

Keith Paul Bishop

December 30, 2015

Via Email (rule-comments@sec.gov)

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE,
Washington, DC 20549-1090

Re: File No. S7-22-15

Dear Mr. Fields:

I am writing to comment on the Securities and Exchange Commission's ("Commission") proposal to adopt amendments to Rule 147 ("**Proposed Amendments**") under the Securities Act of 1933 ("**Securities Act**"). The Proposed Amendments are set forth in Commission Release Nos. 33-9973; 34-76319 ("**Proposing Release**").

1. Background.

I am an attorney in private practice in Irvine, California. I am writing in my individual capacity and not on behalf of my law firm or any of my law firm's clients.

I previously served as California's Commissioner of Corporations and in that capacity administered and enforced California's securities laws. I have taught as an adjunct professor at the University of California, Irvine and Chapman School of Law. I have also served as Co-Chairman of the Corporations Committee of the Business Law Section of the California State Bar and Chairman of the Business and Corporate Law Section of the Orange County (California) Bar Association. I am a practice consultant to the leading treatise on California's securities laws, Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS. As indicated above, I am writing in my individual capacity and not on behalf of any other person.

2. General.

I am in general support of the Commission's efforts to modernize Rule 147 and to assist smaller companies with capital formation consistent investor protection. In particular, eliminating the so-called residence requirement will remove a significant barrier to intrastate offerings.

(a) **Elimination of the “residence requirement” is consistent with modern corporate practice.** Although many corporations maintain their principal place of business in California, they often choose to incorporate in Delaware or Nevada. In fact, the Proposing Release notes that approximately 32% of the Rule 504 offerings had separate states of incorporation and principal places of business.

(b) **Elimination of the “residence requirement” will not impair state oversight.** Offerings conducted under current Rule 147 must be conducted in accordance with state securities laws. The application of state securities laws is not dependent upon the state of incorporation or organization of the issuer.¹ Rather, the application of these laws depends upon whether an offer or sale is being made within the state. *See, e.g.*, Cal. Corp. Code § 25008 (defining when offers and sales are made “in this state”).² In addition, California imposes key provisions of its General Corporation Law on foreign corporations when certain shareholder residence and business activity thresholds are met.³ California imposes certain other provisions of its General Corporation Law on foreign corporations based on other jurisdictional criteria. These criteria include the location of the corporation’s accounting records,⁴ principal executive offices,⁵ and board meetings.⁶ Several penal provisions within the General Corporation Law are applicable to foreign corporations if they carry on business or keep an office in California.⁷ Finally, a state may impose licensing and other business conduct requirements on foreign corporations operating within the state.

(c) **The Commission’s proposed in-state presence requirements are not justifiable.** While I support the elimination of the current “residence requirement”, I do not support the Commission’s proposed “presence” requirements. The Commission justifies its proposal on the basis that “state authorities can effectively regulate an issuer’s activities and enforce states’ securities laws for the protection of resident investors”.⁸ As explained above, however, the jurisdictional reach of state securities law is independent of whether an issuer is conducting any business within the state. Jurisdiction is established by the offer or sale of a security within the state. In California, every applicant for qualification (other than a California corporation, limited partnership, limited liability company or registered broker-dealer) must file a consent to service of

¹ Rule 147 (Preliminary Note 2).

² *See Keith Paul Bishop, California’s Blue Sky Law Problems for Foreign Issues and Foreign Issuers*, 23 *Insights* 7 (2009).

³ *See* Cal. Corp. Code 2115.

⁴ Cal. Corp. Code § 1601(a) (inspection of accounting books and records).

⁵ *Id.* and Cal. Corp. Code 1501(g) (annual report).

⁶ Cal. Corp. Code § 1501(g) (annual report).

⁷ Cal. Corp. Code § 2260.

⁸ A state’s interest is not limited to “resident investors”. A state’s interest extends to all offers and sales made within the state. For example, California would be concerned about a non-exempt offering of securities to a Florida resident by a Delaware corporation headquartered in Massachusetts with no business activity in California if the offer or sale is made in California as set forth in Cal. Corp. Code § 25008.

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process appointing the Commissioner of Business Oversight as agent for service of process.⁹ An issuer applying for qualification by permit must also file with the Commissioner of Business Oversight a Customer Authorization of Disclosure of Financial Records Form.¹⁰

Therefore, the Commission's proposed "presence" requirements would not augment California's ability to enforce its securities laws for the protection of resident investors as assumed by the Commission. If a state believes that its existing qualification or exemption requirements inadequately protect offerees and purchasers, it can amend those requirements. The Commission should not presume to act *in loco parentis* for state securities administrators who in most cases have longer experience in administering and enforcing securities laws than the Commission.¹¹

I believe that it is far more logical to require only that the issuer be organized in the state or territory or qualified to transact intrastate business in the state or territory.¹²

3. The Commission should retain existing Rule 147.

As noted in the Proposing Release, the proposed amendments would no longer satisfy the parameters of Section 3(a)(11) of the Securities Act. Therefore, the Commission must adopt the proposed rule pursuant its authority under Section 28 of the Securities Act. At the same time, the Commission does not claim that current Rule 147 is inconsistent with either Section 3(a)(11) or judicial interpretations of the statute. Although the Proposing Release states that issuers may continue to "to rely on judicial and administrative interpretive positions on Rule 147 issued prior to the effectiveness of any such final rules", the Commission is silent on reliance on current Rule 147. Nothing in the Commission's proposal suggests that current Rule 147 is incorrect and issuers should be able to continue to rely upon it as a safe harbor. The Commission should avoid creating unnecessary uncertainty by retaining existing Rule 147.

4. The Commission should eliminate the limitation on offers to in-state residents.

As noted in the Proposing Release, the current limitation on offers to in-state residents only is a significant barrier to the use of current Rule 147. There is little justification for maintaining this limitation because:

⁹ Cal. Corp. Code § 25165.

¹⁰ 10 CCR § 260.113(I)(2).

¹¹ The California Department of Corporations (now known as the Department of Business Oversight) was created in 1913 (Stats. 1913, ch. 353), more than two decades before the Commission.

¹² In order to qualify to transact intrastate business in California, a foreign corporation must designate an agent for service of process. Cal. Corp. Code 2117(b).

- Offers will continue to be subject to state registration/qualification requirements;¹³
- For a minimum of nine months, any resale of a security by a purchaser must be made only to persons resident within the purchaser's state or territory;¹⁴
- Any resale of a security by a purchaser will remain subject to federal and state qualification requirements; and¹⁵
- Offerees who are not purchasers face minimal financial exposure.

5. Proposed Rule 147(a)(1) should include the term “qualifies”. As proposed, Rule 147(a)(1), an issuer must “register” the offer and sale of securities or conduct the offering pursuant to an exemption from “registration”. Some states, including California, use the term “qualify” rather than “register”.¹⁶ To avoid any uncertainty, I recommend that proposed Rule 147(a)(1) read in relevant part as follows:

“(1) Registers or qualifies the offer and sale of such securities”

6. Proposed Rule 147(a)(1) & (2) should include the term “territory”. Proposed Rule 147(a) refers only to the “state” while Proposed Rule 147(c) refers to the “state or territory”. Section 3(a)(11) of the Securities Act refers to “state or territory” and the Proposing Release indicates that the new exemption would be available if made to purchasers resident within a “state or territory”. Therefore, proposed Rule 147(a) should be made consistent with proposed Rule 147(c).

7. The Commission should clarify how the residency of non-business trusts should be determined. Proposed Rule 147 does not address how the residency of non-business trusts should be determined. Many individual investors purchase securities by means of family trusts. These trusts are estate planning devices. They are not separate legal entities but a description of a fiduciary relationship between the trustee and the property involved.¹⁷ Because residency is a critical condition to the proposed rule,

¹³ Cal. Corp. Code § 25110 (“It is unlawful for any person to offer or sell in this state any security . . .”).

¹⁴ Proposed Rule 147(e). The Commission has requested comment on whether instead of adopting the limitation on resales, securities should be considered “restricted securities” under Rule 144(a)(3). Rule 144(a)(3)(i) defines “restricted securities” to mean, among other things, securities “acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering. It is possible that some issuers may elect to rely on a state exemption from qualification (e.g., Cal. Corp. Code § 25102(f)) that essentially prohibit a public offering. Thus, wouldn't securities offered in these transactions constitute “restricted securities”?

¹⁵ Cal. Corp. Code § 25130 (“It is unlawful for any person to offer or sell any security in this state in any nonissuer transaction . . .”).

¹⁶ Cal. Corp. Code § 25110.

¹⁷ *Portico Management Group, LLC v. Harrison*, 202 Cal. App. 4th 464, 473 (2011) (“In contrast to a corporation, which the law often deems a person, a trust is not a person but rather ""a fiduciary relationship with respect to property." [Citations.]” (*Ziegler v.*

the Commission should specify that the residency of non-business trusts is to be determined by the residence of the trustees. If a trust has more than one trustee, then all trustees must be resident in the state or territory in which the offering is made in reliance upon the exemption. I recommend that proposed Rule 147(d)(1) be amended to read as follows:

(1) A corporation, partnership, limited liability company, trust or other form of business organization that is deemed by the law of the state or territory of its organization to be a separate legal entity shall be is deemed to be a resident of a the state or territory, if at the time of sale to it, it has in which it has its principal place of business, as defined in paragraph (c)(1) of this section, ~~within such state or territory~~ at the time of sale to it. A trust that is not deemed by the law of the state or territory of its creation to be a separate legal entity is deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.

8. The Commission should clarify that bona fide gifts are not subject to the limitation on resales. Although proposed Rule 147(e) expressly refers to “resales”, questions may arise as to whether bona fide gifts are subject to the nine-month coming to rest condition. I therefore recommend the addition of the following statement “Bona fide gifts may be made during such nine month period and a donee is deemed to have acquired the securities when they were acquired by the donor.”¹⁸

9. The Commission should not require that the offering, not the state exemption, be limited to \$5 million. California does not currently have an exemption from its qualification that specifically limits the amount of securities sold to no more than \$5 million in a 12-month period. The Commission does not explain why it is proposing that that the \$5 million limitation be included in a state’s exemption rather simply imposing a limit on the amount that may be sold in reliance upon a state exemption. Imposing a limitation on the size of an exempt offering (as opposed to the size of the exemption) would allow issuers to rely upon existing state law exemptions, such as California’s limited offering exemption.¹⁹ For the same reason, I disagree with the Commission’s proposal that the state’s exemption limit the amount that may be purchased in an offer.

Nickel (1998) 64 Cal.App.4th 545, 548 [75 Cal.Rptr.2d 312], italics omitted.) "Legal title to property owned by a trust is held by the trustee `A . . . trust . . . is simply a collection of assets and liabilities.'" (*Galdjie v. Darwish* (2003) 113 Cal.App.4th 1331, 1343-1344 [7 Cal.Rptr.3d 178].) "[A]n ordinary express trust is not an entity separate from its trustees." (*Powers v. Ashton* (1975) 45 Cal.App.3d 783, 787 [119 Cal.Rptr. 729].)". In contrast, Delaware provides that a “statutory trust” is a separate legal entity. Del. Code, tit. 12, § 3801(g). *See also* NRS 88A.210(2) (providing that business trusts organized after October 1, 2011 are deemed to be an entity separate from its trustee or trustees and beneficial owner except as otherwise provided in the governing instrument).

¹⁸ Compare Rule 144(d)(3)(v).

¹⁹ Cal. Corp. Code § 25102(f).

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I recommend that proposed Rule 147(a)(2) be amended to read as follows:

~~(2) Conducts the~~ Offers and ~~sells the sale of such~~ securities pursuant to an exemption from registration or qualification in the state or territory in which all purchasers of the securities are resident and that limits the amount of securities sold to purchasers does not exceed:

~~(i) An issuer may sell pursuant to such exemption to 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).~~

10. The Commission should eschew the ambiguous use of “shall”. “Shall” is ambiguous and may mean “must”, “will” or “may”.²⁰ To avoid ambiguities, the Commission should eliminate the use of “shall” in the proposed rule.

Very Truly Yours,

/s/ Keith Paul Bishop

²⁰ <http://calcorporatelaw.com/2011/11/when-shallwillmustmay-we-meet-again/>.

