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March 24, 2014

Submitted electronically to rule-comments@sec.gov

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

SUBJECT: Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act; Release Nos. 33-9497, 34-71120, 39-2493; File No. S7-11-13)

Dear Ms. Murphy,

As the Securities Administrator of the Washington Department of Financial Institutions, I am submitting the comments set forth below in response to the Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act ("Proposed Rules") by the Securities and Exchange Commission (the "Commission" or "SEC").

Our greatest concern with the Proposed Rules lies in the broad form of preemption of state regulatory oversight that has been proposed for offerings under Regulation A. As further explained below, it is imperative that the Commission revise the proposed rules prior to adoption to remove the blanket preemption of state registration requirements for offerings under Regulation A. In proposing the broad form of preemption included in the Proposed Rules, the Commission has exceeded the authority granted to it by Congress and ignored the clear Congressional intent behind both the Jumpstart Our Business Startups Act ("JOBS" Act) and the National Securities Markets Improvement Act of 1996 ("NSMIA"). If adopted, the Proposed Rules would handicap the states from providing oversight of these offerings at a time when the Commission lacks the resources to police this area. To ensure that legitimate issuers do not have to compete with unscrupulous or even fraudulent offerings in this market and to provide the investor protection intended by Congress, the Commission must remove the form of preemption included in the Proposed Rules.

Beyond the issue of preemption, we have a number of other concerns with the Proposed Rules which are detailed below.

1. The Commission must rescind its proposed definition of "qualified purchaser".

Acting far beyond the scope of its authority, the Commission has proposed to define "qualified purchaser" as any offeree in a Regulation A offering and any purchaser in a Tier 2 offering. This proposed definition directly defies Congressional intent and effectively preempts states from regulating public offerings occurring in their own backyards, a cause of grave concern for investor protection and for issuers that will compete for investor funds in this market. We object to this proposal for the reasons set forth below.

a. The Commission ignored the unambiguous Congressional intent behind both the JOBS Act and Section 18(b) of the Securities Act, and therefore exceeded its rulemaking authority in proposing to preempt state law.

In the debate and eventual passage of the JOBS Act, one of the issues considered was the extent to which state laws affecting Title IV offerings should be preempted. Congress soundly rejected calls to provide for blanket preemption, recognizing the important role of states in the regulation of these smaller, more localized public offerings.[1] Congress specifically acknowledged that "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]*."[2] (emphasis added).

Instead of providing for outright preemption, Congress amended Section 18(b)(4) of the Securities Act of 1933 to provide for preemption with respect to offerings exempt under Section 3(b)(2) *only* where the securities are:

- Offered or sold on a national securities exchange; or
- Offered or sold to a qualified purchaser, as defined by the Commission pursuant to the authority granted to it under the National Securities Markets Improvement Act of 1996 ("NSMIA").[3]

Moreover, as NASAA has noted on numerous occasions in the past,[4] when Congress passed Section 18(b) and defined "covered security" to include sales to "qualified purchasers," it clearly intended that any definition of "qualified purchaser" ultimately adopted by the Commission would ensure that investor protection would not be altogether sacrificed. The legislative history specifically indicates:

[1] Letter from A. Heath Abshure, Securities Commissioner, Arkansas Securities Department, to Elizabeth M. Murphy, Secretary, SEC (Feb. 20, 2014), *available at* http://www.sec.gov/comments/s7-11-13/s71113-14.pdf.
[2] 157 Cong. Rec. H7229-01 (Nov. 2, 2011) (statement of Rep. Peters).
[3] Securities Act of 1933 Section 18(b)(4)(D); 15 U.S.C. § 77r(b)(4)(D) (2014).
[4] Letter from A. Heath Abshure, NASAA President and Securities Commissioner, Arkansas Securities Department, to Elizabeth M. Murphy, Secretary, SEC (April 10, 2013), *at* http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-25.pdf [hereinafter NASAA Advance Comments on Regulation A+]; Letter from Patricia D. Struck, NASAA President and Wisconsin Securities Administrator, to Nancy M. Morris, Federal Advisory Committee Management Officers, SEC (Mar. 28, 2006), *at* http://www.sec.gov/rules/other/265-23/rastaples1692.pdf; Letter from Joseph P. Borg, NASAA President and Director, Alabama Securities Commission, to Jonathan G. Katz, Secretary, SEC (Mar. 4, 2002) , *at* http://www.sec.gov/rules/proposed/s72301/borg1.htm.

> [T]he Commission is given flexible authority to establish various definitions of qualified purchasers. In all cases, however, [Congress] 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*.[5]

(emphasis added). In that vein, Congress explicitly directs the Commission in Section 18(b)(3) that any definition of "qualified purchaser" must be consistent with public interest and *the protection of investors*.[6]

The Commission's proposed definition of "qualified purchaser" effectively provides a blanket preemption of state regulation and offers no investor protection in return. Instead of imposing investor qualification requirements to protect the investing public from the inherent risks in these types of offerings, the Commission proposes to define "qualified purchaser" as *any* offeree in a Regulation A offering and *any* purchaser in a Tier 2 offering. Investors will be exposed to the risks inherent in these types of public offerings that their own local regulators have been blocked from regulating for their benefit, regardless of their investment sophistication or their financial ability to absorb the risk of loss. This directly contradicts the *unambiguous* legislative intent behind both Section 18(b) and the JOBS Act, in addition to the clear statutory mandate to define the term in the interest of investor protection.

b. State regulation of both Tier 1 and Tier 2 offerings is essential for investor protection and promotes responsible capital formation.

Not only did the Commission ignore Congressional intent and exceed its rulemaking authority, but it also ignored the fact that state regulation is essential to capital formation and investor protection in these offerings. Given the relatively small size of these offerings and the low probability of attracting the attention of national broker-dealers to distribute them, these offerings are likely to be local in nature. Companies that are successful in raising funds in Regulation A offerings will likely be raising funds from local investors who have some level of familiarity with the company and/or its promoters. In light of the local nature of these offerings, state regulation of these offerings is essential to investor protection and the facilitation of capital formation.

i. State regulators are more accessible to local issuers and investors alike.

State regulators provide a level of accessibility to local small business issuers and local investors that is unavailable from the Commission. In addition to responding to inquiries from local investors questioning the legitimacy of offerings, state regulators regularly field inquiries from entrepreneurs, small business owners, and local counsel regarding options for raising capital. We are easily accessible via telephone, e-mail, and even provide in-person consultations. This

[5] H.R. Rep. No. 622, 104th Cong. 2d Sess. at 31 (1996).
[6] Securities Act of 1933 Section 18(b)(3); 15 U.S.C. § 77r(b)(3) (2014).

assistance is provided through all stages of business operations, from formation through issuance of securities.

The staff of the Washington Securities Division also routinely present to entrepreneurs, small business development centers, and other local groups on what businesses need to know if they are contemplating raising capital. This level of accessibility helps to ensure small businesses access the capital needed to start or grow their businesses in a manner consistent with both state and federal regulations. For example, a group of local businesspersons from a small town in Washington contacted our staff to discuss requirements for raising capital before they ever filed with the Division. Our staff regularly corresponded with these individuals and when they subsequently filed their application for registration, our staff reviewed the company's offering materials to ensure all material information appeared to be disclosed and that the offering was not abusive of investors. The offering was registered within three months of filing the application and the company successfully raised over $650,000 from Washington investors.[7] It is doubtful that this issuer would have received the same level of support and attention from Commission staff in D.C.

If state registration requirements are preempted with respect to Regulation A offerings, potential issuers will be dissuaded from seeking out their local regulator and the states will lack the regulatory influence to facilitate small business offerings in their state in this manner. This will have negative consequences for capital formation by the very small businesses the JOBS Act was intended to help. Further, our staff will have limited information available to respond to residents of our states inquiring as to the legitimacy of an offering for which we have been preempted from registering.

ii. State regulators are more accountable to local investors and businesses and have the ability to respond quickly to fraudulent offerings occurring in their own backyards.

In addition to our greater accessibility, state regulators are more accountable to residents of their states, including both investors and local businesses that seek to raise capital. Our accountability to both groups factors into our review of applications for registration, including the adequacy of disclosure to be provided to prospective investors. We must answer questions regarding offerings that have been registered, as well as those that have not been granted registration, from investors, businesses, local legislators, and the local media. This level of accountability is essential to investor protection in these smaller public offerings.

We are also likely to more quickly learn of and respond to fraudulent offerings in our backyards. An example is the case of Columbia City Cinema, Inc. This company filed an application for registration that was materially deficient.[8] Rather than addressing the deficiencies noted by our

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[7] Quimper Mercantile Company, Securities Division File no. 70014897.

[8] For example, the Division learned that the theater had never obtained a proper permit and installation of required safety improvements was never completed. The offering circular submitted to the Division never disclosed this matter; it only contained a vague reference to "possible expensive building repair and code updates" in its Risk Factors section without further explanation. Columbia City Cinema, Securities Division File no. 70014897. *See*

staff, the promoter of this company determined to go forward with the offering in the absence of registration. Purely by chance, one of our staff members was watching a local newscast when a story was presented about this company and its struggles to raise money. The newscast showed a sign posted in the theater headed "Want Stock?" that instructed customers to leave their contact information at the box office. A day earlier, a local newspaper had presented a story about this theater's offering of common stock, and according to the newspaper, the promoter was "about half way to its goal" of raising $50,000 by the end of the year.[9] Within two business days of the newscast, the Division drafted and entered an enforcement order to halt the offering and put investors in our state on notice of the problems with this offering.[10] It would be nearly impossible for the Commission staff, given their distance from many of the states and the enforcement processes the Commission has in place, to learn of and act as quickly to such circumstances. Further, in the absence of state registration requirements, the fraudulent nature of this offering may have never been discovered by our staff and even if it had, we would not be able to respond as quickly as we did if state registration requirements were preempted.

iii. State regulators have more specialized knowledge of matters affecting local offerings, and are thus better positioned to evaluate a local offering.

In addition to our greater accessibility and ability to quickly respond, state regulators are equipped with localized expertise. State regulators have a better understanding of economic conditions and local laws and regulations that will impact a local issuer, and are therefore better positioned to evaluate the disclosure provided in an offering circular by a local issuer.

Consider the recent legislation in Washington State legalizing the sale of marijuana for recreational use. This legislation has required the Division to gain an understanding of evolving local laws, regulations and the economic environment in which this industry operates.[11] We have received securities filings and fielded inquiries from businesses seeking to raise capital to enter this industry, have attended training on the matter, and have members of our agency on statewide task forces exploring the impact of this industry on financial institutions. As a result of

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also, Casey McNerthney, Fire dept: Columbia City Cinema operating illegally for years, Seattle PI Online, May 4, 2011, *at* http://blog.seattlepi.com/seattle911/2011/05/04/fire-dept-columbia-city-cinema-operating-illegally-for-years/.

[9] From this statement, it appeared that not only was the theater offering stock without being properly registered, but money had already changed hands. Amy Rolph, Seattle's small movie theaters facing tough times, SeattlePI.Com (Nov. 28, 2010), *at* http://www.seattlepi.com/local/article/Seattle-s-small-movie-theaters-facing-tough-times-840025.php.

[10] Press Release: DFI Orders Columbia City Cinema, Inc. to Halt Stock Sales, Department of Financial Institutions (Dec. 7, 2010), *available at* http://www.dfi.wa.gov/consumers/news/2010/columbia-city-cinema.htm.

[11] For example, Initiative 502 licenses and regulates marijuana production, distribution and possession for persons over the age of 21, and removes state law penalties for the activities it authorizes. It creates three separate tiers of licensing: marijuana producer, marijuana processor, and marijuana retailer. There are separate licensing requirements and restrictions on the operations of each. The Washington State Liquor Control Board has recently issued its first producer-processor license and regulations are likely to evolve as we see the practical implications of the initiative. It can hardly be expected of the Commission to have a thorough understanding of these matters, which significantly impact the disclosures made in an offering circular.

our involvement with the topic, we are acutely aware of the risks of an offering in this industry. For example, the Division recently took action against an issuer involved in the marijuana industry who failed to provide material information to prospective investors, including the risk the issuer would not be able to obtain the necessary licenses to operate its business and that its business activities could expose shareholders to additional liability for violations of federal law.[12] We question whether the Commission staff has the same level of expertise to impart in reviewing a prospectus by a local issuer given the uniqueness of Washington law in this area.

iv. States that apply merit standards use these tools to ensure basic levels of fairness in an offering.

In states where legislators have authorized their securities regulators to employ merit standards, these regulators have powerful *preventative* tools to protect investors from unscrupulous issuers and offering structures that may seek to take advantage of unsophisticated investors. While "merit" regulation is often criticized, it plays an important role in protecting investors in these types of offerings in those states where it is available.

Most states perform merit reviews through the application of uniform NASAA statements of policy[13] that they have adopted by rule. These NASAA statements of policy seek to ensure a basic level of fairness in a number of areas. For example, these statements of policy require that where an issuer has engaged in material affiliated transactions, the issuer must appoint and maintain at least two independent directors to approve any future affiliated transactions. This is a helpful tool to protect investors in a public offering who may be investing, for example, in a company that intends to use the proceeds to purchase a business from a relative of a promoter.[14] The statements of policy also require an issuer to establish a minimum offering amount in a non-firmly underwritten offering, which prevents an issuer from spending the initial proceeds of the offering only to later realize that the proceeds were insufficient to implement the issuer's business plans to the detriment of investors in the public offering. Another example is that the amount of options and warrants that an issuer may issue or reserve for issuance for one year following the offering is limited to 15% of the issuer's common stock outstanding upon completion of the offering.[15] The obvious purpose here is to protect investors in a public offering from excessive dilution caused by an excessive amount of outstanding options and warrants at the time of the offering. These tools allow state regulators to weed out unscrupulous offerings by promoters who are less interested in the success of the company than they are in lining their own pockets.

[12] Securities Division Order No. S-13-1291-13-SC01 (Jan. 21, 2014), *available at* http://dfi.wa.gov/sd/orders/S-13-1291-13-SC01.pdf.
[13] The Statements of Policy are published on NASAA's website at http://www.nasaa.org/regulatory-activity/statements-of-policy/.
[14] *See, e.g.*, Form 1-A filed with the SEC by Sail Energy Holdings, LLC on February 27, 2013, *available at* http://www.sec.gov/Archives/edgar/vprr/13/9999999997-13-001275 (issuer planned to use proceeds of offering in part to purchase substantially all of the assets of a sole proprietorship owned and operated by the brother of one of the promoters).
[15] Excluded from this limitation are options and warrants that are issued to employees or consultants, options and warrants with exercise prices at or above the public offering price, and options and warrants issued to underwriters, unaffiliated institutional investors, and to unaffiliated persons in connection with mergers and acquisitions.

By proposing to preempt state registration requirements, the Commission is taking away states' ability to use these tools to ensure a basic level of fairness in offerings to retail investors in their states. We urge the Commission to allow us to continue to protect our residents and to promote capital formation in our state.

c. The coordinated filing and registration process for Regulation A offerings approved by NASAA members streamlines the state registration process and ameliorates the concerns cited by the Commission and the U.S. Government Accountability Office.

In proposing to preempt state registration requirements, the Commission relies on the report published by the U.S. Government Accountability Office ("GAO"), which explores the reasons Regulation A has been historically underutilized. The GAO report indicates that state registration requirements are among *several* central factors that may have contributed to the historical lack of use of the current Regulation A.[16]

The GAO report indicated the concerns regarding state securities regulation included the cost of research to determine the requirements of each jurisdiction, the time spent registering the offering in each jurisdiction, and stringency of merit standards in certain jurisdictions.

A new coordinated filing and registration program, recently approved by NASAA members, ameliorates these concerns. The states developed this program through NASAA to streamline state registration of offerings under federal Regulation A. It was created and promulgated after thorough discussions with and feedback from the American Bar Association Business Law Section's working group on Section 3(b)(2) offerings.

The coordinated review program provides for the filing of the application materials with a single state serving as the program administrator to commence the registration process in all states in which registration is sought. The program administrator will select a lead merit and lead disclosure examiner from among the states in which registration is sought.[17] Lead examiners are responsible for drafting and circulating a comment letter to participating jurisdictions, as well as seeking resolution of those comments with the issuer. The program provides *strict* timeframes to be adhered to by participating states.[18] This program works to eliminate costs of identifying and addressing individual state requirements, and provides an expedient registration process.

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[16] Other factors included the time-consuming and costly process of filing the offering with the Commission itself, the availability of alternative exemptions under Regulation D, and the type of investors sought by the issuer. Further, these factors were not ranked in order of importance.

[17] If the issuer is not applying for registration in a state that applies merit standards, then only a lead disclosure examiner will be sought.

[18] The lead examiner(s) will draft and circulate a comment letter to the participating jurisdictions within ten (10) business days after their identification as lead examiner(s) by the program administrator. The participating jurisdictions shall have five (5) business days from the circulation of the draft comment letter to submit additional comments or corrections to the lead examiners. After the expiration of the five (5) business days for review of the

Not only does the program streamline the state review process, but the program relaxes certain standards contained in the statements of policy to accommodate for startup business concerns. For example, the requirement for promoters to invest a minimum amount in the company prior to engaging in a public offering is waived as the Statement of Policy Regarding Promoters' Equity Investment is not applicable. Further, the period of escrow or lock-in for discounted shares issued to promoters is lowered to a maximum period of two years from completion of the offering, with provision for release of 50% of such shares after one year from completion of the offering.

The new coordinated registration program provides a streamlined, expedient review of Regulation A offerings while maintaining the investor protections provided by state registration. This program addresses the Commission's concerns and calls for the Commission to revoke its proposal to preempt state registration requirements.

d. The Commission has failed to weigh the purported cost of state regulation against the benefits afforded by it.

While the value to investors of state registration may be difficult to quantify, that does not mean that the Commission may neglect to weigh the value of state regulation against its purported cost in proposing blanket preemption.

In its economic analysis, the Commission fails to quantify the cost of state registration in either traditional Regulation A offerings or the prospective cost for offerings under Section 3(b)(2). The Commission does indicate that state law filing fees average $35,000 in initial public offerings under $50,000,000, but fails to quantify the legal and compliance costs associated with the filings. As NASAA points out, using the same data relied upon the Commission concerning IPO-related fees, even if one subscribes to the *improbable* assumption that all legal fees incurred by an issuer in an offering between $5 to $50 million are attributable to blue sky compliance fees, such fees equal a mere 1.15% of the total offering amount. The value provided to both small business issuers *and* investors, including proximity, local knowledge, merit protections, and an added air of credibility far exceeds a hypothetical 1.15% of the offering costs in a public offering.

Our state has many examples of issuers using a Small Company Offering Registration (SCOR)[19] application to substantially reduce legal and compliance costs. For example, Washington received a filing by a company formed to develop and own technology to create electricity and carbon offset credits from the waste of dairy farms.[20] Our staff timely provided the issuer with comments regarding its disclosure document so the issuer would not violate anti-fraud provisions

draft letter by the participating jurisdictions, the lead examiner(s) shall have three (3) business days to make any necessary revisions and send the initial comment letter to the issuer.

[19] Issuers completing a SCOR registration use the Form U-7 as the disclosure document. The Form U-7 is a question-and-answer style disclosure document that was last updated by NASAA in 1999. An older version of the Form U-7, dating to 1989, is the same as the Model A disclosure document in the current Form 1-A.

[20] Farm Power Northwest, LLC, Securities Division File No. 70014557.

and to ensure compliance with merit standards. Less than three months after submission of the offering materials, the issuer received a permit and thereafter successfully raised the full offering amount of $750,000. The issuer's total legal and accounting expenses in the offering were a mere $10,000, which allowed nearly 99% of the offering to be applied to business operations. We believe the value of state registration to investors in this offering, and to the issuer itself, exceeded the $10,000 attributed to legal and accounting expenses. This is just one of example of why we believe the value of state registration exceeds the cost.

Moreover, the Commission fails to consider the costs incurred by investors in the wake of state preemption. Without the ability to review and comment on offerings occurring within their own borders, states are relegated to rely solely on their anti-fraud enforcement authority. This after-the-fact approach means that in many cases, investors will have already suffered the *irretrievable* loss of their investments and the issuer may be nowhere to be found. The Commission has made no attempt to quantify the cost to investors of the harm that would result from state preemption.

The Commission's failure to conduct an appropriate economic analysis of all relevant costs and benefits of preempting state registration is additional cause for challenging the proposal.

2. The Commission's Form 1-A should be retained, with a few minor modifications

The Division generally supports the level of disclosure currently required in the Commission's Form 1-A, but suggests the modifications set forth below.

We support the suggestion by NASAA to include the issuer's website address and jurisdiction where the issuer's principal place of business is located. It should be provided in eXtensible Business Reporting Language (XBRL) on EDGAR.

We further support NASAA's suggestion to remove the limit on the disclosure of dilution to those securities that have been acquired by those persons in the past year and to include all outstanding securities in Part II of Form 1-A. The potential that the value of a shareholder's investment will be dramatically diminished by dilution does not depend on *when* the dilutive shares were acquired or by whom.

Additionally, we object to the removal of disclosure of all the names and contact information for persons covered by current Rule 262 except those that have "bad actor" events required to be disclosed. This prevents regulators from performing their own background searches and determining whether an offering is disqualified under applicable bad actor disqualification requirements.

3. The Commission should preserve the ability of issuers to use a question-and-answer style disclosure document for offering circulars as currently permitted under Part II of Form 1-A, but the Commission staff should work with NASAA to further update the form.

The Model A (question-and-answer) disclosure format for offering circulars facilitates capital formation in small offerings. The form minimizes costs for smaller businesses by facilitating the preparation of an offering circular by the issuer's officers and directors and completion of registration with little or no assistance by legal counsel. As suggested by NASAA, rather than tossing out this important tool for the facilitation of capital formation, the Commission should authorize the staff to work with the states through NASAA to update the question-and-answer style disclosure document to maximize efficiencies for small business issuers without reducing investor protections.

Model A provides significant value to both small business issuers and investors alike. For small business issuers, Model A minimizes offering expenses and allows more capital to be devoted to the business operations by reducing the need to hire costly experienced securities counsel.[21] Not only does Model A reduce legal expenses but it provides an essential tool that prompts a startup company to contemplate matters central to the operation of its business and matters fundamental to an investor's informed decision to participate in an offering. For example, question 3(c) of Model A requires a business to identify the industry in which the company expects to sell its products or services and where applicable, any recognized trends within that industry. It also requires a business to indicate whether competition is to be expected by price, service, or other basis. These questions prompt a startup or development-stage company to disclose information that is needed to make an informed investment decision and encourages the issuer to consider key factors essential to its potential sustainability and profitability, and to develop a clear strategic position.

In addition to the value provided to small business issuers, Model A provides significant value to investors beyond the disclosure of material information. Model A provides notes specifically directed towards investors, indicating how investors may use or interpret the issuer's answers to certain questions. As the Commission's proposal contains no level of investor sophistication requirements, the Model A disclosure format may be helpful to retail investors in these smaller offerings.

In its proposal the Commission eliminates the Model A disclosure format based on the mere fact that Model A has been used less frequently and that offerings using Model A have generally taken longer to qualify with the Commission than the traditional narrative format of Model B. These considerations are, however, poor measures for success and do not justify removing a format that provides significant value to small business issuers and investors alike.

As in other portions of the proposed rules, the Commission provides no analysis of the value of this option as compared to its relative cost. We submit that those issuers that voluntarily choose this format have determined its benefits do outweigh its costs and for this reason it should be maintained to facilitate small business capital formation by those issuers who prefer this format. For this reason, we urge the Commission to reconsider its proposal to eliminate this disclosure format and retain, at the very least, this disclosure format for Tier 1 offerings.

[21] Farm Power Northwest, LLC spent $10,000 on legal and accounting fees to raise $750,000. The issuer's founders had prepared the offering materials themselves using the SCOR Form.

At a minimum, Model A should be updated to reflect the most recent format for this disclosure as amended by NASAA in 1999. The 1999 format provides a more logical sequence of plain-English questions directed at an issuer's management and at investors reading the document and provides greater ease in preparation of the document without sacrificing investor protections. For example, the first page of the current Model A offering circular begins with a series of directed questions on more technical matters such as escrow, finders' fees, and restrictions on resale.[22] In contrast, the more recent Form U-7[23] promulgated by NASAA asks the issuer to provide the basic details of the offering: price per share, minimum offering amount, maximum offering amount, etc. It then guides the issuer to the next page, where it asks the issuer to first describe the business of the company. This format is much easier for investors to understand the basics of the offering in a logical manner.[24] Further updating and modernization as suggested by NASAA will yield even more benefits..

4. We generally support the investment limits proposed by the Commission but urge the Commission to proscribe investor self-certification.

Given the risks inherent in these types of offerings and the temptation that sales commissions may create, we generally support the Commission's proposal to limit the amount of securities an investor can purchase in a Tier 2 offering to no more than 10% of the greater of annual income or net worth. We urge the Commission to prohibit, however, an issuer from relying on an investor's representation of compliance with the 10% investment limitation. Instead, we suggest the Commission to adopt a standard similar to that in Rule 506(c), which requires an issuer to take *reasonable steps to verify* that the purchases are in compliance with the 10% investment limitation in the interest of investor protection.

5. We urge the Commission to require the filing of testing the waters materials prior to use in the interest of investor protection.

In its proposal, the Commission departs from the existing Regulation A rules and proposes to permit issuers to use "testing the waters" solicitation materials before the offering statement is filed. We urge the Commission to require the filing of these materials prior to use in the interest of investor protection.

Antifraud measures are insufficient to prevent misleading advertising in an offering that may not involve a registered broker-dealer or other third parties. Permitting unscrupulous promoters (with only minimal written information being disseminated) to hype their products by means of

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[22] The Form 1-A is available at http://www.sec.gov/about/forms/form1-a.pdf.
[23] The Form U-7, as well as the Issuer's Manual, is available on NASAA's website at http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/scor-forms/.
[24] One commenter has noted that in a filing made solely to the SEC, his client chose to use the NASAA updated model for ease of preparation, and that he was frustrated that the SEC asked for substantial revisions. This commenter stated "the outright refusal to deal with the NASAA Revised U-7 format was arbitrary and bureaucratic, and had nothing to do with the quality of disclosures to prospective investors." Letter from Gregory S. Fryer, Verrill Dana LLP, to Elizabeth M. Murphy, Secretary, SEC (Feb. 28, 2014), *available at* http://www.sec.gov/comments/s7-11-13/s71113-30.pdf.

general solicitation and advertising would spell disaster to uninitiated investors.[25] Furthermore, given the Commission's access equals delivery proposal for the final offering circular, investors who lack sufficient opportunity to determine the risks of an offering may be induced to participate in the transaction primarily as a result of sales-oriented pitches but may never actually receive a prospectus with corrective disclosure.

6. We object to the proposed access equals delivery model for Regulation A offering circulars.

The Commission has proposed to allow issuers and intermediaries to deem their duty to deliver the final offering circular to investors satisfied where the final offering circular is filed on EDGAR. EDGAR itself is difficult to navigate, even for experienced investors. For an inexperienced investor, this can be an incredibly daunting task. This becomes further complicated by the use of supplements to a prospectus, which causes difficulty to identify the most current prospectus.

Moreover, actual delivery of a final offering circular, whether in paper or by electronic means, provides an investor opportunity to evaluate all material facts, which is especially important in light of the fact that these offerings may not be firmly underwritten due to their size, the high degree of risk inherent in investing in a startup company, and the fact there may be limited involvement by attorneys and other third parties.

7. We generally support the periodic reporting regime proposed by the Commission but suggest a number of improvements to protect investors.

The Commission proposes ongoing reporting requirements for Tier 2 issuers consistent with the mandate contained in the JOBS Act, but proposes to require semiannual, rather than quarterly, reports. Quarterly reporting is necessary to allow investors and other relevant parties in the marketplace to understand and respond to an issuer's current condition and will reduce the risk of fraud, including insider trading.

In addition, we object to the Commission's proposed change from a "materiality" standard to a "fundamental change" standard for triggering reporting duties. Like the proposed semiannual reporting requirements, this departure from the current standards presents not only the problem of less information flowing to investors, but it causes potential confusion for issuers. Issuers will be confronted with inconsistencies if they are subject to a "materiality" standard under antifraud laws under both federal and state laws, but are only required to report *fundamental* changes. It may also encourage fraud, such as through insider trading.

8. We strongly support the proposed limitation on the amount of securities that may be sold under Regulation A by selling security holders.

[25] Marc I. Steinberg, The Emergence of State Securities Laws: Partly Sunny Skies for Investors, 62 U. Cin. L. Rev. 395, 409-10 (1993)

We support the Commission's proposal to limit the amount of securities to be sold by selling security holders in a Regulation A offering to 30% of the total offering. We believe that this limitation is consistent with the purpose of Regulation A and the intent of Congress in passing Title IV of the JOBS Act to create greater access to capital by issuers. We echo the comments of NASAA suggesting that the ability to use Regulation A to sell shares held by existing security holders should be conditioned upon approval by an issuer's independent directors upon a finding that the offering is in the best interests of both the selling security holders and the issuer.

9. **We support the Commission's proposal to make the exemption under Section 3(b)(2) unavailable to certain types of issuers.**

    a. ***We support the Commission's proposal to make the exemption under Section 3(b)(2) unavailable to an issuer that has failed to make required reports in the prior two years.***

We support the Commission's proposal to disqualify an issuer from relying upon the exemption under Section 3(b)(2) if it has failed to file the required reports in the two years prior to filing a Regulation A offering. We believe this proposal will serve to incentivize issuers to disclose material information necessary to facilitate legitimate trading of securities in a secondary market and is an appropriate deterrent for failures to report that may otherwise facilitate fraud.

    b. ***We support the continued limitation of the exemption under Regulation A to issuers organized and with their principal places of business in the United States or Canada.***

This limitation is not only consistent with Congressional intent, but it is consistent with the principal that we have continuously emphasized throughout this letter – *the ability of regulators to be responsive in the event of fraudulent offerings in their own backyards*.[26]

    c. ***We support the continued prohibition on the use of Regulation A by certain types of issuers.***

We support the Commission's proposal to extend the existing prohibitions on the use of the exemption under Regulation A to Section 3(b)(2) offerings by investment companies, business development companies, blank check companies, special purpose acquisition vehicles, issuers of fractional undivided interests in oil and gas rights and similar interests in other mineral rights, and issuers of asset backed securities for the reasons previously identified by NASAA.[27]

In conclusion, we thank the Commission for the consideration of these comments. We stand ready to work with the Commission to create efficiencies in the regulation of smaller offerings

[26] Title IV is largely understood to be an expansion of Regulation A *as it exists*, which is currently limited to issuers organized and with their principal place of business in the United States or Canada.
[27] NASAA Advance Comments on Regulation A+, *supra* note 4.

that do not sacrifice investor protection. If you have any questions regarding these comments please contact me by phone at (360) 902-8760 or by e-mail at bill.beatty@dfi.wa.gov.

Sincerely,

William M. Beatty
Securities Administrator