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March 23, 2015

Massachusetts Securities Division
McCormack Building
One Ashburton Place, 17th Floor
Boston, MA 02108
Attention: Peter Cassidy, Esq.

Dear Mr. Cassidy:

I very much appreciate the opportunity to comment on the new Massachusetts Crowdfunding Exemption, 950 C.M.R. 14.402(b)(13)(o) (the “Rule”).

I am a partner in the law firm Verrill Dana, LLP, where I specialize in securities and corporate law. I have more than 30 years’ experience with advising issuers about private placements and public offerings of securities. Over the past two years, I assisted the Maine Securities Administrator (Judith M. Shaw, Esq.) with the design of a crowdfunding statute and rule in Maine that differs significantly from the approach taken by your Division in the Rule, and which is further described below.

Recent federal and state crowdfunding initiatives have opened up interesting new opportunities for public offerings that cap the amount any one investor can invest. I was very pleased to see that your Division adopted a new exemption authorizing such an offering for certain Massachusetts issuers.

In this letter, I offer comments on selected Specific Questions identified in your Solicitation of Public Comment. Specifically, I have included comments here on Questions 1, 2, 3, and 6. The opinions expressed in this letter reflect are my own, and do not necessarily reflect the views of Verrill Dana, LLP or any of its clients.

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1) Relationship to the Federal Intrastate Offering Exemption

The Massachusetts Crowdfunding Exemption requires that “The offering is sold only to residents of the Commonwealth in compliance with the requirements of §3(a)(11) of the Securities Act of 1933 (15 U.S.C. §77c(a)(11)) and S.E.C. Rule 147 (17 C.F.R. 230.147).” Basing the Rule on the federal intrastate

exemption imposes important structural barriers that make the Rule less useful to Massachusetts businesses as a route for raising capital.

- a) The federal intrastate exemption is a notoriously limited, complex, and risky exemption. To cite just a few examples:
- i. *Limited.* The federal intrastate exemption is statutorily unavailable to an issuer that is organized under the laws of some state other than the state of its principal residence. It is common practice for businesses in Massachusetts to organize as a Delaware corporation or Delaware limited liability company, for various reasons. Unless they reorganize under Massachusetts law, those businesses in Massachusetts will be ineligible to rely on the federal intrastate exemption, and thus ineligible to rely on the Massachusetts Crowdfunding Exemption.
 - ii. *Limited; Complex.* Over the years, the “doing business within” requirement of the federal intrastate exemption has been construed by the SEC and the courts to mean that the issuer is *predominately* doing business within the state where the offering is being conducted. Rule 147 sets forth a strict, multifactor numerical test for when an issuer is predominately doing business in a given state. Section 3(a)(11) has been construed to provide somewhat more leeway, but not a lot, and there is significant uncertainty over how close is close enough in this regard. Moreover, these factors are measured at the time of each sale, and so a rapidly evolving business must assure that it remains within the necessary parameters for however long the offering lasts.
 - iii. *Risky.* Under the federal intrastate exemption, each and every offeree must be “resident within” the state in which the offering is being conducted. Determining a purchaser’s primary residence is not necessarily an easy task, and a purchaser’s own representations to the issuer are not controlling if the issuer had any reason to suspect that primary residence might be elsewhere. Moreover, the standards for whether the issuer or others have made offers into another state are vague, and do not translate well to offers made through the Internet, a relatively new medium. The SEC has recently given guidance on Internet offerings, suggesting that issuers must take steps to withhold information about investment terms unless the viewer provides an affirmative representation about residence or unless the issuer determines that the viewer’s IP address originates in the state. Nonetheless, a single failure (even if inadvertent) can result in loss of the federal

intrastate exemption, not just for that one sale but for all sales made under the same offering.

- iv. *Risky*. A further risk is the constraint on follow-on financing. If the offering fails to raise sufficient capital, then the business either needs to spend six more months with no further efforts to raise capital, or needs to craft its follow-on activities to avoid integration with the prior offering.
- b) The Massachusetts Crowdfunding Exemption exacerbates the frailties of the federal intrastate exemption in at least two important respects:
- i. Whereas at the federal level Rule 147 is a *nonexclusive* safe-harbor, the Massachusetts Rule *requires* compliance with *both* Section 3(a)(11) *and* Rule 147. This has the effect of turning the safe-harbor's conditions into legal necessities, making compliance more difficult.
 - ii. Whereas the federal statute of limitations period for a registration violation is one year from the date of sale, the limitations period under the Massachusetts Uniform Securities Act for a registration violation is *at least* four years. As a result, the issuer is at increased risk that a disgruntled investor will threaten or file a rescission claim for nonregistration under the Massachusetts Uniform Securities Act, a claim for which the burden of proof is on the *issuer* to prove compliance with all conditions of the exemption. A four-year exposure under the Massachusetts Act is probably *more than* four times as large as a one-year exposure under the federal act, given the longer period over which the issuer might experience some business setback that causes an investor to have regrets about his or her prior investment decision. An increased risk of claims against the issuer quickly translates to increased risk for the issuer's controlling persons and, importantly, subjects otherwise happy co-investors to the risk that the issuer will become capital depleted because of the cost of defending or paying the disgruntled investor's claim.

Even with these constraints, I would expect there are a number of Massachusetts businesses that will find the Massachusetts Crowdfunding Exemption useful. For example, small businesses with a purely local footprint could find it useful to solicit capital over the Internet with the idea that local residents would be the only ones interested in investing. If the proprietor is willing to discard subscriptions from people he or she does not recognize, a local offering of this sort might meet the

requirements of Rule 147 without the necessity of hiring a securities lawyer specialist to guide and monitor the offering.

In the broader context, however, these constraints do impose very real costs. For a business with a regional or national identity, attempting to offer securities under the Massachusetts Crowdfunding Exemption will, as a practical matter, require careful planning and monitoring by a securities law specialist. That level of expense and effort would typically be justified only if the issuer believes that its Massachusetts-only offering will succeed in raising hundreds of thousands of dollars through large numbers of modest subscriptions.

2) Alternatives to Single-State Offering Exemption

Given that the intrastate exemption is such a fussy, unreliable basis for an offering, I believe the Division should consider additional routes for crowdfunding in Massachusetts. SEC Rule 504 provides a potentially more flexible platform than the federal intrastate exemption. One principal limitation is on offering size – not more than \$1 million in a 12-month period – but many small businesses will find such a limit workable. The other principal limitation is the manner of offering – crowdfunding relies on general solicitation and so Rule 504 would require *state* registration of the securities, and public filing and delivery to investors of a substantive disclosure document before sale.

- a) Already, a Massachusetts issuer could conduct a public offering of less than \$1 million in reliance on Rule 504 and 950 CMR 13.303(A)(3). Under existing Massachusetts law, such an offering must be made through a Form U-7 registration statement.
- b) Maine has adopted a 504-based crowdfunding exemption that uses a special short-form registration statement similar to, but simpler than, Form U-7. The Maine exemption is limited to Maine-based issuers, but the Maine Securities Administrator has expressed support for the idea of reciprocal exemptions that would dovetail with 504-based short-form registrations in other states.

From a state regulator's standpoint, a registration-based crowdfunding exemption has the advantage of providing for preclearance of disclosure documents by the state's securities division, and thus provides an opportunity to block offerings where the disclosure document is considered deficient, or where the offering is otherwise considered improper. In contrast, the Massachusetts Crowdfunding Exemption sets forth a list of required topics for disclosure but does not require pre-filing or preclearance of disclosure documents.

3) Limitation on Forms of Security: Equity or Debt

Under the existing Rule, it is unclear what the line of demarcation is between “equity securities” and “debt securities.” Complex securities have some elements of each. If this feature of the Rule is intended to exclude hybrid securities, then it is unclear whether stock that carries a repurchase option by the issuer – or a put option by the holder – at some formulaic price would be considered a prohibited hybrid. Similarly, if a bond or debenture contains a conversion feature exercisable by the holder or the issuer, it is unclear whether this would be considered a prohibited hybrid. If this feature of the Rule is instead to simplify the disclosures to investors, it should be noted that nonredeemable preferred stock, for example, would generally be considered an “equity security” but its terms could be quite complex.

6) Excluded Types of Issuers

If deemed permissible under Rule 147, it would be useful to clarify that a special purpose entity (SPE) is an eligible issuer if its net proceeds cannot be invested in any issuer except a specified target issuer, and if the offering disclosures relate primarily to the target issuer. Using an SPE concentrates the voting and investment leverage of numerous small holders, while at the same time allowing the issuer to deal with a single “record holder” of the crowdfunded securities. These same functions could be satisfied in other ways – for example, to require assignment of shares to a voting trustee – but use of an SPE does seem to be a logical structure to accomplish these reasonable objectives. I note that AngelList sets up a separate LLC for each investment offering; under that structure participants purchase interests in the LLC, and then all net proceeds are then paid out to the target issuer.

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The Division is to be commended for adopting the Massachusetts Crowdfunding Exemption, an important additional step toward facilitating capital formation within the Commonwealth of Massachusetts. I would urge you to consider other related initiatives and exemptions that could facilitate capital formation *across state lines*, a step that I believe could further expand economic activity within, from, and into Massachusetts.

Very truly yours,



Gregory S. Fryer

GSF/ap

cc: Elizabeth K. Riotte, Esq.