

VIA E-MAIL SUBMISSION

Massachusetts Securities Division
March 23, 2015

RE: Massachusetts Securities Division Proposal of a Crowdfunding Exemption

I. INTRODUCTION

I am a Professor at Hofstra Law School, where I have taught Securities Regulation each year since 2002. Prior to becoming a full-time academic, I served for 10 years each as a securities industry regulator and arbitrator, and for 8 years as Compliance counsel for a national broker-dealer.

This letter is submitted in response to Question 1 (“Relationship to the Federal Intrastate Offering Exemption”) of the Massachusetts Securities Division’s January 2015 release (“the Proposal”). In sum, the author believes that Securities and Exchange Commission Regulation D (as opposed to §3(a)(11) of the Securities Act) would serve as a more effective basis for the Division’s Crowdfunding exemption.

II. COMMENTS

Simply put, “Crowdfunding” has become the 800 lb. gorilla in the room. “Kickstarter” values its pledges since 2009 at \$1.5 billion. By comparison, global IPOs, with a head start measured in centuries, raised \$249 billion in 2014.¹

While addressing the gorilla in clear terms is laudatory, it is vital that such attention be grounded in guidance that is both plentiful and dynamic. The scarce authorities for the §3(a)(11) exemption reveal that is plagued by a nebulous start and a draconian progression. Factors prompting its New Deal era adoption ranged from preservation of States rights to legitimate concerns about the permissible reach of federal jurisdiction. The resulting sparse, 50-word statutory provision was made unduly restrictive by a famed 1961 S.E.C. release.² Among other things, that release fleshed out a burdensome exemption so daunting that experts both inside and outside the Commission have since openly called for its liberalization.

The S.E.C.’s subsequent attempt to loosen those constraints via adoption of Rule 147 in 1974 succeeded in establishing some discernible thresholds (e.g., the 80% proceeds rule). But,

¹ “Opening Statements,” **ABA Journal** (March 2015), at 13 (citing a Thomson Reuters statistic).

² Securities Act Release No. 4434, “Section 3(a)(11) Exemption for Local Offerings” (December 6, 1961).

overall, the exemption's persisting limitations – as well as the ease of alternative financing - have resulted in §3(a)(11) languishing in a state of relative disuse. In this regard, it is noteworthy that under present guidance the §3(a)(11) exemption is still vitiated by a sole offer to a non-State resident,³ a likely event in today's world of online capital solicitation. Indeed, the consensus opinion has long been that the §3(a)(11) exemption applies only to “distributions genuinely local in character,”⁴ a means of finance that may have gone the way of the buggy whip.

Nonetheless, an appreciable number of State regulators seeking to balance the twin aims of capital formation and investor protection have looked to §3(a)(11). Such reliance is imminently justifiable because of the statutory provision's express reference to State powers. However, it is respectfully submitted that such reliance and deference are misplaced. Regulation D, adopted decades later and more founded upon industry input, both better addresses capital formation and more reasonably cabins the threat of abuse.

Specifically, initial State regulation of Crowdfunding would be more effectively premised upon Regulation D for the following reasons:

1. Crowdfunding issuers, tied to the least financially burdensome means of attracting capital, are wedded to the Internet. Such issuers thus have no meaningful means of limiting offerings to a sole State. A meaningful balance can be struck by separating *purchasers* from *offerees*. Such distinction is found in recently amended S.E.C. Rule 506(c), whereas the distinction is altogether impermissible under the extant interpretation of §3(a)(11).

2. Reliance upon Regulation D avails the Division of existing interpretive guidance regarding excluded “bad actors” (e.g., S.E.C. Rule 507). Such limitations would well complement the five exclusions presently detailed in section 6 of the Proposal (e.g., development stage companies lacking a specific business plan) or section 10(1)(a)(ii) (e.g., companies subject to orders stemming from the making of a false filing).

3. The proposed monetary ceilings of \$1 million/\$2 million could more easily be enforced through a connection to a reporting protocol effectuated via required issuer filings (similar to “Form D” under the eponymous exemption, and already established in part by the Division's proposed sales report and notice of offering, found at sections 14 and 15).

4. Insignificant/immaterial deviations could be readily forgiven per the guidance emanating from S.E.C. Rule 508. For example, a 2007 S.E.C. Release directly and openly

³ <http://www.sec.gov/info/smallbus/qasbsec.htm#intrastate> (“If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost.”).

⁴ See, e.g., Thomas Lee Hazen, *Securities Regulation/Cases & Materials* (2006), at 468.

addressed whether the failure to abide by Regulation D limits on advertising/solicitation can constitute an insignificant deviation, or must be fatal to the exemption.⁵

5. Perhaps most importantly, the balanced limitation on jurisdiction sought by the Division may be located by simply requiring that issuers provide additional, timely notice of an offering. Such issuers are already required to be registered with the Secretary of State of the Commonwealth (per section 1) and to have described both the issuer and its offering disclosures (per section 15). An efficient means of ensuring both that the offering stays within the monetary cap and is subject to continuing Division jurisdiction could be established through a further requirement that issuers timely submit notice of 1) the planned start and end dates of the offering, 2) the intended use of offering proceeds, and 3) the total sum of capital contributions sought via the offering.

Such additional filing would more resemble the initial notice called for by Rule 503(a) within Regulation D than the onerous, multiple restrictions of domestic headquarters, majority of assets, and majority of proceeds established by Rule 147/§3(a)(11) guidance. And such notice would not pose a significant financial cost to the issuer, while succeeding in recording relevant facts on the offering and weeding out transient entrepreneurs.

III. CONCLUSION

To be sure, the Internet has compelled regulatory attention to a complex compromise. Regrettably, federal guidance on the permissible limits of Crowdfunding has been delayed. Accordingly, the Division is to be applauded for seeking to be among those States at the vanguard of securities regulation in this area. Indeed, in topics ranging from Internet capital formation to proposed Bitcoin regulations there is a subtle but truly meaningful “new federalism” that inures to the benefit of issuers and investors alike.

Because of its unduly strict interpretation and resultant disuse, Securities Act §3(a)(11) serves as poor touchstone for a Crowdfunding exemption. Accordingly, it is respectfully submitted that Securities and Exchange Commission Regulation D and its accompanying body of interpretation would serve as the more meaningful authority.

⁵S.E.C. Proposing Release, “Revision of Limited Offering Exemptions in Regulation D” (August 2007), *available at* <http://www.sec.gov/rules/proposed/2007/33-8828.pdf>, at 24-25.

The undersigned takes no position on other issues raised by the Division's Proposal, but notes that separate questions posed therein may have been indirectly addressed in answering Question 1 via this letter.

Sincerely,

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