

August 1, 2014

The Honorable Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair White:

We write to express our opposition to the significant preemptions of state regulatory oversight contemplated in the Securities and Exchange Commission's (SEC's) recently proposed rules to implement Title IV of the Jumpstart Our Business Startups (JOBS) Act. We appreciate the SEC's goal of implementing its statutory obligations under the JOBS Act. Title IV, which facilitates mid-sized companies in making public offerings of their securities under the SEC's longstanding but previously rarely used regime of Regulation A, was clearly drafted to include several important investor protections. One of the most important of those investor protections was the preservation of the protections of state "Blue Sky" laws for securities unless they are listed on a national securities exchange or sold to sophisticated "qualified" purchasers. Unfortunately, and for reasons unknown to us, the SEC has taken upon itself to ignore the investor protections mandated by the plain letter of the statute, and has instead proposed to broadly preempt the state Blue Sky laws. Not only is that not consistent with the best interests of investors, it is simply and plainly inconsistent with the statute. It must be withdrawn.

Title IV of the JOBS Act, which was signed into law on April 5, 2012,¹ lifted the cap on the amount issuers may raise under Regulation A (an exemption from securities registration for certain small issuances of securities) from \$5 million to \$50 million.² The SEC is now in the process of promulgating a rulemaking under section 401 of that Act, known commonly as "Regulation A+.

Under Title IV of the JOBS Act, Congress opted to delegate to the SEC very limited authority to issue rules exempting Regulation A+ securities from state Blue Sky laws if they are sold on a national securities exchange or sold to sophisticated "qualified" purchasers.³ Strangely, the preemptions contemplated by the SEC's proposed rules are not in any way conditioned upon the qualification of prospective purchasers.

¹ H.R. 3606, 112th Congress, available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d112:HR03606:@@S>

² Securities and Exchange Commission, *Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act*, 79 Fed. Reg. 3926, 3927, January 23, 2014, available at <http://www.sec.gov/rules/proposed/2013/33-9497.pdf>.

³ Section 401(b) amends the Securities Act of 1933 as amended to preempt the Blue Sky laws for a security issued under Regulation A+ that is "(i) offered or sold on a national securities exchange; or (ii) offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale." The JOBS Act, section 401(b), amending 15 U.S.C. 77r(b)(4).

Instead, the proposed rules expand the meaning of qualified purchaser to an exorbitant class of people – indeed “all offerees of securities in a Regulation A offering and all purchasers in a Tier 2 offering.”⁴ This approach effectively defines a qualified purchaser in an entirely circular manner as *anyone* who purchases a Regulation A+ security offering. This stunning evasion of the statutory intent not only eviscerates the meaning of “qualified purchaser” in the text of the JOBS Act but also eviscerates the requirement for listing on a national securities exchange. Indeed, if the security can be sold to anyone without the requirement of listing on a national securities exchange, then the purpose of that requirement is meaningless. The SEC cannot ignore the basic rules of statutory construction.

To the contrary, Congress included that provision precisely because a listing on a national securities exchange comes with the oversight and standards set by an exchange, which plays a regulatory role with respect to the companies that list on it. In addition, listing on a national securities exchange usually entails a fair amount of secondary market liquidity, itself a critical investor protection for ordinary investors. Congress endorsed making the streamlined registration requirements of Regulation A+ available to ordinary investors contingent upon them being purchased from a national securities exchange precisely because Congress knew that securities sold over-the-counter (OTC) were highly risky to ordinary investors and provided ample opportunity for “pump-and-dump” schemes. It also provided an alternative avenue for “qualified purchasers” as a means for sophisticated investors to obtain the securities.

The SEC’s claim of authority to define a “qualified purchaser” as any purchaser of a Regulation A+ security is in direct conflict with well-established legislative history, past positions held by the SEC itself, and pure common sense. Congress has made clear that the “primary factor” in defining the extent of this state-law exemption “must be the financial sophistication of these investors.”⁵ Even the SEC has stated that it believes “the nature of the investor rather than the investment is the critical feature in the determination of whether transactions with qualified purchasers should be exempt from state registration.”⁶ Finally, by the very construction of the term, ‘qualified’ purchasers was meant by Congress to apply to a subset of securities purchasers – not all of them.

Additionally, Congress did not authorize the SEC to craft such a broad preemption to state securities laws for these risky offerings. At no point in the text of Section 401 of the JOBS Act was the subject of additional preemption authority contemplated. In fact, the subject of state Blue Sky Laws was only

⁴ *Id.* at 3930.

⁵ *Defining the Term “Qualified Purchaser” Under the Securities Act of 1933*, 66 Fed. Reg. 66839, 66845 (Dec. 27, 2001). Available at <http://www.gpo.gov/fdsys/pkg/FR-2001-12-27/pdf/01-31742.pdf>; see also House Report on National Securities Markets Improvement Act, 104-622 at 31, available at <http://www.gpo.gov/fdsys/pkg/CRPT-104hrpt622/pdf/CRPT-104hrpt622.pdf> (“In all cases, however, the Committee intends that the Commission’s definition be rooted in the belief that ‘qualified’ purchasers are sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary.”)

⁶ *Defining the Term “Qualified Purchaser” Under the Securities Act of 1933*, 66 Fed. Reg. 66839, 66845 (Dec. 27, 2001). Available at <http://www.gpo.gov/fdsys/pkg/FR-2001-12-27/pdf/01-31742.pdf>

raised in Section 402 of the JOBS Act, which authorized a “study on the impact of state laws regulating securities offerings, or ‘Blue Sky Laws’ on offerings made under Regulation A.”⁷ Moreover, Congress explicitly rejected the approach being contemplated when it adopted a compromise approach during the passage of H.R. 1070 (which was ultimately included in the JOBS Act) that stripped out the provision doing essentially what the SEC is now proposing.⁸

The JOBS Act itself shows that Congress knows how to preempt the state Blue Sky laws when it wants to, as it chose to do in Title III of the JOBS Act.⁹ To read Title IV as authorizing the same level of preemption as Title III is to again to ignore the rules of statutory construction. In short, the statutory history shows clearly that Congress precisely intended the opposite of what the SEC is now proposing.

The Blue Sky laws came into existence over 100 years ago starting in Kansas precisely to deal with OTC securities peddled by hucksters that were “speculative schemes which have no more basis than so many feet of ‘blue sky’.”¹⁰ Today, state regulators continue to play an important role in protecting investors against the dangers of unregulated OTC securities. In many cases, they act as a critical second level of protection for consumers from securities fraud. For example, in 2009, Massachusetts’ Secretary of the Commonwealth was able to recover \$3.9 million from a corporation that was selling “unregistered highly risky securities” to senior citizens in 2008.¹¹ Without the oversight of the state securities regulator, much more time might have passed before these senior citizens received restitution for their injuries. Worse, it is possible that this case could have fallen through the cracks without the involvement of the Secretary’s office. Blue Sky laws are also a means to punish those persons who defraud individuals on a small scale. Just last month, Kansas Securities Commissioner Josh Ney announced that a man had been “sentenced to 72 months in prison for running a fraudulent investment scheme in north central Kansas.”¹² The defendant pleaded guilty to 3 counts of violating Kansas’ Uniform Securities Act.

⁷ *The JOBS Act*, § 402, available at <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf> at 20.

⁸ H.R. Rep. No. 206, 112th Cong. 1st Sess. at 13 (2011) (Rep. Frank: Finally, the gentleman from Arizona has also worked with Democrats on the remaining issue of contention, and that was the preemption of State law. The gentleman from Arizona’s substitute amendment to H.R. 1070 removes the exemption from State level review that was previously provided to an issuer using a broker-dealer to distribute an[] issue. Regulation A securities can be high-risk offerings that may also be susceptible to fraud, making protections provided by the State regulators an essential [feature].)

⁹ In that case, Congress did so because of the range of investor protections provided by the statute and through the oversight and transparency provided by offerings made through centralized crowdfunding portals. See Statement for the Record of Senator Jeff Merkley Regarding Crowdfunding in Title III of H.R. 3606, July 26, 2012, available at <http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/html/CREC-2012-07-26-pt1-PgS5474-3.htm>.

¹⁰ *Hall v. Geiger Jones Co.*, 242 U.S. 539 (1917).

¹¹ *In the Matter of National Planning Corporation*, Docket No. 2009-005, Consent Order, November 10, 2009, at 3, available at <http://www.sec.state.ma.us/sct/archived/sctnpc/consentorder.pdf>.

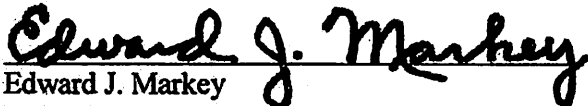
¹² *Belleville Man Sentenced to 72 Months for Securities Fraud*, Office of the Securities Commissioner of Kansas, Press Release, May 13, 2014, available at <http://ksc.ks.gov/DocumentCenter/View/259>.

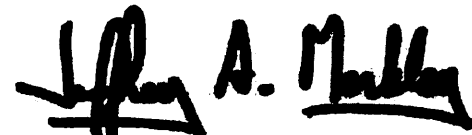
for defrauding “at least 26 Kansas investors out of over \$50,000 between 2007 and 2012 by selling unregistered securities” connected to the manufacturing of entertainment furniture.¹³


We are concerned that preempting state regulators’ authority to effectively police the OTC securities marketplace could unnecessarily place many ordinary investors at increased risk of securities fraud. Indeed, by precluding state authority to review risky OTC offerings prior to their sale, fraud will undoubtedly increase, and many investors will be victimized. The important watchdog role that the states play through the state Blue Sky laws’ registration requirements is precisely what Congress intended when it authorized Regulation A+ by a wide bipartisan margin.


It is critical that ordinary investors continue to have the important protections offered by state Blue Sky laws. In enacting the JOBS Act, Congress did not intend to preempt state authority to review Regulation A+ offerings sold to ordinary, retail “mom and pop” investors. We urge the Commission to decline to include the proposed preemptions in the final rules implementing Title IV of the JOBS Act.

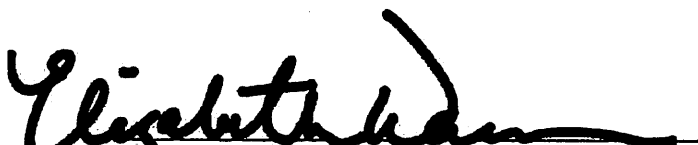
Sincerely,



Edward J. Markey
United States Senator


Jeff Merkley
United States Senator


Carl Levin
United States Senator

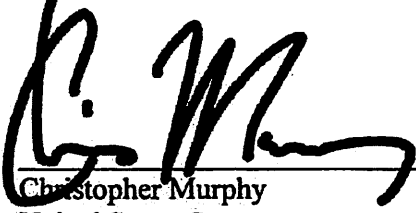

Tom Harkin
United States Senator


Elizabeth Warren
United States Senator

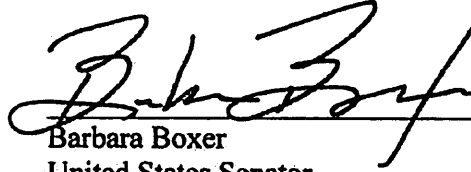

Mazie K. Hirono
United States Senator

¹³ *Id.*

The Honorable Mary Jo White
August 1, 2014
Page 5



Christopher Murphy
United States Senator



Barbara Boxer
United States Senator



Al Franken
United States Senator