JAMES C. KIRKPATRICK
STATE INFORMATION CENTER
(573) 751-4936

JASON KANDER
SECRETARY OF STATE
STATE OF MISSOURI

SECURITIES
(573) 751-4136

March 24, 2014

Submitted electronically to rule-comments@sec.gov

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

RE: Proposed Rule Amendment 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 Commissioner of Securities for the State of Missouri, I welcome the opportunity to comment on the Commission's proposed amendments to Regulation A.[1]

Preliminarily, I recognize that the Commission was congressionally directed to carry out these amendments. And, moreover, the proposed rules show that the Commission's staff put in considerable time and effort in carrying out that directive. In many ways, Regulation A, as proposed to be amended, is a worthwhile addition to the federal laws enabling issuers to finance their growing companies.

However, like my fellow state regulators, I must state my objection to the Commission's proposed preemption of state securities registration authority. For reasons detailed below, I believe that the proposed preemption provision acts as a regulatory overreach that jeopardizes investor protection in Missouri and other States. Further, it ignores how state regulators assist smaller companies in bringing their offerings to the public.

To counteract that risk to investors and issuers, my comments below generally recommend that, if it regrettably insists on preempting the States, then the Commission should make clear when an issuer loses that preempted status. There are many beneficial aspects to the proposed rules, e.g., the increased offering threshold, the expanded the testing-the-waters provisions, and greater

[1] Proposed Rule Amendment for Small and Additional Issues Exemptions under Section 3(b) of the Securities Act, 79 Fed. Reg. 3926 (proposed Jan. 23, 2014) ("Proposing Release").

participation for selling shareholders in the issuer's Regulation A offering. But those benefits are diminished by uncertainty as to which acts void the exemption. Issuers, investors, and regulators all need clear guidelines to fulfill their respective roles. If enacted, the following comments will facilitate that clarity.

I. The Commission should require that, to participate in an issuer's Regulation A-Plus offering, all selling security holders must have owned their shares for at least 12 months (Request for Comment No. 24).

While early stage businesses do benefit from rules liberalizing public-offering exit strategies for venture capitalists and similar investors, I share my fellow regulators' concerns regarding a company's insiders selling to the public.[2]

A fair balance between these two points seems to be a 12-month holding period for eligible, selling shareholders. That is, if allowing selling shareholders to sell is supposed to benefit issuers,[3] then a 12-month holding period seems to reflect purchaser's investment intent. A shorter time period would suggest that the purchaser was less motivated by the desire to invest in the business than by the opportunity to sell to the public.

Alternatively, the Commission could require that selling shareholders not qualifying for the 12-month holding period could only sell a fraction of their shares, for instance no more than 50% of their holdings. This would still provide flexibility to issuers and early-stage investors while not completely shifting the risk to public investors.

II. The Commission should amend the proposed rules to allow for different verification standards for different types of Tier 2 investors (Request for Comment Nos. 27 and 30).

Given that most businesses using Tier 2 offering will most likely be new, less established companies, I agree that, from an investor protection standpoint, an investment limitation is appropriate. However, I do not believe that the proposed limitation—i.e., "ten percent . . . of the greater of [a Tier 2] purchaser's annual income and net worth"[4] (the "10% limitation")—is adequately drafted to achieve its purposes. That is, the Commission should require an issuer to have a reasonable belief that it can rely upon an investor's representation of compliance with proposed Rule 251(d)(2)(i)(C)'s 10% limitation.

---

[2] *See* Comment Letter from the North American Securities Administrators Association, April 10, 2013, *available at* http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-25.pdf ("NASAA April 10 Letter") (noting that offerings involving selling shareholders "may be abusive of not only investors that purchase securities in the resale, but also of the issuers themselves").

[3] *See* Proposing Release at 3984. *See also*, Darian M. Ibrahim, *The New Exit in Venture Capital*, 65 VAND. L. REV. 1, 22 (2012) (noting that "by improving liquidity for individual investors *ex post*, the direct market has the potential to increase the number of start-ups that will receive VC funding *ex ante*") *and* Comment Letter Regarding Proposed Amendments to Regulation A from William R. Hambrecht, January 4, 2013, *available at* http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-21.pdf (stating early-stage investors will more likely invest if they can "monetize some portion of their holdings" through a public offering).

[4] Proposed Rule 251(d)(2)(i)(C).

Some threshold beside the issuer's subjective knowledge must be required: the rules should not allow issuers to blind themselves to observations that belie the investor's net-worth assurances. And even this assumes that the investor understands what he or she is representing: state regulators' investigations frequently involve less-than-reputable promoters who deliberately explain the "accredited investor" standard in vague terms and then tell vulnerable, easily-pressured victims to simply sign the questionnaire. And most of the time, those investigations reveal that, not only were those investors not accredited investors, but also that they did not understand what they were attesting to. Proposed Rule 251(d)(2)(i)(C) would allow these sorts of promoters to sell to those investors who, given their age and station, should not be investing in riskier startups exempt from full registration.

Thus, lacking a reasonable-belief standard, proposed Rule 251(d)(2)(i)(C) puts investors at an unacceptable risk, especially if state oversight of these offerings remains so limited. The benefits of installing the industry-familiar "reasonable belief" outweigh the costs. That is, meeting the reasonable-belief standard does not intrude upon a purchaser's privacy rights, nor does it credibly add to a Tier 2 issuer's compliance costs, especially since it is such a well-known standard. At the same time, by channeling issuers to those investors best situated to invest, placing the reasonable-belief standard in the proposed rule would minimize the inefficiencies of misplaced capital. Accordingly, I encourage the Commission to amend proposed Rule 251(d)(2)(i)(C) to require that an issuer or its intermediary have a reasonable belief that it can rely upon an investor's representation of compliance with the 10% limitation.

Related to efficient capital allocation, accredited investors presumably have more ability to finance small businesses than retail investors, and certainly more than those with limited means and dependent on investment stability. Hence, although I generally support the 10% limitation on a Tier 2 purchaser's investment, such a limitation is historically inconsistent with the Commission's approach towards accredited investors. Instead, it seems more consistent to allow accredited investors to invest in Regulation A-Plus offerings past the 10% limitation.

However, if a Tier 2 issuer is to sell beyond that 10% limitation to an accredited investor, then that issuer should have a higher burden than the above-suggested reasonable belief. Specifically, the Commission should make selling to an accredited investor in Tier 2 offerings conditional on that issuer taking reasonable steps to verify that investor's accredited status, such as that in Regulation D's Rule 506(c)(2)(ii).[5] This higher burden seems a fair tradeoff for selling to wealthy purchasers beyond proposed Rule 251(d)(2)(i)(C)'s protective 10% limitation: it assures that Tier 2 investments past the 10% limitation will only be offered to those able to bear the risk, while simultaneously expanding issuers' financing options. Moreover, investors and issuers benefit from a uniform standard in verifying accredited investor status in potentially generally-solicited offerings. To that end, I suggest the Commission amend Rule 251(d)(2)(i)(C) to allow sales to accredited investors past the 10% limitation but only on conditions materially similar to Regulation D's Rule 506(c)(2)(ii).

III. The Commission should require Tier 2 issuers to electronically file their offering statements and related documents (Request for Comment No. 35).

[5] 17 C.F.R. § 230.506(c)(2)(ii).

I encourage the Commission to adopt electronic-only filings for Tier 2 offerings. It is hard to see how anyone benefits from the unavoidable lag between sending paper documents and their eventual posting to EDGAR.

Instead, mandated electronic filings will only be a net benefit to issuers, investors, and regulators. Tier 2 issuers benefit from electronic-only filings because the market will more quickly receive the assuring signals derived from an issuer who has committed itself to public review by submitting documents to the Commission. And, as the SEC notes, later stage companies are more likely to be using Tier 2.[6] Thus, they should be better able to absorb the costs from electronic filing. Indeed, such costs are a comparatively small price to pay given the benefits increased accessibility to the public offers, particularly given the proposed lack of state registration.

Similarly, investors gain from electronically-filed Tier 2 offerings. The prompt availability of such offerings' documents will facilitate investors' own due diligence. [7]

Finally, if preempted, the States will need EDGAR's timely, publically-available information to be responsive to their citizens. Investors regularly call blue sky regulators to check on an offering that they received. Frequently, these citizens do not have an investment adviser and are inexperienced in researching securities offerings beyond merely reading an offering document. Electronic filing will allow States to answer their citizens' questions about a purported Tier 2 offering. With the proposed requirement, the absence of such a filing could be a signal of a noncompliant, or even fraudulent, offering and would thus better enable the States to police offerings in their jurisdictions.

IV. As proposed, qualification of the Regulation A offering statement should only occur by order by the Commission (Request for Comment No. 82).

If the States are to be preempted, it is even more imperative that investors have the protections from the review of Regulation A-Plus offerings by the Commission staff. Lacking the benefit of state review, investors will only be able to rely on the Commission's examination of the offering documents. Automatic qualification coupled with state preemption unacceptably compromises investor protection.

V. The Commission should make the submission or filing of solicitation materials a condition to the Regulation A-Plus exemption (Request for Comment Nos. 84 and 87).

If Rule 254 is amended to permit issuers to use solicitation materials without filing them at the first use, then it is all the more crucial that those materials do ultimately get filed with the Commission. Potentially losing the exemption will thus ensure that such submission occurs. Further, submitted materials should be made immediately available on EDGAR: preempted state

[6] Proposing Release at 3980 (stating "it is likely that companies seeking to raise capital through an offering conducted under Regulation A, as proposed to be amended, would have been able to access to capital trhough private offerings or registered public offerings").
[7] This makes it important that the Commission ultimately require a format for the submitted documents that is reader friendly and easily searchable.

regulators will need as much information as they can to monitor what offerings are being made to their States' citizens.

Additionally, conditioning the exemption on the filing will also act as a front-end investor protection measure. That is, the knowledge that investors and regulators will review the issuer's filings will act as a check on representations made in those materials. Moreover, such knowledge will serve as another barrier to entry for those issuers not intent on properly using Regulation A-Plus.

Losing the exemption would admittedly be a severe consequence for failing to file. Thus, a reasonable time to cure would not be objectionable.

VI. The Commission should add to Rule 260(a)(2)'s list of significant deviations those deviations concerning pre-qualified sales and sales beyond the investment limits (Request for Comment No. 111).

As currently drafted, proposed Rule 260(a)(2) states what failures will be deemed significant to the offering as a whole, including, for instance, prohibited issuers using Regulation A-Plus[8] and offering the securities without filing the Form 1-A with the Commission.[9]

Yet, proposed Rule 260(a)(2) conspicuously omits deviations from prohibitions on the timing of sales and how much is sold to the investor.[10] This seems counterintuitive. As noted, Rule 260(a)(2) considers a filed Form 1-A to be so important to the entire offering that an issuer significantly deviates from Regulation A by merely offering the security without filing the form. By extension, it would seem that qualification of the offering is an equally integral part of Regulation A-Plus. Indeed, it is hard to imagine how an issuer could credibly claim a good faith attempt to comply with the exemption's requirements when the issuer sold before receiving that qualification. Something similar can be said of an issuer purportedly navigating all of Regulation A-Plus's requirements except for knowingly selling beyond an investor's particular limits.

Arguably, the text of the rule as proposed contemplates that a selling violation would void the exemption.[11] For instance, when faced with a pre-qualified sale, a regulator could claim that, because the Commission staff's review of the offering protects investors,[12] selling after such qualification is a "term, condition or requirement directly intended to protect that particular individual or entity."[13] Therefore, selling before that qualification is a significant deviation. But the omission of selling violations in Rule 260(a)(2) may suggest to some that a pre-qualified sale

---

[8] *See* Proposed Rule 251(a).
[9] *See* Proposed Rule 251(d)(1).
[10] *See* Proposed Rule 251(d)(2).
[11] *See e.g.*, Proposed Rule 260(b) (stating that a "transaction made in reliance upon Regulation A must comply with all applicable terms, conditions and requirements of the regulation").
[12] *See* Proposing Release at 3969 (noting that the Commission expects amended Regulation A to "provide substantial protections to purchasers" by, among other things, "the same level of Commission staff review [of submitted Regulation A offerings] as registration statements").
[13] *See* Proposed Rules 251(a)(1) & 260(b).

is insignificant to the entire offering, and thus not worthy of disqualifying the offering from the exemption.

Understandably, Rule 260(a) does not state that the selling prohibitions are a matter of investor protection: the regulation would be unwieldy if it cataloged all its investor protection measures. Still, the absence of such a reference, especially when Rule 260(a)(2) omits selling violations, prevents an easy answer. But issuers, investors, and State regulators need clear boundaries as to what actions will disqualify an offering from preemption. In similar contexts, we have seen that significant litigation was required to define the boundaries of other, preempted exemptions.[14]

Therefore, please amend Rule 260(a)(2) to include paragraph (d)(2)(i) of Rule 251.

VII. The Commission should align proposed Rule 262's bad-actor prohibitions with those in Rule 506(d) (Request for Comment No. 112).

The States have historically advocated for the greater use of bad-actor prohibitions as sensible, front-end investor protection measures. Because such prohibitions are barriers to entry, they deter disreputable players in the first instance. And a bad actor attempting to use Regulation A would be a clear signal for a state or federal regulatory response.

Hence, Regulation A-Plus's proposed bad-actor prohibitions should be as extensive as Rule 506(d)'s prohibitions, predicated as the latter are on investor protection.[15]

As a practical matter, uniform prohibitions in proposed Rule 262 and Rule 506(d) would simplify the offering process, benefiting issuers, investors, and regulators. Rule 506(d) has already established known and acceptable bad-actor prohibitions, which are being incorporated by issuers and intermediaries. Linking the two rules' prohibitions would ease the industry's use of proposed Regulation A-Plus. For instance, if it were previously funded by Rule 506 offerings, a company preparing for a Regulation A-Plus offering would be better equipped to comply with uniform prohibitions.

VIII. The Commission should not preempt the States' authority to require registration of Regulation A-Plus offerings (Request for Comment Nos. 114 through 119).

Although I applaud the exemption's strong investor protection provisions, I cannot support the Commission' proposal to preempt the States from registering Regulation A-Plus offerings.[16]

---

[14] *See* Jill D. Meyer, *Federal Preemption of the Rule 506 Exemption*, 37 SEC. REG. L. J. 122, 133-141 (2009) (discussing the split in authority on when Rule 506 offerings qualify as federal covered securities, thus preempting state securities regulators' jurisdiction).

[15] *See* Disqualification of Felons and Other ''Bad Actors'' From Rule 506 Offerings, 76 Fed. Reg. 31518, 31533 (noting the Commission's belief that "uniform application of disqualification standards could . . . improve investor protection by more effectively excluding bad actors from the private placement and small offering markets"). *See also*, Proposing Release at 3969 (stating that "investor protections would be afforded by Regulation A's limitations on . . . 'bad actors' disqualification provisions").

[16] For similar reasons, I oppose any attempt to preempt the States from registering Tier 1 offerings as well. *See* Request for Comment No. 123.

Like others, I consider the proposed preemption to be legally infirm, and I agree with others' explanations as to that infirmity.[17]

Moreover, preempting the States wrongly assumes that the States do not help capital formation. What goes unrecognized is that the blue-sky regulators provide issuers state-subsidized guidance as to how to conform their offerings to the securities laws in their States. Like those of my fellow state regulators, my office routinely answers local issuers' questions about federal and state securities laws.

And it is for that reason that I question Commission's decision to preempt the States based on the findings in the Government Accountability Office's 2012 study. Specifically, even though the GAO spoke with NASAA officials and some state securities administrators, the GAO report does not reflect any investigation into the potential offsetting benefits from state reviews of Regulation A offerings. For instance, through their comments on issuers' offerings, state examiners tell issuers how to comply with that state's securities laws. Especially in smaller offerings, state securities examiners work closely with small businesses, entrepreneurs, and their counsel, reviewing the various document drafts and suggesting changes that help shield the offering from private suits. While state securities examiners do not act as legal counsel for issuers, the process of examining draft documents and suggesting revisions helps issuers move forward with clearer, more complainant offering documents. Regardless of how much assistance is needed, issuers pay *nothing* for this guidance, an important consideration for startups that may be unable to afford securities counsel. Yet the GAO report did not reflect this potential benefit.

Further, the Commission seems to have unquestioningly accepted that, if state registration allegedly results in a net loss in a $5-million offering, it necessarily will result in a net loss in offerings up to $50 million. This is a dubious calculus that ignores the effect of scale economies in higher-end offerings. It also implicitly presumes that an offering will be burdened by costs from registering in as many states as possible, even though many Regulation A-Plus issuers will certainly choose to offer in only a few, further undermining preemption's rationale that state registration is cost prohibitive.[18]

---

[17] *See* NASAA April 10 Letter, *above* n.2; Comment Letter Regarding Rulemaking for "Regulation A-Plus" under Title IV of the JOBS Act of 2012 from William Francis Galvin, secretary of the Commonwealth of Massachusetts, Dec. 18, 2013, *available at* http://www.sec.gov/comments/s7-11-13/s71113-1.pdf ("Galvin Letter"); Comment Letter Regarding Proposed Rulemaking for "Regulation A-Plus" under Title IV of the JOBS Act of 2012 from Jack Herstein, assistant director for securities, Nebraska Department of Banking and Finance, Feb. 10, 2014, *available at* http://www.sec.gov/comments/s7-11-13/s71113-7.pdf ("Herstein Letter"); Comment Letter from the North American Securities Administrators Association, Feb. 19, 2014, *available at* http://www.sec.gov/comments/s7-11-13/s71113-12.pdf ("NASAA Feb. 19 Letter"); Comment Letter Regarding Proposed Rule Amendments for Small and Additional Issues Exemptions under Section 3(b) of the Securities Act from Heath Abshure, Arkansas securities commissioner, Feb. 20, 2014, *available at* http://www.sec.gov/comments/s7-11-13/s71113-14.pdf ("Abshure Letter"); Comment Letter Regarding Rule for "Regulation A-Plus" under Title IV of the JOBS Act, from the Honorable Jesse White, secretary of state for the State of Illinois, et al., March 4, 2014, *available at* http://www.sec.gov/comments/s7-11-13/s71113-34.pdf ("Secretaries of States' Letter"); *and* Comment Letter from Damaris Mendoza-Román, assistant commissioner, Securities Regulation Division for the Commonwealth of Puerto Rico, March 5, 2014, *available at* http://www.sec.gov/comments/s7-11-13/s71113-33.pdf ("Mendoza-Román Letter").

[18] On that note, neither the proposing release nor the GAO report quantifies state registration costs for one, some, or all States. Similarly, the proposing release does not reflect that the Commission examined whether Regulation A-Plus's requirements would dovetail with state registration requirements, effectively streamlining state registration

Rather than relying on the proposed, and potentially infirm, qualified purchaser definition, the Commission should allow the States to implement NASAA's coordinated Regulation A review program. For reasons more fully delineated elsewhere,[19] the States support this program, and are ready to work with the Commission to ensure that it meets issuers' needs. Allowing this program to proceed would not only improve investor protection but also alleviate the Commission's budgetary and personnel burden from being solely responsible for reviewing Regulation A-Plus filings.

I urge you to consider the above comments as well as those of my fellow state securities regulators. Thank you for your consideration.

Sincerely,

Andrew M. Hartnett

Andrew M. Hartnett
Commissioner of Securities

---

compliance costs. For instance, the proposing release shows no examination as to whether the Regulation A-Plus's reporting requirements would satisfy state requirements for required financial statements.

[19] *See* NASAA April 10 Letter; Galvin Letter; Herstein Letter; NASAA Feb. 19 Letter; Abshure Letter; *and* Mendoza-Román Letter.