

# PAUL HASTINGS

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March 24, 2014

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

Re: SEC File Number S7-11-13 (Proposed Rule Amendments for Small and Additional Issuers Exemption under Section 3(b) of the Securities Act) (SEC Rel. Nos. 33-9497, 34-71120 and 39-2493)

Dear Ms. Murphy:

The amendments to Regulation A under Section 3(b) of the Securities Act of 1933, as amended (the “**Securities Act**”), proposed by the Commission to implement Section 401 of the Jumpstart Our Business Startups Act of 2012 (the “**JOBS Act**”) are forward-thinking and the Commission and its staff should be commended for the insightful policy choices reflected therein. The Commission has proposed a well-constructed regulatory regime (titled Tier 2 in the proposing release) that draws from and builds on the IPO “on ramp” provisions of the JOBS Act and the Commission’s 2005 securities offering reforms. We endorse the proposals that would provide for the confidential submission of offering statements, the electronic filing of offering statements via the EDGAR system, the expansive use of test the waters communications before and after the offering statement’s filing, the satisfaction of offering circular delivery obligations under an “access equals delivery” model and the filing of post-qualification amendments to offering circulars and offering statements pursuant to rules adapted from Rule 424 and 430A under the Securities Act. Such proposals reflect a modernized offering regime that will enable market participants to execute seamlessly Tier 2 offerings employing familiar offering practices similar to those employed in connection with registered public offerings under the Securities Act.

All in all, the reduced (but substantial) disclosure requirements of Form 1-A, the modernized offering regime and the preemption of state securities law embodied in the Commission’s proposed amendments to Regulation A pave the way for small cap and emerging growth companies not to just take advantage of a special “on ramp” onto the road towards completing their initial public offerings, but rather to elect to pursue their IPOs travelling along an alternative road that has been designed with a disclosure framework envisioned by Commissioner Daniel M. Gallagher that is “geared towards more basic, clearly material information.” We believe the Commission could make this alternative road more viable if it were to conditionally exempt Tier 2 issuers from periodic reporting under Section 13(a) the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”) as described below. Such action would put in place the final component of a new legal framework under which small cap and emerging growth companies could raise significant growth capital in nationwide public offerings and thereafter their securities could be freely traded in a transparent secondary trading market that is informed by the ongoing Commission-required, but reduced disclosure prescribed in proposed Rule 257(b) of Regulation A. We believe that such a legal framework that permits issuers to go public and thereafter periodically report with a reduced disclosure burden will remove the disincentive to going public long associated with the substantially more burdensome one-size-fits-all legal framework that governs registered IPOs and subsequent periodic reporting under the Securities Act and the Exchange Act, respectively. We believe that given the potential for there to develop a large pool of publicly traded companies that go public through Tier 2 offerings and then trade in the aftermarket with the benefit of Commission regulated transparency, private

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sector market participants will be incentivized to sponsor and develop organized trading markets to serve such companies and interested investors (akin to the venture exchanges envisioned by Commissioner Gallagher).

In our letter, dated November 26, 2013, that we submitted prior to the publication of the proposed amendments to Regulation A, we encouraged the Commission to propose rules that would preempt the application of state securities laws to offerings conducted under the new Section 3(b) offering exemption mandated by the JOBS Act. We also encouraged the Commission to consider proposing rules that would conditionally exempt from periodic reporting under Section 13(a) of the Exchange Act, issuers that conduct public offerings and thereafter report periodically pursuant to the now titled Tier 2 offering exemption. We respond below to the Commission's request for comment with respect to the forgoing as well as with respect to requests for comment on certain other matters set forth in the proposing release.

### **Preemption of Blue Sky Regulation**

With the exception of certain state Blue Sky authorities and their trade organization, the North American Securities Administrators Association ("**NASAA**"), the public comment submitted to the Commission has uniformly endorsed some form of preemption of state securities laws for Tier 2 offerings. As reflected in the GAO report cited by the Commission in the proposing release, the costs of compliance with state securities laws is a factor that in the past may have contributed to limited use of Regulation A. In our prior letter, we estimated that an issuer seeking clearance in all 50 states would incur \$50,000 to \$70,000 in filing fees and \$80,000 to \$100,000 in legal fees. NASAA's recently announced Multi-state Coordinated Review Program provides no relief from state filing fee requirements, which represent a direct cost on capital formation. In contrast, issuers will not incur any filing fees for qualification of their offerings under Regulation A.

Moreover, there are too many uncertainties associated with NASAA's proposed coordinated review program. For example, it is uncertain as to whether a critical mass of state securities regulators will officially participate in the program and even if a critical mass of regulators ultimately decides to participate, it cannot be predicted when this will occur. NASAA's coordinated review contemplates the appointment of a lead disclosure examiner and lead merit examiner to coordinate the collection of comments, and therefore an issuer undergoing such coordinated review will remain subject to the varying disclosure policies and interpretations of the participating disclosure-review and merit-review based state securities regulators. Nothing in NASAA's announcements concerning their program suggests that any lead examiner will have the authority to overrule or ignore the comments proffered by an examiner associated with any other any participating state. NASAA has failed to explain satisfactorily what additional benefit will be derived from state-level registration and qualification of Tier 2 offerings that will otherwise be subject to review and oversight by the Commission's staff of highly experienced attorneys, certified public accountants and other professionals. NASAA merely advances a conclusory assertion that the absence of such state regulator review of Tier 2 offerings will exacerbate the risk of fraud and abuse (which risk can be addressed through the law enforcement authority the states otherwise retain).

NASAA has not addressed at all what administrative resources the participating states will invest in the review program in terms of the reassigning or hiring of similarly experienced staff to carry out the coordinated review of Tier 2 offering statements. We submit that even if the participating state regulators staffed their coordinated review programs with similarly experienced professionals, the resultant review, however coordinated, would be entirely duplicative of the Commission staff's review, and to the extent

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such coordinated review reflected merit-related concerns, it would introduce uncertainties in achieving clearance that are unwarranted for a national market for securities publicly offered in Tier 2 offerings under Regulation A.

The preemption proposed for Tier 2 offerings will allow investment capital to flow efficiently across state borders in a national market. The balkanized system of state-by-state securities offering regulation advanced by NASAA is simply outmoded for the modern U.S economy dominated by internet and social media communications and information technology. Therefore, we endorse the Commission's proposed rules that would accord state securities law preemption for Tier 2 offerings by defining "qualified purchaser" for purposes of Section 18(b)(3) of the Securities Act in the manner set forth in proposed Rule 256 of Regulation A. No other conditions are necessary insofar as investors will benefit from a full disclosure document delivered prior to sale that contains financial statements and other substantive information concerning the offering and the issuer's business and financial condition and is otherwise subject to review by the Commission's staff.

We remain concerned about by "back door" regulation of Tier 2 offered securities by state securities regulators in the secondary trading market, and in response to the Commission's request for comment No. 120, we believe that if this concern is not addressed in the Commission's rulemaking, the overhang of potential state regulation will substantially impair the development of an active and liquid secondary trading market for Tier 2 offered securities. We raised this concern in our prior letter, but Commission indicated in the proposing release that it is currently unaware of any evidence suggesting that blue sky laws inhibit trading in OTC markets. We expand on our prior comments to underscore our concern. It is clear that once offered and sold, Tier 2 offered securities held by investors will be freely tradable without restriction under the Securities Act. Section 18(b)(4) of the Securities Act treats as covered securities and therefore accords preemption to securities that are traded in ordinary trading transactions exempt under Section 4(a)(1) of the Securities Act; provided that, the issuer is subject to the periodic reporting under the Exchange Act.<sup>1</sup> As a result, state securities laws that would restrict resales in the over-the-counter market do not apply to the ordinary trading transactions in the securities of Exchange Act reporting issuers. Absent similar preemption, resale trading transactions in the over-the-counter market are subject to state securities regulation. Unless the securities or transactions are registered with the relevant securities regulators or investors are able to rely on exemptions from the securities laws of the relevant jurisdictions, any resales of Tier 2 offered securities to residents of those jurisdictions will be restricted under the applicable state securities law. In general, with state-by-state variances, available exemptions may include a securities manual exemption, an Exchange Act registration or reporting exemption, an isolated non-issuer sales exemption, an institutional investor exemption, an unsolicited broker transactions exemption and a non-defaulted debt securities exemption. We describe briefly below these exemptions:

- Securities Manual Exemption. Available for secondary trading of securities of issuers that publish on an ongoing basis certain prescribed information in a recognized securities manual. A substantial majority states have some form of this exemption with variations as to the recognized

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<sup>1</sup> Section 18(b)(4) provides:

(4) EXEMPTION IN CONNECTION WITH CERTAIN EXEMPT OFFERINGS.—

A security is a covered security with respect to a transaction that is exempt from registration under this title pursuant to —

(A) paragraph (1) or (3) of section 4, and the issuer of such security files reports with the Commission pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

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securities manuals, the most commonly recognized of which being Standard & Poor's and Mergent's manuals.

- Exchange Act Registration or Reporting Exemption. Some states exempt the secondary trading of securities registered under Section 12(g) of Exchange Act and a smaller number of states exempt the trading of securities of issuers that file reports under Section 15(d) of the Exchange Act.
- Isolated Non-Issuer Transactions. Most states have an isolated non-issuer transaction exemption that is available if the number of transactions is limited to one or two transactions in the state in a year.
- Sales to Institutional Investors. Almost all states have a transaction exemption that exempt sales to institutional investors, although the types of institutions for which the exemption applies varies from state to state.
- Unsolicited Broker Transactions. A substantial majority states have some form of exemption for transactions effected through a broker resulting from an unsolicited offer.
- Non-Defaulted Debt Securities. A substantial majority of states have some form of exemption for the secondary trading of debt securities if the securities were not in default during the current year, or for some states, were not in default during the three preceding fiscal years or during the existence of the issuer or any predecessor.

Keeping track of the availability of such exemptions for all Tier 2 offering issuers would present a significant compliance burden for any broker-dealer that would seek to serve as a market maker for such securities and would likely impede the development of a trading market populated with multiple active market makers. We submit that the state regulation giving rise to this compliance burden is unnecessary given the ongoing periodic reporting contemplated in Regulation A for Tier 2 reporting issuers. Consequently, we believe that the Commission should eliminate the regulatory overhang associated with such state securities law compliance and preempt the application of state securities laws to ordinary trading transactions in the securities of Tier 2 issuers; provided that, the issuers file periodic and current reports pursuant to proposed Rule 257(b) of Regulation A. This way, potential market makers and sponsors of alternative trading systems will be able enter the marketplace to develop a trading market (much like the venture exchanges envisioned by Commissioner Gallagher) unrestrained by unnecessary state securities law based compliance burdens.<sup>2</sup> The alternative of allowing state regulators to regulate the secondary trading market will likely reduce trading liquidity and result in liquidity discounts for the securities offered by Tier 2 issuers, which we believe would represent an unnecessary increase in the cost of capital contrary to the policy objectives of the JOBS Act.

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<sup>2</sup> To provide such preemption, proposed Rule 256 could be amended by adding the following text:  
For purposes of Section 18(b)(3) of the Securities Act [15 U.S.C. 77r(b)(3)], a "qualified purchaser" means any offeree and any purchaser of a security offered and sold pursuant to paragraph (1) or (3) of section 4(a) of the Securities Act [15 U.S.C. 77d(a)]; provided that, the issuer of the security files reports with the Commission pursuant to Rule 257(b) (§230.257(b)).

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### **Conditional Exemption from Exchange Act Reporting**

Issuers that have completed Tier 2 offerings of equity securities with \$10 million or more in assets and that have either 2,000 holders of record or 500 holders of record that are not accredited investors would be required to register their equity securities under Section 12(g) of the Exchange Act and therefore would be subject to the full complement of periodic reporting and related requirements promulgated under the Exchange, Sarbanes-Oxley and Dodd-Frank Acts. We believe that the risk of becoming obligated to register and then report under Section 13(a) under the Exchange Act presents a significant disincentive for small cap and emerging growth companies to conduct Tier 2 offerings to raise equity capital. To address this risk, we encouraged the Commission in our prior letter to consider proposing regulations that would conditionally exempt small cap and emerging growth companies from the periodic and other reporting obligations of Section 13(a) of the Exchange Act. The exemption we recommended would not be permanent and would lapse once the issuer's non-affiliate market capitalization reached \$250 million. Any such conditional exemption from Section 13(a) reporting obligations should be available only to the extent the Tier 2 issuer files reports pursuant to proposed Rule 257(b) of Regulation A.

We address the Commission's requests for comment Nos. 33 and 34 which relate to our recommendation for a conditional exemption from Section 13(a) reporting. We believe that an issuer's non-affiliate market capitalization would serve as a superior proxy for market interest in the equity securities of an issuer and note in this respect that Commission already uses non-affiliate market capitalization as a measure to establish eligibility for Form S-3 short form registration and to determine accelerated filer, large accelerated filer status and widely known seasoned issuer status. By design, a successful Tier 2 public offering can result in the issuer becoming widely held by multiple hundreds if not thousands of outside investors who may not be accredited investors, easily surpassing the holders of record thresholds contained in Section 12(g) at the conclusion of the offering. It seems anomalous for a Tier 2 offering issuer to raise its investment capital from investors utilizing the reduced disclosure required by Regulation A, yet as a result of the offering it may become obligated to file a Form 10 registration statement at the beginning of its next fiscal year (which may be just months away) and commence full Exchange Act reporting thereafter. The Commission should recognize this anomaly and permit the equity securities of Tier 2 offering issuers to be registered on Form 8-A and thereafter trade in the secondary trading market on the basis of the reduced (but substantive) disclosure required in the periodic and current reports filed pursuant to Rule 257(b) of Regulation A until they transition to full reporting under Section 13(a) of the Exchange Act. We submit that if the reduced disclosure is sufficient to inform investors in connection with the primary issuance of the securities, it must be sufficient to inform investors in the secondary trading market.

We would recommend that this transition period during which the Tier 2 issuer would report pursuant to Rule 257(b) should lapse if at the end of the first six months of an issuer's fiscal year, the issuer's non-affiliate market capitalization equals or exceeds \$250 million. The rules should provide for the Tier 2 issuer to commence reporting in accordance with Section 13(a) of the Exchange Act commencing with the issuer's next fiscal year, which is consistent the treatment of issuers that exit from "smaller reporting company" status under Rule 12b-2 under the Exchange Act. We note in this respect that the Commission's Advisory Committee on Small and Emerging Companies recommended that the Commission revise the definition of "smaller reporting company" in Rule 12b-2 to include companies with a public float up to \$250 million (or, if unable to calculate the public float, companies with less than \$100 million in annual revenues). We believe the conditional exemption from the reporting obligations of Section 13(a) that we have proposed achieves a similar policy result, a less burdensome ongoing reporting obligation for Tier 2 issuers reporting pursuant to Rule 257(b) of Regulation A.

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We have not recommended a conditional exemption from registration under Section 12(g) of the Exchange Act because we believe that investors should benefit from the beneficial ownership reporting and tender offer regulation under Sections 13(d), 13(g) and 14(d) of the Exchange Act, as well as the insider reporting and short swing profit regulation under Section 16 of the Exchange Act. Similarly, we believe investors holding equity securities of conditionally exempt issuers should benefit from the Commission's proxy regulation under Section 14(a) of the Exchange Act (although Schedule 14A should be revised to instead allow Rule 257(b) reporting issuers to provide reduced disclosure consistent with the disclosure required in the reports filed pursuant to Rule 257(b)).

### **Investment Limitations**

The imposition of investment limitations for investors in Tier 2 offerings that benefit from the delivery of a prescribed offering document reviewed by the Commission's staff is without precedent and we believe is unwarranted. The Commission's investor protection mandate is addressed through delivery of an offering circular that contains required audited financial statements and other information specified in Regulation A. While the disclosure contained in an offering circular is reduced in comparison to that contained in a Form S-1 registration statement, the offering circular remains a full disclosure document with prescribed disclosure that is substantive and adequate to inform investors. If the Commission believes an investment limit is appropriate, the Commission should eliminate the requirement for offerings that are conducted by registered broker-dealers. Broker-dealers are subject to extensive suitability and know your customer regulation which we believe serve as an adequate investor protection substitute for any investment limit imposed by the Commission. Furthermore, we believe that any investment limit should not apply to "accredited investors" who otherwise are permitted to purchase unlimited amounts of securities offered under Regulation D under circumstances where the regulation does not necessarily require delivery of a prescribed offering document and even if an offering document is used, it is not required to be reviewed by the Commission's staff.

### **At the market offerings**

The Commission proposes to prohibit "at the market offerings" under Regulation A expressing a concern as to whether a trading market will develop that is capable of supporting at the market offerings. We question whether an outright ban on such offerings is appropriate in all circumstances and suggest that the Commission consider a rule that would permit at the market offerings of securities that qualify for the actively-traded securities exceptions of Rule 101 and Rule 102 of Regulation M. Securities that have an average daily trading volume of at least \$1 million and are issued by an issuer with a common equity public float value of at least \$150 million are considered actively-traded pursuant to these exceptions. If the securities are considered sufficiently traded to be eligible for the Regulations M exceptions, they should be considered sufficiently traded to permit at the market offerings. In fact, we believe that if the average daily trading volume was at least \$500,000 and the public float value was at least \$75 million, there would exist a demonstrable trading market capable of supporting at the market offerings. We note that seasoned issuers with a \$75 million public float are permitted to conduct at the market offerings on Form S-3 (without regard to its average daily trading volume). With respect to calculating the offering size for purposes of determining the annual offering amount limitation, we recommend that the Commission allow the issuer to make the calculation in the manner set forth in Rule 457(c) under the Securities Act except that calculation should be made as of a specified date within 5 business days prior to the date of qualification of the offering statement.

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**Rule 144, Rule 144A and Rule 15c2-11**

We believe that Rule 144 under the Securities Act should be revised so that Tier 2 issuers' ongoing periodic and current reports filed pursuant to Rule 257(b) will satisfy the "adequate current public information" requirement of the resale safe harbor. Similarly, believe that Rule 144A under the Securities Act should be amended so that the reports filed pursuant to Rule 257(b) will satisfy its information requirement. We note in this respect that Rule 257(b) requires the filing annual reports that will contain a description of the issuer's business and audited financial statements as well as semi-annual reports that will contain unaudited financial statements. As a result, the secondary trading market will have regular access to information concerning Tier 2 issuers' results of operations and financial condition, information that will adequately inform the investing public. For the same reasons, we believe that a broker-dealer review of periodic and current reports filed pursuant to Rule 257(b) should be sufficient for the broker-dealer to initiate quotations in compliance with Rule 15c2-11 under the Exchange Act.

**Repeat Issuers and Prospectus Delivery**

We believe it is appropriate for the Commission to implement rules that are analogous to Rule 15c2-8(b) and Rule 174(b) under the Exchange Act. The requirement that the preliminary or final offering circular be delivered 48 hours in advance of confirmation should apply only to initial public offerings and not to offerings by repeat issuers subject to periodic and current reporting pursuant to Rule 257(b) of Regulation A. Similarly, the post-qualification dealer offering circular delivery requirement should not apply to issuers already subject to the reporting obligations of Rule 257(b). This will align the offering circular delivery requirements with the prospectus delivery requirements applicable to offerings that are registered under the Securities Act consistent with the modernized offering regime embodied in the other Regulation A proposals.

**Part II of Form 1-A – Request for Clarification**

We note that Item 6 of Part II of Form 1-A as proposed requires disclosure with respect to the securities issued by "affiliated issuers." We request that the Commission define the term "affiliated issuer" for purposes of this disclosure item. We note in this respect that the term "affiliate" has been defined by the Commission in other rules to include persons controlling the issuer and under common control with the issuer. We believe that term "affiliated issuer" for purposes of Item 6 should be defined to refer to entities controlled by the issuer; otherwise this disclosure item may require disclosure of securities issuances by parent and sister entities, information that is unrelated to the capitalization of the issuer or any entity controlled by the issuer.

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We would welcome the opportunity to address any part of this letter with the Commission or members of its staff.

Sincerely,

A handwritten signature in black ink that reads "Michael Zuppone". The signature is written in a cursive, slightly slanted style.

Michael L. Zuppone  
of PAUL HASTINGS LLP

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