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Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

RE: Request for Comment
File Number 265-23

Ladies and Gentlemen:

I would like to comment on the proposed agenda with respect to the SEC Advisory Committee on Smaller Public Companies. Specifically the Charter asks the Committee to assess the current regulatory system for smaller companies.

My comments will be largely responsive only to the fourth directive, namely:

(4) the process, requirements and exemptions relating to public offerings of securities by smaller public companies, especially public offerings.

1. The regulatory climate has diminished the number of participating broker-dealers, attorneys, auditors and other professionals devoted to micro-cap and nano-cap companies. Remaining participants, are aging and have dwindled to a fraction of the community that existed just a few years ago.

The NBA star Kareem Jabbar was once asked why he did not lead the league in blocked shots. He answered that he led the league in “shots scared out of.” In effect, the smaller company market is suffering from “shots scared out of” as fewer companies, investment bankers and investors are willing to tread into micro and nano-cap waters. The threat of the costs of Sarbanes – Oxley and especially the specter of 404 keep promising companies on the sidelines.

2. The regulatory climate increases the delays and expense of small company offerings, rendering small companies at a competitive disadvantage vis a vis large cap companies and foreign competitors.

The Task Force for NSMIA reported that the crazy quilt of state regulation did not further any useful regulatory purpose. Similarly, it is now dogma that over 85% of all new job creation comes from small business.

Nonetheless, smaller companies are asked to expend a significantly higher ratio of their assets to obtain and maintain capitalization. For example, a company with sufficient assets and earnings to qualify for listing on national exchanges is not required to comply with state blue sky laws. A smaller company, with fewer resources, must undergo the separate and often conflicting reviews of state regulators in multiple jurisdictions.

In addition, the markets available to micro and nano caps are inherently illiquid – limited to private placements without general solicitation and with limited options for aftermarket liquidity. Since every investor implicitly wants to know how to ultimately get his/her money back out, the lack of liquidity makes the prospect of obtaining initial capital commensurately more difficult.

3. A hodge podge of conflicting state and federal rules prevents the use of virtually all of the regulatorily proffered methods of small business capital formation, such as 504, SCORE or Regulation A. For example, Rule 504 and the SCORE derivation were intended to permit offers of securities that would be freely tradeable at the end of the offering if the registration was reviewed by a state regulator or was offered solely to accredited investors in states that permitted general solicitation and general advertising.

From a federal standpoint, the policy was adopted to provide an exemption for small and early stage companies in very small offerings. Nonetheless, the policy was effectively thwarted at the state level and smaller companies are simply left to navigate a regulatory mine field at the state level.

The intended effect of this national policy is trumped at the state level by imposing a range of compliance hurdles such as merit review, cheap stock rules, escrow requirements, length of business history, limitations on percentage of offering costs and so on. For accredited investors, all but two states (and arguably a third) have removed their allowance for general solicitation. Similar hurdles exist for Regulation A and few states have a corresponding rule.

Without lengthy and expensive registration, small cap companies cannot create liquidity in their securities and therefore make themselves attractive to investors who have the entire panoply of investment possibilities at their disposal.

4. There has been a regulatory trend to criminalize the roles of small company attorneys and auditors that has diminished the availability of these professionals and altered their ability to freely counsel their clients.

Sarbanes Oxley effectively eliminates the ability of the auditor to also act as an advisor to the company. In the large cap context, a cadre of accountants, audit committees, the CFO and outside advisers exist that are not available to smaller companies. These professionals act as an intermediary between the Company and the auditor. There are few counterparts in the smaller company.

Historically, the auditors of smaller companies provided invaluable advice because they were in a unique position to observe the company's financial performance from year to year. The Company got an unbiased look from trained professionals. The changes have had multiple effects:

- a. Smaller companies have a more difficult time with audits since the intermediaries cannot intercept issues before audit;
- b. Smaller companies lose the valuable ability of consulting with independent expert auditors who know their company well and must alternate auditors;
- c. The PCAOB effectively reduced the number of available auditors and the prices for audits have risen correspondingly.

The environment for the attorney client relationship is even more sinister. A recent Director of Enforcement at the SEC made a public pronouncement that the Staff intended to expand Section 8(a) to cast a net around securities lawyers. At a recent ABA seminar, the head of a state securities agency laughingly said it was “more fun to put someone in jail than to just get money.” She also noted that her state now permitted life sentences in the securities arena.

The expansion of exposure to attorneys include:

- a. Re-defining counsel's role in opinions associated with disclosure documents that are subsequently deemed to be misleading;

- b. Routinely asking for waiver of attorney-client privilege in enforcement actions;
- c. Treating counsel as “co-authors” under 10b-5.

In effect, counsel is increasingly being treated as co-conspirators if their actions are less than prosecutorial regarding their clients. This is increasingly problematic in instances where a violation may have occurred since the lawyer must decide whether to advocate for his client’s interests or clamor to protect himself.

- 5. The regulators have looked away at unlawful short selling and other marketplace manipulations that artificially create losses in small public companies, hampering the ability of existing and prospective companies to generate liquidity, maintain fair stock prices, and attract capital.

For the past several years, at each SEC Small Business Forum, the issue has arisen as to naked shortselling in the micro-cap and nano-cap markets. Short sales are limited to marginable securities that can be “borrowed” for the time period in which the seller holds the short position. Theoretically, no new shares are created. The short seller profits when the shares go down in value and covers by purchasing the stock at some later date.

In the micro and nano cap worlds, however, a pernicious practice is believed to have taken hold. The counterbalance to the short sale is the requirement to borrow the stock and the purchase of the stock when the seller covers the sale. Yet the counterbalancing purchase frequently is not made when the company’s stock falls to zero. As a result of this nuance, it is believed that certain market professionals do not borrow shares at all but are simply selling shares short “out of thin air.” If so, the nakedly short shares are sold without a commensurate borrowing, thereby creating “new” shares that act as an undisclosed market overhang. By their very pressure, the illegally shorted shares reduce the market price to zero, reaching the desired goal and eliminating the need to cover. Since there is no counterbalance, an infinite number of shares can be shorted. To the extent that this practice exists it effectively undermines the integrity of the market for securities of smaller companies.

Incredibly, the concerns raised at the Small Business Forum have been largely ignored and rectification has been left to a handful of attorneys filing lawsuits. Query as to the Commission’s position if the share price of General Electric or Microsoft fell to zero as a result of illegally shorted shares? Yet, the collective losses in the micro and nano cap markets over a number of years may equal or exceed the market cap of those giants.

- 6. The current regulatory climate fosters and expands the very securities fraud that it seeks to prevent.

The micro-cap and nano-cap markets are dominated by third party “consultants” who traffic in public shells, unregistered 504 offerings, micro-IPOs and similar techniques that are completely foreign to the large cap marketplace. In practically all cases, these alternatives exist solely because they are the only practical alternatives available.

Having practiced law in this area for over twenty years, I have witnessed the “love-hate” relationship between the regulatory community and small business beginning the small business reforms of 1980. With the exodus of many large cap industries the U. S. economy has now become dependent on the formation, capitalization and maintenance of a vigorous small business community.

Approximately one year ago I spent nearly a month in the Peoples Republic of China meeting with business and civic leaders and giving speeches on access to capital for small and early stage companies. After extended discussions with Chinese counsel, civic leaders and business people, I came to the stunning and regrettable conclusion that the communist government of China was actually far more conducive to current capital formation of Chinese companies than our own government is to our small business environment.

There is no inherent reason why a robust and liquid market cannot exist for small, micro and nano cap companies. I trust that the establishment of this committee will be the impetus for regulatory change that allows smaller companies in the United States to effectively compete for capital.

Very truly yours,

/s/

Charles W. Barkley