issuing companies to file offering materials electronically, (2) the form and types of information companies must disclose, (3) how frequently they must report this information to the Commission, and (4) which "bad actor" disqualification provisions to include in the final rule, there is a notable absence of delegated authority with respect to the issue of whether Regulation A offerings should be exempted from compliance with state securities laws. Rather, Congress simply included a provision requiring that the Comptroller General conduct a study on the impact of state securities laws ("blue sky laws") on offerings made under the Regulation A exemption.[4]

Statutory Authority and the Presence of a Compelling Public Need

Given the information above, it is clear that the Commission was explicitly required by Congress to implement certain revisions to Regulation A through its rulemaking authority. Broadly speaking, the purpose of the Proposed Rule is to promote the use of Regulation A as an effective means of small company capital formation. According to the Commission, its primary objective is to expand and update Regulation

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[2] Id., at 3928.
[3] Public Law 112-106, —401, 126 Stat. 307 (April 5, 2012).
[4] See *Factors That May Affect Trends in Regulation A Offerings, U.S. Government Accountability Office (July 3, 2012), available at* http://www.gao.gov/products/GAO-12-839 *("GAO Report").*

A "in a manner that makes public offerings of up to $50 million *less costly* and *more flexible* while providing a framework for regulatory oversight to protect investors" (emphasis added).[5]

As an independent agency, the SEC is not required to comply with Executive Order 12866 or submit to regulatory review by OIRA. However, E.O. 12866 sets forth several useful principles regarding regulatory planning and review from which to analyze the Commission's Proposed Rules, namely, whether the regulations are "made necessary by compelling public need."[6] In this case, the compelling public need is not a market failure, *per se*, but rather, a "failure of...public institutions that warrant[s] new agency action.[7] In this context, the failure is that, although a variety of registration exemptions currently exist, Regulation A is among the least relied upon, with only one qualified Regulation A offering occurring in 2011.[8]

According to the SEC's analysis and the GAO's 2012 report to Congress regarding trends in the use of Regulation A, the lack of reliance on Regulation A is based on four key factors:

(1) Challenges and costs relating to compliance with state securities regulations ("blue sky laws");

(2) The availability of alternative offering methods, such as the Regulation D exemption;

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[5] Proposed Rule at 3997.
[6] Executive Order 12866. (September 30, 1993). Available at http://www.archives.gov/federal-register/executive-orders/pdf/12866.pdf
[7] Id.
[8] *See Factors That May Affect Trends in Regulation A Offerings, U.S. Government Accountability Office (July 3, 2012), available at* http://www.gao.gov/products/GAO-12-839 *("GAO Report").*

(3) The high costs associated with the SEC Regulation A filing and qualification process; and

(4) The slow pace at which Regulation A offerings are qualified. Notably, according to the GAO, between 2002 and 2012, Regulation A offerings took an average of 241 days to qualify.[9]

II. Comments Regarding the SEC's Proposal to Preempt State Blue Sky Laws

This section will provide specific comments detailing my concerns regarding a key threat to investor protection: the proposed preemption of state securities laws. As currently written, the Commission is proposing to exempt all Tier II Regulation A offerings from registration and compliance with state securities laws. That is, as proposed, offerings of up to $50 million will be completely free of state review and oversight. The Commission recommends preempting state laws by implementing a definitional change in which all offerees in Regulation A offerings, and all purchasers in Tier II offerings, are defined as "qualified purchasers."[10]

While I recognize the challenges facing small companies seeking to raise capital and support streamlining the state registration and compliance processes, preempting state securities laws and the associated investor protections is the wrong solution. It not only shows a strong disregard for investor interests, but, as the North American Securities Administrator Association ("NASAA") and several state securities

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[9] Proposed Rule at 3975.
[10] Proposed Rule at 3969.

administrators have suggested in their comments, based on the legislative history of the JOBS Act, it is an arguable overreach in the Commission's authority.

There is a Lack of Evidence Indicating that Preemption is Necessary

In its brief analysis regarding the potential costs and benefits of preempting state blue sky laws, the Commission relies almost exclusively on the July 2012 GAO report to Congress, which attempts to document "the factors that may affect trends in Regulation A offerings."[11] The Commission cites GAO's finding that "state securities laws were *among several central factors* that may have contributed to the lack of use of Regulation A" (emphasis added).[12] While it is true that some of the mostly qualitative insights presented in GAO's report reference the costs and challenges of navigating state registration and compliance requirements, the GAO notably fails to quantify the costs of blue sky law compliance for Regulation A offerings in a *tangible way*. It also provides no data regarding the average number of states in which small companies relying upon Regulation A or similar exemptions have sought to qualify in the past, or how they may proceed in the future.

In one attempt to quantify the costs of state compliance, the Commission notes that while "state securities law filing fees are likely not significant in any particular state (filing fees are, on average, approximately $1,000 in every state), such fees can become non-trivial when the offering extends across multiple states." [13] Although I agree with this assessment, without more complete data regarding the average number of states in

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[11] Proposed Rule at 3967-3969 ("Relationship with State Securities Laws"). *See also* GAO 12-839.
[12] Proposed Rule at 3968.
[13] Proposed Rule at 3975.

which a small business would likely offer or sell their Regulation A securities, it is difficult to assess the true need for the preemption of state securities regulations for the sake of decreasing compliance costs.

There is a Lack of Evidence Indicating Investors will be Sufficiently Protected in the Absence of State Oversight

Turning to the issue of investor protection, there is also a notable absence of an attempt to quantify the costs (or benefits) to potential investors should Regulation A offerings be exempted from state securities regulation as proposed. As the comment filed by Andrea Seidt, President of the North American Securities Administrators Association (NASAA), correctly points out, when engaging in rulemaking, the SEC is required to not only consider the benefits to companies with respect to capital formation and market efficiency, but is also required to "give due consideration to the potential effects on investor protection, separate and aside from the debate regarding effects on issuers."[14]

Despite recognizing that "certain appropriate investor protections" are necessary given that the current and revised Regulation A offerings will be available to all investors—not just sophisticated *accredited* investors, the Commission fails to explicate how the proposed replacement protections compare to the current framework in which states play a significant role in the review process.[15] Further, what it describes as "*substantial investor protections* embedded in the issuer eligibility

[14] Letter from Andrea Seidt, NASAA President and Ohio Securities Commissioner, to Elizabeth M. Murphy, Secretary, SEC (March 24, 2014), at http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf.

[15] Proposed Rule at 3969.

conditions, limitations on investment, disclosure requirements, qualification process and ongoing reporting requirements of proposed Tier 2"[16] leave much to be desired in that most of the "protection" is dependent on investors making smart decisions and issuers accurately representing the state of their businesses and future plans.

Moreover, given the availability of data regarding the prevalence of fraud and financial crimes relating to Regulation D, Rule 506—a similar, but slightly less restrictive offering exemption which allows for the preemption of state blue sky laws, but is primarily limited to *accredited* investors—it is surprising that the Commission failed to include a comparative study of this data in its analysis. While the Commission seems to view the Regulation D exemption as a promising model towards which Regulation A should strive—especially given its popularity with businesses—NASAA's findings that "during the past three consecutive years, offerings [made under this exemption] have been the *single* most common investment product or scheme involved in state enforcement actions,"[17] provides compelling evidence that this is the wrong model to move toward.

Finally, the Commission makes no attempt to quantify, or even mention, the value derived from the current protections that come from an additional layer of state oversight, especially in the form of merit reviews, or the tangible costs and risks to investors that could arise should this oversight be eliminated.

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[16] Id.

[17] Letter from Andrea Seidt, NASAA President and Ohio Securities Commissioner, to Elizabeth M. Murphy, Secretary, SEC (March 24, 2014), at http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf.

The GAO in its 2012 report does, however, make a qualitative comment, based on its interviews with state securities administrators, regarding the value of state blue sky laws. It notes:

> According to state securities administrators with whom we met, blue sky laws are beneficial because they provide an additional layer of protection for potential investors. Moreover, for states that have the statutory authority to assess the merit of an offering, the state can assess the extent to which the offering is fair to potential investors, and require the business to address the state's concerns before the offering is registered.[18]

In his recent comment on the Proposed Rule, Washington State Securities Administrator, William Beatty, contributed another insightful point as to the valuable role of state regulators in the offering oversight process: accessibility to both issuers and investors, responsiveness, and local knowledge. Mr. Beatty describes these strengths as follows:

> (i) State regulators are more accessible to local issuers and investors alike; ... (ii) State regulators are more accountable to local investors and businesses and have the ability to respond quickly to fraudulent offerings occurring in their own backyards; ... and (iii) State regulators have more

[18] See *GAO Report* 12-839 at 8.

> specialized knowledge of matters affecting local offerings, and are thus better positioned to evaluate a local offering.[19]

Missouri's Secretary of State, Jason Kander, who also filed a comment in response to the Proposed Rule, further echoed the importance of state regulators' role in the blue sky oversight process. In particular, he expanded upon the direct services they provide to inexperienced investors, such as those who would likely be purchasing Regulation A offerings, *as well as* small issuers, explaining:

> Investors regularly call blue sky regulators to check on an offering that they received. Frequently, these citizens do not have an investment adviser and are inexperienced in researching securities offerings beyond merely reading an offering document."[20] ... Moreover, preempting the States wrongly assumes that the States do not help capital formation. What goes unrecognized is that the blue-sky regulators provide issuers state-subsidized guidance as to how to conform their offerings to the securities laws in their States. Like those of my fellow state regulators, my office routinely answers local issuers' questions about federal and state securities laws.[21]

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[19] Letter from William Beatty, Washington State Securities Commissioner, to Elizabeth M. Murphy, Secretary, SEC (March 24, 2014), 4, at http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf.

[20] Letter from Jason Kander, Missouri Secretary of State, to Elizabeth M. Murphy, Secretary, SEC (March 24, 2014), at http://www.sec.gov/comments/s7-11-13/s71113-79.pdf.

[21] *Id.*, at 7.

NASAA'S Proposed Multi-State Coordinated Review Program Represents a Superior Alternative to Preemption

Given the presence of several very strong arguments in favor of continued state participation in the Regulation A offering process, each of which the Commission fails to sufficiently consider in its Proposed Rule, as well as the absence of quantifiable evidence to the contrary, it would seem prudent for the Commission to think twice before cutting states out of the process, especially when they provide such valuable services to *all* parties involved. Moreover, as NASAA and others have indicated, the states are more than willing to work with the SEC to reduce the regulatory burden facing small companies by moving towards a more streamlined and coordinated system of registration and review.

While the SEC raises questions in its Regulation A Proposal as to when NASAA's proposed multi-state coordinated review program would be ready for implementation and how many states would agree to participate, the answers to these questions have since been clarified. According to NASAA, the details of the new coordinated review program have already been largely finalized and the program was approved by a membership vote on March 7, 2014. Regarding the question of states' willingness to partake, as of April 8, 2014, 48 of the 53 regulatory agencies that comprise NASAA had already signed on to participate in the new program and, based on their comments, seem to view it as a constructive compromise between the status quo and the SEC's proposed preemption of blue sky laws.[22]

[22] Sarah Lynch, "SEC's Stein backs states' push to police smaller stock deals." *Reuters* (April 7, 2014), http://www.reuters.com/article/2014/04/08/us-sec-stein-stockdeals-idUSBREA371SZ20140408.

Also notable, the new multi-state coordinated review program appears to be designed to be impressively fast, efficient, and user-friendly for companies making offerings. Based on NASAA's infographic explaining the new system, "if there are no deficiencies in the application, no comments will be necessary and the registration will be cleared by the lead examiners within 21 business days after it is filed."[23] This is a stunning improvement in comparison with the GAO statistics regarding the average qualification time of *241* days for the Regulation A offerings that took place between 2002 and 2012.[24] The efficiency of the new system is based on the premise of streamlining and simplifying the process through the assignment of a lead examiner, who will be responsible for directly communicating with the filer and coordinating with the states to quickly review and approve the filing. Based on the promising information available about the program at this point, as well as the broad support among states to adopt such a program, I believe the Commission should seriously re-examine the merits of this multi-state coordinated approach.

III. Analysis and Consideration of Alternatives

Analysis of Regulatory Principles

When engaging in rulemaking, the SEC is statutorily required by Section 2(b) of the Securities Act and Section 3(f) of the Exchange Act to consider the "costs imposed by, and the benefits to be obtained from," its proposed rules.[25] In conducting a cost benefit analysis, the Commission must consider four key components prior to adopting

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23 *Id.*
24 Proposed Rule at 3975.
25 Proposed Rule at 3972.

or implementing a proposed action. It must evaluate (1) whether an action is necessary or appropriate in the public interest; (2) whether it will provide sufficient investor protections; (3) whether it will promote efficiency, competition, and capital formation; and (4) how it will impact competition. When considering the impact of any new rule on competition, it must "not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act."[26] In analyzing the various provisions of the Regulation A Proposal against the four requirements outlined above, I believe that, in general, the Commission's Proposed Rule complies with each requirement—with the notable exception of its proposal to preempt state securities laws.

With regards to the first consideration, in addition to being statutorily required to implement the modernization of Regulation A as mandated by Title IV of the JOBS Act, I believe that the Commission has made a compelling argument that the action is "necessary or appropriate in the public interest." This is based on two points: (1) the fact that Regulation A has been relied upon so rarely in recent years that it has been rendered essentially obsolete (*i.e.*, the "institutional failure" referenced earlier); and (2) the fact that there is a compelling public need to help small companies access and raise capital through less restrictive methods that will still attract and protect investors. I am also confident that the SEC has successfully demonstrated that increasing the offering threshold from $5 million to $50 million in a twelve-month period, through the creation

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[26] Proposed Rule at 3973.

of a tiered system, is an effective method for making the Regulation A exemption more attractive and useful to small companies without putting investors at risk.

The second question of whether the Proposed Rule will provide sufficient investor protections, however, remains a significant point of contention. As noted above, *without* the provision enabling all Tier II transactions to be exempted from state blue sky laws by altering the "qualified investor" definition, I believe the Regulation A Proposal as a whole would pass the investor protection requirement. However, if the Commission chooses to move forward with its proposal to preempt state blue sky laws, many other aspects of the Regulation A Proposal become problematic as they relate to investor protection. In particular, the higher offering threshold, the ability of shell and holding companies to conduct Regulation A offerings, and the adoption of the "access equals delivery model" present greater risks without the additional layer of state oversight in place. On the other hand, if the SEC chooses to take a middle-ground approach and adopt NASAA's multi-state coordinated review program, which I vehemently advocate for, my concerns regarding the aforementioned provisions would be greatly alleviated.

Turning to the consideration of whether the changes included in the Regulation A Proposal will "promote efficiency, competition, and capital formation," it is easy to conclude that, when compared with the Regulation A status quo—which is highly inefficient and is promoting almost no capital formation—the proposed changes are an almost guaranteed improvement in these respects. However, there is one caveat: as NASAA and several state regulators have argued, if the preemption proposal is adopted, it could have the effect of deterring companies from relying on Regulation A based on concerns about compliance and questions of legality. NASAA describes this risk as follows:

> The Commission's proposed approach is contrary to enacted law such that, should it be finalized, there is a significant likelihood that issuers and their counsel, concerned about the legality of the Commission's actions, would be reluctant to engage in Regulation A offerings.[27]

Finally, regarding the last point of analysis—whether the Proposed Rule will place a new burden on competition—given that they are highly deregulatory in nature and will likely have the effect of "leveling the playing field" for small companies seeking to raise capital, I do not believe this is to be an issue of notable concern.

Consideration of Alternatives

With respect to the SEC's proposal to preempt state blue sky laws, which has been the primary focus of my comment, it is my belief that the Commission has not sufficiently considered two key alternatives to preemption: (1) maintaining the status quo, and (2) adopting NASAA's proposed multi-state coordinated review program. Instead, it seems that the Commission approached its analysis of alternatives with a predisposition toward adopting a state preemption provision based on the GAO Report, and simply focused its energy on determining the most effective method for preempting

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[27] Letter from Andrea Seidt, NASAA President and Ohio Securities Commissioner, to Elizabeth M. Murphy, Secretary, SEC (March 24, 2014), 2, at http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf, citing Letter from Mike Liles, Jr., Karr, Tuttle, Campbell, to S.E.C. (January 17, 2014), available at http://www.sec.gov/comments/s7-11-13/s71113-5.pdf.

state laws. Given the deep concerns I have documented at length regarding the potential undermining of necessary investor safeguards, as well as those of numerous others—namely, state regulators who possess valuable insight, local knowledge, and direct experience interacting with issuers and investors in their respective jurisdictions—I urge the Commission to further reconsider alternatives to preempting state securities regulations.

IV. Conclusion and Recommendation

As described by the SEC, "the proposed amendments to Regulation A are intended to provide small issuers access to sources for capital *unavailable* through other offering exemptions without imposing the full registration and ongoing reporting requirements of a registered public offering."[28] Overall, I am confident that the Commission's Regulation A Proposal will accomplish the above-stated goals and function as an effectiv and useful alternative for small company capital formation. While I commend the SEC on its thoughtful efforts to rework and modernize Regulation A in a way that balances issuer and investor interests, as noted several times above, I strongly encourage the Commission to avoid relying on the preemption of state blue sky laws a the only solution to promoting the use of Regulation A offerings. Instead, I urge the Commission to reconsider adopting the multi-state coordinated review program proposed by

[28] Proposed Rule at 3997.

NASAA, or at the very least, collaborating with the states to identify a workable middle ground that will benefit both issuers and investors while stil involving stat regulators in the oversight process.

Additionally, prior to adopting a preemptive or other alternative approach, I hope the Commission will take it upon itself to engage in further data collection and analysis regarding the impact o investors of preempting state blue sky regulations. Lastly, given the requirement that the Commission re-examine the Regulation A offering threshold, an increase it if it deems necessary, on two year basis, I believe that prioritizing retrospective review to determine whether Regulation A usage i actually increasing, an if so, whic types of companies are finding i most beneficial, would be highly valuable for future rulemaking efforts.

Thank you for the opportunity to comment, and please d not hesitate to contact me should you have any questions regarding the above.

Sincerely,

Lindsay Scherber

Lindsay M. Scherber
[redacted]