November 13, 2012

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: Rulemaking under Title IV of the Jobs Act

Dear Ms. Murphy:

I write to offer comments on the regulatory implementation of Title IV of the Jobs Act.

A. Overview of My Comments

The following is an overview of my comments. In order for the regulatory implementation of Title IV of the Jobs Act (Section 3(b)(2) of the Securities Act of 1933) to provide small businesses efficient and balanced access to external capital: (1) Disclosure obligations required by the regulations must be closely tailored in a manner that does not drive relative offering costs to levels that practically foreclose small businesses from relying on the exemption; and (2) The Commission must preempt state registration authority over small businesses' offerings under Title IV. Unless the regulatory implementation meets both of these conditions, Title IV will be useless to small businesses.

B. Background

Title IV of the Jobs Act amends Section 3(b) of the Securities Act of 1933 by adding a new section, Section 3(b)(2). This new Section 3(b)(2) requires the Commission to adopt rules that provide an exemption from registration for offerings up to $50 million. Some parts of new Section 3(b)(2) are mandatory, requiring the new Section 3(b)(2) regulations to include particular provisions. For the most part, however, the Commission has wide latitude regarding the content of these new Section 3(b)(2) regulations.

Title IV of the Jobs Act is entitled: “Small Company Capital Formation”. One can infer from the title that the Commission’s regulatory implementation of new Section 3(b)(2) should provide “Small” businesses an efficient access external capital.

Regarding the meaning of “small”, I typically use as a reference point data collected and published by the Small Business Administration. The SBA collects data on businesses with less than 20 employees. Until recently, the SBA also collected data regarding businesses with less than 100 employees. Over the years, businesses with less than 20 employees have accounted for nearly 20% of all employment in America, while businesses with less than 100 employees have accounted for nearly 40% of our nationwide employment. The point, of course, is that these “small” businesses within the SBA definitions are a material and essential part of our market economy.

To survive and prosper, small businesses need efficient access to external capital, which seems to be the point of new Section 3(b)(2).

In fulfilling its delegated responsibilities under this new law, the Commission should be informed by the history and empirical data regarding the failure of Regulation A.

In two articles, I have provided data that demonstrate the failure of Regulation A, and I have offered explanations for that failure.[1]

During the years 1995 through 2004, the annual average number of Regulation A offerings was 7.8; during the years 2005 through 2011, the annual average number of Regulation A offerings was 23.1. During that period, the SBA data show that there were in America roughly 5 million businesses with less than 20 employees.

There are two reasons why Regulation A has failed as an exemption for small business capital formation. First, the Regulation is somewhat out of balance in its requirements (disclosures; filings with the Commission, etc.) for the availability of the exemption. The costs generated in meeting the requirements for the exemption make Regulation A less attractive for small businesses, especially for smaller Regulation A offerings.[2]

---

[1]*See* Rutheford B Campbell, Jr., *Regulation A: Small Businesses’ Search for “A Moderate Capital*, 31 Del. J. Corp. L. 77 (2006); Rutheford B Campbell, Jr., *Regulation A and the Jobs Act: A Failure to Resuscitate*, forthcoming in the Ohio State Entrepreneurial Business Law Journal, available in draft at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2134313

[2]It is relative offering costs that preclude small issuers from accessing external capital. Relative offering costs are offering costs compared to the total size of the offering. To use extreme examples, offering costs of $100,000 will preclude a company from offering a total of $100,000 in its securities. Offering costs of $100,000, however, will not preclude a company from offering $50 million in its securities. Because the capital needs of small businesses are small,

Second – and much more significant regarding the non-use of Regulation A – is the pernicious effect of registration requirements under state blue sky laws. Because state authority over Section 3(b) offerings was not preempted by the National Securities Improvement Act of 1996 (NISMA), 15 U.S.C. § 77r (2012), state registration requirements apply to all Regulation A offerings. Small businesses seeking external capital have abandoned any use of Regulation A principally because of these expenses. If a small business proposes to use Regulation A to offer its securities in 3 states, it is required to comply with 4 separate registration regimes (3 state regimes and 1 federal regime); if a small business proposes to use Regulation A to offer its securities in 50 states, it is required to comply with 51 separate registration regimes (50 state regimes and 1 federal regime). The costs generated by the requirements to comply with state registration laws make Regulation A unworkable for small businesses.

New Section 3(b)(2) provides the Commission with authority to deal with both of the problems that undid Regulation A. Section 3(b)(2)(G)(i) gives the Commission authority to enact disclosure provisions that keep relative offering costs at a reasonable level, thus ensuring the required balance of investor protection and capital formation in Section 3(b)(2) offerings. NSMIA, Section 18 of the 1933 Act, was amended to enable the Commission to preempt state authority over offerings of securities by small businesses under Section 3(b)(2).

C. A "Stepped" Disclosure Regime

In a forthcoming article, I offer thoughts regarding how the Commission might impose a disclosure requirement in manner that would facilitate small business capital formation under Section 3(b)(2).[3] I reproduce a portion of my article (omitting footnotes) immediately below:

> The most apparent way for the Commission to implement its obligations under Section 3(b)(2) is by constructing a regime of stepped disclosures that conditions the Section 3(b)(2) exemption on modest disclosures for small offerings but requires an increase in the amount of disclosure as the size of the Section 3(b)(2) transaction gets larger.
>
> This is not, of course, new for the Commission. Regulation D is perhaps the most apparent example of this approach. As Regulation D transactions get larger in size, the exemptions of Regulation D generally require additional

---

relative offering costs are necessarily high and thus more likely to preclude a small business from acquiring external capital.

[3]Rutheford B Campbell, Jr., *Regulation and the Jobs Act: A Failure to Resuscitate*, forthcoming in the OHIO STATE ENTREPRENEURIAL BUSINESS LAW JOURNAL, *available in an earlier draft at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2134313

investor protection devices, specifically mandated disclosure and/or purchaser qualifications (accredited investor status or sophistication). Regulation A is also an example of this stepped approached. In that exemption, the Commission scaled back disclosure requirements for the smaller Regulation A offerings compared to the disclosures required in registered offerings on Form S-1.

Thus, it might make sense for the Commission to require, for example, very modest informational disclosure requirements for Section 3(b)(2) offerings of $1 million or less. For offerings of between $1 million and $5 million, the Commission might model informational disclosure requirements roughly on the present iteration of Regulation A. Above $5 million, relative offering costs come into balance, and the Commission could impose more burdensome disclosure obligations.

As stated above, the Commission is well prepared to construct a stepped disclosure regime for Section 3(b)(2) offerings that appropriately balances investor protection and capital formation.

D. Preemption of State Authority over Small Businesses' Offerings

In a forthcoming article, I offer thoughts regarding the necessity to preempt state authority over Section 3(b)(2) offerings by small businesses and the manner in which the Commission might accomplish such preemption.[4] I reproduce a portion of my article (omitting footnotes) immediately below:

> As stated above, the Commission is well prepared to construct a stepped disclosure regime for Section 3(b)(2) offerings that appropriately balances investor protection and capital formation. Implementing such a strategy also involves the Commission in no apparent political matters or administrative turf wars.
>
> The more difficult problem for the Commission – one that, unfortunately, does involve political matters and turf wars – will be dealing with the preemption of state authority over Section 3(b)(2) offerings. It is here where I fear the Commission by inaction or tepid action will destroy any chance that Section 3(b)(2) has to become an effective and efficient vehicle for small business capital formation.

---

[4]Rutheford B Campbell, Jr., *Regulation and the Jobs Act: A Failure to Resuscitate*, forthcoming in the OHIO STATE ENTREPRENEURIAL BUSINESS LAW JOURNAL, *available in an earlier draft at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2134313

Title IV of the JOBS Act deals with preemption in the context of Section 3(b)(2) offerings by amending . . . NSMIA . . . to preempt state registration authority over Section 3(b)(2) offerings if the securities are "offered or sold on a national securities exchange" or if the securities are "offered or sold to a qualified purchaser, as defined by the Commission . . . ." Since small businesses of the kind [described above] . . . are not "offered or sold on a national securities exchange," preemption of state authority over Section 3(b)(2) offerings by small businesses depends on the investors in such offerings being "qualified purchasers", as that term is defined by the Commission.

The history of NSMIA is important with regard to the Commission's possible definitions of "qualified purchaser".

As originally enacted, NSMIA preempted state authority over offers limited to "qualified purchasers". Congress, however, refused to define "qualified purchaser" and, instead, delegated to the Commission authority to define that critical term.

In NSMIA, Congress delegated very broad authority to the Commission to define the term, "qualified purchasers". The only limitation in the statute on the Commission's authority to define that term was a requirement that the definition of "qualified purchaser" must be "consistent with the public interest and the protection of investors." 15 U.S.C. § 77r(b)(3) (2012). [Section 2(b) of the 1933 Act also requires that when the Commission is making rules "in the public interest", the Commission must "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 77b(b) (2012).] * * * *

Since the enactment of NSMIA in 1996, however, the Commission has shown little interest in expanding preemption by defining the term "qualified purchaser." In 2001 the Commission did propose to define "qualified purchaser" as "any accredited investor" under Regulation D. The Commission failed to adopt the amendment, however. Otherwise, the Commission has done essentially nothing regarding any significant definition of "qualified purchaser."

Faced now, as it is, with the obligation to enact regulations to implement new Section (3)(b)(2), various options are possible regarding a Commission definition of "qualified purchaser" and the extent of preemption of state authority over Section 3(b)(2) offerings

One option for the Commission is to follow its historic practice and refuse to enact any definition of "qualified purchaser". While the JOBS Act requires the Commission to enact a regulatory regime under Section 3(b)(2), the JOBS Act contains no explicit mandate for the Commission to define "qualified purchaser" as a part of its regulatory implementation of the Act.

A Commission failure to define the term, however, would seem an abdication of its responsibilities, since it would destroy the availability of Section 3(b)(2) for small issuers. As noted above, small businesses are not traded on national exchanges, and thus preemption over Section 3(b)(2) offerings by small businesses can come about only if a small business utilizing Section 3(b)(2) limits its investors to “qualified purchasers.” With no definition of that term, small businesses would be unable to attain preemption and, accordingly, effectively foreclosed from use of new Section 3(b)(2).

A second option for the Commission is to define a “qualified purchaser” as an “accredited investor” within the meaning of Regulation D. This second option also essentially kills Section 3(b)(2) for small business capital formation.

Defining “qualified purchaser” as an “accredited investor” severely limits the investor pool. Less than five percent of the population may meet the definition of “accredited investor.” Obviously, excluding such a huge majority of the population from potential investors in a Section 3(b)(2) offering by small businesses takes away any advantages that small businesses may gain by relying on the exemption. Small businesses operating under such a regime cannot solicit broadly for investors.

The consequences of such a definition (whether intended or unintended) will be to move small business capital formation away from any Section 3(b)(2) exemption and into Rule 506 offerings. Once the Commission acts to implement Title II of the JOBS Act, small issuers using Rule 506 and limiting their purchasers to accredited investors will be able to solicit broadly for investors (i.e., use general advertising to find investors) and sell to an unlimited number of accredited investors. These Rule 506 offerings limited to accredited investors, however, generate no disclosure obligations as a condition for the availability of the Rule 506 exemption. It seems certain that the conditions for the availability of the Section 3(b)(2) exemption imposed by the Commission will require some measure of disclosure. It is difficult to see why, in such circumstances, small businesses in search of external capital would use Section 3(b)(2) instead of Rule 506.

A third option for the Commission is to define qualified purchaser as anyone who purchases in a Section 3(b)(2) offering. This, certainly, is the most appropriate of the three options. Unfortunately, it is also the option least likely to be adopted by the Commission.

If the Commission were to define qualified purchaser in this fashion and combine this with a closely tailored, stepped approach to disclosure and periodic reporting requirements, Section 3(b)(2) could become an important exemption for small businesses capital formation. It would enable small businesses to solicit broadly for external capital without any investor qualification requirements (e.g., sophistication or accredited investor requirements), limitations on the number of offerees or purchasers, or restrictions on the resale of securities. Perhaps most important, such a regime would permit a broad solicitation for investors without the necessity of complying with the daunting – and expensive – task of meeting the registration requirements of multiple state registration regimes.

Investors, for their part, would be protected by mandated disclosure of prescribed investment information, which is consistent with the disclosure philosophy that is the very core of the 1933 Act. The Commission with its vast experience, expertise and resources could construct these disclosure requirements under the obligation to balance investor protection and capital formation.

This option, however, is unlikely because it would amount to an expansion of preemption of state authority over registration, and the Commission has a history of unwillingness to push the preemption issue and thus encounter the predictable enmity of state regulators. In the enactment of NSMIA and the Dodd Frank Act, for example, the Commission refused to advocate in favor of preemption, even though it was apparent that state regulation was destroying the availability of efficient federal exemptions from the registration requirements of the 1933 Act. State regulators, however, have robustly fought preemption through advocacy and the use of other legislative strategies.

While one may understand the reluctance of the Commission to get itself crosswise with its fellow regulators, the Commission's inaction has essentially permitted states to wreck Regulation A, which should have been a very attractive path for small business capital formation. This, I suggest, is unfortunate for small business and the economy and amounts to an abdication of the Commission's express responsibilities under Section 2(b) of the 1933 Act to balance investor protection and capital formation.

My fear, therefore, is that the Commission will adopt some version of option one or two, above, essentially foreclosing small businesses from using the new Section 3(b)(2) exemption provided by Title IV of the JOBS Act, which – ironically – is entitled "Small Company Capital Formation."

E. Conclusion

Title IV of the Jobs Act delegates to the Commission broad authority to enact Section 3(b)(2) regulations that provide small businesses efficient access to external capital.

An efficient access to capital for small businesses through Section 3(b)(2) offerings depends on reasonable expenses in meeting the requirements of the federal exemption and eliminating state registration authority such offerings.

The Commission can control relative offering expenses at a reasonable level by a stepped disclosure regime that requires companies to provide investors with increasing levels of investment information as the size of offerings increase.

The Commission can eliminate state authority over Section 3(b)(2) offerings by defining "qualified purchaser" as one purchasing in a Section 3(b)(2) offering. Failure so to preempt state authority means that Section 3(b)(2) will be useless to small businesses.

Sincerely,

Rutheford B Campbell, Jr.
William L. Matthews Professor of Law