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May 19, 2014

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

Re: SEC File Number S7-11-13
(SEC Rel. 33-9497, Proposed Rule Amendments for Small and Additional Issues Exemption Under Section 3(b) of the Securities Act)

Dear Ms. Murphy:

Thank you for considering this restated and supplemental comment related to SEC Rel. 33-9497, which proposes new rules for Regulation A (sometimes referred to herein as the "Proposed Rules").[1]

The Securities and Exchange Commission (SEC) and its Staff should be commended for adopting a "qualified purchaser" definition that allows Tier 2 issuers to avoid prohibitively high costs and delays associated with meeting inconsistent state registration requirements. However, these rules must be changed to declare Regulation A exempt from Section 12(g) of the Exchange Act of 1934, so that Regulation A issuers may avoid high costs and delays associated with full registration under the 34 Act when total assets exceed $10 million because brokerage firms are not willing to be "holders of record" for Regulation A securities. In fact, not one major brokerage firm has submitted a comment declaring that it will act as "holder of record" for Regulation A securities.

This comment focuses on why the legislative history for the JOBS Act requires the SEC to declare Regulation A exempt from Section 12(g), and, in lieu thereof, recommends scaled disclosure requirements based on the larger of the issuer's public float or aggregate securities sold to non-affiliates that include: corporate governance disclosures that compel issuers to adopt internal controls required under PCAOB AU 325, and remove or modify investor purchase limitations. In addition, we call for the SEC to extend the definition of "qualified purchaser" to Tier I offerings to eliminate multiple state disclosure requirements, but delegate the task of review to NASAA and/or the States.

[1] SEC Release Nos. 33-9497, 34-71120 and 39-249, "*Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act*" are reproduced at 79 Fed. Reg. 3926 (Jan. 23, 2014).

Summary of Comments

- SEC must retain the "Qualified Purchaser" definition so that Tier 2 offerings may avoid the prohibitive costs and delays associated with state registration;

- Regulation A must be exempt from Section 12(g), and, in lieu thereof, the SEC should impose scaled disclosure requirements based on the larger of the issuer's public float or aggregate amount of securities sold to non-affiliate purchasers under Regulation A because:

    (i) brokers are not willing to be "holders of record" for securities issued under Regulation A, and

    (ii) Congress expressed clear intent for the qualification of all Regulation A Offerings to require lower costs and delays than for full registration;

- Adopt a single Part 1, S-1 Offering Circular format for all Tier 2 Offerings to standardize and shorten the time to review and qualify offerings, and to reduce investor confusion when comparing different offering circulars;

- Codes of Ethics and scaled Corporate Governance disclosures should be required to encourage issuers to adopt internal controls that promote effective internal control, avoid adverse audit reports required under PCAOB AU 325 and 9325, and conform to the FAR and other federal guidelines;

- Remove Investor Purchase Limitations, or alternatively, exempt accredited investors and non-accredited affiliates who are current or former founders, employees and agents;

- Extend the definition of "qualified purchaser" to Tier 1 Offerings but delegate review to NASAA and the States, and on condition that issuers provide audited financials and comply with all other Tier 2 continuing disclosure requirements;

- Require Regulation A issuers to maintain a corporate web-site where copies of all non-confidential SEC filings may be accessed by the public;

- Establish an on-line, public database that identifies all Bad Actors with copies of the orders that triggered such status; and

- Provide States immediate access and notice of all non-confidential SEC disclosures.

A. <u>Proposed definition for "Qualified Purchaser" must be maintained</u>

The "qualified purchaser" definition for issuers making Tier 2 offerings must be preserved for Regulation A to have any viable chance of success.

All federal studies and reports have found state registration is simply too costly and complicated for Regulation A offerings,[2] thereby causing the total number of Regulation A applications to decline from 116 in 1997 to 19 in 2011, and the number of issuers who completed the qualification process to plummet from 57 in 1998 to 1 in 2011.[3]

State registration has proven to be overly burdensome because States have inconsistent disclosure requirements and procedures, with most States adding a merit review.[4] These differences complicate what information issuers must place in their offering statements, and increase legal and filing fees.[5]

NASAA has asked to be entrusted with developing consensus among all States to conduct and implement a coordinated registration process for all Regulation A Offerings under a "Proposed Coordinated Review Program for Section 3(b)(2). However, there are substantial political and technical grounds to question whether NASAA and its members can agree and implement a coordinated review program for many more years.

There is clear absence of political resolve among the States to reach uniform consensus, as demonstrated by the simple fact that NASAA its member States have known for more than 15 years that the burden of inconsistent state registration requirements has forced nearly all issuers away from Regulation A to seek capital under Regulation D and other private offering exemptions,[6] even though private offerings typically carry higher intermediary fees and investor premiums, and result in founders losing voting control and employment in the company they built. Yet, the best solution that NASAA and its member States could reach consensus was the NASAA SC-SCOR coordinated review program which divided the States into 6 regions, with each having its own registration requirements and procedures, and with some states, like New York, opting out of any coordinated disclosure and review standards, with their own unique set of requirements.

NASAA also lacks technical capacity to implement its proposed, interactive web-site for submitting Regulation A applications. The proposed website for filing Regulation A disclosures is far more complex than the on-line, "check-the-box" filing process NASAA proposed for Form D during or about 2009, that has yet to be implemented.[7]

Our economy and fellow citizens who may benefit from increased economic growth cannot, and should not, be forced to wait years for NASAA to attempt to reach consensus among each of its member

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2 *See, e.g.*, U.S. Gov't Accountability Office, GAO12-839 *Factors that may Affect Trends in Regulation A Offerings* (July 2012), available at http://www.gao.gov/assets/600/592113.pdf.
3 *Id*. at Highlights.
4 *See, id*. at 13, n.28.
5 *See, e.g., id*. at 18.
6 *See, e.g., id*. at Highlights.
7 NASAA's requests to implement a single point on-line state filing process for Form Ds resulted in a *Memorandum of Understanding Between U.S. Securities and Exchange Commission and North American Securities Administrators Association, Inc.*, dated April 5, 2010.

States for a uniform disclosure requirements without merit review, and then attempt to develop a website for submitting Regulation A disclosures that is substantially more complex than the Form D filing sites which has taken NASAA more than 5 years to develop, particularly when the SEC can begin the process of qualifying Regulation A Offerings this year.

B. Congress intended for Regulation A to be exempt from Section 12(g), with disclosure requirements less burdensome than for full registration under the 34 Act

The SEC must declare Regulation A exempt from Section 12(g) because Congress expressly declared that the purpose of Regulation A is to help "**small companies gain access to capital markets without the costs and delays associated with the full-scale securities registration process.**" H.R. 112-206, *Small Company Capital Formation Act of 2011* [to accompany H.R. 1070] at 2-3 (Sept. 14, 2011) (emphasis added). Contrary to presumptions in the Economic Analysis of the Proposing Release, brokers are not willing to be "holders of record" for Regulation A securities, as demonstrated by the absence of any guarantee proffered by any major firm in comments, thereby violating Congressional intent for reduced disclosure for Regulation A offerings above $10 million because issuers will not be able to keep their "holders of record" below 2,000.

Failure to exempt Regulation A exempt from full registration costs imposed by Section 12(g) will force issuers seeking $10 million or more to pursue Regulation D in violation of Congressional intent.[8]

1. Brokers are not willing to be "holders of record" for Regulation A Securities.

Final rules must declare Regulation A exempt from Section 12(g) [15 U.S.C. § 78l(g)][9] because the Proposed Rules state an incorrect presumption that higher costs of full registration imposed by Section

[8] The Proposing Release states there were approximately 25 registered initial IPOs for amounts below $50 million in 2012, *see* 79 Fed. Reg. at 3976, n.553, during the same year there where were 9,986 Regulation D, 506 offerings for amounts up to $50,000,000, *see, id.* at Table of Reg. D Offerings by issuers eligible to rely on Regulation A in 2012. The proposing Release also cites two surveys which found the regulatory cost of compliance for IPOs average $2.5 million with an ongoing annual cost of $1.5 million, *see, id.* at 3977. These numbers demonstrate that the costs of compliance for Smaller Reporting Companies is so high in relation to the offering that they forced issuers to use Reg. D. Imposing similar compliance costs on offerings of $10 to $50 million will raise the percentage costs of capital many more times for Regulation A, thereby making it more probable that the total number of Reg. A Offerings will be less than the 25 registered IPOs which opted to file in the range of a smaller reporting company in 2012. Clearly not the intent of Congress or the Administration when it passed H.R. 1070 and the JOBS Act.

[9] Section 12(g)(1) states, in part, that every issuer shall register with the SEC:

> (A) within 120 days after the last day of its first fiscal year ended on which the issuer has total assets exceeding $10,000,000 and a class of equity security (other than an exempted security) held of record by either—
>
> (i) 2,000 persons, or
>
> (ii) 500 persons who are not accredited investors (as such term is defined by the Commission), and
>
> (B) in the case of an issuer that is a bank or a bank holding company, as such term is defined in section 1841 of title 12, not later than 120 days after the last day of its first fiscal year ended after

12(g) can be avoided because most issuers will use brokerage firms who will be "holders of record" for securities issued under Regulation A.[10]

There is substantial cause to believe brokerage firms will not become "holders of record" for Regulation A securities based on interviews conducted by this counsel with major and regional firms in preparation for a seminar on this topic with SEC Staff. At least one other commentator familiar with the brokerage industry has expressed similar concern,[11] and, most significant, **not one major brokerage firm has filed a comment declaring that it will act as "holder of record" for securities issued under Regulation A**. *See, e.g.*, http://www.sec.gov/comments/s7-11-13/s71113.shtml.

During February 2014, this counsel asked the compliance and/or legal departments of the three largest brokerage firms and several other smaller firms whether they will be "holders of record" for securities issued under proposed Regulation A. Each firm stated: "Yes, if the securities are (i) registered with the SEC, (ii) have a discrete CUSIP, and (iii) can be transferred under DTC." When clarification was sought to determine whether the firms would be holder or record for securities "qualified" under Regulation A, but not "registered," each firm simply repeated they would hold "registered" securities, refused to comment on "qualified" securities under Regulation A. One firm then stated the obvious, "[T]here simply is not enough money for brokerage firms to be 'holders of record' for Regulation A securities in view of all the risks and problems they present, unless needed to retain a large client." That officer listed many other reasons his firm would not to be a holder of record, including:

- Brokers may be barred from selling Regulation A securities before submitted all offering materials for approval by FINRA under FINRA Rule 5123(a) because Regulation A is not within express exemptions from FINRA Rule 5123(a), as stated in FINRA Rule 5123(b);

- Brokers cannot provide a "Market Value" for customer account statements without an efficient market;

- Brokers won't know when to mark the price of Regulation A securities at levels triggering regulatory and internal restrictions on low priced securities; and

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> the effective date of this subsection, on which the issuer has total assets exceeding $10,000,000 and a class of equity security (other than an exempted security) held of record by 2,000 or more persons, ….

[10] The Proposing Release presumes incorrectly that brokers will be "holders of record" for securities issued under Regulation A, and then concludes that subjecting Regulation A issuers to the Section 12(g) trigger will not impose a great burden:

> Because of the manner in which shareholders of record are tabulated, the likelihood of a Regulation A issuer triggering the 12(g) threshold is low if not triggered at the time of offering. In particular, beneficial owners of Regulation A issuers who hold their shares at a broker are not counted as a record holder. Their shares, held in ''street name,'' are counted at the broker level, so that each brokerage at which there is a least one beneficial owner would constitute one shareholder of record. Because of this treatment, the number of shareholders of record is often significantly less than the number of beneficial owners.

SEC Rel. 33-9497, 79 F.R. 3926, 3985 (January 23, 2014).

[11] *See, e.g.*, William Hambrecht, Comment to SEC File No. S7-11-13 at 5 (Mar. 4, 2014).

- FINRA and NYSE Rules on Supervision, Suitability, and Know your Customer" present additional and significantly higher liability risks to brokers who act as holders of record for Regulation A securities because of less efficient markets and less disclosure than for fully registered securities.

While the first of these points may be overcome by amending the FIRNA 5100 Series of Rules, it is clear these expressions demonstrate most brokerage firms will not be "holders of record" for Regulation A securities until after there are efficient trading platforms, and, most important, the firms see fees from Regulation A exceed other opportunities, including underwriting Regulation D and other private placements that are in direct conflict with the Congressional intent for Regulation A.

The SEC should not create a regulatory monopoly that would force issuers to use brokers who may use that monopoly to extract higher fees so that issuers may avoid higher costs of full registration.

2. Legislative History for Titles III and IV demonstrate Congress intended for Regulation A to be from Section 12(g), with disclosure requirements less costly than for full registration

The Legislative History for Titles III and IV of the JOBS Act demonstrate Congress intended for all Regulation A Offerings to be exempt from the Section 12(g) trigger for full registration under the 34 Act, and that no inference should be drawn against that intent because Title III (Crowdfunding) contains an express exemption from Section 12(g), and Title IV did not. Further, SEC Staff working with Congress on the content of H.R. 1070, 112th Cong. (2011)[12] are aware that opposition to raising Regulation A to $50 million dissipated after H.R. 1070 was amended to require disclosure of corporate governance principles.

The JOBS Act was created on March 7 and 8, 2012, when the House formed an omnibus JOBS Act during floor debate by adding Titles II through VII to H.R. 3606,[13] the text of which was taken from Bills that had passed the House and were then pending before the Senate with full Administration support (except for concerns of fraud associated with Crowdfunding).

Title IV was taken from H.R. 1070, introduced by Representative David Schweikert on March 14, 2011. After amendments made during mark-up before the House Financial Services Sub-Committee and Full Committee on May 3 and 4, and June 22, 2011,[14] including disclosure of corporate governance principles and changing liability from Section 11 to Section 12(a)(2), the Bill was reported to the House, where it passed on November 2, 2011, by an overwhelming, bipartisan vote of 421 to 1.

[12] All House Bills referenced in this comment were introduced during the 112th Congress.

[13] H.R. 3606 was introduced on December 8, 2011, after H.R. 1070 had passed the House, and contained only those provisions in Title 1, which directed the SEC to exempt a new category of Emerging Growth Companies from certain 34 Act disclosure requirements and to allow EGC to test the waters with certain investors. *See, e.g.*, H. Rept. 112-406, Reopening American Capital Markets to Emerging Growth Companies Act of 2011 [to accompany H.R. 3606] (Mar. 1, 2012).

[14] *See, e.g.*, http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=238620, and http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=247453.

The initial text of Title III was taken from H.R. 2930, introduced by Representative Patrick McHenry on September 14, 2011 – the same day that H.R. 1070 was reported in amended form by the Full House Financial Services Committee. H.R. 29030 was then heard by Subcommittee on Capital Markets and Government Sponsored Enterprises on September 21, 2011, and reported to the Full House on October 5, 2011.[15] The accompanying House Report made no comment about H.R. 1070 in its analysis of the exemption for crowdfunding from Section 12(g) because H.R. 2930 was then a stand-alone Bill with no person suspecting that it would be used to interpret H.R. 1070.[16]

During floor debate on March 7 and 8, 2011, the Full House agreed to form an omnibus JOBS Act by amending H.R. 3606 to include the text of H.R. 1070, H.R. 2930, and several other bills without comment of any differences involving Section 12(g), where after it passed the House by a vote of 390-23 on March 8, 2011. The Senate stopped considering its own set of bills, and began debate on H.R. 3606. The principal focus of Senate attention was on how to amend Title III to reduce potential for fraud under Crowdfunding. The Senate passed the Merkley Amendment which rewrote Title III, and passed the H.R. 3606 with a substituted Title III on March 22, 2012. The House accepted the Senate change on March 27, 2012, and President Obama signed the JOBS Act into law on April 5, 2012.

H. Report 112-206, Small Company Capital Formation Act of 2011 [to accompany H.R. 1070] (Sept 14, 2011) is the only Congressional Report that describes how Congress intended New Regulation A Plus to be implemented by the SEC. The Purpose and Summary section affirmatively states:

> H.R. 1070, the Small Company Capital Formation Act, raises the offering threshold for companies exempted from registration with the U.S. Securities and Exchange Commission (SEC) under Regulation A from $5 million—the threshold set in the early 1990s—to $50 million. **Raising the offering threshold helps small companies gain access to capital markets without the costs and delays associated with the full-scale securities registration process.**

Id. at 2-3 (emphasis added). The Performance Goals and Objectives section again states:

> H.R. 1070, the Small Company Capital Formation Act, increases the offering threshold for companies exempted from SEC registration under Regulation A from $5 million to $50 million. **The purpose of the change is to help small issuers, such as venture-capital backed companies, gain access to funding without the costs and delays associated with the full-scale securities registration process.** The legislation provides the SEC with the authority to increase the threshold and requires the SEC to re-examine the threshold every two years and report to Congress on decisions regarding the adjustment of the threshold.
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> The objective of H.R. 1070 is to make Regulation A into a viable channel for small companies to access capital, which will permit greater investment in these companies, resulting in economic growth and jobs. Small companies are critical to economic growth in the United States. By reducing the regulatory burden and expense of raising capital from the investing public, H.R. 1070 will boost the flow of capital to small businesses and fuel America's most vigorous job-creation machine. Regulation A offerings can also help entrepreneurial businesses attract private

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[15] *See, e.g.*, H. Rept. 112-262, Entrepreneur Access to Capital Act [to accompany H.R. 2930] (Oct. 31, 2011), and http://thomas.loc.gov/cgi-bin/bdquery/z?d112:HR02930:@@@X.

[16] *See, id.* at 10.

> capital by providing companies with additional working capital at reduced costs than might be feasible when compared with an initial public offering using full SEC registration.

Id. 7 (emphasis added). These same purposes and objectives were repeated many times without opposition during all subsequent proceedings that addressed Title IV of the JOBS Act.

This history demonstrates clear Congressional intent for the SEC to develop:

- disclosure requirements for all Regulation A issuers that would be "**without the costs and delays associated with the full-scale securities registration process,"** which requires a separate disclosure regime and process that is exempt from the Section 12(g) trigger and less burdensome than imposed by the 34 Act on Smaller Reporting Companies; and

- disclosure of corporate governance principles that will induce issuers to adopt internal controls that will enhance the integrity of all corporate disclosures.

There simply is no basis for applying a general rule of statutory construction to infer Title IV is not exempt from Section 12(g).

3. Congress also intended for the SEC to require disclosure of corporate governance principles to protect investor interests by encouraging issuers to adopt internal controls.

Congress also intended for the SEC to require disclosure of "corporate governance principles" in a manner that encouraged Regulation A issuers to adopt internal controls that will help maintain investor protection with lower periodic reporting requirements, as evidenced by debate and voting records during markup of H.R. 1070 to include disclosure of "corporate governance principles."[17]

These should be no increased burden to issuers to adopt codes of ethics proscribed under 17 C.F.R. § 229.406, and disclose scaled corporate governance principles proscribed under 17 C.F.R. § 229.407, with the following modifications:

a. Eliminate the need for Audit Committee Financial Experts;

b. Require at least two Independent Directors, and increase that number based on the size of the issuers and/or offering up to the number of Independent Directors required for Smaller Reporting Companies; and

c. Eliminate requirements for separate audit and other board committees until certain issuer or offering sizes are reached, on condition that the tasks assigned by regulations to these committees remain with the full board.

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[17] *See, e.g.*, http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=238620, and http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=247453

Auditors engaged solely to audit financial statements are required by PCAOB standards to report to the issuer any significant deficiencies that may affect the financial statements, which include absence of codes of ethics and corporate governance principles. *See, e.g*., PCAOB AU Sections 325 and 9325.

Directors who fail to adopt internal controls described in 17 C.F.R. §§ 229.406 and 229.407, or to correct significant deficiencies reported by auditors, will expose themselves, the issuer, and its officers to increased liability for errors in financial reporting and other operational mismanagement.

Further, these same internal controls are imposed on government contractors and other persons that receive grants and other funding under the American Recovery and Reinvestment Act of 2009. *See, e.g.*, 48 C.F.R. Subparts 3.9 (Whistleblower Protections) and 3.10 (Contractor Code of Business Ethics and Conduct), 48 C.F.R. §§ 52.203-13 (Contractor Code of Business Ethics and Conduct), 52.203-14 (Display of Hotline) and 52.203-15 (Whistleblower Protections Under the American Recovery and Reinvestment Act of 2009), and have become part of customary practice for corporate and securities counsel to provide their clients at relatively low cost, particularly in view of the benefits of adopting and maintaining Effective Compliance and Ethics Programs under the U.S. Attorney's Manual, Chapters 9.27.00 and 9.2800, Federal Sentencing Guidelines, §8B1.1 *et seq.*, and SEC Enforcement Manual at § 6.1.2.

Since these internal controls also tend to improve management effectiveness and stewardship of investor proceeds, reduce D&O insurance premiums and those premiums charged by lenders, there is no reason for the SEC to exempt Regulation A from 17 C.F.R. §§ 229.406 and 229.407 as modified.

4. Disclosure requirements should be based on the larger of the Issuer's Public Float or Aggregate Regulation A Offerings to non-affiliates

The Congressional mandate for Regulation A disclosure requirements "**without the costs and delays associated with the full-scale securities registration process,** H. Rept. 112-206 at 7, anticipates the SEC will impose a disclosure requirements that increase on a metric more closely related to market/ investor risk than number of "holders of record." These goals are best met by requiring all Tier 2 issuers to use Part 1 of Form S-1, and then add a subsection to proposed regulation 17 C.F.R. § 230.257 which identifies which disclosure items are eliminated or modified based on the larger of public float or aggregate shares sold to non-affiliates under Regulation A.

C. All Tier 2 Offerings should be required to use the Part I of S-1 disclosure format to standardize <u>and shorten time to qualify Regulation A Offerings, and to reduce Investor confusion</u>

All issuers making a Tier 2 Offering should be required to use only the Part I of S-1 Offering Circular format to standardize and reduce the time for the SEC to review and qualify Regulation A Offerings, and to reduce any potential investor confusion when comparing different offering circulars.

Smaller companies need less time from the date they decide to make an offering to when they may commence sales than required by larger companies. The reasons for this difference include the simple fact that smaller companies generally have lower financial reserves than larger companies and lack diversification necessary to lower their financial sensitively to changing market conditions. While this commenter is not aware of recent studies that demonstrate when most small issuers are forced to pursue private offerings because of the time to register or qualify a public offering, it is fair to say that most practitioners here clients become concerned when the must delay commencing their offering by more than 60-90 days. For this reason, the SEC should require a standardized disclosure format that will allow most offerings to be qualified within 90 days. This is best accomplished by adopting the Part 1, S-1 format most reviewers and securities counsel are familiar.

The ability for issuers to "test the waters" will help issuers and their creditors determine market demand and value for a proposed offering; but the need for firm financial commitments will force smaller companies to pursue private offering exemptions if the average time to qualify an offering exceeds 90 days.

While it is reasonable to expect that Regulation A Offerings will take more time to be qualified than for private placements to begin solicitations, that difference in time should not be so great that it forces most smaller companies to pursue private offering exemptions which result in higher dilutions of the founders' equity, loss of founders' voting rights, and, ultimately, loss of founders' employment with the company they built.

Statistics cited in the Release suggest that Offering Circulars prepared with the Part I of S-1 format are qualified more quickly than other formats, with the average time for a Regulation A filings to be qualified during the period 2002 through 2012 at 301 days for Model A, 220 days for Model B, and 167 days for those using Part I of S-1. *See* Release 33-9497, 79 F.R. 3926 at 3975. The Release states that the median for qualification was 189 days, and suggests a steep learning curve to prepare Offering Circulars because issuers with more than $1.4M in assets were qualified 97 days faster than smaller issuers, with 4 days being the fastest time to qualify. *See, id.*, 79 F.R. at 7935. While the Release states that state registration and other factors contributed to increasing the time for Regulation A offerings to be qualified, the statistics suggest that the average time to review an Offering Circular and number of office actions can both be reduced by adopting requiring the Part I of S-1 format for all Regulation A Offerings that exceed $10 million.

It stands to reason that the SEC can review and qualify Regulation A Offering in less time when there is only one uniform Offering Circular format because: (i) time to train SEC reviewers should be reduced; (ii) the depth of SEC guidance on disclosure items can be increased; and (iii) the quality of disclosures should improve because counsel will tend to be more specialized.

There are other reasons for requiring all Tier 2 offerings above $10 million to use the Part 1 of S-1 filing format. First, while Congress intended disclosure requirements to be less costly than full registration requirements imposed on Smaller Reporting Companies. It is reasonable to believe that Congress also expected Regulation A disclosure requirements to increase in relation to size of the offering and/or issuer, and not create regulatory arbitrage with requirements for Rule 506 Offerings or those for Smaller Reporting Companies. These objectives are best met by requiring Regulation A Offerings to follow the same format as Smaller Reporting Companies, but with reduced disclosure.

Requiring the S-1 Offering Circular format, will also reduce investor confusion when comparing two Regulation A offerings that may otherwise be allowed to use different Offering Circular formats, or an offering of $50 million subject to Regulation A disclosure and an offering of $75 million that must follow S-1 format under the 34 Act.

D. Investor Limitations should be removed or modified.

The proposed ten percent (10%) limitation on investor purchases should be removed because such limitations were not intended by Congress, will place transactional burdens on brokers and issuers, and may unfairly exclude those persons who participated in building the issuer from buying securities they have the most knowledge. In lieu of investor purchase limits, the SEC should consider a rule that requires all Regulation A Offering Circulars to contain a conspicuous notice stating that non-accredited investors should limit their total holdings in Crowdfunding and Regulation A securities to 10% of their total net worth and income.

There is no basis within the legislative history of Title IV that suggests Congress intended for the SEC to apply limitations imposed on crowdfunding to Regulation A. H.R. 1070 was passed before H.R. 2930, and there is no discussion within the legislative history of either bill to impose limitations in H.R. 2930 on to Regulation A.

The costs to impose any limitation, whether by means of self-verification or not, is particularly harmful to the viability of Regulation A for multiple reasons. First, the duty to collect certifications will, in itself, prevent brokerage firm from becoming involved with Regulation A offerings, and holder of record of any Regulation A securities. Brokers have duties of supervision and suitability that will require verification of any self-certifications made by purchasers, will impose further costs on the firm and increased exposure to liability when soliciting orders. There are other technical expenses to ensure that purchases made with one broker do not exceed 10% limits when combined with purchases made with another broker.

Should it become politically necessary to impose some form of investor purchase limits to preserve the definition of "qualified purchaser" for Tier 2 offerings, then such limits should exclude accredited investors, and any current or former investor, employee, or agent of the issuer. These persons have better knowledge of the issuer and its potential than any other person, and, given that these persons sweated to help build the issuer to a point where the issuer may have its greatest growth potential, it would be perverse for the SEC to prevent these persons from partaking in that growth.

E. SEC should preempt state registration for Tier I Offerings, but delegate review of Tier 1 Offerings to NASAA and/or the States

Tier 1 Offerings should also be exempt from state registration requirements given the probable use of the internet in any offering and the recognized burden of multiple state registration on existing Regulation A Offerings.[18] Smaller issuers must have a uniform disclosure standard and review process for multistate offerings with a single point for filing. It should not matter to issuers whether their filings are reviewed by SEC or state personnel, so long as the reviews are uniform and conducted timely. It is reasonable to expect that the principals of most small issuers will be located near the principal office or operations of the business, and that state regulators will have greater familiarity with principals of smaller businesses

[18] *See, e.g.*, U.S. Gov't Accountability Office, GAO12-839 *Factors that may Affect Trends in Regulation A Offerings* at Highlights.

than the SEC. Given these interests, and NASAA's opposition to full preemption of registration, the best balance would be for the SEC to expand the definition of "qualified purchaser" to include Tier 1 purchasers, impose a uniform disclosure standard, and direct the SEC to delegate the task of review to state regulators having jurisdiction over the location of the issuer's principle office or operations when practicable. This solution gives Tier I issuers the benefit of conforming to one disclosure standard for all states, a single point for filing, and more resources to review submissions timely, while using the resources and knowledge held state regulators to full effect.

F. Issuers should be allowed to Test the Waters with Non-Accredited Investors

The SEC proposal to allow Regulation A issuers to test the waters without restriction on the type of investor on condition that all statements are filed with the SEC before they are communicated to others, and all other required filings are up to date. These proposals are reasonable and should be kept in the final rules.

It would be unreasonable and counter to Congressional intent for the SEC to bar prospective issuers of Regulation A from testing the waters with accredited and non-accredited investors so that issuers may better determine demand and price sensitivity of Regulation A offering made to capital markets not available under Regulation D and to EGCs. Since most Regulation D and other private and public offerings are largely dependent and targeted on Accredited Investors and Qualified Institutional Buyers (QIBs), it is clear that Congress intended, and the market will require, for Regulation A issuers to be able to test the waters with non-accredited and all other potential investors.

It is also necessary for the SEC to require that all required filings and disclaimers be kept confidential and exempt from any public FOIA request during the qualification phase so that the issuer's competitors may not have access to vital information before the issuer desires to make a public offering.

G. States should have immediate access to all Testing the Waters Disclosures

It is equally important for the SEC to give the States immediate access to all Testing the Water disclosures filed by issuers with the SEC so that duplicate State filings are not required, and so that States may have notice of such activities for enforcement actions that may become necessary.

H. SEC should require all issuers of Regulation A Securities to maintain a corporate web site where copies of all non-confidential filings to the SEC may be accessed by the public.

Issuers should be required to maintain a corporate web site where the public may access copies of all non-confidential filings to the SEC in a timely manner so that investors not familiar with EDGAR may access the most complete information provided to the SEC. This disclosure requirement is in the public interest, and should not impose significant costs.

I. SEC should establish a public data- base that identifies all Bad Actors with copies of the <u>Findings and Orders that triggered such status.</u>

Issuers and potential investors alike should have access to an On-Line Data Base that lists all "Bad Actors" for purposes of Regulations A and D, and to prevent regulatory arbitrage by Bad Actors who may use other offering exemptions.

Issuers and their counsel should have access to a data base that identify all Bad Actors before preparing to submit any filing that requires disclosure or may bar an offering from going forward. Even if issuers can show reasonable care in detecting and removing Bad Actors from its management, board and shareholder groups, there will be adverse economic consequences to the issuer for any such failure.

While it is presumed that commercial data bases like Westlaw and Lexis/Nexis will develop such databases, those service providers charge fees that vary substantially on size and geographic location of subscribers, which may be unreasonably burdensome on some issuers. Further, this counsel has had many instances where Lexis and Westlaw databases have not included decisions issued by non-court forums, including SROs and state administrative proceedings. The bottom line is that issuers and the public should have reasonable accessible to a database to obtain relevant information necessary for issuers to prepare an offering and for the public to consider management.

Further, a database accessible to the public may deter conduct that would trigger Bad Actor status.

<u>CONCLUSION and RECOMMENDATIONS</u>

Congress expressed clear intent for New Regulation A to:

- reinvigorate our economy by expanding the exemption for unrestricted securities to $50 million so that smaller businesses would have access to more capital without the higher costs of compliance and delays imposed by the 34 Act on Smaller Reporting Companies; and

- protect investors by requiring audited financials and disclosure of other items, specifically including corporate governance principles to encourage internal controls that will enhance the integrity of all disclosures.

Congress also knew and intended for Regulation A to:

- Democratize our markets by allowing the lower 93% of all US. Households (those who do not have enough money to qualify as an accredited investor) to invest in economic opportunities that have been restricted to the wealthiest 7% of all U.S. Households; and

- Allow founders who conceived and built a company to access existing and new capital markets at lower costs, and under terms that will not impose substantial premiums that dilute the founders' equity, restrict their voting rights, and, in most instances, terminate the founders' employment with the business they built, . for the founders and their employees in the company.

The Proposed Rules go a long way to meeting these goals by adopting a definition for "qualified investors" that avoids the overly burdensome costs and delays imposed by state registration, but must be modified further to reduce the costs of compliance for all Regulation A Offerings because brokers are not willing to commit to becoming holders of record for securities offered under Regulation A:

1. Declare Regulation A exempt from Section 12(g);

2. Require all Tier 2 issuers to use the Part I of S-1 Offering Circular format, with reductions from those disclosure Items imposed on Small Reporting Companies based on the larger of the issuer's public float or aggregate Regulation A Offering sold to non-affiliates;

3. Require issuers to adopt a Code of Ethics in compliance with 17 C.F.R. § 229.406; and

4. Require issuers to adopt corporate governance principles that meet 17 C.F.R. § 229.407, as modified by the larger of their "public float" as defined in 17 C.F.R. § 229.229.10(f) or aggregate Regulation A sales to non-affiliates, where Regulation A issuers are not required to have Audit Committee Financial Experts, but shall:

    (a) have at least two independent directors, with that number increased by the size of the issuer, public float, or offering amount to non- affiliates,

    (b) maintain an anonymous reporting line to the board or audit committee for reports of financial fraud and other enterprise risk, and

    (c) adopt audit and other committees as determined by the issuer's size.

Respectfully submitted,

Ford C. Ladd