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155 Rene Levesque Boulevard West
Montreal, QC H3B 3V2
Canada
514-397-3333
wrosenberg@stikeman.com

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wjohnston@ycst.com

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vtucker@hunton.com

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Via Electronic Submission

April 8, 2016

Mr. Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-22-15
Release Nos. 33-9973; 34-76319
Exemptions to Facilitate Intrastate and Regional Securities Offerings

Dear Mr. Fields:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee" or "we") of the Business Law Section (the "Section") of the American Bar Association (the "ABA"), in response to the request for comments by the U.S. Securities and Exchange Commission (the "Commission" or "SEC") in the proposing release referenced above (the "Release"). In the Release, the Commission proposes to modernize Rule 147 under the Securities Act of 1933, as amended (the "Securities Act") and establish a new exemption to facilitate capital formation. The Commission further proposes amendments to Rule 504 of Regulation D under the Securities Act to facilitate issuers' capital raising efforts and provide additional investor protections by increasing the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and disqualify certain bad actors from participation in Rule 504 offerings. The Release also solicits comment on the impact of proposed amendments to Rule 504 on Rule 505 of Regulation D under the Securities Act. This letter has been prepared by the Committee with the participation of members of the Middle Market and Small Business Committee and the State Regulation of Securities Committee of the Section (along with the Committee, the "Committees").

The comments expressed in this letter (this "Comment Letter") represent the views of the Committees only and have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this Comment Letter does not represent the official position of the Section of Business Law of the ABA.

Overview

Current Rule 147 was adopted by the Commission in 1974 to provide more objective standards for issuers intending to raise capital pursuant to the Section 3(a)(11) intrastate offering exemption under the Securities Act. The Section 3(a)(11) exemption under the Securities Act recognizes that securities offerings that are confined to a single state do not require federal regulation and are best left to the applicable state to regulate. In the intervening 42-year period since its adoption, the basic terms and conditions of Rule 147 have not been substantively changed. During this same period there have been significant technological developments as well as important changes in state regulation and capital formation methods. In its present form, many of the terms and conditions in Rule 147 are at odds with modern communication and capital market practices. Simply stated, Rule 147 is out of date and underutilized.

The shortcomings in the content and operation of Rule 147 have been recognized for some time. In 1991, members of the Committee submitted a letter to the then Director and Associate Director of the Division of Corporation Finance identifying issues that hampered the use of Rule 147 and recommending consideration of a number of changes to the rule.[1] Among the suggested changes set forth in the letter were proposals that: (1) there be closer conformance with Regulation D, including use of the "reasonable belief" test with respect to the residences of purchasers; (2) Rule 147(d) offering limitations should apply only to purchasers and not offerees; (3) an issuer's residence should be where the issuer's principal operations or executive offices are located rather than the place where it is incorporated or organized; and (4) consideration should be given to lowering, eliminating or modifying the three 80% tests dealing with proceeds from the offering, gross revenues and assets. The 1991 letter also made recommendations with respect to integration, secondary distributions and leaving certain regulations and limitations for the states to decide. That letter was operating under the constraints of the Securities Act as then in effect, which did not include the grant of general exemption authority to the Commission under Section 28 of the Securities Act.

More recently, the Securities and Exchange Commission Advisory Committee on Small and Emerging Companies (the "Advisory Committee") recommended in a letter to Chair Mary Jo White that the Commission take steps to modernize Rule 147 to facilitate recently enacted and future state-based crowdfunding initiatives.[2] The letter identifies three areas that currently make it difficult for issuers to use Rule 147: (1) offers to out-of-state residents are not allowed; (2) the three 80% tests that an issuer must meet to be deemed "doing business" within a state are difficult to satisfy and leave many small businesses that are seeking local financing unable to use the rule; and (3) the requirement that the issuer be incorporated or organized in the state where the

[1] Letter from Stanley Keller, Fed. Regulation of Sec. Comm. of the Bus. Law Section of the ABA, to Linda C. Quinn and Mary E.T. Beach of the SEC Div. of Corp. Fin. (August 9, 1991).

[2] Letter from Advisory Committee to Chair Mary Jo White (September 23, 2015).

intrastate offering will occur prevents many issuers from proceeding with a Rule 147 compliant offering.

The Release was issued by the Commission on October 30, 2015, the same day as the issuance of the final release adopting Regulation Crowdfunding under Title III of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). The adoption of Regulation Crowdfunding completed a series of rulemaking actions under the JOBS Act that Congress had directed the Commission to undertake to assist small business capital formation. Among the new regulations implemented by the Commission pursuant to the JOBS Act are the adoption of new paragraph (c) of Rule 506 of Regulation D, which removed the prohibition on general solicitation or general advertising for securities offerings relying on Rule 506, and the new rules contained in Regulation Crowdfunding which now allow companies to use the internet to offer and sell securities through crowdfunding.

During the past several years, many states have also taken steps to facilitate crowdfunding. These efforts have included adopting statutes or rules that are premised on crowdfunding offerings qualifying under Section 3(a)(11) and Rule 147 thereunder.[3] A number of state securities regulators[4] and commentators have brought to the Commission's attention that both Section 3(a)(11) and Rule 147 currently contain statutory and regulatory requirements that make it difficult for issuers to take advantage of the recently adopted state-based crowdfunding provisions. The cited problems are substantially similar to those identified by the Advisory Committee in its September 23, 2015 letter to the Commission.

In the Release the Commission acknowledges many of the perceived shortcomings found in Section 3(a)(11) and Rule 147 and it now proposes to remedy these shortcomings by adopting a new Rule 147 exemption based on the Commission's rulemaking authority in Section 28 of the Securities Act. The new Rule 147 is intended to modernize and expand capital-raising options. The proposed rule also recognizes important technological advances, especially regarding the use of the internet as a means of soliciting and transacting investment activity. In addition to the Rule 147 proposal, the Release includes a proposal to increase the aggregate dollar amount that may be offered under Rule 504, which we believe represents an appropriate deferral of regulatory authority for smaller offerings to the states.

We would like to commend the Commission for undertaking the review of existing Rule 147 and proposing changes to it. We would also like to acknowledge and recognize the efforts of the staff in the Office of Small Business Policy in the Division of Corporation Finance for their substantial effort in reviewing, drafting and implementing

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[3] As of January 11, 2016, 29 states, plus the District of Columbia, have adopted or are undertaking rulemaking to implement crowdfunding exemptions. *See,* Letter from Judith M. Shaw, President of the North American Securities Administrators Association, Inc. ("NASSA") to the Commission concerning the Release (January 11, 2016).

[4] *Id*. at page 2.

many of the new regulations under the JOBS Act as well as their most recent effort to update Rule 147.

Summary of Comments and Recommendations

We are in general agreement with substantially all of the proposed changes to Rule 147 to modernize the rule and the proposal to increase the dollar amount that may be offered and sold in offerings pursuant to Rule 504. However, we believe the Commission's proposal can be further improved in certain respects, as described in this letter. Our four principal comments and recommendations are as follows:

- Existing Rule 147 should be maintained as a safe harbor pursuant to Section 3(a)(11) of the Securities Act, but updated, using the Commission's exemption authority under Section 28 to the extent necessary, to include the proposed modernizations in the Release. However, the proposed cap on the offering or investment size of a transaction under the rule should not be adopted because it is inconsistent with the underlying statutory purpose of the intrastate offering exemption, intrudes upon the regulatory authority of the states and is unnecessary for the protection of investors.

- If the Commission determines that an offering cap is necessary for a new exemption, it should still maintain existing Rule 147 as a safe harbor, modified to include the Commission's proposed updates to modernize the rule, but without any cap. The Commission should also adopt a new standalone enhanced intrastate offering exemption pursuant to the Commission's exemption authority under Section 28 of the Securities Act. If the Commission adopts an intrastate offering exemption it should index the limit to inflation.

- Rule 504 should be amended to permit the aggregate amount of securities that may be offered and sold in any twelve-month period to be increased from $1 million to $5 million. Rule 504 should also be amended to disqualify certain bad actors from participation in Rule 504 offerings as proposed. In addition to the proposed changes, the Commission should consider amending Rule 504 to permit resales of securities issued in Rule 504 "public offerings" in states where the offering complies with exemptions that permit general solicitation or advertising and that require dissemination of a state law compliant disclosure document.

- Concurrently with the amendment of Rule 504 to increase the aggregate offering amount to $5 million, Rule 505 should either be amended to increase the aggregate permitted to at least $10 million or consideration should be given to eliminating Rule 505 as unnecessary.

Comments and Recommendations

1. Existing Rule 147 Should be Maintained and Updated

The Release notes that the proposed amendments to Rule 147 would establish a new exemption under Section 28 of the Securities Act for intrastate offerings by companies doing in-state business, but subject to certain limitations not at present included in Rule 147. The Release further provides that if the amendments to Rule 147 are adopted as proposed, current Rule 147 would no longer be available as a safe harbor for conducting a valid intrastate offering under Section 3(a)(11).[5]

As we noted above, a number of states have either adopted or are in the process of adopting rulemaking to implement crowdfunding exemptions. In nearly all of these states and the District of Columbia, the state crowdfunding exemptions explicitly reference Section 3(a)(11) and Rule 147. Because amendments proposed in the Release would eliminate the existing safe harbor under Rule 147, legislative or administrative rulemaking action would have to be undertaken in such states to amend their current crowdfunding exemption provisions. The problem would be compounded if states were not, for procedural or other reasons, able to adopt such amendments prior to the effective date of the new SEC rules. For example, some legislatures meet infrequently and legislation may be subject to legislative calendar priorities. In other instances, administrative rulemaking may be subject to state-mandated notice and comment periods. Such delay could cause issuers to lose the very benefits the state legislation or rulemaking was intended to extend to them.

In view of the importance of permitting issuers to continue to have available a workable intrastate offering exemption without new limits, we recommend that Rule 147 remain as a safe harbor under Section 3(a)(11), modernized as proposed, using Section 28 to the extent necessary, but without the offering and investor cap of $5 million. This action would implement the statutory intrastate offering exemption and update it to be consistent with current communication and offering methods allowed under many state laws and regualtions. We do not believe these changes would weaken investor protections, but instead implement the Congressional intent that local offerings do not require federal regulation and are best left to be regulated by the states. Implementation of this policy by modernizing the exemption does not require limitations on the offering or investment size of a transaction.[6] We do not believe it is either mandated or necessary for the Commission to require states to impose limitations on local offerings that are substantially consistent with the statutory 3(a)(11) exemption. Neither Section 3(a)(11) nor Rule 147 have ever had such a limitation and we see no reason to institute such a change now. The history of the statute and the regulation

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[5] *See,* Release, footnote 30.

[6] The Release proposes that Rule 147 contain a requirement that the offering be registered with the state or if conducted pursuant to an exemption from registration in the state that "…(i) An issuer may sell pursuant to such exemption no more than $5 million in a twelve-month period; and (ii) An investor may purchase in such offering (as determined by the appropriate authority in such state)." *See* Release, proposed Rule 147(a)(2)(i) and (ii) at 161-162.

show that this type of financing is best managed at the local level where regulators are familiar with the demographics and needs of the state as well as the issuer and potential purchasers.

Other than the requirement that an issuer be incorporated in the state or territory from which the intrastate offering is being made, we believe that substantially all of the updating changes proposed by the Commission could be included in Rule 147 without having to use Section 28 exemption authority.[7]

One issue that arises in the context of using general solicitation or general advertising in an intrastate offering is whether an "offer" may be made to a person who is not a resident of the state or territory in which the intrastate transaction originates. Section 3(a)(11) provides that the offering be "…part of an issue ***offered*** and sold only to persons resident within a single state or territory…" (emphasis added). The existence of the word "offered" in Section 3(a)(11) raises the question as to whether the SEC may permit "offers" to non-resident offerees in an updated Rule 147.

We believe that both the legislative history concerning Section 3(a)(11) and early guidance from the Commission provide that certain forms of communication involving the use of the mails or intrastate commerce will not be treated as offers for purposes of the Section 3(a)(11) requirement that offers be only made to residents of a single state.[8] In this regard, the 1961 SEC Release notes:

> The intrastate exemption is not dependent upon nonuse of the mails or instruments of interstate commerce in the distribution. Securities…may be offered and sold without registration through the mails or by use of any instruments of transportation or communication in interstate commerce, may be made the subject of general newspaper advertisement (provided the advertisement is appropriately limited to indicate that offers to purchase are solicited only from, and sales will be made only to, residents of the particular State involved) and may even be delivered by means of transportation and communication used in interstate commerce, to the purchasers.[9]

The legislative history and early SEC guidance clearly recognize that an issuer will almost certainly use some form of communication or facility of interstate commerce that will reach parties outside the state in which it was conducting an intrastate

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[7] Although revised Rule 147 would permit an issuer to be incorporated in a state or territory other than the issuer's principal place of business, Section 3(a)(11) requires that an issuer which is a corporation to be incorporated in the state or territory in which the intrastate offering is being made. Because the statutory authority for Rule 147 is based on Section 3(a)(11), it cannot include this exemption without reliance on Section 28.

[8] *See*, H.R. Rep. No. 73-1838, at 40-41 (1934); SEC Rel. 33-1459 (May 29, 1937); and SEC Release 33-4434, Fed. Sec. L. Rep (CCH) (December 6, 1961), hereinafter the "1961 SEC Release". The Release specifically notes this legislative and administrative history at 14-16.

[9] *See*, 1961 SEC Release at 2610.

offering. The intrastate nature of the transaction, however, is maintained by the requirement that such communications make clear that the offer to purchase is only solicited from, and sales will only be made to, residents of the single state in which the issuer is conducting the offering. SEC no-action letters issued after the adoption of Rule 147 in 1974 have followed a similar pattern in allowing communications that may reach out-of-state residents by emphasizing that all advertising and solicitation materials should conspicuously state that the offering is intended only for bona fide residents of the referenced state.[10]

The only possible contrary guidance on communications and offerees we have been able to locate is found in three Compliance and Disclosure Interpretations ("CDIs") issued by the Division of Corporation Finance in 2014.[11] The first of the three CDIs dealt with an inquiry from an issuer that proposed to engage in general advertising and general solicitation in an intrastate offering conducted pursuant to the Section 3(a)(11) exemption. The staff responded:

> Securities Act Rule 147 does not prohibit general advertising or general solicitation. Any such general advertising or solicitation, however, must be conducted in a manner consistent with the requirement that ***offers*** made in reliance on Section 3(a)(11) and Rule 147 be made only to persons resident within the state or territory of which the issuer is a resident.[12] (emphasis added).

The next CDI responds to an inquiry from an issuer that plans to use a third-party internet portal to promote an offering in a single state in accordance with the state's crowdfunding regulations. The issuer asks if all of the other conditions of Rule 147 are met, would the use of an internet portal "…necessarily entail making offers to persons outside the relevant state or territory?" The staff responded:

> Use of the Internet would not be incompatible with a claim of exemption under Rule 147 if the portal implements adequate measures so that ***offers*** of securities are made only to persons resident in the relevant state or territory. In the context of an offering conducted in accordance with state crowdfunding requirements, such measures would include at a minimum, disclaimers and restrictive legends making it clear that the offering is limited to residents of the relevant state under applicable law, and ***limiting access to information about specific investment opportunities to persons who confirm that they are residents of the relevant state…***[13] (emphasis added)

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[10] *See*, Master Financial, Inc., SEC No-action letter, Fed. Section Rep (CCH) at ¶ 77,560 (May 27, 1999). This no-action letter involved newspaper and radio advertisement broadcasts that reached across state lines.

[11] *See*, CDI Questions 141.03 (April 10, 2014), 141.04 (April 10, 2014) and 141.05 (October 2, 2014).

[12] *See*, CDI Question 141.03 (April 10, 2014).

[13] *See*, CDI Question 141.04 (April 10, 2014).

The third CDI deals with an inquiry as to whether an issuer can use its own website or social media presence to offer securities in a manner consistent with Rule 147. In its response, the staff advised that issuers generally use websites and social media to advertise their market presence in a broad and open manner that is widely disseminated to the general public. They further noted that using such an established internet presence would likely involve offers to residents outside the state. As a possible solution, the staff suggested "…issuers could implement technological measures to limit communications that are offers only to those persons whose Internet Protocol, or IP, address originates ***from a particular state or territory and prevent any offers to be made to persons whose IP address originates in other states or territories***."[14] (emphasis added)

Each of the three CDIs cited above might be read to contain requirements and limitations that may be inconsistent with the proposed changes to allow general solicitation and general advertisement as well as to the treatment of offers and offerees in the Release.[15] In view of the legislative history and the Commission's longstanding recognition that certain issuer communications (e.g., newspapers, printed and radio advertisements) will not be treated as offers for purposes of Section 3(a)(11) if certain steps are taken to clearly communicate that the offer is only intended for residents of a particular state, we do not believe that the limitations that might be drawn from the CDIs are necessary.

The content and purpose of advertisements and communications over the internet are substantively no different from the newspaper or radio communications the Commission has long permitted. We believe that issuers should be permitted to use the internet as a communications medium, provided that the issuer takes appropriate steps (i.e. disclaimers and legends highlighting the intrastate nature of the offering) to assure that sales are only made to residents of the relevant single state. We do believe it would be inconsistent with the Commission's authority under the intrastate safe harbor to allow out-of-state persons to receive communications so long as the issuer takes reasonable steps to prevent such persons from purchasing any of the securities in the offering. For all of the above reasons, we support amending existing Rule 147 to reflect the communications provisions proposed for the new rule in the Release and thereby allow offers using any form of general solicitation and general advertising, provided that the issuer takes reasonable steps to assure that sales are made only to residents of the state from which the issuer's offering emanates.

2. Approach if Commission Determines to Retain Limits

Should the Commission determine to include the offering or investment size limitations it has proposed, we recommend that existing Rule 147 be retained as a safe harbor under Section 3(a)(11) without such limitations and that it be updated to include many of the changes proposed by the Commission, using, to the extent necessary, its

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[14] *See*, CDI Question 141.05 (October 2, 2014).

[15] On the other hand, the CDIs could be read as providing non-exclusive guidance on ways an issuer could conduct a 3(a)(11) internet offering being certain that the requirements for the exemption are met.

exemptive authority under Section 28. In this way, the statutory purpose of Section 3(a)(11) can be realized and the role and authority of the states properly respected.

A separate exemption with further enhancements, including investment size limitations, could then be established. This could be accomplished by adopting a separate rule (Rule 147A) or by including a separate paragraph in Rule 147 (similar to paragraphs (b) and (c) in Rule 506). In such an instance, we recommend that this separate rule include a provision with an inflation index.

3. Rule 504 Should be Amended to Increase the Aggregate Offering Amount.

We support the proposed amendment of Rule 504 to increase the aggregate amount of securities that may be sold by an issuer in a twelve-month period from the current $1 million to $5 million. The maximum offering amount under Rule 504 was last changed in 1988, when the limit was increased from $500,000 to $1 million. Both because of the effects of inflation and due to the needs of our markets for small business capital formation, we believe the proposed increase to $5 million is appropriate.[16]

We also support the proposed amendment to Rule 504 that would disqualify certain issuers from participation in Rule 504 offerings. We note that the proposed "bad actor" disqualification provisions would be implemented by reference to the disqualification provisions of Rule 506(d) of Regulation D and that disqualification would only occur for triggering events that occur after effectiveness of any final rule amendments, but disclosure would be required for preexisting triggering events.

In addition to the proposed changes above, we recommend that the Commission consider amending Rule 504 to modernize and relax provisions limiting resales of securities issued in certain "public offerings" under the rule. Historically, Rule 504 was intended in part to facilitate small "public offerings" of unrestricted securities that would allow issuers to access a broader group of potential investors and possibly limit the impact of the built-in illiquidity discount associated with resale restrictions. Currently, potential resellers are required to comply with the narrow parameters of Section 504(b)(1), requiring state registration and dissemination of a state-approved disclosure document or limiting resales of securities purchased in exempt public offerings only to accredited investors. In light of the recent expansion of State and Federal rules permitting public offerings through general solicitation and advertising using the internet, Rule 504(b)(1) seems unnecessarily restrictive. We believe that in addition to the current small offering size limitation, the narrow means for permitting resales has made Rule 504 a less attractive alternative for conducting small public offerings, as is borne out by its relatively limited use.

[16] If the increase to $5 million is adopted, after there is experience with the use and operation of new Rule 504, the Commission may wish to consider using its exemption authority under Section 28 to increase the dollar limitation amount that may be offered under Rule 504.

To remedy this shortcoming, we recommend that the Commission amend Section 504(b)(1) by adding a new sub-clause (iv) substantially along the following lines:

> (iv) Exclusively pursuant to state law exemptions from registration that permit general solicitation and general advertising and that require public filing and delivery of a state law compliant disclosure document before any sales to purchasers.

4. Rule 505 Should Be Amended to Increase the Amount that May Be Offered and Sold to at Least $10 Million or Consideration Should Be Given to its Elimination.

If the proposed changes to Rule 504 are adopted, Rule 505 would be substantially similar to Rule 504. Both rules would have the same dollar amount limitation and bad actor disqualification provision. As a consequence, we believe that Rule 505 is unnecessary unless the Commission raises the authorized dollar threshold of the amount that may be raised in a twelve-month period.

We recommend that the Commission consider retaining Rule 505 and use its exemption authority under Section 28 to increase theaggregate amount that may be sold during a twelve-month period. For example, the amount could be increased from $5 million to $10 million or some larger amount and thus preserve the alternatives currently available for exempt offerings for smaller issuers. Rule 505 serves the purpose of permitting issuers to sell to up to 35 investors who may not be accredited without having to be satisfied that they meet an uncertain sophistication test.

We appreciate the opportunity to comment on the Release and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission and its staff, and to respond to any questions.

Very truly yours,

David Lynn
Chair, Federal Regulation of Securities Committee
ABA Business Law Section

Drafting Committee:
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