March 24, 2014

Via Electronic Mail at rule-comments@sec.gov

Honorable Mary Jo White, Chair
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Comments on SEC Proposed Rule: Crowdfunding; Release Nos. 33-9497, 34-71120; 39-2493 File Number S7-11-13

Dear Chair White:

Thank you for the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on its proposed rule amendments to Regulation A made pursuant to Title IV of the JOBS Act of 2012 (the "Proposed Rules").[1]

The Commission through the Proposed Rules has taken a number of bold and important steps in furtherance of opening up public markets to private companies seeking raises of up to $50 million – matching historic legislation, the JOBS Act, with historic rulemaking.[2] However, as the Proposed Rules acknowledge, further work remains to be done to maximize the potential of Regulation A through final rulemaking.

On February 19, 2014, I had the opportunity to meet with members of the Staff to present my thoughts and concerns regarding the importance of adding long needed vitality to Tier 1 financings. Since that time I have had the opportunity to further refine my thoughts and ideas. Hence this comment letter sets forth specific proposals for the Commission to consider in order to resuscitate Tier 1 financings – and what I believe are sound policy reasons to do so.

ISSUES PRESENTED

The following comment letter focuses on a limited number of key issues where the SEC's proposed rulemaking has thus far failed to either definitively or adequately address the needs of smaller issuers on the lower rung of the capital formation ladder:

- Private companies who could benefit from accessing the public markets,
- seeking financing in the $3 million to $10 million range, and

[1] These comments are submitted by the undersigned, Samuel S. Guzik, formerly of Guzik & Associates, and currently Of Counsel to Richardson Patel LLP, in his individual capacity, and do not necessarily represent the views of Richardson Patel LLP or any of its members.
[2] *See*, in this regard, Samuel S. Guzik, *Regulation A+ Offerings – A New Era at the SEC*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCE (January 15, 2014). https://blogs.law.harvard.edu/corpgov/2014/01/15/regulation-a-offerings-a-new-era-at-the-sec/.

- who wish to broaden their access to an investor pool which is inclusive of unaccredited investors.

The issues discussed are generally described as follows:

- The need for the Commission, through rulemaking, to transition what is currently characterized in the Proposed Rules as Tier 1 from a dead space for capital formation to a vibrant option for smaller issuers seeking to access public securities markets, but with initial and ongoing disclosure that is "right sized" for smaller companies raising under $10 million. [3]

- The need for the Commission to reconsider its position on the impact of retaining the Section 12(g) shareholder threshold – something which will likely preclude any meaningful participation by unaccredited investors in larger Tier 2 offerings, and could impair the viability of a modified Tier 1 offering as a viable funding option for smaller businesses.

SUMMARY OF CONCLUSIONS

- Tier 1, as presently constituted, is of marginal use, and simply memorializes, rather than solves, longstanding problems associated with Regulation A. Tier 2 is simply not a viable alternative for many smaller issuers seeking raises under $10 million in view of the heavy ongoing reporting obligations imposed upon Tier 2 companies under the Proposed Rules.

- The SEC has the power to revitalize Tier 1, rather than leave it as an historical anomaly, by exempting Tier 1 offerings from state blue sky regulation – which the SEC is empowered to do under Title IV of the JOBS Act of 2012 simply by conditioning use of Tier 1 on providing audited financial statements and ongoing periodic disclosure – albeit with a light disclosure regime tailored to smaller issuers –a substantially lighter burden than the currently proposed Tier 2 disclosure.

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[3] The difficulties of raising equity in the $3-$10 million range have been widely recognized in the financial community . *See*, *e.g.*, Stefano D'Aniello (Co-founder and COO of Groundbreaker), *Crowdfunded Deals Can be Quality Deals*, February 26, 2014, http://www.globest.com/commentary/acquisitions_dispositions/Crowdfunded-Deals-Can-Be-Quality-Deals-343184.html?zkPrintable=true. A copy of Mr. D'Aniello's article is included with this letter. Note the observations of Mr. D'Aniello, in the context of the need for additional equity financing options in the real estate industry for companies seeking raises of between $3-$7 million: "There is a category of deals that are too small for institutional money and too big for friends and family investors. The *equity* for these deals is usually $7 million or less. I call this deal category the 'equity dead zone.'"

In the opinion of the undersigned, this "equity dead zone" is an issue which cuts across many industries – and is a vital rung in the capital formation ladder for smaller issuers. Hence, the importance of viable alternatives for companies seeking capital generally in this dollar range.

- Not only would smaller issuers benefit from having less burdensome access to public markets, but a viable Tier 1 option, *with lighter disclosure*, would in many instances provide a more viable alternative to shell company reverse mergers.

- It is critical that the Commission exercise its rulemaking power under Section 36 of the Securities Exchange Act of 1934, by conditionally exempting all Regulation A offerings under Section 401 of the JOBS Act from the current Section 12(g) thresholds which trigger full 1934 Act reporting status, *i.e.* 500 unaccredited investors or 2,000 total investors.

DISCUSSION

I commend the Commission for recognizing both the need for, and value of, effective and less burdensome alternatives for capital formation for small companies. In particular, I commend the Commission for crafting a definition of "Qualified Purchaser" for Tier 2 offerings within the current legislative framework, conditioned not simply on the financial wherewithal of an investor, but by building into the Proposed Rules significant protections for *all* investors (*e.g.* both ongoing periodic disclosure as well as improved accessibility to this disclosure through mandatory filings on the EDGAR system).

Though reasonable minds may differ as to the exact details of these investor protections, and some adjustments may be necessary or appropriate, clearly the Commission has come to the right conclusions regarding the absolute necessity for state blue sky pre-emption – at least if Title IV of the JOBS Act is to have any vitality. The Commission has properly utilized the broad discretion that Congress gave to the SEC through Title IV rulemaking by alleviating one of the largest impediments to capital formation by small business, the costly and time consuming labyrinth of state merit review of small business offerings.

The burden of state level merit review of small business offerings falls disproportionately on smaller companies, simply by reason of their more limited options for accessing capital, and the obvious cost-benefit calculus: Issuers seeking to raise smaller amounts of capital are, in pure dollar terms, disproportionately impacted - and the smaller the company and the offering, the greater the burden.

However, in my opinion the Commission has not gone far enough.

In particular, the proposed Tier 1 exemption, allowing for raises up to $5 million, remains of little or no value for small business capital formation. Though the SEC has solicited comment on certain aspects of Tier 1 – including whether Tier 1 offerings ought to be exempt from blue sky review, this lower tier remains, as it has for years – at the back of the line and largely an historic relic – absent blue sky pre-emption.

With regard to Title IV, Congress has spoken, perhaps imperfectly in some important respects. Nonetheless, Title IV and the proposed Tier 1 in particular can be a powerful vehicle for capital formation by smaller issuers with proper rulemaking by the Commission.

THE PATH TO A REVITALIZED TIER 1

Blue Sky Pre-Emption for Tier 1

The *sine qua non* of a revitalized Tier 1 Regulation A offering is the elimination of blue sky review. The overlay of a state review process on a federal regime premised upon SEC registration and the opportunity for Staff review adds both delay and expense which smaller issuers can ill afford. In some states, merit review standards pose an absolute bar to the sale of securities to the general public, particularly when arbitrary investor protection rules addressing such matters as valuation or near term prospects of profitability are applied.

As a matter of law, in order for the Commission to accomplish the necessary task of blue sky pre-emption in the context of Regulation A, and Tier 1 in particular, absent further legislation by Congress, the Commission must revitalize Tier 1 within the confines of the mandatory of requirements of Title IV of the JOBS Act, *i.e. audited financial statements and ongoing periodic reporting.* As to the latter requirement, Section 401 empowers the Commission with broad rulemaking discretion, even allowing for "the suspension and termination" of ongoing periodic disclosure with respect to an issuer. Currently, the existing Regulation A promulgated under Section 3(b)(1) of the Securities Act of 1933 does not mandate the provision of audited financial statements unless they are already available to the issuer. Nor is there any requirement of ongoing disclosure. However, as of yet, Congress has failed to provide explicitly for pre-emption of state blue sky review for Section 3(b)(1) offers and sales.

Thus, the Commission is faced with a choice – leave Tier 1 in tact as a dead space for small business capital formation, albeit without a requirement of audited financials and periodic disclosure – or conform Tier 1 to the financial and non-financial disclosure mandates of Title IV. The path for the Commission to take ought to be obvious: unless and until Congress acts, something is better than nothing. Congress has spoken, albeit imperfectly. More than a dozen years of SEC Government-Small Business Forum recommendations are in accord. And history has demonstrated that the *status quo* for Regulation A will be of no material benefit to small issuers – or to job creation.

A Lightened Disclosure Burden for Tier 1 Companies

Apart from meeting a key requirement of Title IV, adding to Tier 1 a requirement of periodic disclosure is both an important step towards investor protection and a necessary ingredient of a functional secondary market. Moving from the traditional Regulation A regimen of no ongoing disclosure, and no transparency, to periodic disclosure is a step in the right direction. *However, the disclosure burden on smaller business must be scaled to the size of the issuer and the offering – the original operative principle behind Regulation A.* As some commentators have noted, correctly in my view, the disclosure burden imposed upon Tier 2 companies will limit the usefulness of Tier 2 offerings to smaller issuers[4], particularly those seeking to raise less than $10 million. Thus, in terms of the substance and level of detail of disclosure, of necessity a lighter disclosure burden ought to be applied for Tier 1 issuers.

The precise level of detail to be required by the Commission is outside the scope of this letter. However, a step in the right direction would be to have Tier 1 disclosure parallel the frequency of Tier 2 disclosures by requiring ongoing annual disclosure and interim "8-K like" reporting, *but eliminating the*

[4] *See* Comment Letter of Rutheford B. Campbell, Jr., Spears-Gilbert Professor of Law, March 5, 2014.

requirement of semi-annual disclosure for Tier 1 issuers. And Tier 1 issuers ought to have the *option* to provide semi-annual reporting - the pressure for an issuer to increase the level of disclosure to Tier 2 type disclosure would emanate not from mandatory SEC requirements, but from market forces dictating the need for more frequent disclosure – greater transparency presumably translating into the likelihood for improved liquidity in a secondary market.

Raising the $5 Million Ceiling for Tier 1 Offerings

The current ceiling for Regulation A offerings conducted under Section 3(b)(1) of the 1933 Act is set by Congress at $5 million. However, a new class of Regulation A offering under Section 3(b)(2) is capped at $50 million. Therefore, a Tier 1 offering cap higher than $5 million is both feasible and, in my opinion, necessary. Indeed, the $5 million benchmark set by Congress has not been revisited since 1980. Thus, if the "old" Regulation A is to truly be revitalized, it is essential that the $5 million limit for a Section 3(b)(2) compliant exemption be raised to at least $10 million.

THERE ARE MANY STRONG POLICY REASONS FOR THE COMMISSION TO FASHION A MEANINGFUL TIER 1 EXEMPTION

A Less Burdensome Alternative to Tier 2 Offerings – Tier 1 Offerings Exempt From Blue Sky Regulation

The most basic reason to revitalize Regulation A through a viable Tier 1 exemption is simple. Non-use of Regulation A has been widely attributed to two factors: the cost in time, money and uncertainty attendant to blue sky review; and the cost-benefit equation for conducting a registered offering for lower dollar amounts. Congress failed to address the basic problems of Regulation A – instead focusing on the needs of companies conducting raises in the tens of millions of dollars. This was not the result of legislative introspection, but rather was the end result of a political process undoubtedly influenced by powerful lobby groups. The result – the original problem – finding a path for smaller companies to access the public markets – to a large extent remains unsolved – notwithstanding the moniker attached by Congress to Title IV of the JOBS Act – "Small Company Capital Formation." To be sure, Title IV if implemented properly, has the potential to revitalize the IPO market for smaller companies. But absent proper rulemaking – the benefits of Title IV will remain unavailable to those companies in need of capital in the more modest range of $3-$10 million.[5]

Indeed, private companies seeking financing in this range find themselves in the most difficult area of capital formation.[6] Some will achieve success through other means, such as a Rule 506 offering. But as a practical matter, this will entirely (and some argue arbitrarily) exclude issuers from access to a large pool of "unaccredited investors." Moreover, the ability of an issuer to offer freely tradeable securities may not only mean the difference between a funded versus an unfunded offering – but will also likely negatively impact the valuation of the offered securities.

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[5] The real estate industry is just one example of where an expanded and viable Tier 1 exemption could be utilized. *See, e.g.,* Stefano D'Aniello, at Note 3 *supra.* It is no coincidence that the recent limited use of Regulation A (Section 3(b)(1) includes real estate development companies. Unfortunately, the utility of the Section 3(b)(1) exemption is limited in many instances due to the cost and complexity of state blue sky review.

[6] *See, e.g.,* Stefano D'Aniello, at Note 3 *supra.*

A Viable Alternative to Going Public Utilizing a Reverse Merger with a Shell Public Company

Historically, some companies seeking to avoid the cost and expense of going public through an SEC registered offering have sought to access the public markets through a reverse merger with a fully reporting shell company. I expect that if the SEC were to provide a viable alternative for smaller companies to access public markets with a functional Tier 1 exemption, including significantly lighter ongoing disclosure than a fully reporting company, many companies would find a reverse merger less attractive.

A Viable Alternative or Adjunct to Title III Crowdfunded Offerings

Though final Title III rules have yet to be implemented, embedded in Title III is a great deal of cost and complexity, vastly overshadowing anticipated benefits of a crowdfunded offering. A Tier 1 offering, modified as suggested above, could present a viable alternative to a crowdfunded offering for companies seeking capital in excess of the Title III limit of $1 million.[7] Indeed, a Tier 1 offering could even be an *adjunct* to an otherwise cost-prohibitive Title III offering – (Title III securities are exempt from the 2,000 shareholder limit and 500 unaccredited investor limit under Section 12(g) of the 1934 Act) – thus leveraging the initial and ongoing disclosure burdens attendant to a Title III financing in a concurrent or follow-on Tier 1 offering.

A Tier 1 crowdfunded offering would also allow issuers – through testing the waters - to leverage the social media, and to elicit interest in the offering *before* an issuer expends large amounts of money on offering documents. These features are currently absent from Title III crowdfunding.

The SEC has the power, through rulemaking, to make Tier 1 an even more vibrant crowdfunding vehicle than Title III, particularly if the SEC were to exercise its *general exemptive authority* under Section 36 of the 1934 Act by conditionally or unconditionally exempting Tier 1 securities from the Section 12(g) reporting requirements. Such exemption could be conditioned on any number of factors, such as the size of the issuer or the value of its float.

Other Valid Policies

Revitalizing Tier 1 offerings would serve to open up greater access to capital by smaller companies – particularly those who wish to have some liquidity for their securities and to access a large pool of unaccredited investors. A vibrant Tier 1 exemption would also serve another salutary function – allowing a formerly private company to get its feet wet as a public company without being overly burdened with the entire panoply of regulations which accompany the status of being either a fully reporting company or an exchange listed company. Having this intermediate rung on the ladder – in effect allowing a company to crawl before it walks – may ultimately facilitate improved regulatory compliance as a Tier 1 company grows and matures.

[7] *See, e.g.*, Stefano D'Aniello, at Note 3 *supra.*

EXEMPTING TIER 1 AND TIER 2 COMPANIES FROM THE SECTION 12(G) SHAREHOLDER “CAP”

This is an issue which deserves comment, both for Tier 1 and Tier 2 offerings. Presently, when an issuer exceeds 500 unaccredited shareholders of record, or 2,000 shareholders of record, and has total assets of more than $10 million, it becomes a fully reporting company under Section 12(g) of the 1934 Act. The SEC in the proposing release is adamant in its view that this ought not to be a material issue for smaller companies utilizing Regulation A, as the rule only applies to record ownership, not beneficial ownership, and most shareholders hold their shares in street name. Some commentators, however, have disagreed with this conclusion – going so far as to suggest that unless the SEC allows greater flexibility to securities issued in Regulation A offerings, their utility will be limited to accredited investors – defeating the purpose of Title IV.[8] This issue becomes increasingly real for offerings above $5 million – especially on the high end of the Tier 2 range – allowing unaccredited investors to participate would create an overwhelming risk of a Regulation A company becoming a fully reporting company.

As to Tier 1 offerings, though the current shareholder caps may be less problematic, they will ultimately cause many issuers to limit participation by unaccredited investors. Alternatively, a conditional exemption from the Section 12(g) caps for Tier 1 offerings could make it a safe and effective crowdfunding vehicle for issuers seeking raises over Title III’s $1 million cap.

Moreover, regardless of the SEC’s views on the likely impact of allowing large numbers of unaccredited investors to participate on a Tier 1 or Tier 2 offering, a credible perception by the financial community and issuers that there is a substantial risk of unwittingly becoming a fully reporting company will, as a practical matter, act as a deterrent to an issuer considering the use of Regulation A.

CONCLUSION

The SEC has every reason to make Tier 1 a viable alternative to the more burdensome disclosure regime under Tier 2 – burdens which disproportionately, if not exclusively, fall on smaller issuers. The only thing that stands in the way of the SEC achieving this longstanding objective is the SEC itself – and the will to act on behalf of smaller issuers.

Respectfully submitted,

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[8] *See* Comment Letter of William Hambrecht, dated March 4, 2014, filed with the Commission on March 5, 2014.

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D'Aniello, Stefano. "Crowdfunded Deals Can Be Quality Deals." *GlobeSt.com*., 26 Feb. 2014. Web. 24 Mar. 2014. Available at http://www.globest.com/commentary/acquisitions_dispositions/Crowdfunded-Deals-Can-Be-Quality-Deals-343184.html