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The SEC’s Regulation A+: Small Business Goes Under the Bus Again

Rutheford B Campbell, Jr.¹

Title IV of the JOBS Act, which is entitled “Small Company Capital Formation,” requires the Securities and Exchange Commission to adopt new rules regarding offerings under Regulation A. The Commission has now adopted its final regulations implementing Title IV and providing a new regulatory regime for exempt offerings under Section 3(b) of the Securities Act of 1933. The new regime is generally referred to as Regulation A+.

Unfortunately, history and empirical data regarding the use of Regulation A and Regulation D strongly suggest that the final Regulation A+ rules are unlikely to provide any material relief for small businesses in their difficult search for efficient sources of external capital. Instead, the exemption provided by Regulation A+ will likely be attractive only to larger businesses that are not currently reporting companies under the Securities Exchange Act of 1934.

To a significant extent, this outcome is the result of an effective campaign mounted by state securities regulators, prosecuted through their trade association, the North American Securities Administrators Association (NASAA), and enabled by the Securities and Exchange Commission (Commission). Once again, NASAA—aided and abetted by the Commission—effectively blocked small businesses from a fair and efficient path to external capital, destroying an important component of the JOBS Act that was specifically designed to facilitate small business capital formation. In the vernacular of the day, small businesses were—again—thrown under the bus.

INTRODUCTION

Title IV of the JOBS Act, which is entitled “Small Company Capital Formation,” requires the Securities and Exchange Commission to adopt new rules

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regarding offerings under Regulation A. The Commission has now adopted its final regulations that implement Title IV and provide a new regulatory regime for exempt offerings under Section 3(b) of the Securities Act of 1933 (the 1933 Act).

The new regime is generally referred to as Regulation A+. While the anticipation of the Regulation A+ rules generated enthusiasm in some quarters, the new, final Regulation A+ rules seem unlikely to provide any material relief for small businesses in their difficult search for efficient sources of external capital. Unfortunately, history and empirical data regarding the use of Regulation A and Regulation D strongly suggest that small businesses will not be able to utilize Regulation A+. Instead, the exemption provided by Regulation A+ will likely be attractive only to larger businesses that are not currently reporting companies under the Securities Exchange Act of 1934 (the 1934 Act).

To a significant extent, this outcome is the result of an effective campaign mounted by state securities regulators, prosecuted through their trade association, the North American Securities Administrators Association (NASAA), and enabled by the Securities and Exchange Commission (SEC or Commission). Once again, NASAA—aided and abetted by the Commission—effectively blocked small businesses from a fair and efficient path to external capital. In the vernacular of the day, small businesses were—again—thrown under the bus.

Today, only the most extreme free market economists would argue that capital formation needs no governmental intervention—that the entirely free and unregulated capital market will result in an efficient allocation of capital. Governmental regulation of capital formation, however, must be logical, fair, and directed to improving, not throttling, efficient and fair allocation of our precious capital among the businesses in our market economy.

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5 See, e.g., 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/. On May 22, 2015, Maura Healey, Attorney General of the Commonwealth of Massachusetts, filed a Petition for Review with the United States Court of Appeals for the District of Columbia Circuit "relating to the preemption of state securities law registration and qualification requirements for certain Regulation A securities." Petition for Review at 1, Galvin v. SEC, No. 15-1150 (D.C. Cir. May 22, 2015). The Petition asks the Court to issue a permanent injunction against the preemption rules. Id. at 2. As a basis for that relief, the Petition states that the rules are "arbitrary, capricious, and otherwise not in accordance with the Administrative Procedure Act, the Securities Act of 1933, and other law." Id. At the time of this article, the case is still pending.

6 See, e.g., Raneri, supra note 5.

7 Under Section 12(g) of the Securities and Exchange Act of 1934, a company becomes subject to periodic reporting requirements if the company has assets in excess of $10 million and either 2,000 shareholders of record or 500 unaccredited shareholders of record. 15 U.S.C. § 78l(g) (2014).
With regard to the rules governing capital formation by small businesses, it 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. At the risk of overly simplifying one's criticism—but not at the risk of overstatement—such a regulatory system is bizarre.

Nonetheless, NASAA for decades has fought vigorously and successfully to preserve such a system to govern small business capital formation. Even more disturbing, perhaps, is the fact that the Commission— for reasons that are difficult to understand—has cooperated with NASAA, allowing state laws and regulations to eviscerate efficient and well-conceived federal exemptions from registration, rules that were designed for small businesses and their special needs and compelling circumstances.\(^8\) Perhaps it should be no surprise, therefore, that it has happened again in the Commission's final Regulation A+ rules.

The purposes of this article are to explain the Regulation A+ rules and their likely impact—if any—on small business capital formation and to offer comments regarding who bears responsibility for the failure of these new rules to offer small businesses an efficient access to external capital.

I. SMALL BUSINESSES

It is difficult, at least with precision, to define a “small business.” When considering the issue of capital formation, one can typically begin with the categories used by the Small Business Administration (SBA) for collecting and publishing data about small businesses.\(^9\) Historically, the SBA has reported data for firms employing less than twenty persons and firms employing less than one hundred persons.

SBA data indicate that there are about five million firms in the United States operating with less than twenty employees.\(^10\) These very small firms account for approximately eighteen percent of the employment in America.\(^11\) Historical data also indicate that there are about five and one-half million firms with less than one

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hundred employees and that such firms over the years usually account for around thirty-five percent of employment.\textsuperscript{12}

We also know that these firms overwhelmingly need external capital and that there are unique structural and economic impediments these small firms face when they attempt to secure external capital.\textsuperscript{13} Specifically, the small firms typically have high relative transaction costs when they go after external capital. They need small amounts of external capital, which means that their relative offering costs (offering costs as a percentage of the total size of the offering) go up.\textsuperscript{14} Additionally, and related to the matter of relative offering costs, financial intermediation is typically not available for small offerings. Small offerings simply will not support the costs that reputable investment bankers or brokers encounter in learning and selling small deals.\textsuperscript{15}

Title IV of the JOBS Act, by most appearances, was designed to provide efficient access to external capital for these small businesses. The title of Title IV, after all, is “Small Company Capital Formation.”\textsuperscript{16}

It is these five million-plus businesses that this article addresses, and, regrettably, that this article concludes will not, to any material extent, be able to use Title IV as a means to access external capital.

II. A BRIEF LOOK BACK AT THE HISTORY OF SECTION 3(b) AND REGULATION A\textsuperscript{17}

Regulation A was first adopted by the Commission in 1936\textsuperscript{18} and was extensively revised in 1941.\textsuperscript{19} It was 1953, however, before the modern structure for Regulation A was finally enacted by the Commission.\textsuperscript{20} There were later amendments to Regulation A by the Commission. In 1992, for example, the Commission amended Regulation A to increase the limit of the offering to $5

\textsuperscript{13} See Campbell, A Moderate Capital, supra note 9, at 86–88.
\textsuperscript{14} 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, 817–18 (2014) [hereinafter Campbell, The Impact of JOBS]. For example, if offering expenses (e.g., fees paid to lawyers, accountants, underwriters, etc) amount to $10 and the total amount of the offering is $100, the relative offering costs are ten percent.
\textsuperscript{15} See generally id. at 818 (showing that only 5.8% of all Regulation D offerings of $1 million or less from a sample had financial intermediation).
\textsuperscript{17} For a history of Regulation A, see generally 7 WILLIAM HICKS, EXEMPTED TRANSACTIONS UNDER SECURITIES ACT OF 1933 §§ 6.2–6.4, (2d. ed. 2014); 3 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1322-27 (3d ed. 1989).
\textsuperscript{18} Securities Act Release No. 627, 1936 WL 30895 (Jan. 21, 1936).
\textsuperscript{20} See HICKS, supra note 17, § 6.3.
million and to add the “test the waters” provision. Nonetheless, at the time the JOBS Act became law in 2012, the core of the exemption provided by Regulation A had been unchanged for decades.

Fundamentally, the Regulation A exemption was predicated on filing and disclosure. Issuers relying on Regulation A were required to file an offering statement (roughly similar to a registration statement in a registered offering) with the Commission and provide investors with an offering circular (roughly similar to a prospectus in a registered offering). Both the offering statement and the offering circular contained prescribed investment information that the Commission, over time, had determined to be appropriate for these offerings by small businesses. Because Regulation A offerings were designed for small businesses—the exemption was limited to $5 million and available only for issuers that were not reporting under the 1934 Act—the Commission made an effort to scale back the disclosure requirements from the more extensive disclosures required in a registration statement under the 1933 Act. This was apparently in response to the high relative offering costs encountered by small issuers searching for small amounts of external capital. The Commission was also no doubt influenced by Section 2(b) of the 1933 Act—enacted as a part of the National Securities Markets Improvement Act of 1996 (NSMIA)—which required the Commission, in enacting its rules governing capital formation, to “consider, in addition to the protection of investors, whether the action will promote . . . capital formation.”

It is significant in this brief look at the history of Regulation A to recall that at the time the JOBS Act was signed into law, Regulation A was the only generally available federal exemption from registration that enabled a small business to make broad, interstate solicitations for external capital.

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22 17 C.F.R. § 230.251(a)(2).
23 For an overview of the filing and disclosure requirements, see Campbell, A Moderate Capital, supra note 9, at 104–06.
24 At the time of the passage of the JOBS Act, the Securities Act of 1933 limited Regulation A offerings to $5 million. 15 U.S.C. § 77c(b) (2011).
25 17 C.F.R. § 230.251(a)(2).
26 See id.; Campbell, A Moderate Capital, supra note 9, at 104–06 (discussing the nature and extent of these disclosures).
28 For an explanation of why other federal exemptions of general availability were unavailable for offers involving a broad, interstate solicitation for investors, see Campbell, A Moderate Capital, supra note 9, at 92–99. Stated briefly and simply, the private placement exemption provided by Section 4(a)(2) of the 1933 Act, 15 U.S.C. § 77d(a)(2) (2014), was unavailable because it prohibited any public solicitation for investors; the intrastate exemption provided by Rule 147, 17 C.F.R. § 230.147 (2015), was unavailable because it prohibited any interstate solicitation for investors; and the exemptions provided by Regulation D, 17 C.F.R. §§ 230.504–506, were unavailable because they prohibited any general solicitation or general advertising. Campbell, A Moderate Capital, supra note 9, at 92–99.
Notwithstanding the fact that there were approximately five million small businesses with less than twenty employees and that the large majority of those businesses needed external capital to survive and compete, in the decades before the JOBS Act, Regulation A fell into nearly complete disuse.

Table I, immediately below, provides information regarding the use of Regulation A in two recent time periods.

<table>
<thead>
<tr>
<th>Time Periods</th>
<th>Total Number of Regulation A Offerings During the Period</th>
<th>Average Annual Number of Regulation A Offerings During the Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/95 – 12/31/04</td>
<td>78</td>
<td>7.8</td>
</tr>
<tr>
<td>1/1/05 – 1/1/11</td>
<td>162</td>
<td>23.1</td>
</tr>
</tbody>
</table>

While this data may at first seem curious, the most apparent principal cause for the non-use of Regulation A was state blue sky registration requirements. The burden of meeting the registration requirements of the fifty states raised relative offering costs associated with a Regulation A offering to an unbearable level for small businesses.

The apparent purpose of Title IV of the JOBS Act was to turn Regulation A into a workable exemption for small business capital formation. Thus, the title of Title IV of the JOBS Act is "Small Company Capital Formation." The strategy that Congress used to achieve this goal was to provide in Title IV a skeletal statutory structure and then to delegate very broad authority to the Commission to implement Title IV, including broad authority for the Commission to preempt state registration authority over offerings made under the new regulations.

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29 See generally Campbell, A Moderate Capital, supra note 9, at 84–88 (detailing historical data on the number and nature of small businesses and small businesses' demand for external capital).
30 Campbell, Failure to Resuscitate, supra note 11, at 321.
31 See Campbell, A Moderate Capital, supra note 9, at 106–12, 119–21.
33 See 15 U.S.C § 77r(b)(4)(D)(ii) (2014) (preempting of state registration authority over securities that are "offered or sold to a qualified purchaser, as defined by the Commission").
III. OVERVIEW OF FINAL REGULATION A+ RULES

Fundamentally, the Commission's final Regulation A+ amendments remain philosophically consistent with the pre-JOBS Act Regulation A rules.\(^{34}\) Regulation A+ continues as an exemption that is predicated on filing prescribed information with the Commission and providing prescribed investment information to investors.\(^{35}\) The new rules, however, make significant changes from the pre-JOBS Act Regulation A requirements.

To explain these changes and the nature of offerings likely to be conducted under Regulation A+, it is helpful to emphasize two new definitions in Regulation A+: Tier 1 offerings and Tier 2 offerings. The limit on a Tier 1 offering is $20 million, and the limit on a Tier 2 offering is $50 million.\(^{36}\) There is no lower amount limit for a Tier 2 offering.\(^{37}\)

The Commission in Regulation A+ establishes somewhat different requirements for a Tier 1 offering and a Tier 2 offering. There are, however, a number of important requirements that apply to both Tier 1 and Tier 2 offerings.

Consider first the more significant of these generally applicable requirements. Both Tier 1 and Tier 2 offerings are subject to the same requirements regarding the nature of the issuer that may use Regulation A+. These include the requirement that the issuer is a United States or Canadian entity and, most importantly, the requirement that the issuer is not a company subject to the reporting requirements under the 1934 Act.\(^{38}\)

Regulation A+ provides both Tier 1 and Tier 2 offerings regulatory safe harbors from integration. These include a safe harbor from integration with any prior offering and a safe harbor from integration with any offering made six months after the Regulation A+ offering.\(^{39}\)


\(^{36}\) Id. § 230.251(a)(1)–(2). As proposed by the Commission, the upper limit of a Tier 1 offering was $5 million in a twelve-month period. Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, 79 Fed. Reg. 3926, 3936 (proposed Jan. 23, 2014) (to be codified at 17 C.F.R. pts. 230, 232, 239, 240, and 260) [hereinafter Proposed Regulation A+ Amendments].

\(^{37}\) See 17 C.F.R. § 230.251(a)(2). This means that an issuer selling only $2 million in securities, for example, may rely on the Tier 2 conditions for a Regulation A+ exemption, provided, of course, that the issuer is able to meet all of the Tier 2 conditions.

\(^{38}\) Id. § 230.251(b)(1)–(2). Under Section 13 of the 1934 Act, an issuer becomes subject to the reporting requirements of the 1934 Act if it has a class of securities registered pursuant to Section 12 of the 1934 Act. Securities Exchange Act of 1934, Pub. L. No. 73-291 § 13, 28 Stat. 881, 894–95 (codified at 15 U.S.C. § 78m(a) (2014)). Under Section 12(g) of the 1934 Act, a company is required to register any class of equity securities if the company has assets in excess of $10 million and either 2,000 shareholders of record or 500 unaccredited shareholders of record for the class of equity securities. Act of Aug. 20, 1964, Pub. L. No. 88-467 § 3(c), 78 Stat. 565, 566–68 (codified at 15 U.S.C. § 78g(g) (2014)).

\(^{39}\) 17 C.F.R. § 230.251(c).
All Regulation A+ offerings, no matter whether Tier 1 or Tier 2, are subject to filing and disclosure requirements that, at least as a matter of process, are similar to the filing and disclosure requirements of a registered offering. Generally under Regulation A+, no offers can be made until the offering statement has been filed. After the offering statement has been filed, the issuer can, for example, make oral offers and offers through the use of a preliminary offering circular. Generally, only after the offering statement is qualified (roughly equivalent to a final registration statement that is declared effective by the Commission) is the issuer permitted to sell the Regulation A+ securities.

Regulation A+ also retains, with some changes, the "test the waters" concept of the pre-JOBS Regulation A, and this provision is also applicable to Tier 1 and Tier 2 offerings alike. This provision is an exception to the general prohibition in Regulation A+ of pre-filing offers. Issuers may, under the final Regulation A+ rules, communicate with potential investors about the offering and seek from the potential investors indications of interest in the proposed Regulation A+ offering. These communications are expressly made subject to antifraud provisions and require the offer to contain protective and informative legends and disclaimers. "Testing the waters" communications may continue after filing the offering statement, but during that period such communications must be accompanied by a preliminary offering circular or provide the offeree with information as to where such preliminary offering circular can be obtained.

Tier 1 offerings and Tier 2 offerings under Regulation A+ do, however, differ in regard to the nature and extent of disclosure obligations. Broadly stated, Tier 2 offerings require significantly more disclosures than Tier 1 offerings, both at the time of the offerings (ex ante disclosures) and following the completion of the offering (ex post disclosures). This stepped or "scaled" approach in Regulation A+ is an attempt by the Commission to balance investor protection and capital formation, which is a statutory obligation of the Commission when it enacts


17 C.F.R. § 230.251(d)(1)(i).

17 C.F.R. § 230.251(d).

Id. § 230.251(d)(2)(i)(A).

See id. § 230.255(a). In the pre-JOBS era, this concept had become essentially unusable. The reason was that state blue sky laws applied to pre-JOBS offerings under Regulation A, and such actions as testing the waters were almost certain to run afoul of state registration provisions. See Campbell, A Moderate Capital, supra note 9, at 110.

17 C.F.R. § 230.255(a).

17 C.F.R. § 230.255(b). The required legends and disclaimers must inform the offeree, for example, that no offer to buy can be accepted until the offering statement is qualified and that the offeree's indication of interest creates no obligation to purchase. Id. § 230.255(b)(2)–(3).

Id. § 230.255(b)(4).

In earlier works, I used the term "stepped" for disclosures that vary according to the size of the offering. Campbell, The Wreck of Regulation D, supra note 8, at 926. The Commission uses the term "scaled." E.g., Adopting Release Regulation A, supra note 3, at 21,830. I accede to the Commission's wisdom on this matter and adopt the term "scaled" for the balance of this article.
regulatory exemptions from the registration requirement of the 1933 Act. It amounts to a sensible response to the stifling effect of relative offering costs on small businesses' capital formation.

The ex ante narrative disclosures required in Tier 1 and Tier 2 offerings, although somewhat different, are to a large extent similar. There are fourteen items of narrative disclosures required. These disclosures, while less than the disclosures required in Form S-1, are nonetheless extensive and will certainly impact the relative offering costs in a Regulation A+ offering, especially for smaller offerings.

There are significant differences, however, between the financial disclosures required in a Tier 1 offering and a Tier 2 offering, both with regard to ex ante and ex post financial disclosures.

The requirements for ex ante financial disclosures in a Tier 1 offering are for two years of financial statements (in some cases, interim statements may also be required), but the statements do not have to be audited and do not have to be prepared in compliance with Regulation S-X. The only ex post filing or disclosure for a Tier 1 offering is the obligation to file an “exit report” with the Commission upon termination of the offering.

A Tier 2 offering, on the other hand, requires the issuer to file and disclose significantly more financial information, both ex ante and ex post, than is required in a Tier 1 offering. Ex ante, the principal difference from Tier 1 is that Tier 2 offerings must provide audited financial statements and meet the requirements of a significant part of Regulation S-X.

An even more important difference in a Tier 2 offering is the ex post obligation to continue to report narrative and financial information to the Commission in filings that are reminiscent of the periodic reporting requirements found in the 1934 Act. Regulation A+ imposes on issuers utilizing Tier 2 the obligation to file annual reports, semiannual reports, and current reports with the Commission. These amount to significant obligations and may have a dramatic impact on relative offering costs, especially for small Regulation A+ offerings. For example, the annual report, which is filed on Form 1-K, in addition to extensive narrative

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50 See supra notes 13–15 and accompanying text.
51 See, e.g., Adopting Release Regulation A, supra note 3, at 21,828, 21,830 (discussing the compensation disclosure requirements in Item 11 of the Offering Circular requirements).
53 See Campbell, The Impact of JOBS, supra note 14, at 840–43.
54 Form 1-A, supra note 52, at Part F/S(b).
56 Form 1-A, supra note 52, at Part F/S(c).
57 Adopting Release Regulation A, supra note 3, at 21,899.
disclosures about the company's business and management's discussion and analysis of financial condition, requires two years of audited financial statements that are compliant with a significant portion of Regulation S-X.\(^{58}\)

Importantly, this obligation of periodic reporting continues until such time as the issuer becomes subject to the reporting requirements under the Securities Exchange Act of 1934 or the securities of the issuer are held by less than 300 shareholders of record.\(^{59}\) In all events, the issuer is required to go through one annual cycle of reporting, even if the issuer has less than 300 shareholders.\(^{60}\)

Finally, the most significant difference between Tier 1 and Tier 2 offerings is that Regulation A+ preempts state authority over registration in Tier 2 offerings but does not preempt state authority over registration in Tier 1 offerings.

As originally proposed, the Commission had preempted state authority over Tier 2 offerings and had offered what was an unworkable compromise with regard to preemption over Tier 1 offerings. Specifically, the Commission had proposed that in Tier 1 offerings, state authority over registration be preempted with regard to offers but not with regard to sales.\(^{61}\) This, upon reflection, appeared to be an unworkable compromise\(^{62}\) and was not part of the final version of Regulation A+.\(^{63}\) In the final rules, states continue to exercise authority over registration in Tier 1 offerings.

It is worth noting that the battle over preemption was robust and fought out on various fronts. The Commission’s release adopting Regulation A+ devotes a significant amount of space to recounting the spirited debate and tactics deployed in the effort to preserve state authority over registration of Regulation A+ offerings and to explain its final reckoning on the matter.\(^{64}\) Not surprisingly, this effort was principally from state regulators and NASAA.\(^{65}\)

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\(^{58}\) See Form 1-K: Annual Reports and Special Financial Reports, at 4–5, Part II, Item 1, 2, 7 (2015), http://www.sec.gov/about/forms/form1-k.pdf, Form 1-A, supra note 52, at Item 7, 9(a)–(b), (d).

\(^{59}\) See Adopting Release Regulation A, supra note 3, at 21,899–900.

\(^{60}\) Adopting Release Regulation A, supra note 3, at 21,853. The issuer’s ability to extricate itself from the periodic reporting requirements of Regulation A+ will be significant in regard whether small businesses making smaller offerings will migrate to Tier 2 offerings. See infra note 123 and accompanying text.

\(^{61}\) The JOBS Act amended the preemption in NSMIA by preempting state registration authority over Regulation A+ securities "offered or sold to a qualified purchaser, as defined by the Commission..." 15 U.S.C. § 77r(b)(4)(D)(ii) (2014). In the Commission’s initial proposed Regulation A+ rules, proposed Rule 256 stated: "For the purposes of Section 18(b)(3) of the Securities Act [15 U.S.C. § 77r(b)(3)], a ‘qualified purchaser’ of a security offered or sold pursuant to Regulation A means any offeree of such security and, in a Tier 2 offering, any purchaser of such security." Proposed Regulation A+ Amendments, supra note 36, at 4003.

\(^{62}\) See Campbell, The Impact of JOBS, supra note 14, at 845–47.

\(^{63}\) The final version of Rule 256 states: “[A] ‘qualified purchaser’ means any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A.” Adopting Release Regulation A, supra note 3, at 21,899.

\(^{64}\) See id. at 21,856–62.

\(^{65}\) Id. at 21,857 n.772 (citing letters from NASAA and individual state regulators)
Representatives were also convinced to write letters in support of continuing state registration authority over Regulation A+ offerings.\footnote{Id. (citing letters from United States Congressmen and Senators).}

In addition to attacking the Commission's authority to preempt state registration authority over Regulation A+ offerings, NASAA—following the publication of the Commission's proposed Regulation A+ rules—adopted a multi-state coordinated review program for offerings under Regulation A+ and reported that forty-nine of NASAA's fifty-three members had agreed to participate in the program.\footnote{Id. at 21,860–61, 21,861 n.826.}

These strategies may have provided the incentive for a compromise by the Commission and its final decision to withdraw any preemption of state registration authority over Tier 1 offerings. Even this, however, was not enough to satisfy state regulators, and on May 22, 2015, a suit was filed asking the court to issue a permanent injunction against the preemption of state authority over Tier 2 offerings.\footnote{See Petition for Review, Galvin v. SEC, No. 15-1150 (D.C. Cir. May 22, 2015).}


A. Overview

The Commission's Regulation A+ rules will do little for small businesses. Neither the Tier 1 regime nor the Tier 2 regime offers small issuers an efficient access to external capital. It is unlikely that small businesses will make Tier 1 offerings, because there is no preemption of state registration authority for Tier 1 offerings. Migration to Tier 2 solves the state registration problems for small businesses, but it may increase small issuers' relative offering costs to an intolerable level.

These predictions of an unfortunate, inefficient, and seemingly unintended outcome for the Commission's final Regulation A+ rules are based on the history one finds regarding Regulation A, Regulation D, and NASAA's attempts to corral states into coordinated actions regarding states' registration provisions.

B. Tier 1 Offerings: Nothing Has Changed

Prior to the JOBS Act, Regulation A had fallen into nearly total disuse. This disuse is reflected in Table I in Section II of this article.\footnote{The data in Table I}
become even more dramatic when one realizes that during the years covered by the Table there were about five million small businesses in the United States, and most of those businesses needed external capital to survive and compete.

One may speculate, of course, that some small businesses may have been reluctant to use Regulation A because of the requirements for constructing and filing an offering statement with the Commission and constructing and providing an offering circular to investors. Small issuers may also have had a general fear of getting tangled up with the Commission. The Commission, however, took steps to ameliorate those concerns by scaling back the expensive disclosure requirements for Regulation A—especially as concerned financial disclosures—in a manner that should have made Regulation A popular for offerings in excess of $1 million.

The most apparent principal culprit in the failure of Regulation A was state registration requirements. The niche for Regulation A was public offerings: the ability of firms in Regulation A offerings to make broad, interstate solicitations for capital. But state registration obligations seemingly destroyed that space. The five million small businesses in the United States apparently were unwilling to underwrite the costs of complying with the registration requirements of fifty states, each with its own individual registration regime.

The regime under Tier 1 changes nearly nothing for small businesses. Issuers utilizing Tier 1 are still required to file an offering statement with the Commission and to provide an offering circular to investors, and—most importantly—the Tier 1 issuers are still required to meet the registration requirements of all states in which they conduct an offering. Since nothing has changed, one should not

[Footnotes]

70 See supra Table I. For Regulation A data covering periods before that reflected in Table I, see HICKS, supra note 17, at § 6.3, tbls.2, 2.1 (providing data on the use of Regulation A for most years from 1947 through 1988).

71 For historical data on the number and nature of small businesses and small businesses' demand for external capital, see Campbell, A Moderate Capital, supra note 9, at 84–88.

72 See id. at 86–87 ("Data show that slightly over 85% of firms with ten to nineteen employees utilize some form of credit as a source for financing. That number increases to slightly over 90% for firms employing between twenty and ninety-nine persons.").

73 See id. at 101–06.

74 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 [hereinafter GAO REPORT]. In its adopting release, the Commission reported that the GAO "found that state securities laws were among several central factors that may have contributed to the lack of use of Regulation A." Adopting Release Regulation A, supra note 3, at 21,856.

75 In fact, the financial disclosure requirements for a Tier 1 offering are, at least to some degree, even more demanding than the requirements for a pre-JOBS Act Regulation A offering. For example, the pre-JOBS Act offering circular required only one year's financial statements. See 17 C.F.R. § 239.90 (2011); Form 1-A, supra note 52, at Part F/S; Tier 1 offering under the Commission's final Regulation A+ rules requires two years' financial statements. Id.

76 See 17 C.F.R. §§ 230.251(d), 252, .253 (2015); see Form 1-A, supra note 52, at Part F/S.

expect a different outcome, and it seems highly unlikely, therefore, that small business will, to any meaningful degree, utilize Tier 1 offerings.

C. Inefficient Options for Small Businesses to Meet State Registration Requirements in Tier 1 Offerings.

As is always the case, there are options for how small businesses making a Tier 1 offering can meet state registration requirements. Even the best of those options, however, is unworkable for small businesses that wish to use Regulation A+.

1. NASAA’s New Coordinated Review Program for Regulation A+ Offerings—The JOBS Act was signed into law in April of 2012, and it offered the Commission, once again, the opportunity to preempt state registration authority over Section 3(b) offerings, specifically in this case, Regulation A+ offerings. Indeed, such a targeted, statutory restatement of the Commission’s authority could be viewed as strong evidence that Congress intended for the Commission to do something this time.

In what appears to have been a strategic response, NASAA published a release in October of 2013 requesting comments on a new Proposed Coordinated Review Program for Section 3(b)(2) (Regulation A+ Coordinated Review). This NASAA proposal was in place at the time the Commission first proposed its Regulation A+ rules in January 2014. NASAA subsequently reported that forty-nine of its fifty-three members had signed on to participate in the coordinated review program.

Under this Regulation A+ Coordinated Review, an issuer can file a single state registration statement, which will then be circulated to all states participating in the coordinated review program. The registration statement is first reviewed by one

81 See id.; Proposed Regulation A+ Amendments, supra note 36.
lead state for compliance with disclosure matters. A second lead state is appointed to deal with merit qualifications if any of the states involved in the offering also are subject to merit regulation. The lead state or states prepare comments on the registration statement (both regarding matters of disclosure and merit standards) that are then circulated to all the other participating states. Each of the participating state or states, in turn, has the right to make its own comments and return the comments to the lead state or states. The lead state or states then forward the combined comments to the issuer, who, in the usual manner in which these matters are resolved, is required to work with all states to resolve matters raised by each of the states' comments. The lead state or states are the go between and mediator to facilitate the resolution of each states' comments with the issuer.

Not surprisingly, a number of the comments offered on the Commission's proposed Regulation A+ rules expressed strong doubts that the Regulation A+ Coordinated Review program could provide a workable regime for small businesses to meet blue sky registration provisions in the fifty states. Commenters pointed out that even if all states participated in the programs, each state's laws remained applicable to an offering in each state. Commenters expressed concerns about delays and expenses and generally about getting tangled with the large number of sovereign state regulators with different legal rules. Thus, for example, in the states that apply merit requirements, each state's individual merit requirements must be met, and as the GAO Report emphasized, merit requirements vary from state to state. It would also seem that the "test the waters" provision of Regulation A+ would cause trouble for offerings in particular states, since all matters regarding "offers" and "sales" still remain a matter of each state's laws.

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84 Id.
85 The GAO Report states that "most states . . . conduct merit reviews." GAO REPORT, supra note 74, at 13. The Report goes on to discuss the significant differences in merit standards among the states. Id. at 14 ("Merit reviews have varying degrees of stringency, with some states applying stricter standards than others.").
87 Id.
88 Id.
89 See id. ("The lead examiners will communicate with the applicant and participating jurisdictions, as necessary, to resolve any outstanding comments.").
91 See, e.g., KVCF Letter, supra note 90.
92 See, e.g., id.; Hastings Letter, supra note 90.
93 The GAO Report states that "[m]erit reviews have varying degrees of stringency, with some states applying stricter standards than others." GAO REPORT, supra note 74, at 14. This point was also emphasized by a commenter. See ABA BLS Letter, supra note 90.
Commenters also emphasized that each state retained the right to charge registration fees for its state.95 This generates both out of pocket expenses for the state fees and legal expenses in determining the amount and required process for paying those fees.

If one overlays such concerns and issues on the process described above, one sees that NASAA's Regulation A+ Coordinated Review program is unlikely to attract a significant amount of use from small businesses making Tier 1 offerings under Regulation A+. History also supports this conclusion.

Over the decades, state regulators and NASAA have made attempts at uniformity. These initiatives have, at best, appeared to enjoy modest success. For example, NASAA's Uniform Limited Offering Exemption (ULOE)96 was designed to permit a uniform state regime for coordination of some Regulation D offerings with state blue sky laws and was widely adopted by states.97 It turned out, however, that the ULOE provisions varied significantly from state to state.98

In a 2000 article, I gathered and presented data regarding NASAA's Small Company Offering Registration initiative (SCOR), relying on a ten state sample.99 NASAA described SCOR as designed to "provide for the uniform treatment of registrations of small company offerings which are exempt from federal registration under Rule 504 of Regulation D, Regulation A, or Rule 147."100 While my research indicated that states had widely adopted SCOR, that research also suggested that SCOR was less than uniform across states and had barely been utilized by issuers.101

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95 See, e.g., Hastings Letter, supra note 90.

The ULOE was intended to ease [the] burden by providing a uniform exemption in all fifty states which would also coordinate with Regulation D. In actual practice, however, the ULOE has not achieved its goal. The modifications made by the NASAA member states have resulted in the same confusing array of exemptions that existed prior to the ULOE.

Id. at 504.
99 See Campbell, The Insidious Remnants, supra note 97, at 420, 423. For my sample states, I selected Kentucky and other states falling close to Kentucky alphabetically. Id. at 420 n.52. Much of the data I used was gathered from individual states, since I was at that time unable to find any centralized source for the data.
101 See Campbell, The Insidious Remnants, supra note 97, at 424. ("Iowa reports that only four SCOR registration statements became effective . . . during each of the calendar years 1997, 1998, and
More recent data show that SCOR registrations continue rarely to be used. SCOR filings can now be filed centrally within multi-state regions or with individual states. The total number of central filings of SCOR registration statements in all regions during more recent periods were: three in 2012; three in 2013; and one in 2014. The total number of individual state filings during those periods from a nine state sample were: four in 2012; four in 2013; and one in 2014.

In my 2000 article, I also looked at NASAA's Coordinated Equity Review initiative, and found similar results as with SCOR: participating states retained sovereignty over rules respecting offers and sales of securities, and the small amount of information available suggested that Coordinated Equity Review was very lightly used by issuers. Recently I updated this data and found that during the three years 2012–2014, only one Coordinated Equity Review was filed.

My data regarding the use of SCOR and Coordinated Equity Review are consistent with softer anecdotal evidence. For example, evidence gathered for the 2012 GAO Report from state securities administrators suggests that usage of such uniformity initiatives has been insignificant with regard to any Regulation A offerings.

1999. Indiana reports that only two SCOR registration statements became effective between January, 1997 and August, 1999. Information gathered from other sample states reflects similarly modest utilization of SCOR.


103 Out of the ten sample states used in my 2000 article, we were able to get data on nine of the states. Indiana, Kansas, Kentucky, Louisiana, Maine, and Maryland, had zero SCOR filings in 2012, 2013, and 2014. Email from Patrick Sanders, Registrations Attorney, Ind. Sec. Div., to author (Jan. 13, 2016) (on file with author); Telephone interview with Steven Wassom, Exec. Dir., Kan. Sec. Comm'n's Office (Dec. 22, 2015); Telephone interview with Anthony Murphy, Registration Branch Manager, Div. of Sec., Ky. Dep't of Fin. Instrs. (Jan. 6, 2016); Telephone interview with Len Riviere, Deputy Chief Exam'r, Sec. Div., La. Office of Fin. Instrs. (Dec. 28, 2015); Telephone interview with Paige Turney, Assistant Sec. Admin'r, Office of Sec., Me. Dep't of Prof'l and Fin. Regulation (Dec. 28, 2015); Email from Joy Sakamoto-Wengel, supra note 102.


104 Campbell, The Insidious Remnants, supra note 97, at 425–27, 426 n.93 (only two coordinated reviews by 1997, and only seventeen coordinated review offerings had become effective by 1999).


106 GAO REPORT, supra note 74, at 15 ("According to several of the state securities administrators . . . they have not participated in regional reviews or used SCOR forms for Regulation A filings because . . .")
Finally, preliminary data suggest that NASAA's newly minted Regulation A+ Coordinated Review program will have limited appeal for issuers, especially small issuers. The Regulation A+ final regulations became effective on June 19, 2015. Between that date and May 24, 2016, only 37 Tier 1 Regulation A+ offerings were filed with the Commission. As of June 2, 2016, only eleven Tier 1 Regulation A+ filings had utilized NASAA's Regulation A+ Coordinated Review program.

In summary, history supports the conclusion that NASAA's Regulation A+ Coordinated Review initiative will not solve the problems of small businesses in Tier 1 offerings under Regulation A+.

2. Migration of Tier 1 Offerings to the Tier 2 Regime—It is possible for offerings by small businesses within the amount limit of Tier 1 to migrate to a Tier 2 offering, since there is no lower amount limitation on Tier 2 offerings under Regulation A+. Some small businesses seeking an amount of external capital within the Tier 1 limit, therefore, may be tempted to try to solve their state registration problems by migrating to a Tier 2 offering, because the Regulation A+ rules preempt state registration authority over Tier 2 offerings. Similar strategies have been extensively employed by small businesses in Regulation D offerings.

Rule 504 is a Regulation D exemption from registration that is designed for and attractive to small businesses seeking small amounts of capital. The exemption allows small businesses to offer up to $1 million in securities, and it does not require disclosures or any offeree or purchaser qualifications (such as

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there have been so few Regulation A filings in their state. Similarly, ... some of these methods, like SCOR, have not been widely used because of the low number of Regulation A filings in recent years."). While these data may appear thin, this anecdotal evidence suggests that such uniformity initiatives have not been able to overcome the negative effect of state registration rules on Regulation A offerings.

107 Regulation A+ data were obtained from the subscription-only Lexis Securities Mosaic website. See Form 1-A Data, LEXIS SEC. MOSAIC, www.lexissecuritiesmosaic.com (last visited May 24, 2016) (click "SEC Filings" tab; then follow "SEC Filings" hyperlink; then search "Form 1-A").

During that same period there were twenty-five Tier 2 offerings of less than $20 million, a range in which issuers could have relied on Tier 1 rules. Id.

108 Following the passage of the JOBS Act, NASAA adopted a new coordinated review regime for offerings under Regulation A+. NASAA Coordinated Review Protocol, supra note 83, at 1.

NASAA reported that the regime had been adopted by forty-nine of its fifty-three members. Adopting Release Regulation A, supra note 3, at 21,861 n.826; 17 C.F.R. §§ 230.251–263 (2015). As of June 2, only eleven coordinated reviews had been filed with the states. Email from Faith L. Anderson, Esq., Chief of Registration & Regulatory Affairs, Wash. Dep't of Fin. Insts. Sec. Div., to author (June 2, 2016, 5:17 PM EST) (on file with author).

109 See 17 C.F.R. § 230.251(a)(2) (2015). The only amount limitation on a Tier 2 offering is that the offering cannot "exceed $50,000,000." Id.

110 See id. § 230.256.


112 See 17 C.F.R. § 230.504.

On the other hand, Rule 506, another Regulation D exemption, provides an exemption that is unlimited in amount but may require either accredited investors or significant disclosures of prescribed investment information, or both.115

Notwithstanding the additional burdens and compliance costs, small offerings under Regulation D within the $1 million limit of Rule 504 overwhelmingly migrate to Rule 506.116 Data show that approximately 80% of Regulation D offerings of $1 million or less are made as Rule 506 offerings.117 Issuers migrated from Rule 504 in order to solve their state blue sky problems, since NSMIA preempts state registration authority over offerings under Rule 506.118

Migrating to Rule 506, however, has costs for the issuer. One possible cost in moving from a Rule 504 offering to a Rule 506 offering is the expense of extensive disclosures that may be required in a Rule 506 offering.119 These disclosures, however, are not required if the Rule 506 offering is limited to accredited investors.120 Not surprisingly, therefore, one finds that the vast majority of offerings that migrate from Rule 504 to Rule 506 are limited to accredited investors. Thus, in a sample I constructed and used in prior research, I found that 88% of Rule 506 offerings of $1 million or less were limited to accredited investors.121

The net of this is that in small Regulation D offerings, the principal cost of migrating to a Rule 506 offering is the cost of limiting the offering to accredited investors. While this certainly amounts to a significant reduction in the pool of investors,122 the out of pocket expenses—for example, legal and accounting costs—in moving to a Rule 506 offering may not be great.

Under Regulation A+, however, the costs of migration to a Tier 2 offering are different from the Regulation D migration and would seem to be significantly more daunting for a small issuer attempting to raise a relatively small amount of capital. Most important here are the additional disclosure requirements generated by

114 Id.
115 Id. § 230.506. For an overview of Rule 504 and Rule 506, see generally Campbell, The Wreck of Regulation D, supra note 8, at 923–26.
116 See Campbell, The Wreck of Regulation D, supra note 8, at 928. A recent article by Professor Manning Warren shows the relatively small number of Regulation D offerings that utilize Rule 504 or Rule 505. Manning Gilbert Warren III, The False Promise of Publicly Offered Private Placements, 68 SMU L. REV. 899, 903 fig.1 (2015) (noting that out of a sample of 33,440 Regulation D filings, only 450 were Rule 504 offerings and only 825 were Rule 505 offerings).
117 Id. tbl.III.
119 See 17 C.F.R. § 230.502(b).
120 Id. § 230.502(b)(1).
121 Campbell, The Wreck of Regulation D, supra note 8, at 930 tbl.VII.
122 While it is difficult to be precise, data suggest that accredited investors may amount to 3% to 5% of the population. An analysis of Internal Revenue Service data shows that approximately 3.62 percent of all 2012 tax returns reported income of $200,000 or more. Justin Bryan, High-Income Tax Returns for 2012, IRS STAT. INCOME BULL., Spring 2015, at 4, fig. C. For tax year 2007, see Justin Bryan, High-Income Tax Returns for 2007, SOI BULLETIN, Spring 2010, at 4 fig.A (noting that 3.172 percent of all 2007 tax returns reported income of $200,000 or more).
moving to the Tier 2 regime. As described above in Section III, ex ante disclosures, especially the financial disclosures, are significantly more demanding, and thus more expensive, in a Tier 2 offering. But more off-putting for a small issuer are the ex post disclosure requirements, which may require periodic filings with extensive narrative and financial disclosures for years to come.

There is also the matter of the opportunity costs in migrating to a Tier 2 offering. Faced with the practical loss of Tier 1 offerings due to continuing state authority over registration, there may be other opportunities that are more attractive for the small issuer that needs to make a broad solicitation for external capital. A more likely migration for small issuers foreclosed from Tier 1 offerings may be—as it was for Rule 504—to a Rule 506 offering limited to accredited investors. Under new Rule 506(c), if limited to accredited investors, a small issuer may offer its securities through a general solicitation and sell to an unlimited number of purchasers. Rule 506(c) imposes no mandated disclosure requirements or offeree qualification requirements (such as sophistication), and state registration authority over Rule 506(c) offerings is preempted. It may seem more likely that small issuers precluded from Tier 1 offerings would migrate to Rule 506(c), not to Tier 2.

Preliminary data suggest that few small offerings under Regulation A+ will migrate from a Tier 1 offering to Tier 2 offering. From June 19, 2015, the effective date for the Regulation A+ rules, to May 24, 2016, only twenty-five Regulation A+ offerings of $20 million or less—offerings that could have been filed under the Tier 1 regime instead—were filed as Tier 2 offerings.

In summary, it is difficult to see how Regulation A+ will materially benefit small issuers searching for a small amount of external capital. For such businesses using the Tier 1 regime under the new Regulation A+ rules, essentially nothing has changed. The requirements and impediments faced by issuers using Tier 1 are fundamentally the same as the requirements and impediments faced by issuers using Regulation A in its pre-JOBS Act form. Migration to Tier 2 for such small offerings by small businesses seems likely to generate unacceptably high offering and post offering costs and thus does not appear to be an attractive path for small businesses to solicit broadly for external capital.

123 See supra notes 48–59 and accompanying text.
124 See 17 C.F.R. § 230.506(c).
125 See id.
127 Regulation A+ data were obtained from the subscription-only Lexis Securities Mosaic website. See Form 1-A Data, LEXIS SEC. MOSAIC, www.lexissecuritiesmosaic.com (last visited May 24, 2016) (click "SEC Filings" tab; then follow "SEC Filings" hyperlink; then search "Form 1-A").
Although Regulation A+ may not work well for small issuers seeking relatively small amounts of external capital, as the size of the offering increases, Tier 2 offerings under Regulation A+ may become more attractive. Relative transaction costs decrease as the size of the offering increases, and thus the expenses associated with the Tier 2 disclosure requirements become less of an impediment to financing.

The most significant limitation on the availability of Regulation A+ for these larger Tier 2 offerings is that the issuer cannot be a reporting company under the 1934 Act. The niche for Regulation A+ offerings, therefore, seems likely to be for offerings by businesses with the need for significant amounts of external capital—perhaps amounts between $5 million and $50 million—provided that those businesses are not subject to the reporting requirements of section 13(a) or section 15(d) of the 1934 Act.

One point of this discussion is to recognize that there may be a niche for Tier 2 offerings, although the niche is likely limited to a group of larger privately and semi-privately owned companies. The existence of this limited niche, however, does not change the fundamental fact that Regulation A+ is unlikely to provide any material relief for small businesses searching for small amounts of external capital. Still, one may question whether denying small businesses access to Regulation A+ is significant. One might, for example, point out that small businesses are no worse off than they were before Regulation A+.

My view is that the Commission’s failure is significant. The Commission, by its failure to make Regulation A+ available to small businesses with smaller capital needs, missed the opportunity offered by the JOBS Act to construct a much better overall exemption regime for small businesses.

Considered as a whole, the JOBS Act, although certainly not without its challenges to regulatory implementation, offered the Commission the opportunity...
to construct three essentially new and rational paths for small business capital formation. Title II opened the way for a broad solicitation of accredited investors under Rule 506.\footnote{133 See Campbell, *The Impact of JOBS*, supra note 14 at 825–30.} 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.\footnote{134 17 C.F.R. § 230.506(a)–(c) (2015).} 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.

Title III of JOBS opened the way for internet offerings of up to $1 million through a technique referred to as crowdfunding, but subject to the disclosure of investment information to investors.\footnote{134 15 U.S.C. § 77d-1(b) (2011); see also Campbell, *The Impact of JOBS*, supra note 14 at 830–39.} Essentially, this permits small issuers to post their offerings on the internet but prohibits any other sales activities.

The third leg of the JOBS Act for small business capital formation is Title IV, and it is an important complement to Title II and Title III. Title IV permits broad solicitation for investors, does not limit purchasers to accredited investors, and allows the use of traditional and usual selling efforts and techniques, but subject to prescribed, scaled disclosures.\footnote{136 17 C.F.R. § 230.251; see also Campbell, *The Impact of JOBS*, supra note 14, at 839–47.}

Without a viable Title IV, the JOBS Act limits small businesses to selling to accredited investors, which amounts to a small percentage of the population, and the passive posting of offers on the internet. There is, in short, no way under the JOBS Act for small businesses to raise a small amount of capital through traditional marketing techniques that have always been and will always be at the heart of small business capital formation.

VI. WHO IS TO BLAME? WHO CAN FIX THE PROBLEM?

NASAA and the Commission are two obvious parties to blame for what appears to be a subversion of the legislative intent of Title IV, which apparently was to provide an efficient exemption from registration for small offerings by small businesses.

introduced as the Capital Markets Deregulation and Liberalization Act of 1995,\textsuperscript{139} in its original form would have preempted all state registration authority over exempt offerings, except for shares offered under the federal intrastate exemption.\textsuperscript{140} As enacted, however, NSMIA had significantly more limited preemption and, most importantly, did not preempt state authority over offerings under Section 3(b) of the 1933 Act.\textsuperscript{141}

A more exotic strategy to limit preemption, and a strategy generally considered to have been orchestrated by NASAA,\textsuperscript{142} occurred in connection with the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").\textsuperscript{143} In 2009, an early discussion draft of that legislation was made available.\textsuperscript{144} That draft of the legislation, even at that early stage, was an exceedingly contentious and complex bill that ran well over one thousand pages and was designed to enact significant reforms in the conduct of financial institutions and Wall Street practices and to avert future financial crises of the type that had severely damaged the economy in 2008. Buried deep in that document, however, was a provision that had nothing to do with financial institutions or Wall Street reform. Specifically, Section 928 would have eliminated preemption of state registration authority over Rule 506 offerings, which was the only meaningful preemption in NSMIA of state registration authority over small business capital formation.\textsuperscript{145} Ultimately, the provision did not survive the legislative process, and the preemption of state registration authority over Section 506 offerings continued.

NASAA continues its vigorous opposition to preemption of state authority over registration. It has established the NASAA Preemption Resource Center on its
website, where it offers up its various activities and its encouragement in the fight against preemption.\textsuperscript{146}

Not surprisingly, NASAA and its members fought preemption of state authority over Regulation A+ offerings, following a traditional path of expressing opposition to preemption through letters commenting on the Commission’s rules.\textsuperscript{147} One might additionally assume that NASAA and its members were also influential in convincing members of the House and the Senate to write letters directly to the Chair of the Commission opposing preemption over Regulation A+ offerings.\textsuperscript{148} It is difficult to miss the implied threat in such letters from members of the body that controls the Commission’s budget. Finally, a new strategy was unleashed in response to the Commission’s preemption of state authority over Tier 2 Regulation A+ offerings, which was to challenge preemption in the courts.\textsuperscript{149}

NASAA is subject to criticism for the adverse and inefficient effects its efforts have had on small business capital formation. Efficient and well-balanced federal exemptions from registration designed specifically to promote efficient capital formation for small businesses have been wrecked by state authority over registration.\textsuperscript{150} One may, of course, put various spins on NASAA’s activities, but it has at least the specter of turf protection at the expense of efficient capital formation. It also substantially misallocates state resources, which could be much more efficiently used to prevent fraud.\textsuperscript{151}

One must realize, however, that NASAA and the state securities regulators that comprise its membership will never change. They will continue to be—as they have in the past—an organized, vocal, and formidable force advocating the nonsensical position that it is appropriate in a market economy to require small businesses that search for external capital to comply with fifty-plus separate registration regimes.

The Commission for its part has a history over the last twenty years of actions and inactions enabling NASAA. Principally, the Commission’s enabling of NASAA has taken two forms. The Commission has failed to advocate in favor of preemption, and the Commission has failed responsibly to use its delegated authority to expand preemption.


\textsuperscript{147} See Adopting Release Regulation A, supra note 3, at 21,857 n.772 (citing the list of letters sent in opposition). A significant majority of the letters cited therein opposing preemption were either from NASAA, from those apparently inspired by NASAA’s lobbying efforts, or from members of NASAA (i.e., state securities regulators). See id.

\textsuperscript{148} See id.


\textsuperscript{150} See, e.g., Campbell, The Wreck of Regulation D, supra note 8, at 922; see also Campbell, A Moderate Capital, supra note 9, at 80–81.

\textsuperscript{151} See Rutheford B. Campbell, Jr., Federalism Gone Amuck: The Case for Reallocating Governmental Authority over the Capital Formation Activities of Businesses, 50 WASHBURN L.J. 573, 573–74 (2011) (arguing that states should reallocate “scarce state resources to their most efficient use, which is the support of the states’ enforcement of their antifraud provisions.”).
Actions of the Commission in connection with the enactment and implementation of NSMIA provide examples of the Commission's significant failures. First, in the Congressional hearing leading to the adoption of NSMIA, the Commission refused to support preemption. State authority over registration was choking small business capital formation, yet the Commission refused to support the Congressional remedy that was originally offered, namely broad preemption of state authority over registration.

Even without the Commission's support for preemption, Congress in NSMIA handed the Commission broad authority to expand preemption by regulation. It did so by preempting in NSMIA state registration authority over offerings to "qualified purchasers" and delegating broad authority to the Commission to define "qualified purchasers."

In the twenty years after the passage of NSMIA, however, the Commission has never acted to expand preemption over exempt offerings by small businesses, even as states' registration obligations have continued to choke small business capital formation and wreck the Commission's rational, efficient exemptions from federal registration.

The second sin of the Commission, therefore, was its refusal to use its broad delegated authority to expand preemption by regulation in a manner that enhanced efficient small business capital formation. This latter failure of the Commission seems to have been significant enough to cause Congress to say it again in Title IV of the JOBS Act. Specifically, Title IV of the JOBS Act, in the same language as used in NSMIA, preempted state authority over Regulation A+ offerings that are "offered or sold to a qualified purchaser, as defined by the Commission."

Even with this somewhat dramatic reiteration, the Commission once again refused to enact a regulatory expansion of preemption that would make Regulation A+ relevant for small business capital formation. Small business—once again—went under the bus as a result of the Commission's enabling action or inaction, and

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152 See, e.g., Hearing on H.R. 2131, supra note 138, at 102-31 (statement of Arthur Levitt, Chairman of the SEC); see also Campbell, The Wreck of Regulation D, supra note 8, at 937 ("The testimony and prepared remarks of then-Chairman Levitt offered during the legislative hearings skillfully dodged any support for broad preemption of state authority over securities offerings.").

153 As described above, as originally introduced, NSMIA provided for broad preemption of state authority over registration, including a preemption of authority over offerings under Section 3(b) exemptions. See supra notes 139–141 and accompanying text.


156 See Campbell, The Wreck of Regulation D, supra note 8, at 922; see also Campbell, A Moderate Capital, supra note 9, at 80-81.

Regulation A+ wound up providing a small niche that practically is available only for larger, closely held (or at least non-reporting) companies.

Perhaps the Commission saw a risk that an expanded preemption over Tier 1 offerings would draw a court challenge from NASAA and state regulators, claiming that such a regulation exceeded its delegated authority under Title IV of the JOBS Act. Obviously, that fear would have been justified, in light of the fact that a suit challenging the preemption over Tier 2 offerings has been filed.\(^{158}\)

Although any suit challenging preemption inevitably will have a significant disruptive effect,\(^{159}\) it is difficult to imagine that a court will conclude that a broad preemption over all Regulation A+ offerings exceeds the Commission's delegated authority under Title IV.

Following the adoption of NSMIA, I wrote urging the Commission to adopt and implement an expansive view of its power to preempt state registration authority through the regulatory definition of "qualified purchasers."\(^{160}\) In preparing that article, I examined the legislative history of NSMIA as it related to the Commission's delegated authority to define "qualified purchaser," and I found Committee language that was confusing, contradictory, and ultimately inconclusive.\(^{161}\)

The statutory language of NSMIA itself, however, shows a very broad delegation of Commission authority to define "qualified purchaser." As if to emphasize the breadth of that delegated authority, the statute states that the Commission may define the term "differently with respect to different categories of securities."\(^{162}\) The only limitation on the Commission's authority in the statute is


\(^{159}\) It seems unlikely, for example, that many issuers will utilize Tier 2 offerings until the litigation is resolved. Indeed, these disruptive effects may be part of the new NASAA strategy. The delay of the effectiveness of the regulation and the risk that a court may strike down the regulation reduce the anticipated value of the regulation. In addition, the Commission also faces the costs of litigating the matter. This reduction in the value of the regulation and the regulation's increased costs may deter the Commission from beneficial risk taking with regard to regulatory expansion of preemption.


\(^{161}\) While there is some legislative history of NSMIA reflecting a limitation on the Commission's authority to define "qualified purchaser," the language from the Committee considering NSMIA is so confusing as to be essentially worthless. For example, the report states that the definition of "qualified purchasers" should "[i]n all cases . . . be rooted in the belief that 'qualified' purchasers are sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary." H.R. REP. NO. 104-622, at 31 (1996). In the same paragraph, however, the Report states that "the Commission may define the term 'qualified purchaser' differently with respect to different categories of securities, consistent with the public interest (including consideration of efficiency, competition and capital formation) and the protection of investors." Id. at 32. The two sentences cannot be reconciled, since the first sentence seems to say that the only definition for qualified purchaser is sophistication, while the second sentence says that the Commission may define the term differently and explains the factors that can go into that determination.

the requirement that the definition must be "consistent with the public interest and the protection of investors."\(^{163}\) Another section of NSMIA states that when the Commission in its rulemaking is required to act "in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."\(^{164}\) In the case of Title IV, the same statutory language authorizes—once again—the Commission to preempt state registration authority over Regulation A+ offerings.\(^{165}\)

Any claim that the Commission would exceed its delegated authority by the preemption of state registration authority over Tier 1 or Tier 2 Regulation A+ offerings seems unsupportable. Both Tier 1 and Tier 2 offerings depend on the issuer's disclosing closely-tailored investment information to each investor. The claim that the Commission could not declare an investor that is protected by disclosure of investment information prescribed by the Commission to be a "qualified purchaser" is contrary to the core principle of the 1933 Act, which is disclosure as the bedrock protection for investors.

Even if there is some risk of an erroneous outcome in which a court declares that the Commission's definition of qualified purchaser exceeds it delegated authority, the Commission fails its responsibility if it allows the risk of disruption and the remote risk of an erroneous, adverse court opinion to keep it from doing the right thing, which is to craft a Regulation A+ that offers small businesses an efficient access to external capital. Such risks do not justify a bad outcome that is contrary to the purpose of Title IV.

Notwithstanding, history suggests that the Commission, like NASAA, will continue down the path it has been on for twenty years, continuing to be unwilling to expand preemption via regulation. If the Commission is unwilling to do this—even after Congress has re-delegated to the Commission broad authority in a piece of legislation entitled "Small Company Capital Formation"—it seems unlikely that a broadly worded delegation will ever generate the will at the Commission to preempt state registration over small business capital formation. Indeed, a moment of reflection reveals that the only preemptions of state authority over exempt offerings by small businesses have been the result of statute, specifically the preemption over Rule 506 offerings\(^{166}\) and crowdfunding.\(^{167}\)

Simply stated, my conclusion is that the Commission will continue to enable NASAA and state regulators to preserve a regime to makes it unnecessarily difficult, inefficient, and unfair for small businesses to access external capital. My other simple, related conclusion is that only Congress can break this gridlock by enacting statutory preemptions of state authority over registration.

\(^{163}\) Id.

\(^{164}\) Id. § 77b(b).

\(^{165}\) See id. § 77r(b)(3), (b)(4)(D)(ii).

\(^{166}\) Id. § 77r(b)(4)(C).

\(^{167}\) Id. § 77r(c)(2)(F).
CONCLUSION

The Commission's regulatory implementation of Title IV of the JOBS Act fails to provide small businesses with an efficient and fair access to external capital. Regulation A+—assuming, as is likely, that it survives the court challenge to the preemption of state authority over Tier 2 offerings—may find some life as an exemption for public offerings by larger, non-reporting companies, but the Regulation A+ rules offer nearly nothing to the millions of small businesses that are an important component of our national economy.

It is an inescapable irony that Title IV of the JOBS Act, which is entitled "Small Company Capital Formation," is of no material benefit to small businesses searching for external capital. But history continues to repeat itself, and once again, in the face of an aggressive campaign by NASAA and state regulators, the Commission was unwilling to use its delegated authority in a way that would benefit small businesses and the economy as a whole.