Ketsal
1100 15th St NW, Floor 4, Washington DC 20005 ■ (917) 503-9050 ■ info@ketsal.com

June 30, 2020

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

VIA EMAIL: rule-comments@sec.gov

*Re: File Number S7-05-20*
*Proposed Rules on Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*

Dear Secretary Countryman,

Ketsal[1] respectfully submits this letter in response to a request by the U.S. Securities and Exchange Commission (the "Commission") for comments regarding the above-referenced release (the "Proposing Release").[2] We appreciate the opportunity to comment and, with a few minor suggestions for the Commission's consideration, we are writing in support of the Commission's proposal to revise its exempt securities offering framework under the Securities Act of 1933 (the "Securities Act").

## 1. Introduction

Ketsal is a boutique regulatory, litigation, and corporate law firm with attorneys practicing in New York, Washington, D.C., California, and Washington state. Our clients include emerging companies taking advantage of the exempt securities offering rules to access the funding they need to build and maintain their businesses. While our experiences advising these clients inform our comments, our comments represent our own views and are not intended to represent those of our clients.

We write in general support of the Commission's Proposing Release, and in particular of the Commission's integration, offering and investment limits, and, with modest adjustments, general solicitation proposals. With respect to these proposals, we would also encourage the Commission to consider:

- Eliminating—or clarifying the reasons for—the limit on non-accredited investors who can participate in an offering made pursuant to Rule 506(b) of Regulation D;
- Revising proposed Rule 148(c) to be less restrictive;

[1] Blakemore Fallon PLLC d/b/a Ketsal.

[2] Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 85 Fed. Reg. 17956 (proposed Mar. 31, 2020) (to be codified at 17 C.F.R. pts. 227, 229, 230, 239, 249, 270 & 274).

- Revising proposed Rule 241 to preempt state securities law registration and qualification requirements;
- Raising the offering limits for offerings made pursuant to Tier 2 of Regulation A to $100 million (rather than $75 million);
- Not amending the category of eligible securities under Regulation Crowdfunding;
- Exploring ways to revisit the Investment Company Act of 1940 (the "Investment Company Act") to facilitate indirect investment by non-accredited investors; and
- Providing transitional guidance for offers being conducted near in time to the date when the final rules become effective.

**2. Integration**

While we generally support the Commission's efforts to modernize and simplify the Securities Act integration framework, we believe that the Commission should consider whether to eliminate the limit on non-accredited investors who can participate in offerings conducted pursuant to Rule 506(b) of Regulation D; or, if not, to provide clarity as to why Rule 506(b) offerings are limited to no more than 35 sophisticated, non-accredited investors. We acknowledge the Commission's concern that serial Rule 506(b) offerings could potentially result in sales to a large number of sophisticated, non-accredited investors, but note in response the following:[3]

- Rule 506(b) already prohibits general solicitation, and any sales to sophisticated, non-accredited investors pursuant to Rule 506(b) would be made in private offerings to, e.g., persons with whom the issuer has a preexisting, substantive relationship;
- It is odd that an issuer can communicate with an unlimited number of persons with whom it has a pre-existing, substantive relationship—irrespective of their status as accredited investors—but only sell to up to 35 sophisticated, non-accredited investors; and
- Section 12(g)'s 500 non-accredited investor threshold and the lack of any conditional exemption from registration of a class of securities pursuant to that section[4] will operate as a natural limit on serial Rule 506(b) sales to a large number of sophisticated, non-accredited investors.

[3] *See* Proposing Release at 17968-69. *See also* Revisions of Limited Offering Exemptions in Regulation D, 72 Fed. Reg. 45115, 45130 (Aug. 10, 2007) (codified at 17 C.F.R. pts. 200, 230, & 239) ("It would be an anomalous result that an issuer could make an offering to hundreds of non-accredited investors in reliance on the integration safe harbor, triggering reporting requirements under the Exchange Act, without a public offering.").

[4] *Cf.* Exchange Act Rules 12g5-1(a)(7) and Rule 12g-6 (conditionally exempting securities sold pursuant to Regulation A and Regulation Crowdfunding from the "held of record" definition in Exchange Act Section 12(g)).

### 3. Generic Solicitation and Offering Communications

We support the Commission's proposal to adopt a specific exemption for communications made in connection with demo days and similar events. We believe, however, that proposed Rule 148(c) is far too limited in the scope of information that can be conveyed at a demo day event to be effective, including because it would prevent issuers from sharing even the most anodyne information about their businesses.

Additionally, where an issuer, within 30 days of its most recent generic testing-the-waters communication pursuant to proposed Rule 241, commences an offering that requires a filing with the Commission of a substantive disclosure document, we support requiring that issuer to file its generic testing-the-waters materials as an exhibit to that substantive disclosure document. In other words, we support the requirement in the case of offerings made pursuant to Regulation Crowdfunding or Regulation A, but not Regulation D or other rules that do not themselves require the public disclosure of substantive information. In order to be effective, proposed Rule 241 should not itself impose additional conditions on use beyond the rule's proposed legend requirements. The existing requirements and investor protections that apply to any subsequent exemption that the issuer relies upon to actually sell the securities are presumably sufficient in their own right without the imposition of additional filing requirements.

We support amending Regulation Crowdfunding, as proposed, to permit testing the waters for a Regulation Crowdfunding offering pursuant to proposed Rule 206. Consistent with the proposed rules, we do not believe that issuers should be required to conduct Rule 206 testing-the-waters activities on an intermediary's platform. Of course, companies could elect to conduct testing the waters activities on an intermediary's platform if they believe that it would be beneficial to their efforts to determine interest in an offering. Companies, however, should not be required to do so.

Regulated intermediary platforms provide important services to companies and essential investor protections once a decision to proceed with a Regulation Crowdfunding offering has been made, but not before. Companies should retain their ability to determine on their own and through their own efforts whether there is sufficient interest in a contemplated Regulation Crowdfunding offering before deciding whether to proceed and, if so, on which intermediary platform. To require otherwise would essentially require companies to choose an offering partner before they have decided whether there is sufficient interest to pursue an offering.

Finally, we would suggest that the Commission preempt state securities law registration and qualification requirements for offers made pursuant to proposed Rule 241, including because:

- We see no practical reason to distinguish among communications made pursuant to any of Rule 506 of Regulation D, Rule 255 of Regulation A, or proposed Rule 206 of Regulation Crowdfunding (all of which preempt or would preempt state securities law requirements) and proposed Rule 241;

- Eligibility for preemption should not, in our view, be based on the intent of the issuer to offer under one exemption rather than another;
    - The only discernible substantive difference between, and that would result from, an issuer's:
        - intent to conduct a Rule 506 or Regulation A (Tier 2) offering and any solicitations of interest actually so conducted; and
        - the same intent and conduct under a proposed Rule 241 that does not provide for preemption,

    would be a lack of utility in, or desire to rely on, Rule 241.
- As proposed, the rule risks incentivizing issuers to claim an intent, even where untrue, to conduct an offering pursuant to an exemption that provides for the preemption of offers, rather than to simply rely on proposed Rule 241;
- A version of proposed Rule 241 that preempted state law requirements would be consistent with Rule 206 of Regulation Crowdfunding and Securities Act Rule 255 and Rule 506 in the case of offers that are initiated and subsequently abandoned; and
- Any offers made pursuant to proposed Rule 241 that result in the actual pursuit of any of a Regulation Crowdfunding, Regulation A, or Rule 506 offering arguably already preempt state securities laws. This is presumably the reason why the Commission would, for example, require the filing of Rule 241 materials as an exhibit to any Regulation Crowdfunding or Regulation A offering materials.

**4. Offering and Investment Limits**

We support the Commission's proposal to raise the offering limits for offerings made pursuant to Tier 2 of Regulation A and pursuant to Rule 504 of Regulation D, and to conform Regulation Crowdfunding's investment limits to Regulation A's. Higher offering limits may encourage greater use of Regulation A and Rule 504. We further support conforming Regulation Crowdfunding's investment limits to Regulation's A's, as we believe the benefits of reduced complexity between the exemptions outweigh any increase in investor protection the current discordance might effect. With respect to Tier 2 of Regulation A, we respectfully suggest the Commission consider raising the Tier 2 limit higher still, to at least $100 million, including for the following reasons:

- A higher offering limit could help spread the cost of a Regulation A offering across a larger pool of investors or investor funds—an important consideration for many companies contemplating an offering under the exemption;
- A higher offering limit is likely to make the exemption a more attractive alternative to initial public offerings for smaller issuers; and

- More issuers taking advantage of Regulation A would mean more investment opportunities for non-accredited investors.[5]

**5. Eligible Securities Under Regulation Crowdfunding**

Contrary to the Commission's proposed rule,[6] we respectfully suggest that the Commission not amend the category of eligible securities to conform it to the category under Regulation A, including because:

- Title III of the Jumpstart Our Business Startups ("JOBS") Act, unlike Title IV, does not explicitly direct the Commission to define a class of Regulation Crowdfunding-eligible securities;
- The language of the proposed rule in our view leaves unclear whether so-called SAFEs and similar instruments qualify as eligible securities, as SAFEs themselves are commonly understood to be "securities convertible or exchangeable to equity interests";[7] and
- The proposed rule injects uncertainty into the rule, subjects issuers to this risk, and tasks portals (rather than the SEC staff, as under Regulation A) with determining what qualifies as an eligible security.

**6. Community Investment Funds**

We applaud the Commission's ongoing efforts to revisit the Securities Act to facilitate direct investments by non-accredited investors. We would also suggest that the Commission begin to explore ways to similarly revisit the Investment Company Act to facilitate *in*direct investment by non-accredited investors. In particular, we would ask the Commission to consider expanding access to pooled investment vehicles by retail investors through appropriately structured and professionally managed funds that facilitate access to a diverse set of community-

[5] Elsewhere we have advocated for the independent increase of Regulation A's secondary sales limitation, along with a number of other suggestions to update and modify Regulation A. *See* Zachary Fallon, James Blakemore, & Josh Garcia, *The Case for Reg A: A Response to Commissioner Peirce*, THE BLOCK (Feb. 28, 2020), https://www.theblockcrypto.com/post/57207/case-for-reg-a-response-commissioner-peirce-sec-token. We would encourage the Commission to consider how amending this limitation could expand liquidity options for early-stage accredited investors and thereby encouraging initial investments into private companies in the first instance. While we made our Regulation A-related suggestions, which included proposed modifications to Regulation A's qualification process, secondary sale limitations, and exit reporting, in the context of the conversation surrounding Commissioner Hester Peirce's recent proposal for a safe harbor for token issuers, we believe our suggested modifications would inure to the benefit of the full gamut of small companies seeking capital and workable securities law exemptions and not merely token issuers.

[6] Proposing Release at 18001; Proposed Rule 227.100(b)(7).

[7] *See also,* e.g., Joseph M. Green & John F. Coyle, *Crowdfunding and the Not-So-Safe SAFE*, 102 VA. L. REV. 168, 171, 174 n.22 (2016) (defining SAFEs, along with convertible notes (on which SAFEs were modeled), as "convertible securities").

based investment opportunities. The Commission might consider, for example, similar to Rule 147A under the Securities Act, whether Investment Company Act Section 6(a)(5) should be expanded to allow for the participation of non-accredited investors as a matter of Commission rule rather than exception. The default position of the Commission's rules should be inclusion, with appropriate protections, rather than exclusion to the detriment of all but those with the resources sufficient to advocate for inclusion.

**7. Transitional Guidance**

Finally, we would request that the Commission provide transitional guidance for offers being conducted near in time to the date when the final rules become effective, to help issuers operating within the confines of the previous rules conform their communications, offers, and sales to the new framework.

* * *

The ongoing global pandemic has only intensified the need to ensure that emerging companies have ready access to capital and we commend the Commission's efforts to continue to clarify and simplify the regulations implementing the JOBS Act where necessary. We are grateful for the opportunity to comment. Please feel free to contact us with any questions.

Sincerely,

Zachary O. Fallon
Principal
[redacted]

James M. Blakemore
Principal
[redacted]