kaplan voekler cunningham & frank PLC

March 23, 2014

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 33-9497, File No. 57-11-13-Regulation A and Exemptions Under Section 3(b) of the Securities Act of 1933

Dear Ms. Murphy:

As a law firm with deep relationships to lower mid-market businesses or smaller, we believe Regulation A ("Regulation A"), promulgated under Section 3(b) of the Securities Act of 1933, as amended (the "Securities Act"), and as revised by Title IV of the Jumpstart Our Business Startups ("JOBS") Act, presents the best possible balance between allowing such businesses the ability to form meaningful capital while maintaining a rigorous, but workable regulatory structure at the federal and state levels.

We believe that the Commission has, overall, done an excellent job of maintaining that balance between investor protection and an efficient capital channel for companies with home we deal in the crafting the rules proposed for implementing Title IV. As such, our comments will be limited to areas we believe should be of particular focus to the Commission in light of our general support.

State Preemption

We strongly encourage the Commission to maintain the definition of "Qualified Purchaser" as proposed by the Commission. The stated intent of the JOBS Act, set forth in the preamble to the statute, is "To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies."

State securities regulation has been one of the largest obstacles inhibiting the usage of Regulation A. State preemption is a critical element of a workable Regulation A solution. The Government Accountability Office ("GAO") found precisely the same when, in its study of Regulation A required under the JOBS Act, GAO indicated that state securities regulation was a significant factor contributing to Regulation A's lack of usage.[1] State preemption is an integral

[1] See also, Testimony of Robert R. Kaplan, Jr., before the Senate Subcommittee for Securities, Insurance and Investment Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.LiveStream&Hearing_id=c2fe9f9a-0e5e-4b44-a566-4a8cef26c06e.

piece of making this an efficient and workable means of forming capital and a market with sufficient size so that the advantages of Regulation A can be realized fully.

Certain state regulators have argued that the proposed definition would subject the investing public to unreasonable risk. This position is sensational and without merit. Despite claims in the abstract, the states will not be hampered in their pursuit of protecting investors from fraud. In fact, the states are perhaps assisted in the context of this exemption like never before.

First, let's consider what has been preempted. All that has been preempted is a laborious and unwieldy state registration process, for which the correlation to actual fraud prevention is unclear. In those states that engage in review of disclosure, that process is being handled ably by the Commission at the federal level. As to those states that engage in "merit review," that process imposes arbitrary and formulaic guidelines (either derived from NASAA statements of policy or created from whole cloth) to an issuer's composition, governance, or offering structure, without regard to the actual circumstances of either or the actual efficacy of what is being imposed. It is hard to imagine what fraud protection comes from this process, and certainly none that justifies or merits the cost, delay and uncertainty attendant with a multistate blue-sky registration process. [2]

Now let's consider what actual fraud protection can take place under the system being proposed by the Commission. State regulatory agencies will have at their fingertips full access to the offering disclosure and ongoing reporting of Tier 2 issuers through their use of the EDGAR system. The states can monitor issuer activity at will and have a complete set of information related to issuers active within their jurisdictions. They can use this information to make inquiries of the issuer, look for patterns of illicit conduct, assist in investigations, etc. States can and do play an important role in the protection of investors by being on the front line of day to day activity in the marketplace and responding to actual fraudulent conduct – not by commenting to the provisions in an issuer's by-laws or engaging in a duplicative process of disclosure review. By making Regulation A as viable as possible, the states have the opportunity to have information on a more diverse range of issues than ever before.

Various state regulators have also argued that the Commission's proposed "qualified purchaser" definition is inconsistent with Congressional intent – that a sophistication standard was contemplated in any definition of qualified purchaser, as evidenced by legislative history of early iterations of the Small Company Capital Formations Act (the predecessor to Title IV of the JOBS Act) and the National Securities Markets Improvement Act of 1996 (NSMIA). However, the cited legislative history did not identify investor sophistication to the exclusion of other methodologies. Further, and perhaps more importantly, plain statutory language trumps any proffered evidence of legislative intent. If Congress intended sophistication to be the exclusive means by which to define "qualified purchaser," Congress could have easily included such language within either statute. It did not.

[2] For example, the Commonwealth of Massachusetts has been quite vocal in its opposition to the qualified purchaser definition, but its assertion that state review is a necessary component of balancing capital formation and investor protection. However, that assertion is not consistent with our past experience with Regulation A filings in Massachusetts where we have seen delay of up to 12 months to receive commentary to initial filings.

Finally, where Congress and the Commission have historically applied a sophistication standard to definitions of classes of investors, <u>there have been no limitations on the amount that an investor may commit in the context of these offerings and little to no oversight of the offering process or disclosure</u>.[3] As the Commission correctly points out in its proposal, Tier 2 does both - it limits the amount that an investor can place in a given offering, as discussed below, thus limiting any exposure by a given investor to loss and requires a thorough and standardized method of disclosure and ongoing reporting **overseen by the Commission.**

Admittedly, NASAA has proposed a coordinated review process for Regulation A, but this apparatus falls far short of the effective and efficient balance achieved by the Commission through the "qualified purchaser" definition. The proposal provides timeframes for preparation of an initial response letter, response by other reviewing states and submission to the issuer. The proposal further provides that lead examiners will reply to each issuer's response to a comment letter within five (5) days of receipt. However, the proposal seems to be far more focused on the "form" of the coordinated review and not on implementing critical substantive elements necessary to creating a transparent, understandable and expeditious review process upon which issuers can rely.

For example, the proposed protocol requires the lead merit examiner to apply applicable NASAA statements of policy, as modified in the proposal, in preparing the initial comment letter, but is silent as to whether the other reviewing jurisdictions should approach their review and submission of comments in the same manner. Our experience is that the examination process associated with Regulation A offerings by state securities authorities has prompted them in many cases to make all sorts of inquiries, including inquiries into the conduct of unrelated offerings by affiliated entities of the issuer over which they have no control. Nothing within this proposal would impose a disciplined standard for review upon reviewing jurisdictions beyond the lead examiners. Furthermore, there would appear to be no authority under this program for the lead examiner to impose such a standard on the other reviewing jurisdictions or "overrule" comments outside of such standards.

While the proposal provides specified timeframes for replying to issuer responses to comment letters, and further provides that jurisdictions will clear once the lead examining jurisdictions clear, it provides no process, timeline or standard for resolving controversies between issuers and jurisdictions related to comments.[4] An application could conceivably remain open indefinitely if the comments are not addressed to the arbitrary satisfaction of the lead examiner or an individual jurisdiction, if the lead examiner is inclined to leave registration open until <u>all</u> reviewing jurisdictions are fully satisfied.

---

[3] For example, "accredited investors" under Regulation D offerings where the Commission does not engage in disclosure review, or the "qualified purchaser" definition in the context of exemptions from reporting and regulation under the Investment Company Act of 1940 . *See* 17 C.F.R. § 230.501 and 17 C.F.R. § 230.506 in respect of the definition and usage of the term "accredited investor" under Regulation D and *see* 15 U.S.C. § 80a-2(a)(51) for the definition of "qualified purchaser."

[4] The proposal also does not provide for coordination between the disclosure and merit review jurisdictions. So, for example, you could have quick review and clearance by the disclosure jurisdictions, but have the merit review process drag on indefinitely. Through unfortunate experience we have learned that merit review changes to an offering often come very late in the offering process putting an issuer in the difficult position of making wholesale changes to its offering structure, which then result in delays in the Commission's review, or, alternatively, dropping its registration in states providing excessive or late comments.

The NASAA proposal also provides no process where an issuer may appeal or otherwise seek redress where an issuer does not believe a given review process is in compliance with the requirements of this proposal. While cost is an important factor issuers consider, far more pressing in the issuer's mind, is the lack of definition and the complete uncertainty which is characteristic of the current state review process. Without mechanisms built into this program to hold coordinating states to its terms, that uncertainty shall persist and pervade, further discouraging offerings under Section 3(b)(2) of the Act.

The proposal also does not speak to the interplay of state and federal review. For example, while the proposal provides for timeframes to reply specifically to responses by issuers to comment letters generated by the specific coordinated review group in a given case, the proposal does not state that those timeframes apply to amendments to offering circulars caused solely by federal review and comments. Are the timeframes indicated intended to apply in these situations? Also, no guidance is provided as to the interplay of federal review of disclosure versus state disclosure review should conflicts arise in the commentary provided to the issuer.

Finally, NASAA can provide no assurance as to the timeframe for adoption of the program by states, or that a significant number of states will adopt. Title IV has been on the books for almost two years, how long will we need to wait for this program, assuming other issues cited above are addressed? Further delay confounds Congress's intent in enacting this law.[5]

We note that the "qualified purchaser" definition does not apply to resales of Regulation A securities, even where issuers are up-to-date in their reporting requirements. While we do not believe this fatal to a secondary market, the complications presented by having to ensure that resale complies with registration requirements or exemptions under applicable state law could create unnecessary complexity to the development of an active secondary market as intended by Title IV.[6] Ultimately, a secondary market will provide features for Tier 2 securities, like liquidity and market accepted governance practices, that will be accretive to both capital formation and investor protection, so the Commission should act to apply to the "qualified purchaser" definition in the context of secondary transactions in Tier 2 securities.

The 10% Cap on Investment in Tier 2 Offerings

The Commission has proposed a 10% cap on investment in an individual offering, but has requested comments as to whether the cap should be imposed on the aggregate. An aggregate cap on Tier 2 investments is not a necessary or appropriate investor protection. While the individual offering cap can arguably help protect investors from the downside risk associated with investing in smaller companies by forcing investment diversification, the aggregate cap

[5] NASAA's track record in recent history is not stellar in creating programs to expedite and streamline the state regulatory process. For example, NASAA and the Commission entered into a Memorandum of Understanding regarding a coordinated state Form D filing process in April of 2010 (see http://www.sec.gov/info/smallbus/nasaa-mou-040510.pdf); however, no such process has come to fruition.

[6] For example, we recently approached Depository Trust Corporation ("DTC") to qualify securities offered under Regulation A for their platform, but were not successful. One of the reasons we could not accomplish this was DTC's concerns with the applicability of a multitude of state securities laws to secondary activity and what issues that might entail, although we do understand that DTC is looking into these questions now.

could serve to prevent that very same diversification into other Tier 2 offerings. Tier 2 offerings, and Regulation A in general, if successfully transformed into the viable, vibrant exemption intended by the JOBS Act, can offer smaller investors opportunities that were previously only available to those meeting accredited investor status and we do not believe the Commission should limit those opportunities with an aggregate cap.

Another critical feature of the 10% cap is the method by which an issuer must verify that each investor is not exceeding his or her cap. The current proposed rule permits issuers to rely on representations made by the prospective investor as to his or her income and net worth, unless the issuer knows that the prospective investor's representations are untrue. The Commission has solicited comment as to whether additional verification steps should be required of issuers in Tier 2 offerings. As the Commission notes in its proposal, there are investor privacy and practical concerns with requiring additional verification of investor information in a Tier 2 offering. We concur with the Commission on this front.

In addition, we urge the Commission to adopt a rule permitting an issuer to rely on representations from its underwriters and broker-dealers as to the 10% cap, rather than directly from the investors. We anticipate that investment closings for Tier 2 offerings will occur in much the same manner as closings of publicly registered offerings, with little or no direct contact between the issuer and the investor. Permitting the financial intermediaries with whom the issuer has a direct relationship to verify compliance with the 10% cap will eliminate unnecessary administrative procedure in Tier 2 closings. Further, as a result of the typical relationship between a financial intermediary and its investor clients, such intermediaries will likely be better positioned than the issuer to assess compliance, and in many instances will already have on hand the type of private investor financial information the Commission rightfully worries over an issuer requesting.

Potential Limitation to Operating Companies

Traditionally, Regulation A has excluded investment companies, blank check companies and issuers of fractional interests in oil and gas or other mineral rights. We have no objection to the Commission's determination to maintain these exclusions, and we support the Commission's decision not to expand the exclusions from Regulation A in a significant manner.[7]

Nevertheless, the Commission has solicited comment whether Regulation A's exclusions should include any issuer that is not an "operating company." While the Commission has not laid out a specific definition of "operating company", the Proposing Release indicates that any such definition would be expected to exclude "those enterprises with the principal business of investing or reinvesting funds in securities, properties, commodities, business opportunities or similar media of speculative opportunity" from reliance on Regulation A.

---

[7] That said, we do believe that Business Development Companies ("BDCs") should be permitted to utilize Regulation A, despite their regulation under the Investment Company Act of 1940. BDCs invest in the types of companies that stand to benefit the most from new Regulation A and, therefore, permitting BDCs themselves to rely on Regulation A will serve Congress's intent under Title IV.

We do not believe that Regulation A should be confined to such a narrow group of issuers. The JOBS Act is intended to facilitate the formation of capital to create jobs. The formation of capital, whether directly by operating companies, or by enterprises that invest or reinvest the funds, leads to job creation. Rendering Regulation A the exclusive purview of operating companies will unnecessarily limit the capital raising options of the very financial facilitators needed to make Regulation A viable.

At the same time, the distinction between "operating companies" and other vehicles that the request assumes is fallacious in that the request presumes that only "operating businesses" create meaningful employment. That, however, is mistaken. Take real estate, for example – professional real estate funds create varied and numerous avenues of employment, including leasing staff, marketing staff, property maintenance, landscaping, security, investor relations, accounting, legal – and the list goes on.

Finally, enterprises for the purpose of investing or reinvesting funds can provide a means for investors to achieve greater diversity with less exposure to investment in Regulation A securities – an effective strategy for mitigation of risk.

Given the lack of precedent for the exclusion of all issuers other than operating companies, and the plethora of reasons to permit the use of Regulation A by enterprises and structures which aggregate capital, we would encourage the Commission not to expand the exclusions related to Regulation A beyond their current scope.

Application of Section 12(g) of the Securities Exchange Act of 1934

The Commission has determined that Section 12(g) of the Securities Exchange Act of 1934, as amended by Title V of the JOBS Act, and the Commission's jurisprudence related to Rule 12(g) should apply to Regulation A securities. We do not object to this determination. That said, we would point out that we do not understand the application of the distinction between accredited and non-accredited investors to Regulation A.

More to the point, the Commission should dispense with the cap of 500 non-accredited investors for purposes of issuers making Tier 2 offerings who are current in their reporting as required by new Regulation A. Accreditation is not required to purchase securities in a Tier 2 offering. There does not appear to be any logical reason for why this would matter in the after market.

Furthermore, Regulation A issuers may choose not to access capital through broker-dealers, or may access it through broker-dealers unwilling or unable to hold securities on behalf of their clients. In these cases, the 500 non-accredited investor cap could have a chilling effect on such an issuer's capacity to raise capital in a Tier 2 offering. In a $50 million dollar Tier 2 offering or even in Tier 2 offerings of significantly less than the maximum, an issuer would be required to sell a significant portion of the offering to accredited investors because the proposed 10% investment limitation would cap the amount a non-accredited investor could put into a Tier 2 offering at less than $100,000. The 500 non-accredited investor threshold should not be

applied in respect of the holders of Tier 2 securities, as long as the issuer of such securities is current in its reporting.

Implications of Tier 2 Reporting: Exchange Act Rule 15c2-11 and Securities Act Rule 144

As a preliminary matter, we believe the reporting requirements proposed for issuers in Tier 2 offerings will be a powerful factor in the development of a workable secondary market for these securities.

We would also commend the Commission in its foresight in addressing certain other matters related to the issue of liquidity which should (i) attract more issuers to the Regulation A format and/or (ii) should facilitate the creation of meaningful liquidity in these securities. We strongly support the proposal that the reports required of issuers in a Tier 2 offering will qualify as adequate information under Rule 15c2-11.

We also strongly support the Commission's suggestion that Rule 144 promulgated under the Securities Act could be amended to include reporting under Tier 2 in the categories of publicly available information for a non Exchange Act reporting issuer that will allow such an issuer's securities holders to rely on Rule 144 to sell their otherwise restricted securities to the public. This makes logical sense as the Tier 2 reports will contain substantially all of the public information enumerated in Rule 144 for non-reporting issuers. It will create a powerful motivator for issuers to gravitate towards the Regulation A regime, since they will now be able to provide a modicum of liquidity for their investors in restricted securities – thus, providing for enhanced oversight and transparency in investments across a broad spectrum of issuers and product types. Finally, it would further enhance Regulation A's ability to provide a viable exit to companies which would otherwise not be viable IPO candidates in the traditional listed markets due to their size or current market conditions.

Application of Regulation D "Bad Actor" Provisions in Proposed New Rule 262

We have represented multiple issuers in Regulation D offerings made following the effectiveness on September 23, 2013 of the Regulation D "bad actor" rules in Rules 506(d) and (e) (the "Reg D Bad Actor Rules"). While we generally maintain our position of support for the application of the Regulation D "bad actor" provisions to Regulation A, as first stated in our comment letter of May 14, 2013, we believe the Commission should consider the following changes to the proposed Rule 262 ("Proposed 262").

1. Indicate that representations and warranties from broker-dealers *directly paid* by the issuer suffice for compliance with the "reasonable care exception" set forth in Section

b(4) of Proposed 262 in respect of the investigation of "compensated solicitors"[8] receiving indirect compensation through such broker-dealer.

As Proposed 262 is written, all managing and participating broker-dealers and their executive officers, directors, general partners, managing members and officers participating in the offering would be covered persons[9]. Furthermore, all of the registered representatives of each managing or participating broker-dealer would also be potential covered persons. In this respect, the breadth of compensated solicitors under Proposed 262 significantly departs from current rule 262 in which only underwriters and their partners, directors and officers are covered persons.

We believe the advantages revised Regulation A will offer over Regulation D in conducting offerings, primarily public solicitation coupled with sales to non-accredited investors, together with the increase in the Tier 2 offering limit to $50 million will lead to much greater numbers of compensated solicitors being involved in Regulation A offerings than is commonplace under Regulation D. Whether smaller broker-dealers form larger syndicates or larger broker-dealers with many registered representatives become involved in Tier 2 offerings, the result will be that an issuer may have hundreds, if not thousands, of broker-dealers, officers and registered representatives of which to make factual inquiry under the requirements of the "reasonable care exception" in Proposed 262. Any mistake in carrying this compliance burden could invalidate the entirety of the Regulation A offering.

In the context of our representation of Regulation D clients regarding compliance with the Reg D Bad Actor Rules, we have had a recent telephone conversation with the staff of the Commission regarding what factual inquiry would be necessary of a broker-dealer and its control persons and registered representatives. The staff indicated to us that the critical piece of the factual inquiry is that questions regarding potential disqualifying events are asked of, and answers received from, each potential covered person. Notably the staff indicated that reliance on representations and warranties and a review of a public database, such as FINRA's Broker-Check in the case of a broker-dealer or registered representative, would not be enough to satisfy the factual inquiry requirements.

We believe a direct factual inquiry requirement is perfectly reasonable in respect of the issuer, its predecessors, control persons, promoters and others generally having a direct relationship with the issuer (such as a managing underwriter or broker-dealer) because these persons will have the capacity to directly influence the structure, management and, ultimately, success of the issuer. On the other hand an issuer should not be required to directly investigate the myriad control persons and registered representatives of broker-dealers who become covered persons by virtue of their participation in a Regulation A offering syndicate. These persons are merely salesmen, or the control persons of salesmen, for the issuer's securities without the ability to influence the issuer's policies or management. Therefore the investor risk associated with one

---

[8] The term "compensated solicitor" is used to refer to the class of covered persons defined in Rule 506(d) and Proposed 262 as "any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities."

[9] We generally refer to the executive officers, directors, general partners, managing members, and officers participating in the offering of a "compensated solicitor" as "control persons" in this letter.

of such persons being subject to a disqualifying event does not compare to that of other covered persons and does not justify the burden placed on issuers to make factual inquiry of each and every one of them in order to qualify for the "reasonable care exception."

The stated purpose of the JOBS Act is to create greater access to capital for our country's job creating small businesses. Increasing the compliance burden, and legal risk, associated with engaging those persons who may help a small business access capital in a Regulation A offering is not the path to this goal. We believe that altering Section (b)(4) of Proposed 262 to indicate that in respect of "compensated solicitors" not paid directly by the issuer, or the control persons of a such an indirectly compensated solicitor, the receipt of representations and warranties as to disqualifying events, or the lack thereof, from the applicable broker-dealer (or other compensated solicitor directly receiving payments from the issuer) is sufficient factual inquiry to comply with Proposed 262's "reasonable care exception" will ameliorate an otherwise excessive regulatory burden without compromising the intent of Proposed 262 to prevent bad actors from participating in Regulation A offerings.

Such an alteration is minimal in nature, and therefore would comply with the JOBS Act requirement that "bad actor" rules under revised Regulation A be substantially similar to the Reg D Bad Actor Rules.

2. Revise the "look back" periods associated with Proposed 262's disqualifying events to run from the time of sale, not from the time of filing of the offering statement as proposed.

Most of the disqualifying events set forth in Proposed 262 (a)(1)-(8) have a look back period associated with them indicating that an event that would otherwise be disqualifying is not if it happened a certain amount of years in the past. Looking back from the time that an offering statement is filed, rather than from the date a sale is made, in determining whether a past event is disqualifying will create undesirable results in certain circumstances, especially in the context of continuous or delayed offerings.

By way of example, under Section (a)(5) of Proposed 262, an issuer with a covered person who is subject to a Section 5 cease and desist order of the Commission entered less than five years prior to the filing of the offering statement, but greater than five years prior to any sale, would be disqualified from reliance on Regulation A. On the other hand, under Proposed 262, an issuer with a covered person who becomes subject to a Section 5 cease and desist order following the filing of the offering statement[10], but before the date of sale, would not be disqualified from reliance on Regulation A. The potential for a similar result exists across several of the provisions of Section (a) of Proposed 262. We do not believe this within the intent of the bad actor rules, and, therefore, propose that the Commission revise Proposed 262 to provide that the disqualifying event look backs run from the date of sale, rather than the date of the offering statement.

[10] If the Commission elects to retain the look backs as proposed, then we would ask that the Commission clarify whether the "filing of the offering statement" means the filing of the initial offering statement or its most recent amendment.

We would like to thank the Commission in advance for its consideration of our comments. As stated previously, we believe the Commission's proposal presents a well thought out regulatory scheme overall, which should allow for the effective implementation of Regulation A as a viable alternative to the middle market and smaller businesses. Our comments are only intended as suggested improvements to an excellent piece of work on the part of the Commission.

Kind regards,

Robert R. Kaplan, Jr.
Managing Partner, Practices

T. Rhys James
Attorney