September 30, 2019

Submitted electronically to [rule-comments@sec.gov;](mailto:rule-comments@sec.gov) File No. S7-08-19

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Concept Release on Harmonization of Securities Offering Exemptions

Dear Sir or Madam:

I write to offer comments on the Commission's *Concept Release, Harmonization of Securities Offering Exemptions,* Release 33-10649 (June 18, 2019) (Concept Release).

My comments focus, at least primarily, on the special problems small businesses face when they attempt to access external capital.

There are more than five million small businesses in this country. Small businesses are vital to our national economy, accounting, for example, for more than 20% of all employment in our country.

These small businesses face structural and economic disadvantages when they attempt to secure the vital external capital necessary for them to compete and survive. Financial intermediation is rarely available, and relative offering costs (offering costs/size of the offering) often foreclose them from the capital markets.

What makes matters worse – indeed, substantially worse – for small businesses seeking external capital is that federal and state rules governing capital formation significantly, inefficiently and unfairly impose additional barriers to their access to external capital.

The JOBS Act and its regulatory implementation and other federal initiatives have attempted to provide some relief for small businesses in the area of capital formation. These actions have generally fallen short of the mark and in too many cases have amounted to downright failures.

Myself, therefore, I heartily welcome the Commission's Concept Release.

It is, however, a daunting document, both for those offering comments and for the Commission, as it attempts to construct appropriate and long overdue regulatory changes necessary to facilitate an efficient access to external capital for small businesses.

One can only hope that the Concept Release signals a commitment from the Commission to devote adequate resources necessary to provide prompt and meaningful relief from the inefficient regulatory barriers faced by small businesses when they attempt to find external capital.

I offer my comments in a "layered" fashion, somewhat similar to the format traditionally used in a prospectus under the Securities Act of 1933 (the 1933 Act). I begin with an "Overture" in which I outline briefly the points raised in the Concept Release that I consider most significant. I then offer my "RESPONSE" to specific "QUESTIONS" raised in the Concept Release.

OVERTURE

I offer the following broad comments to the Concept Release. I number my comments, attempt to keep them relatively brief, and later in this letter provide amplifications of my thoughts. My numbers in this section do not necessarily follow the order of the Commission's request for comments.

1. The Commission must finally come to a full appreciation of the importance of small business to our national economy and make a significant commitment to the construction of efficient rules governing small business capital formation.

2. Fundamentally, the Titles II, III, and IV of the JOBS Act make sense: the Rule 506(c) exemption (Title II) is predicated on investors' cheap access to investment information or ability to bear the risk; the Crowdfunding exemption (Title III) is predicated on the availability of electronically accessible investment information); and the Regultation A+ exemption (Title IV) is predicated on the more traditional forms of access to investment information.

3. Notwithstanding, data demonstrate that the Crowdfunding exemption and the Regulation A+ exemption in their present forms are failures. Primarily, Regulation A+ failed as a result of state registration requirements and the failure properly to scale disclosure requirements. The Crowdfunding exemption failed because of the strict limitation on offering strategies and inefficient and overly burdensome disclosure requirements. These problems can be substantially ameliorated or eliminated by Commission action.

4. Some of the changes suggested by my comments that follow may require or at least be facilitated by changes to statutes. This may be true, for example, regarding Title III of the JOBS Act, which is the basis for the Crowdfunding Exemption. In such cases, it is the duty of the Commission to identify such situations and urge Congress to

make changes necessary to achieve the goals of the particular statute. Such a relationship between Congress and the Commission is vital to achieving good outcomes.

5. The Commission needs to continue and expand its collection of data regarding the extent to which small businesses use particular exemptions. At the point when I wrote my article, *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 66 Bus. Law. 919 (2011), the Commission was sitting on a wealth of data regarding the use of Regulation D but apparently had never to any significant degree examined the data closely. When I examined the data, it showed that Regulation D was not working the way it was intended.

The Commission, to its credit, now pays more attention to data regarding the use of particular exemptions, and its own data reported in the Concept Release demonstrate the failure of the Regulation A+ exemption and the Crowdfunding exemption. Data that I consturcted using the Mosaic website confirm the failure of the two exemptions.

6. The integration doctrine should be eliminated. The doctrine makes no sense. It drives up offering costs and provides no protection for investors. It applies to issuers of all sizes but its pernicious effects falls most heavily on small issuers. It has been especially destructive to the Crowdfunding exemption.

7. The Commission's theory underlying the permissibility of a broad solicitation in offerings under the exemptions provided by Rule 506(c) and Rules 147 and Rule 147A should be expanded to cover other exempt offerings to the extent possible

The theory is to allow a broad solicitation of investors even if it involves offers to offerees who are not qualified to invest in the particular exempt transaction. Thus, for example, an issuer using Rule 506(c) is permitted to engage in a general solicitation or advertising, even if the advertising involves offers to unaccredited offerees, so long as sales are limited to accredited investors. By imposing the investor protection device – in this case the accredited status of investors – at the point of sale, unqualified offerees are not harmed because they cannot invest, while qualified offerees – those that are accredited – are permitted to invest. Investors, therefore, are not harmed, while issuers' search for capital is more efficient because they can solicit broadly for investors.

8. The Commission needs to recognize and integrate into their analyses the mandate in Rule 10b-5, which is that issuers selling their securities must provide investors with all material investment information about the issuer and the transaction. Failure to meet that obligation subjects the issuer to civil and criminal penalties, and that provides a strong incentive for issuers to disclose material investment information to investors. This mandate is especially significant in exemptions, such as Rule 504, which are not predicated on prescribed disclosures.

9. The pernicious impact of relative offering costs continues to be underappreciated

by the Commission. Relative offering costs are offering costs as a percentage of total proceeds from the offering.

The Commission long ago recognized this problem and as a result scaled disclosure requirements in offerings under Regulation D and more recently in offerings under Regulation A+ and Crowdfunding. In the latter instances, however, the Commission failed appropriately to deal with the problem, which is a major contributor to the failure of those JOBS Act exemptions.

10. The Commission must exercise its very broad, delegated authority to preempt state registration authority. State registration requirements under state blue sky laws continue to be a major barrier for small businesses' access to potentially efficient exemptions from federal registration requirements.

RESPONSES TO PARTICULAR REQUEST FOR COMMENTS

In this section of my letter, I offer responses to the "Request for Comments" (Request) in the Concept Release. In order to identify each Request, I give the Commission's number for the particular Request and the page in the Concept Release where the particular Request occurs. I also provide a portion or summary of the particular Request and, of course, my RESPONSE.

QUESTION 1, p. 24:

"Does the existing exempt offering framework provide appropriate options for different types of issuers to raise capital at key stages of their business cycle? . . . are there capital-raising needs specific to any of the following that are not being met by the current exemptions: small issuers; start-up issuers; issuers in a particular industry . . . ; issuers in different geographical regions . . . ?"

RESPONSE:

The Commission needs better to understand the nature of small business in this country.

The Commission and some of the critics and writers in this area seem nearly hypnotized by the image of brilliant techies who are working in a garage in Silicon Valley developing the next billion dollar app, and need a few thousand dollars to get their project off the ground. While those entrepreneurs have important needs for capital and are entitled to efficient capital formation rules, there is an even more important component to small business that needs attention. These are the small businesses operating small bank holding companies, restaurants, retail stores, businesses in extractive industries, farms, primary health care facilities, transportation, construction, etc. These are the heart of small businesses in this country, and their significance is reflected in data compiled by the Small Business Administration.

SBA data historically have been broken down into firms with less than 20 employees and firms with less than 100 employees (the SBA no longer provides data for firms of less than 100 employees), and generally over time there have been more than five million such firms. Firms with less than 20 employees have accounted for approximately (but slightly less than) 20% of all employment; firms with less than 100 employees have accounted for approximately (but slightly more than) 35% of all employment.

These are bedrock firms for our economy, and they need external capital to survive and compete. Too often, however, federal and state securities laws hinder or, indeed in some cases, block small businesses' efficient access to capital.

The Commission and Congress also have allowed "small business" initiatives to be highjacked by larger company interests. Title IV of the JOBS Act, which is the statutory basis the Regulation A+ exemption, is an example of this. It is entitled "Small Company Capital Formation" but provides an exemption from registration for offerings of up to $50 million. My experience suggests that it is very rare for a small business to need $50 million, and now there is a move afoot to expand the limit of a Regulation A+ offering to an even higher amount.

Another example of how this exemption entitled Small Company Capital Formation was co-opted by large business interests is that the Commission preempted state registration authority over the larger Tier 2 offerings but failed to do so in the case of smaller Tier 1 offerings.

The result of this, which was predictable, is that small businesses very rarely use Regulation A+.

QUESTION 5, p. 25:

This question asks if the criteria for regulatory exemptions from registration should be judged at the point of sale or at the point of offer.

RESPONSE:

Criteria should be judged at the point of sale.

Exemptions are generally based on situations where investors do not need the protection of the 1933 Act's registration requirement and its mandated, prescribed disclosures. Applying the exemption requirements at the point of sale (instead at the point of offer) enables issuers to engage in a wide search for external capital. That generates a reduction in offering costs that is especially important to small businesses that always face high relative offering costs. It also protects investors by requiring that the investor protection requirement be in place at the time purchasers make the decision to invest. Offers to unqualified offerees generate no material harm, because they are not allowed to invest.

Rule 506(c) is an example of a sensible rule. The Rule eliminated the prohibition against general solicitation or advertising. As a result, issuers using the Rule 506(c) exemption can now engage in a broad solicitation for investors, even though it amounts to offers to unsophisticated or unaccredited offerees. Purchasers, however, must be accredited. The result is that purchasers are protected by their accredited status. The unaccredited offerees suffer no material harm, since they are not allowed to purchase. Allowing such a broad solicitation reduces the issuer's offering expenses. The rule, in short, amounts to a sensible and efficient balance of investor protection and capital formation.

QUESTION 6; p. 26:

The question asks how we should evaluate whether an exemption promotes capital formation.

RESPONSE:

The evaluation of whether an exemption promotes capital formation should be based on hard data regarding use of the exemption. Such data are generated in some (but not all) cases as a result of filing requirements in some (but not all) exempt offerings. The exemption provided by Regulation D is an example of such a filing requirement.

These filing data can now be retrieved through the SEC's EDGAR system and Mosaic website.

In all cases, the filings should require issuers to file only simple forms that generate essentially no cost to the issuer. Filing should not be a requirement for the availability of the exemption and should have only small penalties for the failure to file the notice of use. The filing requirement for Regulation D (perhaps with some modification) provides a model for efficient filing requirements.

It was these type of data that I was able to use in my article, *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 66 Bus. Law. 919 (2011). At the point when I wrote that article, the Commission was sitting on a wealth of data regarding the use of Regulation D but apparently had never to any significant degree examined the data closely. When I examined filing data from approximately 27,000 Form D filings, the data showed the enormous under use of Rule 504 and Rule 505 and the migration of small Regulation D offerings (offerings of $5 million or less) away from those rules to Rule 506. In short, the filing data showed Regulation D was not working as anticipated and suggested very strongly that a major culprit was state registration requirements.

The Commission, to its credit, now pays more attention to data regarding the use of particular exemptions. Thus the Commission's own data reported in the Concept Release demonstrate the failure of the Regulation A+ exemption and the Crowdfunding exemption. Data that I constructed using the Mosaic website confirm the dramatic failure of the two exemptions and suggest strongly why the exemptions have failed so badly.

Simple and inexpensive filing requirements should be expanded to other exempt offerings such as, for example, offerings under Rule 147, Rule 147A, and Rule 701. Those exemptions are examples of offerings that could be important for small businesses, but they are all presently in a "black hole": We have no data on use and the extent to which the requirements for availability are efficiently balanced.

QUESTION 7; p. 26.

The question asks how technology affects "issuers' ability to communicate with investors?"

RESPONSE

To start with the obvious, technology *does* affect issuers' ability to communicate with investors.

The task for the Commission is to identify those situations in which technology makes investment information so cheap and available that mandated disclosure of prescribed investment information (i.e., registration) is no longer efficient and appropriate.

The market provides an example – the Crowdfunding exemption – where technology delivery of investment information simply does not work. The idea that a neutral posting (my term) of investment with a third party, coupled with strict limitations on other contacts between the issuer and investors, would enable issuers to sell securities obviously was misplaced. Technology so limited did not permit issuers to reach a sufficiently deep pool of investors.

This does not mean that technology as a delivery mechanism for investment information should be abandoned. It means only that technology alone may be insufficient as a delivery mechanism. Raising any significant amount of capital in a predictable and efficient fashion likely requires "old fashioned" selling techniques that include personal contacts (e.g., electronically, written or in person) that allow the issuer to explain it's proposed transaction and respond to questions and concerns of investors.

QUESTION 10; p. 27:

What are the most effective conditions or requirements for protecting investors?

RESPONSE:

I respond to this QUESTION in the context of exemptions from registration for small businesses, although principles underlying my RESPONSE may have broader application.

Point 1. Antifraud provisions provide protection for investors. Rule 10b-5, for example, is vitally important and often underappreciated as an effective incentive for issuers to disclosure material investment information to investors. Rule 10b-5 protects investors by requiring issuers to disclose all material facts. A failure by a small issuer selling its securities to disclose all material investment information generates significant civil penalties and criminal penalties.

In my practice, for example, I sometimes represented issuers relying of Rule 147. Inevitably I put together on behalf of those issuers an “offering circular” disclosing material investment information. The purpose of the document was to shield my client from antifraud liability. Thus, even when an exemption is not predicated on the disclosure of investment information, Rule 10b-5 incentivizes issuers (and their lawyers) to disclose all “material” investment information.

Point 2. In situations where exemptions are predicated on prescribed disclosures of investment information, properly “scaled” disclosure requirements are essential. Consistent with very core of the 1933 Act, balance between protection of investors and capital formation is critical (*see* Section 2(b) of the 1933 Act, directing that the “Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation”). In both the Crowdfunding disclosure requirements and Regulation A+ exemption requirements, the Commission badly missed proper scaling of disclosure. It was a major contibutor to the failure of those JOBS Act exemptions.

QUESTION 11; p. 28:

Should exemptions be available to non-accredited investors?

RESPONSE:

Yes.

It is estimated on p. 36 of the Concept Release that only 13% of all households are accredited investors.

Excluding 87% of households from investment opportunities is both unfair to potential investors (excluding them from access to desired investments) and amounts to an unfair and inefficient condition for small businesses' access to external capital. Both arguments support – and powerfully so – continuing to allow unaccredited investors to invest in exempt transactions.

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A discussion of Private Placements and Regulation D offerings starts on p. 60 of the Concept Release.

On page 79 of the Concept Release, the Commission provides recent data regarding the extensive use of Rule 506.

Data that I collected from an earlier twenty-five month period from approximately 27,000 Form Ds (*see The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 66 Bus. Law. 919 (2011)) are generally consistent with the Commission's data, although I arranged and used my data somewhat differently from that of the Commission's. The most important conclusions supported by my data were:

1. Approximately 55% of all Regulation D offerings were for $5 million or less.

2. These small offerings (offerings of $5 million or less), although within the offering size that could use Rule 504 or Rule 505, overwhelmingly were made under Rule 506. The migration rate to the Rule 506 exemption was approximately 85% for such small offerings.

3. The migration to the Rule 506 exemption was driven by state blue sky laws requiring registration. State registration authority over Rule 506 offers was preempted by the National Securities Market Improvement Act (15 U.S.C. Section 77r (2019)) (NSMIA).

4. In order to minimize the offering costs of Rule 506 offerings (e.g., the costs of required disclosures of investment information in Rule 506 offerings), a sample of small offerings migrating to the Rule 506 exemption suggests that approximately 90% of all of the small migrating offers were limited to accredited investors.

Below I address specific questions in the Concept Release that are directed to Regulation D and Rule 506.

QUESTION 36; p. 83:

Should the information disclosure requirements of Rule 506(b) be modified?
RESPONSE:

Regarding all exemptions predicated on a disclosure of investment information (e.g., the Rule 506(b) exemption, the Regulation A+ exemption, and the Crowdfunding exemption), the information required for each such exemption should be reviewed by the Commission. Each such review should be conducted in light of Section 2(b) of the 1933 act, which requires the Commission to balance protection of investors and capital formation. The failure on the part of the Commission properly to balance these interests (or otherwise stated, properly to "scale" required disclosures) was a significant reason for the failures of the Crowdfunding exemption and the Regulation A+ exemption.

QUESTION 37; p. 83:

"Should we amend Regulation D to clarify or define 'general solicitation' or 'general advertising'? Does the current definition pose any particular challenges?"

RESPONSE:

Yes.

In the case of any exemption from registration that is predicated on a condition or requirement that eliminates the need for registration, prohibiting a general solicitation or general advertising unnecessarily and inefficiently eliminates or limits a broad solicitation for external capital. Issuers should be allowed and, indeed, encouraged to solicit broadly for investors, so long as the investor protection condition is imposed at sale.

For example, the investor protection conditions underlying the exemption provided by Rule 506(b) are that all investors must either be accredited or supplied with prescribed investment information. These policies are not compromised by a broad solicitation for investors that includes offers to unaccredited offerees, so long as all purchasers are accredited or are provided with material investment information.

Similarly, the investor protection conditions underlying Rule 147 (geographic proximity to the issuer that enables investors to have cheap access to investment information, or state laws requiring registration and compliance with state antifraud provisions) are not compromised by a broad solicitation that includes offers to out of state offerees, so long as all purchasers meet the appropriate conditions. Offerees who do not purchase are “protected” from any material harm, because they do not purchase. Purchasers are protected because they meet the underlying policy objectives of the exemption.

The benefit of such a regime, of course, is that it significantly reduces offering costs. This is especially important to small issuers, which generally face high relative transaction costs and are foreclosed from efficient financial intermediation.

QUESTION 44; p. 85:

Should we allow non-accredited investors to purchase securities in an exempt offering that allows general solicitation.

RESPONSE:

Generally, yes. See RESPONSE to Question 37, above.

QUESTION 45; p. 85:

Should the filing requirements for Form D be amended?

RESPONSE:

No. The filing requirements should not be amended.

In fact, filing obligations should be expanded to apply to offerings under other exemptions from registration, such as, for example, offerings under Rule 147 and Rule 147A and Rule 701.

All filing requirements in connection with exempt offerings should be simple, inexpensive and not a prerequisite for the availability of the exemption. These filings are essential for monitoring the effectiveness of an exemption. It has enabled us to discover, for example, the problems with Regulation D and Regulation A, and the disastrous failures of Crowdfunding exemption and the new Regulation A+ exemption.

It is impossible to monitor the effectiveness of exemptions from registration without basic information about use.

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Starting on p. 86, the Concept Release focuses on Regulation A+, which is a regulatory exemption based on Title IV of the JOBS Act. Title IV is entitled "Small Company Capital Formation."

Unfortunately, however, Regulation A+ does essentially nothing for the more than five million small businesses in the United States. For reasons that were predictable, Regulation A+ is very rarely used by small businesses.

Data on page 105 of the Concept Release confirm the failure of Regulation A+ to provide any material help for the more than 5 million small businesses in this country. Over a 44 month period ending 12/31/18 ("Commission Data Period"), only 119 Tier 1 offering statements were filed (an average of approximately 2.7 filings per month); a mere 86 Tier 1 offerings were "qualified" (an average of approximately 2 offerings per month); and only 27 of those issuers reported the aggregate amount of proceeds raised.

Earlier, I collected data regarding Regulation A+ offerings over a 33 month period ending on March 31, 2018 (hereinafter "Campbell Data Period"). Although my methodology and arrangement of my data are somewhat different from that of the Commission, the Commission data are generally consistent with mine. Both data sets confirm and demonstrate the very scant use of Regulation A+ by small businesses.

One calculation that I made, which the Commission did not, was the extent to which offerings that could have qualified for the Tier 1 regime were, instead, qualified to meet the requirements of Tier 2. My data revealed that 41% of all Regulation A+ offerings of $20 million or less migrated to Tier 2, which obligated the issuer to provide more expensive disclosures, including (most likely) ongoing, future periodic reporting requirements.

The apparent reason for this seemingly counterintuitive move is that the Commission by regulation preempted state registration requirements for Tier 2 offerings under Regulation A+. The Commission, however, failed to preempt state registration authority in Tier 1 offerings.

This is another significant indication that Regulation A+ is not working. Small offerings are abandoning the Tier 1 regime, which was specifically designed for small offerings, migrating instead to Tier 2, a regime with significantly higher offering costs.

The irony here is that the core policies or bases behind Regulation A+ make sense. Fundamentally, Regulation A+ offers an exemption from registration based on the mandatory disclosure of prescribed investment information. It permits a broad solicitation for investors, including unaccredited investors. Properly implemented by Commission regulations, such an exemption could become significant.

Principally Regulation A+ for two reasons failed to provide any significant benefit to the economy, small investors and small businesses: First, the Commission failed to preempt state registration authority of Tier 1 offerings; and second, the Commission failed to scale properly the disclosure requirements for Regulation A+ offerings, especially regarding small offerings.

These problems can be fixed by the Commission.

Below I respond to selective questions raised by the Concept Release in regard to Regulation A+.

QUESTION 47; p. 107:

Do the requirements of Regulation A+ appropriately address capital formation and investor protection considerations?

RESPONSE:

No. The relative offering costs for small offerings make Regulation A+ practically unavailable for small offerings.

This is the result of two factors: state registration requirements, and improper (unbalanced) scaling. Until those are addressed efficiently, Regulation A will be nearly useless to small businesses and will fail to deliver the benefits to society that are possible.

QUESTION 47; p. 108:

Do the costs associated with conducting a Regulation A+ offering dissuade issuers from relying on the exemption?

RESPONSE:

Yes.

It was predictable Regulation A+ would fail as an efficient vehicle for small business capital formation. The same factors described above – unbalanced disclosure requirements and state registration provisions – destroyed the pre-JOBS Act Regulation A for small business offerings, and Regulation A+ changed nothing in that regard.

QUESTION 48; p. 108

Should we increase the $50 million Tier 2 offering limit?

RESPONSE:

Title IV of the JOBS Act is entitled “Small Company Capital Formation.” Increasing the size for permissible Regulation A+ offerings is irrelevant for small business capital formation. Small businesses very rarely need even $50 million, and if they do, relative offering costs do not foreclose them from the market. Offerings of that size can be offered with manageable relative offering costs via registration or other pathways to capital, such as offerings under Rule 506(c).

The question is important, however in that it demonstrates the way that large business interests have been able to co-opt initiatives that were designed for small businesses.

While there is nothing particularly bad about expanding the size of Regulation A offerings, it distracts and deflects from the more important issue: How do we offer small businesses – the more than five million of them that account for more than 20% of all employment nationwide – efficient access to vital external capital?

QUESTION 54; p. 110:

Are the ongoing reporting requirements of Rule 257 appropriate from the perspective of issuers and investors?

RESPONSE:

No, and this is especially important with regard to small Regulation A+ offerings (and Crowdfunding offerings).

Periodic reporting requirements have no place in small offerings under Regulation A+ or otherwise (including Crowdfunding offerings).

The trigger for periodic reporting obligations is governed generally by Section 12(g) of the 1934 Act. To the extent we are dissatisfied with the scope of Section 12(g), we should address the matter globally and uniformly by legislative and regulatory changes. We should not use reporting requirements as a way to impose what amounts to penalties on small issuers using particular exemptions from registration, such as Regulation A+ (or Crowdfunding).

Imposing periodic reporting requirements on issuers using Regulation A+ (and Crowdfunding) is one of the worst ideas in the JOBS Act. It is one of the major reasons for the failures of Title III and Title IV of the JOBS Act.

QUESTION 60; p. 111:

". . . should we eliminate the staff's review and qualification of Tier 1 offering statements . . . ?"

RESPONSE:

Assuming there are information disclosure requirements, filing the information with the Commission does not materially raise offering costs for the small business issuer.

The real problem at the heart of questions 60 and 61 is the state registration and filing requirements, which subject small companies to more than fifty separate and independent registration regimes. It is a bizarre regulatory regime, which can only be explained (but not justified) by historical circumstances and accidents.

The failure of the Commission to preempt, to the full extent of its Congressionally delegated power, state registration authority has been a significant failure on the part of the Commission.

The Commission should by regulation preempt all state registration authority over all Regulation A+ offerings.

QUESTION 61; p. 111.

Do issuers find state advance notice and filing requirements burdensome?

RESPONSE:

Yes, although the question is somewhat confusing.

It is state registration requirements that are burdensome. If a small business were to post on its website an offer to sell $100,000 in common stock, it would likely be subject to 50 separate state registration regimes (plus registration regimes of territories and the District of Columbia). If a small company in Ashland, Kentucky (a small town near the border with Ohio and West Virginia) wishes to offer its securities to residents of Kentucky, Ohio, West Virginia and Virginia, it would be subject to the registration requirements of four states, plus the federal regime.

The impact on transaction costs is significant. As stated earlier, it is the most apparent reason that the more than five million small businesses in the United States average only about 2.7 Tier 1 Regulation A+ offerings per month and that 41% of all offerings of $20 million or less (offerings that could be made under a Tier 1 regime) migrate to the Tier 2 regime.

QUESTION 61; p. 111

". . . . are there changes that would be possible and appropriate for us to consider to alleviate such burdens or would legislative changes be necessary or beneficial in order to do so?"

RESPONSE:

The Commission enjoys broad authority to preempt by regulation state registration authority over all Regulation A+ offerings.

Even before the JOBS Act, Section 18(b)(3) of the 1933 Act (NSMIA) authorized the Commission to expand the definition of covered securities to include securities sold to "qualified purchasers" and delegated to the Commission the broad authority to define "qualified purchasers", limited only by consistency to "public interest and protection of investors". Section 2(b) of the 1933 Act was also amended to require the Commission in such cases to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation."

The Commission never to any material extent used its delegated authority in NSMIA to preempt state registration authority, even in the face of evidence that state registration authority was at times undermining federal exemptions from registration.

Congress in the JOBS Act, restated this broad delegation to the Commission to preempt state registration authority specifically regarding Section 3(b) offerings (the statutory basis for Regulation A+). The Court of Appeals in the *Lindeen v. SEC,* 825 F. 3d 646 (D.C. Cir. 2016) confirmed the breadth of this delegation of authority to the Commission to preempt state registration authority over Regulation A+ offerings.

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Starting on p.110, the Concept Release focuses on the common law intrastate exemption and the regulatory intrastate exemptions in Rule 147 and Rule 147A.

The Concept Release offers no data regarding the use of the intrastate exemptions, since neither the common law exemption nor the regulatory exemptions require any filing with the Commission.

Based on my own experience in practice and informal information from issuers and other lawyers, I believe that generally the regulatory intrastate exemptions work well (the common law is a mess, with residual risk of liability at a level that is unacceptable to issuers in most cases). Perhaps some minor adjustments in the predicates for the exemption under the 147 rules may be helpful, but as I indicate below, my view is that the regulatory exemptions are clear and predictable enough to be attractive to small issuers in many cases, and strike an appropriate balance between investor protection and capital formation.

Below I respond to selective questions raised by the Concept Release in regard to the common law intrastate exemption and the regulatory exemptions provided by Rule 147 and Rule 147A.

QUESTION 71; p. 125:

To what extent are the intrastate exemptions being used?

RESPONSE:

It is impossible to answer this with any degree of certainty, because the exemptions do not require any filing with the Commission.

The Commission should amend the 147 rules to require such a filing. It should be modeled on Form D, the filing of which is not a predicate to the availability of the exemption but contains an incentive to file the notice of use.

We have learned in recent years the value of information regarding the use of certain exemptions. Filings similar to Form D are inexpensive for the issuer and gives the Commission important information that allows it to improve the efficiency of exemptions.

This is, at least in my view, an important requirement. Indeed, in my view it is a very important requirement.

QUESTION 73; p. 126:

Should we eliminate Rule 147 and Rule 147A?

RESPONSE:

No. These are important exemptions for small issuers. I relied on Rule 147 when I was in practice and representing small issuers. In fact, I found Rule 147 useful for an offering or two by a small local company traded under on NASDAQ. The point is that the breadth of use of the 147 rules may be underestimated by some.

When combined with antifraud provisions (which require issuers in connection with their offerings of their securities to disclose to all investors all material investment information), the Rules generally strike an appropriate balance between capital formation and investor protection.

My guess, therefore, is that reliable data would show the regulatory intrastate exemption (Rule 147 and Rule 147) is an important exemption for small businesses in the United States. That is my "guess", perhaps somewhat educated, but still a guess. We need data to monitor these exemptions.

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Starting on p. 127, the Concept Release focuses on the Crowdfunding exemption, which is a regulatory exemption based on Title III of the JOBS Act.

The Crowdfunding exemption has been a dismal failure. For reasons that were predictable, the Crowdfunding exemption is very rarely used by the more than five million small businesses in the United States. In fact, its use numbers are remarkably close to that of Regulation A+.

Commission data in the Concept Release, for example, show that the "aggregate . . . amounts reported as raised in completed [Crowdfunding] offerings" between May 16, 2016 and December 31, 2018 (approximately 31 months) was a paltry $108.2 million. The SEC data show a total of 519 "completed offerings". On a monthly basis, that amounts to $3.5 million per month in aggregate capital raised in an average of 16.7 completed Crowdfunding offerings.

This is consistent with data that I prepared regarding the filing of Forms C (required to be filed before the start of a crowdfunding offering) and Forms C-U (required to be filed as issuer meets its target or at the offering deadline). In the first 23 months following the effective date of the final Crowdfunding Regulations, on average small businesses filed only 38 Forms C filed per month and only 14 Forms C-U filed per month.

Data, therefore, overwhelmingly demonstrate that the more than five million small businesses in this country rarely used the Crowdfunding exemption.

The two most important reasons why the Crowdfunding exemption failed are: (1) The strict limitation on marketing strategies; and (2) the burdensome and expensive disclosure and filing requirements.

Regarding the limitation on marketing strategies, meeting the requirements for the Crowdfunding exemption requires issuers to limit their selling efforts *exclusively* to posting investment information on a third party website. There is no historical basis for the assumption that small businesses can to any material extent raise capital in that fashion. It was, it turned out, a badly misguided bet on technology.

If a small business wants to sell one million dollars to fund a lumber mill, replenish the capital of a small bank, or finance a new restaurant, limiting capital formation strategies to the mere posting of the offer on the internet and forgoing any other selling techniques makes no sense. Old fashioned techniques – identification of likely investors and personal contacts (e.g., face to face, telephonic and electronic conversations, etc.) with those likely investors – are in most cases an essential part of a strategy to raise capital.

Certainly in *some* cases *some* capital can be raised by an internet offer, but limiting strategies to internet offers *exclusively* was the death knell for any widespread use of Crowdfunding.

The other reason for the failure of the Crowdfunding exemption can best be described as the high transaction costs generated by meeting the terms of the exemption. The most obvious of those costs are generated by the filing and disclosure requirements for the exemption.

At the point of offering (ex ante), the issuer is required to file and disclose to investors extensive narrative and financial information. There are more than twenty types of information that must be disclosed, and the information is in some instances reminiscent of the types of disclosures required in a registration statement.[1] Financial disclosures, for example, require two year statements that are compliant with generally

[1]There are, of course, differences. But the similarities are unmistakable. For example, in Crowdfunding offerings, risk factors are required to be discussed, 17 C.F.R. § 237.201(f) (2018). Issuers in Crowdfunding offerings are also required to provide information roughly equivalent to management's discussion and analysis, 17. C.F.R. § 237.201(s) (2018) ("discussion of . . . financial condition, including, to the extent material, liquidity, capital resources and historical results of operations").

accepted accounting principles and include “statements of . . . income, . . . cash flows, . . . changes in stockholders’ equity and notes to financial statements.”[2]

[2] 17 C.F.R. § 227.201(t), Instr. 3 (2018).

While the ex ante disclosures and filing generate significant costs and exposure for the small issuer, it is the ongoing reporting requirements (ex post filing and disclosure requirements) that are likely the most daunting. The annual reports required to be filed following a Crowdfunding offering must include extensive disclosures[3] and may go on for a significant period of time.[4]

Below I respond to selective questions raised by the Concept Release in regard to the Crowdfunding exemption.

QUESTION 79; p. 149:

"Do the requirements of Regulation Crowdfunding appropriately address capital formation and investor protections?"

RESPONSE:

No. See above.

QUESTION 79, p. 149:

"Do the costs associated with conducting a Regulation Crowdfunding offering dissuade issuers from relying on the exemption?"

RESPONSE:

Yes. The costs of ex ante and ex post disclosures of investment information and the costs of the limitations on reasonable marketing strategies (i.e., limiting selling strategies to posting offers on third party websites) overwhelm the value of the Crowdfunding exemption for small businesses.

QUESTION 79; p. 150. ". . . can we alleviate burdens in the rules or reduce costs for issuers, while still providing adequate protection?"

[3] 17 C.F.R. § 227.202(a) (2018).

[4] 17 C.F.R. § 27.202(b)(2018). For example, the issuer can terminate filing its periodic reports following a Crowdfunding offering if the issuer has less than 300 shareholders or becomes a reporting company under the terms of the 1934 Act. In all events, however, the issuer must file one annual report.

RESPONSE:

Yes. The key here is to appreciate the impact on small business capital formation of relative offering costs, the statutory obligation of the Commission under Section 2(b) of the 1933 Act (to consider both investor protection and capital formation), and the disclosure incentive of Rule 10b-5 (requires issuers selling securities to disclose all material investment information).

The Commission should re-scale the ex ante disclosure requirements and jettisoning entirely all ex post disclosure obligations. Ex post periodic reporting and filing should be governed by the terms of Section 12(g) of the 1934 Act. Imposing periodic requirements on issuers utilizing the Crowdfunding exemption amounts to a financial penalty for using the Crowdfunding exemption and is unfair to small businesses.

QUESTION 82; p.150:

"Should we increase the $1.07 million offering limit for the Crowdfunding exemption?"

RESPONSE:

The failure of the Crowdfunding exemption is not to any material extent due to the amount limitation on Crowdfunding offerings. As stated above, the failure of the Crowdfunding exemption is due to the expenses of the ex ante and ex post disclosure requirements and the strict limitation of selling strategies and efforts.

If those problems were eliminated, it might make sense to raise the limitation on the size of the offering. Those larger offerings could be made subject to a scaling of disclosure requirements.

The overall theory of the exemption – protecting investors by electronic delivery of information – is in today's world a sound idea.

QUESTION 86; p. 152:

"Should we revise the rules that require issuers to provide reviewed or audited financial statements?"

RESPONSE:

These rules should be revised as part of a review and re-scaling of the entire disclosure requirements of Regulation Crowdfunding.

QUESTION 89; p.153: “. . . should we allow for more communication about the offering outside the funding portal?”

RESPONSE:

Yes.

QUESTION 89; p.153:

“. . . what would be the benefits of allowing more communications?”

RESPONSE:

The benefits would be an increase in the investment information available to investors and a more workable exemption for small issuers.

QUESTION 104; p.170:
“Should we articulate one integration doctrine that would apply to all exempt offerings? If so, what should that integration doctrine be?”

RESPONSE:

My RESPONSE to this QUESTION, which follows, is my answer to QUESTION 104 through QUESTION 110 in the Concept Release, all of which deal with integration.

The goal of the Commission should be to eliminate the integration doctrine in its entirety. The doctrine makes no sense: It offers no protection to investors and generates additional offering costs for issuers. It rears its ugly head in many different settings but is most prevalent and pernicious in offerings by small businesses. *See* Rutheford B Campbell, Jr., The Overwhelming Case for Elimination of the Integration Doctrine Under the Securities Act of 1933, 89 Ky. L.J. 289 (2001).

I offer the following examples to demonstrate the absence of any policy basis for the integration doctrine.

Assume a small issuer that needs capital proposes to make a $2 million offering of its common stock. One half of the offering ($1 million) will be made under the common law private placement exemption of Section 4(a)(2), and the other one half ($1 million) will be made under the common law intrastate exemption of Section 3(a)(11). The entire offering – both the Section 4(a)(2) component and the Section 3(a)(11) component – will be made simultaneously.

Application of the integration doctrine to this situation makes it highly unlikely that the issuer can make this offering. Allowing this offering to go forward (abandoning the integration doctrine), however, in no way compromises the policy underpinning the two exemptions and thus does not harm investors.

The policy usually given for the Section 4(a)(2) exemption is that investors are protected because they can fend for themselves (e.g., they are insiders and/or are sophisticated and have access to investment information). The policy usually given for the intrastate exemption is that investors are protected by cheap access to investment information due to their geographic proximity to the issuer or are protected because of state registration and antifraud laws.

The fact that the two parts of the $2 million offering are made at or about the same time in no way compromises the policy bases for the two exemptions. The protections of investors in both components of the offering are still present: The investors in the private placement component are still protected because they can fend for themselves; the investors in the intrastate component are still protected by their geographic proximity to the issuer and by state securities laws.

The application of the integration doctrine to the situation, however, obviously and significantly harms the small issuer seeking external capital. It exacerbates the structural and economic impediments otherwise facing small businesses when they look for external capital.

In short, the doctrine makes no sense.

One can, of course, demonstrate the nonsense of the integration doctrine by using other exemptions as examples. Imagine, for example, that the issuer would like to make a simultaneous $2 million offering that is split equally between the Rule 506(b) exemption and the Crowdfunding exemption. Once again, the integration doctrine makes it unlikely that a well advised issuer would pursue such an offering strategy. The safe harbor of Rule 502(a) would not seem to be available to protect the Rule 506(b) portion of the offering, and notwithstanding the Commission’s exceedingly confusing and theoretically problematic “guidance” (discussed more fully below), I would be unwilling to opine that the Crowdfunding offering – which has no regulatory safe harbor – is safe from the application of the integration doctrine.

To its credit, the Commission has over the years attempted to ameliorate the pernicious effect of the integration doctrine by offering number of regulatory safe harbor protections. The regulatory safe harbors, however, often have been confusing, inconsistent and void of any legitimate policy bases. The Commission's approach to the integration doctrine in its Crowdfunding exemption has been especially confusing and problematic.

In its release adopting the final Crowdfunding rules, the Commission undertook to "provide guidance . . . that issuers may conduct other exempt offerings without having those offerings integrated with the . . . [Crowdfunding offering], provided that each offering complies with the applicable exemption relied upon for that offering." (SEC Crowdfunding Release No. 33-9974, p. 391). Not only is that an exceeding confusing rule for the issuer to try to apply, but also it is a rule that would otherwise supplant the common law of integration. While the Commission clearly has that right to enact a regulatory safe harbor, it is difficult to understand how the Commission can create a regulatory safe harbor essentially overruling the common law of integration without a properly authorized and enacted regulation.

In its Concept Release, however, the Commission attempted to clarify its basis for this rather unorthodox method of making rules. (*See* p. 69 of the Concept Release.) There the Commission cited Section 4A(g) of the 1933 Act, using the following language from that statute as authority for its "guidance": "Nothing in the [Crowdfunding] exemption shall be construed as preventing an issuer from raising capital through means other than [S]ection 4(a)(6)." Based on this new citation of authority, the Commission repeats its guidance first offered in the final release adopting the Crowdfunding rules, which is that ". . . an offering made reliance on Section 4(a)(6) is not required to be integrated with another exempt offering made by the issuer to the extent that each offering complies with the requirements of the applicable exemption that is being relied on for that particular offering."

For two reasons the guidance does not resolve the integration problem for an issuer that wants to make a simultaneous offering under Rule 506(b) and the Crowdfunding exemption. First, it is not at all certain that a court would agree with the guidance. Second, even if a court did agree with the guidance, it is unclear that the guidance protects the offering from integration. Rule 506 has its own integrations safe harbor, which conditions would not be met in the simultaneous offering. Literally, therefore, the conditions for the Rule 506(b) exemption, therefore, would not be met.

While there is no absolute certainty regarding integration in a simultaneous offer under the Crowdfunding exemption and Rule 506(b), it would seem unreasonably risky for the issuer to rely on the guidance in such a case. For myself as lawyer, I would be uwilling to opine that such a course of conduct is legal. The probabilities of illegality (and the resulting civil and criminal penalties) are simply too great.

This revised approach by the Commission, therefore, does not resolve the problems for a small business that proposes to raise $2 million in an offering that relies on the Commission's integration guidance.

To repeat, the Commission should work to eliminate in its entirety the integration doctrine.

Sincerely,

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