

SPLITTING THE BABY: THE DEATH OF SMALL BUSINESS

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I. INTRODUCTION

When Congress passed the Jumpstart Our Business Startups Act (JOBS Act), Congress gave the Securities and Exchange Commission (SEC or the Commission) three new tools for small business capital formation.¹ First, Title II of the JOBS Act allows for broad solicitation of investors for offerings under Rule 506.² Second, Title III of the JOBS Act allows for offerings of up to \$1 million through crowdfunding over the Internet.³ Third, Title IV of the JOBS Act focuses on small business capital formation through the addition of section 3(b)(2) to the Securities and Exchange Act of 1933 (Securities Act).⁴ The SEC's unworkable and ineffective implementation of Title IV, commonly referred to as Regulation A+, will be the main focus of this Comment.

Although there was initial enthusiasm in anticipation of the final Regulation A+ rules,⁵ the final rules as adopted by the SEC are unlikely to provide any relief for small businesses that are in desperate need of external capital. This is due in large part to the SEC's failure to balance investor protection and the promotion of "efficiency, competition, and capital formation."⁶ The final rules for Regulation A+ are plagued with over-

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¹ Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, § 401(b)(2), 126 Stat. 306, 323–24 (codified at 15 U.S.C. § 77c(b)(2) (2012)); *see also* Rutheford B. Campbell, Jr., *The SEC's Regulation A+: Small Business Goes Under the Bus Again*, 104 KY. L.J. 325, 345 (2016).

² Campbell, *supra* note 1, at 345 ("Rule 506(c) now permits a broad solicitation for investors, imposing the investor protection provision—which is the accredited status of the investors—at the point of purchase. The correct implicit assumption of this is that no material harm to investors results from the broad solicitation, so long as the *purchasers* meet the accredited investor requirement.").

³ *Id.* (stating essentially, this permits small issuers to post their offerings on the Internet but prohibits any other sales activities).

⁴ 15 U.S.C. § 77c(b)(2) (2012).

⁵ *See* Michael Raneri, *Raising Growth Capital via Regulation A+*, CFO (May 29, 2015), <http://ww2.cfo.com/credit-capital/2015/05/raising-growth-capital-via-regulation/>.

⁶ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,864 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts.

regulation, which defeats Regulation A+'s own underlying goal: reducing costs for capital formation by small businesses.⁷ While governmental regulation of the formation of capital has its historic roots and serves a clear beneficial purpose,⁸ that same regulation must be reasonable so as not to extinguish the entrepreneurial spirit that drives our economy forward.

Part II of this Comment will provide a brief background of the history of securities regulation. Part III traces the evolution of Regulation A and other relevant portions of the Securities Act. Part IV provides an overview and explanation of the final rules for Regulation A+ that were adopted by the SEC. Part V compares the final rules with the myriad of superior alternatives that the SEC ignored. Finally, Part VI provides a temporary solution for small businesses seeking external capital, by way of Rule 506(c), and invites Congress to direct the SEC to revisit its adopted regulations. Part VII concludes.

II. BRIEF HISTORY OF STATE SECURITIES REGULATION

Securities regulation has existed in the United States since the mid-nineteenth century.⁹ Beginning in the early twentieth century, people began to realize the need for a more comprehensive securities regulation regime.¹⁰ Although the federal government dominates the realm of securities regulation today, the earliest securities regulations regimes were under the exclusive control of the states,¹¹ and these regulations are now known as "Blue Sky" laws.¹² These state Blue Sky laws placed several burdens on the

200, 230, 232, 239, 240, 249, and 260); *Lindeen v. SEC*, 825 F.3d 646, 652 (D.C. Cir. 2016).

⁷ Campbell, *supra* note 1, at 327 ("[I]t is impossible to conclude that an efficient and fair allocation of capital in the case of small businesses is facilitated by imposing fifty-plus separate and independent securities registration regimes on small businesses when they search for external capital.").

⁸ Norman S. Poser, *A Monument to a Regulatory System*, 92 MICH. L. REV. 1797, 1800 (1994) ("The complex and interesting history of federal securities regulation goes back to the common law of England and the United States and to English statutes of the nineteenth century, as well as to the efforts of state legislatures in the early twentieth century to regulate the securities markets in order to protect investors.").

⁹ See, e.g., *Lindeen*, 825 F.3d at 648 (citing Act of May 21, 1852, ch. 303, 1852 Mass. Acts 208) ("[R]equiring railroad companies chartered in Massachusetts to file certificates 'stating that all of the stock named in [their] charter has been subscribed for by responsible parties, and that twenty per cent [] of the par value of each and every share of the stock thereof has been actually paid into the treasury of the company'").

¹⁰ See generally STUART BANNER, *ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS 1690-1860* (2002).

¹¹ The Supreme Court, by 1917, had affirmed the constitutionality of these state laws. See *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 549-50 (1917) (describing the origins of state Blue Sky laws); *Caldwell v. Sioux Falls Stock Yards Co.*, 242 U.S. 559, 562 (1917) (describing early Blue Sky laws in North Dakota); *Merrick v. Halsey & Co.*, 242 U.S. 568, 571-72 (1917) (describing early Blue Sky laws in Michigan).

¹² Elisabeth Keller, *Introductory Comment: A Historical Introduction to the Securities*

sale of securities, including pre-sale registration of the securities with the state and pre-sale “merit” reviews of the security sale.¹³ The hurdles created by state Blue Sky laws remain in place today¹⁴ and are a main source of failure for Regulation A+.

III. HISTORY OF REGULATION A

The SEC first adopted Regulation A in 1936,¹⁵ but the statutory basis for Regulation A can be found in section 3(b) of the Securities Act.¹⁶ When it was originally adopted by the Securities Act, section 3(b) allowed the SEC to adopt exemptions that were “in the public interest” for offerings of up to \$100,000.¹⁷ By 1945, it became clear that this exemption was underutilized so Congress tripled the limit to \$300,000.¹⁸ Congress again raised the limit to \$500,000 in 1970, but the exemption was still ignored.¹⁹ In 1978, Congress raised the limit twice, first to \$1,500,000 and then to \$2,000,000 a few months later.²⁰ Finally, in 1980 Congress raised the limit for offerings under section 3(b) to \$5,000,000 where it remained until the recent adoption of Regulation A+.²¹

When adopted, Regulation A was heavily predicated on exemptions from the usual filing and disclosure requirements of other types of offerings.²² Instead of the typical registration statement and prospectus required under other registered offerings, Regulation A required the issuer to file an offering statement with the SEC and to provide investors with an offering circular.²³ These requirements were theoretically designed to save small businesses money when trying to raise capital by reducing disclosure obligations and thereby reducing the cost of conducting an offering.²⁴

Act of 1933 and the Securities Exchange Act of 1934, 49 OHIO ST. L.J. 329, 331 (1988) (“State securities statutes were known as ‘blue sky’ laws, because some lawmakers believed that ‘if securities legislation was not passed, financial pirates would sell citizens everything in [the] state *but* the blue sky.’” (emphasis in original) (citation omitted)).

¹³ Campbell, *supra* note 1, at 330, 338.

¹⁴ *Id.* at 335–44.

¹⁵ Securities Act Release No. 33-627, 1936 WL 30895 (Jan. 21, 1936).

¹⁶ 15 U.S.C. § 77c (2012).

¹⁷ Securities Act of 1933, ch. 38, §3(b), 48 Stat. 74 (codified as amended at 15 U.S.C. § 77c (2012)); Rutheford B. Campbell, Jr., *Regulation A: Small Businesses’ Search for “A Moderate Capital,”* 31 DEL. J. CORP. L. 77, 100 (2006).

¹⁸ Act of May 15, 1945, ch. 122, 59 Stat. 167.

¹⁹ Act of Dec. 19, 1970, Pub. L. No. 91-565, 84 Stat. 1480.

²⁰ Compare Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 18, 92 Stat. 275 (1978), with Act of Oct. 6, 1978, Pub. L. No. 95-425, § 2, 92 Stat. 962.

²¹ Small Business Investment Incentive Acts of 1980, Pub. L. No. 96-477, tit. III, § 301, 94 Stat. 2275 (codified as amended at 15 U.S.C. § 77c(b)(1) (2012)).

²² Campbell, *supra* note 1, at 329.

²³ Commodity and Securities Exchanges, 17 C.F.R. § 230.251(d)(1)–(2) (2005).

²⁴ Campbell, *supra* note 1, at 329.

The offering statement, which needs to be filed with the SEC, is composed of four parts: the notification, the offering circular, the exhibits, and the signature page.²⁵ The offering circular, which is circulated to potential investors, contains the basic investment information and has proven to be prohibitively expensive.²⁶ The two main components of the offering circular are the narrative statement and the prescribed financial information.²⁷ The narrative statement in the offering circular was one of the bigger barriers for small businesses seeking external capital because of the costs associated with preparation.²⁸ The financial disclosures included both a one-year balance sheet and income information for two years, which added to the costs of a Regulation A offering.²⁹ These requirements undermined the purpose of Regulation A, as “the costs involved in preparing and distributing the offering statement and the offering circular are significant relative to the yields from a smaller offering. These relative costs are an important reason why small businesses seeking small amounts of capital so rarely rely on Regulation A.”³⁰

Regulation A was also limited in scope by conditions involving both the issuer and persons who are associated with the issuer.³¹ First, the issuer must have been an entity “organized under the laws of the United States or Canada, or any State, Province, Territory or possession thereof, or the District of Columbia, with its principal place of business in the United States or Canada.”³² An issuer also could not be a reporting company that is subject to sections 13 or 15(d) of the Securities Exchange Act of 1934.³³ Regulation A was also limited to an issuer that is “not a development stage company that either has no specific business plan or purpose, or has indicated that its business plan is to merge with an unidentified company or companies.”³⁴

²⁵ See Form 1-A, 57 Fed. Reg. 36, 473, 36,476 (Aug. 13, 1992) (codified at 17 C.F.R. § 239.90); Campbell, *supra* note 17 at 104.

²⁶ Campbell, *supra* note 17, at 105.

²⁷ Form 1-A, Part F/S, 57 Fed. Reg. at 36,491.

²⁸ Campbell, *supra* note 17, at 105 (discussing how extensive disclosure requirements and counsel’s lack of familiarity with Form 1-A drove up costs associated with the narrative statement).

²⁹ *Id.* at 106.

³⁰ *Id.*

³¹ Small Business Initiatives, 57 Fed. Reg. 36,442 (Aug. 13, 1992) (to be codified at 17 CFR Parts 200, 228, 229, 230, 239, 240, 249, and 260).

³² *Id.* at 36,468; see also *id.* at 36,443 (explaining the addition of Canadian entities because although “Canadians have not relied on the exemption, the changes in Regulation A may make the exemption more attractive not only to domestic but also Canadian companies.”).

³³ *Id.* at 36,468; see also Campbell, *supra* note 17, at 103 (explaining that “[t]he point of this requirement is apparently to force public offerings by larger, 1934 Act companies onto either S Forms or SB Forms, with their more extensive disclosure requirements”).

³⁴ Small Business Initiatives, 57 Fed. Reg. at 36,468; see WILLIAM J. HICKS, EXEMPTED

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Another qualifier for issuers seeking an offering under Regulation A was that issuers could not be investment companies under the Investment Company Act of 1940,³⁵ nor could Regulation A be used for the issuance of “fractional undivided interests in oil or gas rights.”³⁶

One of the most well-known exclusions under Regulation A was the “bad boy” provision.³⁷ This provision excluded issuers from the use of Regulation A if the issuer, or certain persons associated with the issuer,³⁸ committed any of the prohibited acts that were enumerated by the SEC.³⁹ These prohibited acts included a number of securities-related felonies,⁴⁰ and were clearly put in place with investor protection in mind.

Historical use of Regulation A was also heavily curbed by another significant factor, the cost of compliance with state Blue Sky law regulations.⁴¹ Congress had contemplated preempting state securities regulations for offerings under Regulation A to allow the SEC to have exclusive authority over Regulation A offerings.⁴² These efforts, however, failed and the Blue Sky laws continued to act as a barrier for many small businesses seeking external capital.⁴³

The reason that state Blue Sky laws are so detrimental to Regulation A offerings, “is that a small business making a Regulation A offering is still obliged in each state in which it offers its securities either to register the securities with the state or qualify for a state exemption to the state registration obligation.”⁴⁴ Exemptions for small businesses under state Blue Sky law regulations were few and far between. One example is the state small offering exemption; however, that exemption destroyed the benefits of Regulation A offerings because it limits the number of offerees and

TRANSACTIONS UNDER THE SECURITIES ACT OF 1933 §§ 6.27–6.38 (2001) (providing a history of this exemption and explaining that it applied only to offerings by “blank check” companies which are companies “that [have] no specific business or plan except to locate and acquire a presently unknown business or opportunity”).

³⁵ Small Business Initiatives, 57 Fed. Reg. at 36,468.

³⁶ *Id.*

³⁷ Campbell, *supra* note 17, at 103.

³⁸ HICKS, *supra* note 34, at §§ 6.10–6.26.

³⁹ 17 C.F.R. § 230.262(a) (2005).

⁴⁰ *See id.*

⁴¹ Campbell, *supra* note 1, at 330.

⁴² An earlier House version of the legislation that became the National Securities Markets Improvement Act would have preempted state control over nearly all securities offerings, except offerings made under the intrastate exemption. Capital Markets Deregulation and Liberalization Act of 1995, H.R. 2131, 104th Cong. (1995). If this version had been adopted, the Commission would have had exclusive authority in all Regulation A offerings. Campbell, *supra* note 1, at 345–46.

⁴³ Campbell, *supra* note 1, at 335–44.

⁴⁴ Campbell, *supra* note 17, at 107.

purchasers.⁴⁵

States eventually adopted three different schemes for registering Regulation A offerings, but none of these schemes proved effective. The first—and more expensive—scheme was the traditional registration by qualification.⁴⁶ Another ineffective scheme that many states adopted was implementing a new registration form, the Small Corporate Offerings Registration (SCOR) form, for offerings of up to \$1,000,000.⁴⁷ The SCOR form was specifically designed to be simpler and less expensive than registration by qualification,⁴⁸ yet both failed to gain any traction despite their benefits.⁴⁹

The third scheme adopted by a number of states was registration by coordination.⁵⁰ Registration by coordination was alleged to be the most effective scheme because it allows issuers to meet the state requirements by filing their Form 1-A with the State, which greatly reduces compliance costs.⁵¹ Even this scheme, however, has its drawbacks, as indicated by Professor Rutheford Campbell:

[P]ermitting state registration by coordination for Regulation A offerings does not necessarily protect the issuer from the loss of Regulation A benefits. Consider the “test the waters” provision of Regulation A. Under that rule, issuers are able to solicit indications of interest in a Regulation A offering before writing the Form 1-A, even though the activity otherwise would amount to an unauthorized “offer” of a security in violation of the provisions of the 1933 Act. The benefit to the issuer, of course, is that it can better gauge the demand for its securities, before investing the significant amount of money necessary to put together a Regulation A offering. Adopting a rule permitting a

⁴⁵ UNIF. SEC. ACT § 402(b)(9), 7C U.L.A. 220 (2000); KAN. STAT. ANN. § 17-1262(I) (1) (2004); KY. REV. STAT. ANN. § 292.410(1)(i) (West 2004); IOWA CODE ANN. § 502.203(9) (West 1999) (less than thirty-six purchasers); KAN. STAT. ANN. § 17-1262(I)(1) (2004) (not to exceed twenty sales).

⁴⁶ Campbell, *supra* note 17, at 107; *see also* 10 PA. CODE § 206.010 (2012) (provides an example of all the necessary filings and materials that make this scheme prohibitively expensive).

⁴⁷ Campbell, *supra* note 17, at 107–08; Form U-7: Small Company Offering Registration Form, NASAA, <http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/scor-forms/> (last visited Feb. 14, 2018).

⁴⁸ Campbell, *supra* note 17, at 108. *See also* SCOR Statement of Policy, NASAA (Apr. 26, 1998), <http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/scor-statement-of-policy/>.

⁴⁹ Campbell, *supra* note 17, at 108 (“Although both registration by qualification and registration through the SCOR form preserve the right of the issuer to make an unlimited number of offers and sales, the additional costs and complexities added to a Regulation A offering apparently overwhelm any benefits to the issuer.”).

⁵⁰ *See* 10 PA. CODE § 205.02.

⁵¹ Campbell, *supra* note 17, at 110 (footnotes omitted).

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Regulation A offering to be registered by coordination does not necessarily affect the determination of whether prefiling testing of the water activity amounts to an illegal offer under state law. Thus, a state permitting registration by coordination could take the position that prefiling testing of the water activity amounts to illegal gun jumping under state law. The small business using Regulation A in such a case would have to forego the benefits of testing the waters in order meet state blue sky law requirements.⁵²

The states' failures to create an effective scheme to accommodate Regulation A offerings demonstrates how necessary it is to change the way small businesses seek external capital.

IV. REGULATION A+ FINAL RULES

This Section will provide an overview of what the SEC changed, and failed to change, when adopting the regulations that give Regulation A+ its guidelines. From this overview, this Comment will outline in detail the newly adopted rules and how the SEC has justified them.

A. Regulation A+ Basics

When considering what steps to take to effectively implement section 3(b)(2), the SEC noted that the JOBS Act did not authorized it to amend the current Regulation A statutory authority,⁵³ and, therefore, wanted to build off of and preserve Regulation A's underlying provisions.⁵⁴ The Commission explained that the:

[P]rimary objective is to implement Section 401 of the JOBS Act by expanding and updating Regulation A in a manner that makes public offerings of up to \$50 million less costly and more flexible while providing a framework for regulatory oversight to protect investors. In so doing, we have crafted a revision of Regulation A that both promotes small company capital formation and provides for meaningful investor protection. We believe that issuers, particularly small businesses, benefit from having a wide range of capital-raising strategies available to them, and that an expanded and updated Regulation A could serve as a valuable option that augments the exemptions from registration more frequently relied upon, thereby facilitating capital formation for small businesses.⁵⁵

⁵² *Id.*

⁵³ Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, 79 Fed. Reg. 3,926 (Jan. 23, 2014) (to be codified at 17 C.F.R. pts. 230, 232, 239, 240, and 260).

⁵⁴ *See id.*

⁵⁵ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,892 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260).

To carry out its goal, the SEC implemented a two-tier system for Regulation A+ offerings, similar to the framework found in Regulation D.⁵⁶ The SEC explained, “[t]he proposal[] for offerings under Tier 1 and Tier 2 build on current Regulation A, and preserve, with some modifications, existing provisions regarding issuer eligibility, offering circular contents, testing the waters, and ‘bad actor’ disqualification.”⁵⁷ Therefore, to begin the overview, two new definitions must first be explained: Tier 1 offerings and Tier 2 offerings.⁵⁸

Both Tier 1 and Tier 2 offerings have a limit on the amount of capital sought in a twelve-month period.⁵⁹ Under a Tier 1 offering, issuers are limited to seeking \$20 million within a twelve-month period.⁶⁰ For issuers involved in a Tier 2 offering, they are limited to seeking no more than \$50 million in a twelve-month period.⁶¹ It is of note that there is no requirement for the minimal amount of capital being sought to initiate a Tier 2 offering.⁶² This means that an issuer seeking only \$1 million in external capital from the sale of securities may seek a Tier 2 offering, provided all other criteria are met.⁶³

B. *Qualified Issuers under Regulation A+*

Whether conducting a Tier 1 or Tier 2 offering, issuers are subject to the same qualifications and restrictions.⁶⁴ As discussed in more detail later in this Comment, these limitations on the nature of issuers who may take advantage of Regulation A+ have been an area of controversy.

Just as under Regulation A, issuers must be “an entity organized under the laws of the United States or Canada, or any State, Province, Territory or possession thereof, or the District of Columbia, with its principal place of business in the United States or Canada.”⁶⁵ When making its decision on whether to allow foreign issuers, the SEC noted, “[a]s its name suggests, one goal of the JOBS Act was the creation of jobs within the United States.”⁶⁶

⁵⁶ See 17 C.F.R. §§ 230.504, 230.505, 230.506 (2005) (commonly known as Rules 504, 505, and 506).

⁵⁷ *Id.*

⁵⁸ See 17 C.F.R. § 230.251 (laying out the basic characteristics of Tier 1 and Tier 2).

⁵⁹ 17 C.F.R. § 230.251.

⁶⁰ *Id.*; § 230.251(a)(1); see also Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, 79 Fed. Reg. 3,926, 3,927 (Jan. 23, 2014) (to be codified at 17 C.F.R. pts. 230, 232, 239, 240, and 260). The proposed limit under Tier 1 offerings was originally capped at only \$5 million. *Id.* at 3,929.

⁶¹ 17 C.F.R. § 230.251(a)(2).

⁶² *Id.*

⁶³ See *id.*; Campbell, *supra* note 1, at 331 n.37.

⁶⁴ 17 C.F.R. § 230.251(b).

⁶⁵ *Id.* at (b)(1).

⁶⁶ Proposed Rule Amendments for Small and Additional Issues Exemptions Under

Similarly, just as under Regulation A, issuers must not:

[B]e subject to section 13 or 15(d) of the Securities Exchange Act of 1934;⁶⁷ . . . be a development stage company that either has no specific business plan or purpose, or has indicated that its business plan is to merge with or acquire an unidentified company or companies;⁶⁸ . . . be an investment company registered or required to be registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of the Investment Company Act of 1940;⁶⁹ . . . be issuing fractional undivided interests in oil or gas rights, or a similar interest in other mineral rights;⁷⁰ or . . . be disqualified under Rule 262.⁷¹

From the final rules adopted by the SEC, it becomes clear that not much has changed with regard to issuer qualification.

The lack of updates and expansion to Regulation A+'s issuer qualifications can be attributed to the SEC's concern with investor protection.⁷² As explained by the SEC, the goal was to establish continuity with the Regulation A regime.⁷³ The SEC was hesitant to expand the scope of eligible issuers under Regulation A+, and instead chose the allegedly "prudent" route of waiting to see the impact of Regulation A+ before making any expansion of eligible issuers.⁷⁴

While not much has changed to the original qualifications of a Regulation A issuer, the SEC did add two additional restrictions to Regulation A+ regarding who can qualify as an issuer.⁷⁵ The first restriction applies to issuers who have participated in previous Regulation A+ offerings.⁷⁶ It requires that in order to remain eligible, the potential issuer must have filed all on-going reporting requirements under Regulation A+ for

Section 3(b) of the Securities Act, 79 Fed. Reg. 3,926, 3,932 (Jan. 23, 2014) (to be codified at 17 C.F.R. pts. 230, 232, 239, 240, and 260)

⁶⁷ § 230.251(b)(2).

⁶⁸ *Id.* § 230.251(b)(3).

⁶⁹ *Id.* § 230.251(b)(4) (internal cross-reference omitted).

⁷⁰ *Id.* § 230.251(b)(5).

⁷¹ *Id.* § 230.251(b)(8) (also known as the "bad boy" restriction).

⁷² Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,811 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260).

⁷³ *Id.*

⁷⁴ *Id.* ("We are concerned . . . about the implications of extending issuer eligibility before the [SEC] has the ability to assess the impact of [Regulation A+]. [W]e believe it prudent to defer expanding the categories of eligible issuers (for example, by including non-Canadian foreign issuers, BDCs, or Exchange Act reporting companies) until the [SEC] has had the opportunity to observe the use of the amended Regulation A exemption and assess any new market practices as they develop.").

⁷⁵ § 230.251 at (b)(6)–(7).

⁷⁶ *Id.* § 230.251(b)(7).

the two years preceding a new Regulation A+ offering.⁷⁷ The second restriction mandates that “issuers subject to orders by the Commission entered pursuant to Section 12(j) of the Exchange Act within a five-year period immediately preceding the filing of the offering statement will not be eligible to conduct an offering.”⁷⁸ These two additional restrictions, while justified by investor protection, do nothing to expand the market for Regulation A+, and only act to further complicate the originally overregulated Regulation A framework.

C. Disclosure and Filing Requirements

With regard to the disclosure and filing requirements of Regulation A+, the SEC made a number of significant changes from Regulation A that affect Tier 1 and Tier 2 offerings differently. There are still, however, a number of basic requirements that apply to both Tier 1 and Tier 2 offerings.⁷⁹ For example, both Tier 1 and Tier 2 are still subject to the same basic filing and disclosure requirements.⁸⁰ These basic requirements are still procedurally similar to the filing and disclosure requirements of other registered offerings,⁸¹ since no offers can be made in a Regulation A+ offering until an offering statement has been filed with the SEC.⁸² Only then can an issuer solicit oral offers for the securities through the use of a preliminary offering circular.⁸³ Finally, in order to sell the Regulation A+ securities, the offering statement must be qualified by the SEC.⁸⁴

Tier 1 and Tier 2 offerings also have access to an updated version of the “test the waters” provision.⁸⁵ This provision acts as an exception to the general prohibition of pre-filing offers of Regulation A+ securities.⁸⁶ Under

⁷⁷ *Id.*; Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,811 (The SEC reasoned that “[t]his requirement will benefit investors by providing them with more information, with respect to issuers that have previously made a Regulation A offering, to consider when making an investment decision, facilitate the development of an efficient secondary market in such securities, and enhance [the SEC’s] ability to analyze and observe the Regulation A market.”).

⁷⁸ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,811–12 (seeking investor protection “by excluding issuers with a demonstrated history of delinquent filings under the Exchange Act from the pool of eligible issuers under Regulation A.”).

⁷⁹ *See, e.g.*, 17 C.F.R. § 230.251(d).

⁸⁰ *Id.*

⁸¹ Campbell, *supra* note 1, at 332.

⁸² § 230.251(d)(1)(i).

⁸³ *Id.*

⁸⁴ Campbell, *supra* note 1, at 332 (explaining that the qualification of the offering statement is “roughly equivalent to a final registration statement that is declared effective by the Commission”).

⁸⁵ 17 C.F.R. § 230.255.

⁸⁶ *Id.*

the “test the waters” provision, Regulation A+ issuers are able to reach out to potential investors and gauge their interest in the offering, before incurring any expenses related to filing.⁸⁷ The SEC based this provision off the rationale that “allowing issuers to gauge interest through expanded testing the waters will reduce uncertainty about whether an offering could be completed successfully.”⁸⁸ There are still, however, a number of limits on what the communications may include.⁸⁹ Under the current regulations, there are several restrictions on the content of the communications, including: (1) the communication cannot state that money or consideration is being solicited;⁹⁰ (2) the communication must state that no offer to buy the securities can be accepted and no part of the purchase price can be accepted until after the offering statement has been qualified by the SEC;⁹¹ and (3) the communication must state “that a person’s indication of interest involves no obligation or commitment of any kind.”⁹²

Where Tier 1 and Tier 2 begin to differ is with regard to the nature and extent of the disclosures that must be made for a Regulation A+ offering.⁹³ There are two general types of disclosures that must be made by an issuer under both Tier 1 and Tier 2: *ex ante* disclosures (at the time of the offering) and *ex post* disclosures (following the completion of the offering).⁹⁴ When looking at the nature of the *ex ante* and *ex post* disclosures under Tier 1 and Tier 2, it is obvious that Tier 2 offerings require significantly more disclosures.⁹⁵ This “scaled” disclosure regime was put in place by the SEC as a balanced approach to its goals of capital formation and investor protection.⁹⁶

⁸⁷ *Id.*; Campbell, *supra* note 1, at 331.

⁸⁸ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,882 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260) (wanting this provision to be “useful for smaller issuers, especially early-stage issuers, first-time issuers, issuers in lines of business characterized by a considerable degree of uncertainty, and other issuers with a high degree of information asymmetry.”).

⁸⁹ 17 C.F.R. § 230.255(b).

⁹⁰ *Id.* § 230.255(b)(1) (The communication must also state that if any consideration is received, that it will not be accepted.).

⁹¹ *Id.* § 230.255(b)(2) (The communication must also make it clear that any offer can be freely revoked before the end of the qualification process and notice of acceptance has been received.).

⁹² *Id.* § 230.255(b)(3).

⁹³ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,829.

⁹⁴ Campbell, *supra* note 1, at 332.

⁹⁵ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,829.

⁹⁶ *Id.*

One type of an ex ante disclosure requirement is the narrative disclosure requirement that must be made under both Tier 1 and Tier 2 offerings.⁹⁷ The narrative disclosures are largely the same under both Tier 1 and Tier 2, but there are a few differences.⁹⁸ In general, Form 1-A includes fourteen items for narrative disclosures.⁹⁹ Where Tier 1 and Tier 2 narrative disclosures differ is in the disclosure of executive compensation.¹⁰⁰ Under Tier 1 offerings, the issuer may provide the aggregate amount of executive compensation for the three highest paid executives.¹⁰¹ On the other hand, under Tier 2 offerings, the executive compensation data must be provided on an individual basis for each of the three highest paid executives.¹⁰² As explained by the SEC, this difference will “alter the format of, but not the ultimate aggregate amount of information required to be disclosed in . . . Tier 1 offerings.”¹⁰³ Ultimately, these narrative disclosures are comparatively similar to the disclosures required under Form S-1 and therefore serve as a point of controversy.¹⁰⁴

The required financial disclosures under Tier 1 and Tier 2 also differ significantly. Under Tier 1, both the ex ante and the ex post disclosures are drastically less burdensome.¹⁰⁵ At the time a Regulation A+ offering is filed under Tier 1, the issuer must provide two years of financial statements.¹⁰⁶ These financial statements, however, do not need to be audited nor do they need to be prepared in accordance with Regulation S-X.¹⁰⁷ As the SEC explains, this lack of an auditing requirement was justified by “the relatively low maximum offering size for Tier 1”¹⁰⁸ and concerns over “Tier 1 offerings

⁹⁷ Form 1-A: Regulation A Offering Statement Under the Securities Act of 1933, at 10–23, <http://www.sec.gov/about/forms/form1-a.pdf> (last visited Oct. 22, 2017) [hereinafter Form 1-A].

⁹⁸ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,829; *see* Form 1-A, *supra* note 97.

⁹⁹ *See* Form 1-A, *supra* note 97.

¹⁰⁰ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,829; Form 1-A, *supra* note 97.

¹⁰¹ Form 1-A, *supra* note 97 at 19 (listing Item 11: Compensation of Directors and Executive Officers).

¹⁰² *Id.*

¹⁰³ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,829.

¹⁰⁴ *See* Rutheford B. Campbell, Jr., *The New Regulation of Small Business Capital Formation: The Impact—If Any—of the Jobs Act*, 102 KY. L.J. 815 (2014).

¹⁰⁵ *See* Form 1-A, *supra* note 97; Form 1-SA: Semiannual Report Pursuant to Regulation A or Special Financial Report Pursuant to Regulation A, <https://www.sec.gov/files/form1-sa.pdf> (last visited Oct. 22, 2017) [hereinafter Form 1-SA]; Form 1-Z: Exit Report Under Regulation A, <https://www.sec.gov/about/forms/form1-z.pdf> (last visited Oct. 22, 2017) [hereinafter Form 1-Z].

¹⁰⁶ Form 1-A, *supra* note 97.

¹⁰⁷ *Id.*; Campbell, *supra* note 104, at 820.

¹⁰⁸ Amendments for Small and Additional Issues Exemptions Under the Securities Act

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becoming not cost-effective.”¹⁰⁹ The only ex post requirement for Tier 1 is the filing of an “exit report” with the SEC.¹¹⁰ The SEC justified the imposition of an exit report requirement on Tier 1 offerings because the form “contains limited summary information about the issuer and the completed offering and, therefore, should not impose substantial additional compliance costs on the issuer.”¹¹¹

Tier 2 offerings, on the other hand, are burdened with significantly more ex ante and ex post disclosure requirements. At the time of filing, an issuer conducting a Tier 2 offering must provide audited financial statements.¹¹² The SEC made the decision to include this requirement to protect investors.¹¹³ The Commission reasoned that by increasing the accuracy and quality of the financial statements, the relative cost of the sought capital would be lowered and thus benefit the issuers as well as the investors.¹¹⁴ Additionally, these audited financials must be audited in accordance with “either the auditing standards of the American Institute of Certified Public Accountants (AICPA) (referred to as U.S. Generally Accepted Auditing Standards or GAAS) or the standards of the Public Company Accounting Oversight Board (PCAOB).”¹¹⁵ The SEC adopted this choice of accounting standards to increase flexibility and lower compliance costs for issuers.¹¹⁶

The other significant burden faced by Tier 2 offerings is the extensive ex post disclosure requirements.¹¹⁷ Tier 2 offerings face a periodic filing regime that presents a similar burden to the requirements found in the 1934 Act.¹¹⁸ Currently:

An issuer subject to the Tier 2 periodic and current event reporting . . . is required to provide information annually on Form

(Regulation A), 80 Fed. Reg. at 21,881.

¹⁰⁹ *Id.*

¹¹⁰ 17 C.F.R. § 230.257 (2005); see Form 1-Z, *supra* note 105.

¹¹¹ 17 C.F.R. § 230.257; Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,884.

¹¹² 17 C.F.R. § 230.257; Form 1-A, *supra* note 97 at 4; Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,807.

¹¹³ 17 C.F.R. § 230.257; Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,881.

¹¹⁴ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,881

¹¹⁵ *Id.*; see Form 1-A, *supra* note 97, at 4.

¹¹⁶ 17 C.F.R. § 230.257; Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,881.

¹¹⁷ 17 C.F.R. § 230.257; see Form 1-K, <http://www.sec.gov/about/forms/form1-k.pdf>; Form 1-SA, *supra* note 105; Form 1-U: Current Report Pursuant to Regulation A, <https://www.sec.gov/about/forms/form1-u.pdf>; Form 1-Z (exit report).

¹¹⁸ Campbell, *supra* note 1 at 334; see also 17 C.F.R. § 230.257.

1-K, including the issuer's business and business plan; conflicts of interest and related party transactions; executive and director compensation; financial condition and results of operations; and audited financial statements. The semiannual update on Form 1-SA consists primarily of unaudited, interim financial statements for the issuer's first two fiscal quarters and information regarding the issuer's financial condition and results of operations. The current event reporting on Form 1-U requires issuers to disclose certain major developments, including changes of control; changes in the principal executive officer and principal financial officer; fundamental changes in the nature of business; material transactions or corporate events; unregistered sales of five percent or more of outstanding equity securities; changes in the issuer's certifying accountant; and non-reliance on previous financial statements.¹¹⁹

What makes this ongoing disclosure requirement for Tier 2 offerings even more burdensome is the fact that the issuer must comply with them until the company becomes subject to the requirements of the Securities Exchange Act of 1934 or the shares are held by less than 300 shareholders of record.¹²⁰ In addition, in order to be released from the ongoing reporting requirements, the issuer must have completed at least one full cycle of the reporting regime and then filed an exit report with the SEC.¹²¹ Therefore, even if the Tier 2 securities are held by less than 300 shareholders of record the issuer must bear the cost of doing another full year of reporting.¹²² The SEC recognized that the option to cease the ongoing reporting would be attractive to some issuers because of the relative cost of compliance.¹²³ The SEC, however, decided to restrict this option since it "might be costly for investors because it will decrease the amount of information available about the issuer, making it more difficult to monitor the issuer and accurately price its securities or to find a trading venue that will allow liquidation of the investment."¹²⁴

¹¹⁹ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,806. *See, e.g.*, 17 C.F.R. § 230.257; 17 C.F.R. § 239.91 (Form 1-K); 17 C.F.R. § 239.92 (Form 1-SA); 17 C.F.R. § 239.93 (Form 1-U).

¹²⁰ 17 C.F.R. § 230.257(d)(1)-(2); 17 C.F.R. § 240.12g5-1 (defining shareholder of record).

¹²¹ 17 C.F.R. § 230.257(d)(2) (stating reporting requirements "shall be suspended for such class of securities immediately upon filing with the Commission an exit report on Form 1-Z if the issuer of such class has filed all reports due pursuant to this rule before the date of such Form 1-Z filing").

¹²² Campbell, *supra* note 1, at 335.

¹²³ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,854.

¹²⁴ *Id.*

D. State Blue Sky Law Preemption

The other major distinction between Tier 1 and Tier 2 offerings is the federal preemption of state Blue Sky law regulations. Regulation A+ currently preempts state securities laws for Tier 2 offerings, but does not protect Tier 1 offerings.¹²⁵ This relationship to state securities laws is important because many commentators and critics have identified state Blue Sky law regulations as the main cause of Regulation A's continued failure.¹²⁶ Originally, the SEC proposed a preemption framework that would have preempted state securities laws for Tier 2 offerings and would have preempted state securities laws for offers and not sales for Tier 1 offerings.¹²⁷ The SEC, however, abandoned this framework and refused to preempt any part of Tier 1 offerings.¹²⁸

When Congress passed the JOBS Act, it granted the SEC broad statutory authority to create exemptions for Regulation A+ securities with regard to state Blue Sky law regulations.¹²⁹ Congress recognized the drawbacks of forcing small businesses to register their securities with state authority and how that could stifle the purpose of the JOBS Act, increasing access to external capital for small businesses.¹³⁰ Therefore, Congress, when adopting the JOBS Act, passed a statutory regime that preempts all state authority over a "covered security."¹³¹

To further emphasize the importance of capital formation for small businesses, Congress gave the SEC wide latitude in defining the scope of covered securities.¹³² Congress created this latitude by adopting the following language: "A security is a covered security . . . as defined by the Commission by rule. In prescribing such rule, the Commission may define the term 'qualified purchaser' differently with respect to different categories of securities, consistent with the public interest and the protection of investors."¹³³ Therefore the SEC was given two main directives: (1)

¹²⁵ *Id.* at 21,856; 15 U.S.C. § 77r(b)(3) (2012); 17 C.F.R. § 230.256.

¹²⁶ See U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-839 SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS (2012), <http://www.gao.gov/assets/600/592113.pdf> (last visited Feb. 17, 2018) [hereinafter GAO REPORT]

¹²⁷ Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, 79 Fed. Reg. 3,926, 3,968 (Jan. 23, 2014) (to be codified at 17 C.F.R. pts. 230, 232, 239, 240, and 260).

¹²⁸ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,856.

¹²⁹ See 15 U.S.C. § 77r.

¹³⁰ 15 U.S.C. § 77c; see Rutheford B. Campbell, Jr., *Regulation A and the Jobs Act: A Failure to Resuscitate*, 7 OHIO ST. ENTREP. BUS. L.J. 317 (2012).

¹³¹ 15 U.S.C. § 77r.

¹³² See Campbell, *supra* note 1, at 330.

¹³³ 15 U.S.C. § 77r(b)(3).

establish its own definition of a “qualified purchaser” to decrease the cost of compliance with state Blue Sky laws; and (2) adopt different definitions of “qualified purchasers” for different categories of securities, which provides flexibility with regard to investor protection.¹³⁴ The only limitation on these two directives was “the public interest and the protection of investors.”¹³⁵

In the final rules adopted by the SEC, “a ‘qualified purchaser’ means any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A.”¹³⁶ This means that state Blue Sky laws are preempted only in a Tier 2 offering, while Tier 1 offerings are still subject to state regulation. To even be qualified as a purchaser under Tier 2, the purchaser must be an accredited investor,¹³⁷ or the purchase price must be no more than ten percent of the purchaser’s annual income, if a natural person,¹³⁸ or the previous fiscal year’s revenue, if a non-natural person.¹³⁹ By restricting Tier 2 offerings to accredited investors, the SEC has rendered the benefit of Blue Sky law preemption, along with all of Regulation A+’s other benefits, virtually useless.

When adopting this language, the SEC unsuccessfully tried to strike a balance between the protection of investors and decreasing the relative costs of compliance with state securities laws.¹⁴⁰ The SEC explained that:

For Tier 2 offerings, the additional disclosure, audited financial statements, and transactional requirements relative to Tier 1 offerings are expected to provide an additional layer of investor protection, thus reducing the need for, and the expected benefits of, state review. . . . [While] Tier 1 offerings will face significantly lower offering costs as a result of not being subjected to the requirements of audited financial statements and ongoing reporting in the final rules. For these offerings, the local knowledge of state regulators is anticipated to add value to the review process to the extent that the issuer and the investor base are more likely to be localized. Thus, state qualification is more likely to have incremental investor protection benefits in Tier 1 offerings.¹⁴¹

¹³⁴ *See id.*

¹³⁵ *Id.*

¹³⁶ 17 C.F.R. § 230.256 (2005).

¹³⁷ 17 C.F.R. § 230.251(d)(2)(i)(C). The SEC adopted the same definition for “accredited investors” as found in Rule 501 of Regulation D, which includes institutional investors, executive officers of the issuer, and high net worth individuals. *See* 17 C.F.R. § 230.501.

¹³⁸ § 230.251(d)(2)(i)(C)(1).

¹³⁹ § 230.251(d)(2)(i)(C)(2).

¹⁴⁰ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,856 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260).

¹⁴¹ *Id.*

The SEC also focused on the smaller and more local nature of Tier 1 offerings as a reason in favor of state oversight.¹⁴² It is likely that the SEC, when creating this framework, was trying to avoid challenges from those seeking a more prominent role for State authority in the regulation of securities. However, several states have already challenged this regulatory scheme.¹⁴³ In the end, the SEC created an unworkable framework, the purpose of which undermines the reasoning used to adopt the other portions of Regulation A+.

VI. ANALYSIS AND RECOMMENDATIONS

This section of the Comment will explain the superior Regulation A+ solutions that were overlooked and deliberately ignored by the SEC when formulation the final rules. Similar to the previous section, this discussion will be broken down into issuer qualifications, registration and reporting, and preemption of State securities laws. This Comment will identify and explain specific solutions that were presented to the SEC by commenters and show how they are superior to the final rules of Regulation A+.¹⁴⁴

A. *Easing Issuer Qualifications*

One of the provisions of Regulation A+ that received some heavy criticism was the requirement that issuers be “an entity organized under the laws of the United States or Canada, or any State, Province, Territory or possession thereof, or the District of Columbia, with its principal place of business in the United States or Canada.”¹⁴⁵ During the commenting process, several authorities expressed their concerns to the SEC that this requirement unnecessarily excluded other foreign issuers from entering the United States

¹⁴² *Id.* at 21,886 (“Tier 1 offerings are more likely to be concentrated in fewer states, the cost of complying with state review procedures is likely to be diminished for these types of offerings.”).

¹⁴³ *See* *Lindeen v. Sec. & Exch. Comm’n.*, 825 F.3d 646 (D.C. Cir. 2016) (The chief securities regulators for Massachusetts and Montana sued the SEC challenging Regulation A+’s definition of “qualified purchasers.” They argued that, because the SEC declined to adopt a qualified-purchaser definition limited to investors with sufficient wealth, revenue or financial sophistication to protect their interests without state protection, Regulation A+ fails both parts of the United States Supreme Court’s statutory construction standards enunciated in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842–43 (1984). The D.C. Circuit Court upheld the SEC’s definition as within the scope of their administrative authority.).

¹⁴⁴ For submitted comments, see U.S. Sec. & Exch. Comm’n, *Comments on Proposed Rule: Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act*, SEC (Mar. 31, 2015), <https://www.sec.gov/comments/s7-11-13/s71113.shtml>.

¹⁴⁵ 17 C.F.R. § 230.251(b)(1) (2005).

capital market.¹⁴⁶ The International Securities and Capital Markets Committee of the American Bar Association (ABA) was especially critical of this limitation on Regulation A+ issuers.¹⁴⁷ The ABA believed that maintaining Regulation A's status quo for the eligibility of foreign issuers undermined the policy concerns behind the adoption of the JOBS Act—job creation and economic growth in the United States.¹⁴⁸

This criticism is well deserved and indicates a major flaw in the final rule of Regulation A+. Currently, a Canadian issuer with its principle place of business in Canada, with little to no business inside the United States, is able to conduct a Regulation A+ offering. But, a foreign, non-Canadian issuer that conducts a large amount of business inside the United States cannot utilize Regulation A+ offerings.¹⁴⁹ Despite its position and likelihood to spend capital inside the United States, the foreign non-Canadian issuer is ineligible under the current framework.¹⁵⁰ Therefore, the SEC should revisit this qualification and amend it in a way that includes other foreign issuers.¹⁵¹

B. Reducing Disclosure and Registration Requirements

The disclosure and registration requirements, which the SEC adopted for Regulation A+, provide further examples of inefficient regulations that undermine the true purpose of this exemption. Many commenters questioned the requirement that the financial statements provided on Form 1-A be no older than nine months from the filing date.¹⁵² One criticism of this requirement is that it would be redundant and unnecessarily prohibitive for newly formed businesses.¹⁵³ The final rules would require newly formed

¹⁴⁶ Gabrielle Buckley, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act (May 14, 2014), <https://www.sec.gov/comments/s7-11-13/s71113-111.pdf>; Jonathan Guest, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act (Feb. 19, 2014), <https://www.sec.gov/comments/s7-11-13/s71113-11.pdf>.

¹⁴⁷ Buckley, *supra* note 146, at 2.

¹⁴⁸ *Id.*

¹⁴⁹ See 17 C.F.R. § 230.251(b)(1).

¹⁵⁰ *Id.*

¹⁵¹ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,811 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260) (The SEC indicated that it would defer the inclusion of foreign non-Canadian issuers until the SEC could review the impact of Regulation A+. This hesitation, however, serves little purpose since the exclusion of these foreign non-Canadian issuers is illogical.)

¹⁵² Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21837; Ernst & Young, LLP, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, at 2 (Mar. 24, 2014), <https://www.sec.gov/comments/s7-11-13/s71113-83.pdf>.

¹⁵³ Ernst & Young, LLP, *supra* note 152, at 2.

businesses, which formed within nine months, to provide financial statements covering everything since the period of inception.¹⁵⁴

Commenters argued that instead of the current system, newly formed businesses should be provided an extra layer of relief for one main reason—the benefit does not justify the cost.¹⁵⁵ For newly formed businesses, the only kind of financial disclosure they are often able to make is a “seed balance sheet” which provides the investor with little meaningful information.¹⁵⁶ Because these seed balance sheets are of little value, compelling newly formed businesses to incur the costs to prepare them makes little to no sense.¹⁵⁷

Instead, the SEC should adopt the proposed alternative and allow newly formed businesses to provide a narrative discussion of their financial condition and operations since their inception.¹⁵⁸ This narrative disclosure alternative provides a far superior alternative that serves the interests of both the issuer and the investors. Issuers would benefit from the reduced cost of preparing financial statements. Investors would benefit from being provided information that is actually relevant to the financial condition of the newly formed company. Therefore, the SEC should revisit the possibility of creating an exception for newly formed businesses.

Another criticism of the disclosure and registration requirements is the nature and extent of the ongoing reporting requirements for Tier 2 offerings.¹⁵⁹ The reason for this criticism is that the ongoing requirements prevent issuers seeking a smaller amount of capital from conducting a Tier 2 offering.¹⁶⁰ As mentioned earlier, Tier 2 offerings have no minimum requirement for the amount of capital sought in order to conduct an offering.¹⁶¹ Therefore, the SEC opened the door for businesses seeking a small amount of capital to receive the benefits of Tier 2 offerings, but made it too expensive to be feasible. When considering that Tier 2 offerings are exempt from state Blue Sky law regulations, while Tier 1 offerings are not exempt, there is a clear advantage for issuers seeking smaller amounts to

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ Under Tier 1 offerings, the balance sheet does not have to be audited so the costs of preparing the seed balance sheet will remain low. *See* Form 1-A, *supra* note 97, at 24. But, for Tier 2 offerings, which have an auditing requirement, the costs of having the seed balance sheet audited will disincentive this path for newly formed businesses. *See* Form 1-A, *supra* note 97, at 26.

¹⁵⁸ Ernst & Young, LLP *supra* note 152, at 2.

¹⁵⁹ Rutheford B. Campbell, Jr., Comment Letter on Proposed Amendments to Regulation A Implementing Title IV of the Jobs Act, at 8 (Mar. 5, 2014), <https://www.sec.gov/comments/s7-11-13/s71113-36.pdf>.

¹⁶⁰ *Id.* at 8–9.

¹⁶¹ 17 C.F.R. § 230.251(a)(2) (2005).

conduct a Tier 2 offering.

The prohibitive costs of the ongoing reporting requirements for Tier 2 offerings led many commenters to call for a scaled disclosure regime.¹⁶² Instead of requiring every business to meet the same reporting requirement, despite the amount of capital being raised, the SEC should have followed the recommendations of commenters and created a scaled disclosure scheme based on the issuer's size and sophistication.¹⁶³ Since Tier 2 offerings are a clear alternative for a fully registered Initial Public Offering, scaling the disclosure requirements would allow smaller businesses to enjoy the benefits of external capital without jeopardizing investor protection.¹⁶⁴

The SEC's goal of protecting investors can still be achieved by simplifying, rather than abandoning, the required disclosures. For example, it was suggested that the SEC could allow businesses to simplify expensive disclosures that do not provide much investor protection such as: generic risk factors, five years of executive biographical data, and executive compensation information.¹⁶⁵ The SEC should, therefore, revisit the disclosure requirements of Tier 2 and implement a scaled approach based on the issuer's size and sophistication.

C. Complete Preemption of State Blue Sky Laws

One of the most controversial portions of Regulation A+ is the relationship with state securities laws. Before Regulation A+ was implemented, the United States Government Accountability Office (GAO) conducted a study to identify the factors that inhibited the use of the original Regulation A exemption.¹⁶⁶ In a study called "Factors that May Affect Trends on Regulation A Offerings" (GAO study), the GAO reviewed Regulation A offerings from 1992 through 2011 and found a significant decline in the number of Regulation A offerings during that period.¹⁶⁷ Despite this decrease, the GAO study also found a sharp increase in the use of Regulation D as an alternative to Regulation A for small businesses.¹⁶⁸ The GAO study investigated the causes of this trend and determined that one

¹⁶² Morrison & Foerster LLP, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act (Mar. 26, 2014), <https://www.sec.gov/comments/s7-11-13/s71113-87.pdf>.

¹⁶³ *Id.* at 4; Campbell, *supra* note 159, at 8; Catherine Dixon, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, at 2 (Apr. 3, 2014), <https://www.sec.gov/comments/s7-11-13/s71113-99.pdf>.

¹⁶⁴ Morrison & Foerster LLP, *supra* note 162, at 4–5.

¹⁶⁵ *Id.*

¹⁶⁶ GAO REPORT, *supra* note 126.

¹⁶⁷ *Id.* at 9.

¹⁶⁸ *Id.* at 18–19.

of the most significant factors is compliance with state Blue Sky law regulations.¹⁶⁹ The study noted that “[i]dentifying and addressing the securities registration requirements of individual states is both costly and time-consuming for small businesses.”¹⁷⁰ Because the results of this study were readily available to the SEC when drafting the final rules of Regulation A+,¹⁷¹ there was a clear incentive to alleviate the burdens of state Blue Sky law regulations. Instead, the SEC failed to create a workable framework for small businesses.

Much of the criticism of Regulation A+ is derived from the lack of state Blue Sky law regulation preemption for Tier 1 offerings. Essentially, nothing has changed for Tier 1 offerings and it requires virtually the same Blue Sky law compliance as the original Regulation A rules.¹⁷² Issuers under Tier 1 are still required to file a registration statement with the SEC, provide offering circulars to investors,¹⁷³ and meet the registration requirements of all the states in which the issuer sells securities.¹⁷⁴ It is, therefore, unreasonable to expect that Tier 1 offerings will be any more successful than their Regulation A predecessor, since the law has all the same basic requirements.

Commenters are very critical of Tier 1’s lack of state Blue Sky law regulation preemption because of the lack of an efficient method to comply with every state’s laws.¹⁷⁵ Proponents of Regulation A+’s current language point to the North American Securities Administrators Association’s (NASAA) Coordinated Review Program for Regulation A+.¹⁷⁶ Pursuant to this coordinated review program, an issuer is able to file a single state registration statement that is then circulated to all the other states within the coordinated review program.¹⁷⁷ At least one state is appointed to be the “lead” state, which reviews the registration statement for compliance with disclosure requirements.¹⁷⁸ The lead state then prepares comments on the

¹⁶⁹ *Id.* at 17–18.

¹⁷⁰ *Id.* at 17.

¹⁷¹ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,813 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260) (discussing the findings of the GAO report).

¹⁷² Campbell, *supra* note 1, at 340–43.

¹⁷³ See 17 C.F.R. §§ 230.251(d), 230.252–253 (2005).

¹⁷⁴ See 17 C.F.R. § 230.256 (limiting preemption to Tier 2 offerings).

¹⁷⁵ Campbell, *supra* note 1, at 340–43.

¹⁷⁶ NASAA COORDINATED REVIEW OF REGULATION A OFFERINGS: REVIEW PROTOCOL, NASAA, (Mar. 7, 2014), <http://www.nasaa.org/wp-content/uploads/2014/05/NASAA-Regulation-A-Review-Protocol-final-Adopted-March-7.pdf>.

¹⁷⁷ *Id.* (stating that forty-nine of NASAA’s fifty-three members participate in the coordinated review program).

¹⁷⁸ *Id.* (stating that a second lead state may be appointed if the securities are being offered in states that also have merit qualification requirements).

registration statement and then the registration statement, along with the comments, are circulated to all the participating states where the securities are being offered.¹⁷⁹ All of the participating states are free to also add comments to the registration statement.¹⁸⁰ Finally, the lead state returns all the comments to the issuer, who has to work with any state that made a comment to resolve each issue.¹⁸¹

Comments submitted to the SEC during the rulemaking process were especially critical of the Coordinated Review Program and an alternative to preemption.¹⁸² Many felt that there were too many uncertainties and obstacles involved with the NASAA's program.¹⁸³ For example, issuers will still be required to comply with each state's disclosure and merit review requirements with no clear benefit added by appointing a lead state.¹⁸⁴ The lead examiner is unable to overrule or ignore comments from other states; therefore, having this single point of contact is only likely to add confusion.¹⁸⁵ Another big problem is that the Coordinated Review Program does not provide relief from state filing fees, one of the larger costs of capital formation.¹⁸⁶

The next problem that many commenters identified is the delay that is caused by imposing the Coordinated Review Program rather than preemption.¹⁸⁷ Because of the unclear and inconsistent nature of state Blue Sky law regulations,¹⁸⁸ there are likely to be serious delays for Tier 1 issuers who are trying to issue securities in states with conflicting standards. Therefore, issuers are left with only a few options: spend the time and money to comply with each state's requirements; spend the time and money to comply with the strictest existing state requirements in anticipation; spend the time and money to comply with the ex post and ex ante requirements of

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* (stating that each state is able to make comments and then return those comments to the lead state).

¹⁸¹ *Id.*

¹⁸² *See, e.g.,* Dixon, *supra* note 163, at 14; Robert R. Kaplan, Jr. & T. Rhys James, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, at 3 (Mar. 23, 2014), <http://www.sec.gov/comments/s7-11-13/s71113-89.pdf>; Michael L. Zuppone, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, at 2–3 (Mar. 24, 2014), <http://www.sec.gov/comments/s7-11-13/s71113-73.pdf>; Campbell, *supra* note 159, at 2.

¹⁸³ *See* Zuppone, *supra* note 182, at 2.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* (citing GAO REPORT, *supra* note 126, to show how the costs of compliance with state securities laws is a factor that limits the use of Regulation A).

¹⁸⁷ *Id.*

¹⁸⁸ Campbell, *supra* note 1, at 340–43; Campbell, *supra* note 130, at 322; Campbell, *supra* note 17, at 95–96; GAO REPORT, *supra* note 126.

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Tier 2 offerings;¹⁸⁹ or find an alternative to Regulation A+.

Another aspect of Regulation A+ that commenters feel is weakened by the lack of preemption is the “test the waters” provision.¹⁹⁰ When deciding to keep the “testing the waters” provision of pre-JOBS Regulation A, the SEC believed that this provision was key to the success of Regulation A+ offerings.¹⁹¹ The SEC noted that permitting “issuers to test the waters . . . will make the use of solicitation materials more beneficial for issuers. . . . [T]he final rules will generally reduce compliance burdens and entirely eliminate the filing requirement for issuers that, after testing the waters, decide not to proceed.”¹⁹² The “test the waters” provision, however, will likely go underutilized by Tier 1 issuers because many state Blue Sky laws prohibit such conduct.¹⁹³ Any Tier 1 issuer seeking to conduct an offering across a broad number of states will likely have its hands tied and be unable to use the “test the waters” provision.

VII. CONCLUSION

The SEC’s failure to implement a workable framework of Title IV of the JOBS Act means that small businesses will continue to suffer from a lack of access to external markets. There are millions of small businesses in the United States and other countries that would benefit immensely from gaining access to the capital markets. Instead, these small businesses are left without a viable option other than traditional private placements. Regulation A+, similar to its predecessor, suffers from over regulation for the sake of investor protection. While the SEC’s concerns over fraud are legitimate and substantial, by trying to balance those concerns with the goal of allowing small businesses to raise capital, the final rules of Regulation A+ do nothing but split the baby. Therefore, the SEC should revisit its adopted regulations and strike a more efficient balance between investor protection and capital formation.

¹⁸⁹ Campbell, *supra* note 1, at 341–43 (explaining that it is possible for offerings, which would fall within the amount limit of Tier 1, to instead conduct a Tier 2 offering, since there is no lower amount limitation on Tier 2 offerings under Regulation A+ and because the Regulation A+ rules preempt state registration authority over Tier 2 offerings, but that such offerings might be deterred from doing so because of the more expensive disclosure regime).

¹⁹⁰ 17 C.F.R. § 230.255 (2005).

¹⁹¹ Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,842 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, and 260).

¹⁹² *Id.* at 21,843.

¹⁹³ Campbell, *supra* note 1, at 340.