**Brooklyn Law Review**

Volume 82 | Issue 2 Article 18

1-1-2017

# Regulation A-Plus's Identity Crisis: A One-Size-Fits-None Approach to Capital Formation

Zachary Naidich

# Regulation A-Plus's Identity Crisis

## A ONE-SIZE-FITS-NONE APPROACH TO CAPITAL FORMATION

### INTRODUCTION

Regulation A-Plus, designed as a replacement for the failed Regulation A, was supposed to increase capital market liquidity and spur economic growth. The Regulation, however, does little to address the needs of the very companies it was crafted to help. This failure is rooted in the statute that created Regulation A-Plus, the JOBS Act.

Congress enacted the JOBS Act in 2012 for the express purpose of increasing access to capital and promoting business growth.[1] Noting the important role of small and emerging growth companies in promoting job growth, the JOBS Act contained several provisions aimed at easing restrictions on capital formation.[2] Title IV Section 401 of the JOBS Act mandated a revision to the rarely used Regulation A.[3] The new rule, dubbed Regulation A-Plus, sought to provide companies with a new capital raising mechanism.[4] Unfortunately, Regulation A-Plus suffers from many of the same deficiencies as its predecessor, such as a high cost of capital and time-consuming application process.

Rather than adopting a one-size-fits-all solution for small and emerging growth companies—two classes of companies with different needs and concerns—the SEC should create fundraising mechanisms that address the individual concerns of both types of companies.

Part I of this note discusses the legislative history of the JOBS Act and describes Regulations A and A-Plus. It posits

---

[1] *See* Luis A. Aguilar, *Making Capital Formation Work for Smaller Companies and Investors*, SEC (Oct. 30, 2015), http://www.sec.gov/news/statement/aguilar-regulation-crowdfunding-147-504.html [https://perma.cc/TWR3-ULVU].

[2] *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

[3] *Id.* § 401; *see* Press Release, SEC, SEC Adopts Rules to Facilitate Smaller Companies' Access to Capital: New Rules Provide Investors with More Investment Choices (Mar. 25, 2015), http://www.sec.gov/news/pressrelease/2015-49.html [https://perma.cc/3R58-QFLH].

[4] *See* Press Release, SEC, *supra* note 3.

that, rather than remedying the flaws in Regulation A, Regulation A-Plus attempts to address new problems facing a different class of company. This is reflected in the structure and intent of Regulation A-Plus, as well as its position in the wider regulatory landscape.

Part II considers two characteristics of Regulation A-Plus that may ultimately increase access to capital: the preemption of state blue sky laws and the relaxation of the ban on general solicitation. State blue sky laws, which represent a second level of regulation, require issuers to register securities with state agencies before sale within the territorial bounds of that state.[5] Relaxing the ban on general solicitation will permit companies to "test the waters" by gauging investor interest before completing the long and costly Regulation A-Plus process. This part weighs the concerns associated with both the preemption of state blue sky laws and the relaxation on general solicitation, and ultimately concludes that these provisions are desirable and indeed should be expanded.

Part III examines the impact of Regulation A-Plus on both small businesses and emerging growth companies. It demonstrates that small businesses will not be helped by Regulation A-Plus, and proposes several reforms that might remedy this problem. Specifically, it suggests reducing the total, rather than average, cost of capital through various means. Having established how Regulation A-Plus could be successfully applied to small companies, this part considers the dangers facing emerging growth companies and suggests appropriate reforms.

Based on these findings, this note concludes by suggesting: (1) an expansion of state blue sky law preemption; (2) an expansion and clarification of the rules governing general solicitation; (3) a renewed focus on small businesses; (4) a reduction in the limits on Regulation A-Plus funding so as to make Regulation A-Plus less attractive as an alternative to low-end IPOs; and (5) a streamlining of the filing process. These changes will increase the attractiveness of Regulation A-Plus to small businesses, providing an additional, cost-effective, means of raising capital.

---

[5] *See, e.g.*, Brandon F. White & Andrew J. Palid, *The Rise of the Massachusetts Uniform Securities Act*, 94 MASS. L. REV. 117, 118 (2013); *see also* Hall v. Geiger-Jones Co., 242 U.S. 539, 549–50 (1917) (describing the origins of state blue sky laws).

## I. BACKGROUND

### A. *From Financial Crisis to JOBS Act*

In 2012, following a financial crisis that rocked the world economy, Congress passed the JOBS Act.[6] Among its many goals, the JOBS Act sought to alleviate a credit crunch many commentators blamed for America's sluggish economic recovery.[7] Usually, when a company seeking to raise capital sells stock to the public, the shares must be registered with the relevant state and federal authorities.[8] Several exemptions exist to this general rule,[9] and Title IV of the JOBS Act instructed the Securities and Exchange Commission (SEC) to rewrite one such exemption—Regulation A.[10] The result, published in the Federal Register in early 2015, would come to be known as Regulation A-Plus.[11] The decision to update Regulation A, and the one-size-fits-none result, is directly traceable to the intentions and shortcomings of the JOBS Act itself. This section will place the JOBS Act in its relevant historical context. It will then analyze Title IV of the JOBS Act and discuss the intentions of its drafters.

The JOBS Act was enacted against the backdrop of the global financial crisis, which began with the collapse of the subprime housing market in August of 2007.[12] In the preceding years, banks and large financial institutions had increasingly tied their financial fate to the subprime housing market.[13] As a result, the subprime housing crisis quickly spread to America's major financial institutions and by September 2008, the banking giant Lehman Brothers Holdings, Inc. (Lehmans)

---

6 *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. at 306; *see also* Lori Schock, Dir., Office of Inv'r Educ. & Advocacy, Speech at InvestEd 2012: Outline of Dodd-Frank Act and JOBS Act (June 9, 2012), http://www.sec.gov/News/Speech/Detail/Speech/1365171490596 [https://perma.cc/G4TL-QTWV].

7 *See* NAT'L COMM'N ON THE CAUSES OF THE FIN. & ECON. CRISIS IN THE U.S., THE FINANCIAL CRISIS INQUIRY REPORT 340 (2011).

8 I WILLIAM M. PRIFTI, SECURITIES: PUBLIC AND PRIVATE OFFERINGS § 1:02 (rev. ed. 1994).

9 *Id.* § 1:03.

10 *See infra* Section I.D.

11 *See* Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806, 21,806 (Apr. 20, 2015).

12 *See* Schock, *supra* note 6. Arguably, the seeds of the financial crisis were planted long before the housing market collapsed. However, for the purposes of this note, the more conventional starting point will be accepted. *See* INT'L MONETARY FUND, WORLD ECONOMIC OUTLOOK: CRISIS AND RECOVERY 2 (2009), http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf [https://perma.cc/2RDG-ZJY2] [hereinafter IMF, CRISIS AND RECOVERY].

13 *See The Origins of the Financial Crisis: Crash Course*, ECONOMIST (Sept. 7, 2013), http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article [https://perma.cc/ZU39-CC4N].

collapsed.[14] Founded in 1850, Lehmans was one of the oldest investment banks in the country.[15] By 2008 Lehmans, having survived every financial crisis and downturn it had previously encountered, was the nation's fourth-largest investment bank.[16] Its eventual bankruptcy filing remains the largest in U.S. history, with the cost of administration almost $1 billion as of 2010.[17] The damage was not limited to Lehmans itself; the day the company entered bankruptcy, the Dow dropped over 500 points wiping out "$700 billion in value from retirement plans, government pension funds, and other investment portfolios."[18] In the aftermath, credit dried up and companies in every line of business found themselves without access to capital.[19]

This was the start of what former Federal Reserve Chairman Ben Bernanke later described as "the worst financial crisis in global history."[20] In describing the need for subsequent intervention, Mr. Bernanke would note that following the demise of Lehmans, 12 "[o]f the 13 'most important financial institutions in the United States . . . were at risk of failure within a period of a week or two.'"[21] Former Treasury Secretary Tim Geithner recalled the economy as being "in free fall."[22] In an attempt to halt the spread of the crisis, the government embarked on a massive bailout of struggling financial institutions.[23]

This was not the first financial crisis to befall the Western economies. In the past, lawmakers responded to banking failures by enacting laws and creating agencies to curb economic excess and maintain public confidence in the nation's financial systems.[24] The initial reaction to the 2008 crisis was no

---

[14] *Id.*

[15] *See Case Study: The Collapse of Lehman Brothers*, INVESTOPEDIA, http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp [https://perma.cc/NYF3-U2ZA] (last updated Feb. 16, 2017).

[16] *Id.*

[17] NAT'L COMM'N ON THE CAUSES OF THE FIN. & ECON. CRISIS IN THE U.S., *supra* note 7, at 340.

[18] *Id.* at 339.

[19] *Id.*

[20] Pedro Nicolaci Da Costa, *Bernanke: 2008 Meltdown Was Worse than Great Depression*, WALL ST. J. (Aug. 26, 2014), http://blogs.wsj.com/economics/2014/08/26/2008-meltdown-was-worse-than-great-depression-bernanke-says [https://perma.cc/2C8M-GGHT].

[21] *Id.* (quoting Ben Bernanke, former Federal Reserve Chairman).

[22] *Id.* (quoting Timothy Geithner, former Treasury Secretary).

[23] *See The Origins of the Financial Crisis: Crash Course*, *supra* note 13; *see also* IMF, CRISIS AND RECOVERY, *supra* note 12, at 2 (commenting on the need for swift and effective government intervention to prevent a total economic collapse).

[24] The Federal Reserve Bank, for example, was created in the wake of the nearly catastrophic financial crises of 1907, while the Glass-Steagall Act and the Securities Exchange Act of 1934, which established the Federal Deposit Insurance Corporation (FDIC) and the SEC, were passed in reaction to the Great Depression. *See The Slumps that Shaped Modern Finance*, ECONOMIST, http://www.economist.com/

different.[25] After the stimulus had stabilized America's banks and financial institutions, economists turned their attention to limiting long-term systemic risk and preventing future crises. Kenneth Rogoff, professor of economics and public policy at Harvard, described the $790 billion stimulus package as "giving a blood transfusion while the patient is still bleeding" and argued that "[i]f we're not going to fix the banking system at the same time, then it's just a temporary boost in the economy."[26] Other economists warned of a Japanese style L-Shaped recovery—where economic decline is followed by a period of relative stability rather than the desired period of economic growth—unless additional measures were taken.[27] In 2009, President Obama issued a press release declaring the need "to build a new foundation for sustained economic growth."[28] The President called for "strong, vibrant financial markets, operating under transparent, fairly-administered rules of the road that protect America's consumers and our economy from the devastating breakdown that we've witnessed in recent years."[29] Tellingly, the President spoke not only of the need for reform but also "to build a new foundation for sustained economic growth" and to "put in place rules that will allow our markets to promote innovation" resulting in "new jobs and new businesses."[30]

Once the initial panic passed, and the financial sector became largely stabilized, the political focus turned to job creation. Between December 2007 and April 2009, 5.1 million Americans lost their jobs, and the national unemployment rate soared to 8.5%.[31] Despite rebounding corporate profits and economic growth, the job market failed to recover.[32] One cause

---

news/essays/21600451-finance-not-merely-prone-crises-it-shaped-them-five-historical-crises-show-how-aspects-today-s-fina [https://perma.cc/LMN6-NMVK].

[25] *See The Origins of the Financial Crisis*, *supra* note 13 (describing fiscal stimulus and regulatory reforms that quickly followed the initial crisis, including a tax-payer funded bailout and the Basel committee reforms).

[26] *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps Are Not Taken*, BUS. WIRE (Feb. 13, 2009), http://www.businesswire.com/news/home/20090213005161/en/Top-Economists-Agree-2009-Worst-Financial-Crisis [https://perma.cc/W22Y-7FNV] (quoting Kenneth Rogoff, former chief economist at the International Monetary Fund (IMF)).

[27] *See id.*

[28] Barack Obama, U.S. President, Remarks of the President on Regulatory Reform (June 17, 2009), https://obamawhitehouse.archives.gov/the-press-office/remarks-president-regulatory-reform/ [https://perma.cc/6NEU-5BBX].

[29] *Id.*

[30] *See id.*

[31] *See* IMF, CRISIS AND RECOVERY, *supra* note 12, at 63.

[32] *See* Myles Udland, *The Number of Jobs Created During This Recovery Is Either a Lot or Not That Many, Depending on How You Look at It*, BUS. INSIDER (June 1, 2015), http://www.businessinsider.com/jobs-created-during-the-recovery-2015-6 [https://perma.cc/CBC5-9BQA]; *see also Current Employment Statistics—CES (National): CES*

was the high cost of capital, which slowed economic activity and inhibited growth.[33] Cost of capital refers to the cost of raising money.[34] One way corporations can raise the money needed to fund ongoing activities or expansion is to sell or issue shares of stock. This provides access to capital but at the cost of equity in the company.[35] As post-collapse stock prices fell, companies were forced to sell more shares per dollar raised, making capital raising through share issuance less attractive.[36] Against this backdrop, and despite the government's efforts to inject liquidity into capital markets, "new securities issues came to a virtual stop."[37] During this time, job creation was largely stagnant.[38] In 2011, at the Thirtieth Annual Forum on Small Business Capital Formation (the Forum), the SEC identified increased liquidity as one of three key components of any plan to address economic weakness.[39] The Forum's recommendations are reflected in the JOBS Act. By this time, the government's focus had shifted from stabilizing the economy and preventing future crises to promoting economic growth.[40] The law, which sought to increase employment by supporting emerging growth companies, passed

---

*Peak-Trough Tables*, BUREAU OF LABOR STATISTICS, http://www.bls.gov/ces/cespeak trough.htm [https://perma.cc/VR3R-6MGK] (last updated Dec. 10, 2012) (showing seasonally adjusted employment peaking in January 2008 only to fall for thirty-seven consecutive months, finally bottoming out in February 2011).

[33] *See* IMF, CRISIS AND RECOVERY, *supra* note 12, at 63 ("Despite large cuts in policy interest rates, credit is exceptionally costly or hard to get for many households and firms . . . . [which has] elevated uncertainty about job security . . . .").

[34] *See* Brenda M. Clarke & Ronald L. Seigneur, *Definition of Cost of Capital*, *in* VALUING PROFESSIONAL PRACTICES & LICENSES § 11.02 (William F. Murray ed., 4th ed. Supp. 2016). This is often reflective of the required rate of return to attract investment. While the transaction costs associated with raising capital are usually not included, in the context of this note they take on primary importance.

[35] *See* Brenda M. Clarke & Ronald L. Seigneur, *Correlation Between Risk and Cost of Capital*, *in* VALUING PROFESSIONAL PRACTICES & LICENSES, *supra* note 34, § 11.03.

[36] *See* IMF, CRISIS AND RECOVERY, *supra* note 12, at 2–3, 63; Davin Chor & Kalina Manova, *Off the Cliff and Back? Credit Conditions and International Trade During the Global Financial Crisis* (Nat'l Bureau of Econ. Research, Working Paper No. 16174, 2010), http://www.nber.org/papers/w16174.pdf [https://perma.cc/WT4Z-T7YS].

[37] *See* IMF, CRISIS AND RECOVERY, *supra* note 12, at 3–4.

[38] *See id.* at 3–4 & fig.1.4.

[39] *See id.* at 39 ("There are three key elements of a strategy to restore financial institutions to health: (1) ensuring that financial institutions have access to liquidity, (2) identifying and dealing with distressed assets, and (3) recapitalizing weak but viable institutions.").

[40] *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.); *see also* Nav Athwal, *Does the JOBS Act of 2012 Work in the Economic, Investor, and Tech Climate of 2016?*,, FORBES (May 5, 2016), https://www.forbes.com/sites/navathwal/2016/05/05/does-the-jobs-act-of-2012-work-in-the-economic-investor-and-tech-climate-of-2016/#3ccf 69fb563f ("When the JOBS Act was first proposed . . . . [u]nemployment was at 8.2 percent, home prices had just hit a nine-year low and the Dow Jones industrial average was fighting to hold steady . . . . In the midst of this turmoil, the JOBS Act was designed to be the remedy.").

with "overwhelming bipartisan support."[41] Sadly, the law's focus was never as narrow, or focused, as its name might suggest. In the case of Regulation A-Plus, this overbroad and unfocused approach undermined the intent of Congress.

The intent of the JOBS Act appears evident on its face. The title of the law is the Jumpstart Our Business Startups Act: "An Act [t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies."[42] However, the legislative history of the Act shows a tension between supporting small companies and emerging growth companies.[43] The JOBS Act was not originally conceived of as a single unified bill, but rather was an amalgamation of several bills that had been enacted by the House before stalling in the Senate.[44] During debate, lawmakers commented that "small businesses and entrepreneurs cannot access the capital they need to grow and create jobs," echoing statements made by industry leaders before the Subcommittee on Capital Markets and Government Sponsored Enterprises in March of 2011.[45] When the President signed the bill into law, the accompanying press release described the Act as "provid[ing] for Federal securities law exemptions intended to ease access to capital and investments for emerging growth companies."[46] The Act contains several key provisions including: (1) an IPO on-ramp for emerging growth companies,[47] (2) relaxation of the rules prohibiting general solicitation and advertising in relation to certain offerings,[48] and (3) the creation of Regulation A-Plus.[49]

---

[41] *See* Eric Hammesfahr, *House Panel to Examine SEC's Finance Division*, CQ ROLL CALL, July 22, 2014, 2014 WL 3587773 (quoting House Panel Chairman Scott Garrett).

[42] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. at 306.

[43] Under both the Exchange Act and the JOBS Act, smaller reporting companies and emerging growth companies have different definitions based on annual revenue. Similarly, they are subject to different reporting requirements and distinct regulatory schemes. *See* 15 U.S.C. §§ 77b(a)(19), 77c(b)(1) (2012); *see also Comparing Emerging Growth Company vs. Smaller Reporting Company*, LEXISNEXIS, https://advance.lexis.com (last updated Jan. 7, 2017); *Jumpstart Our Business Startups Act Frequently Asked Questions: Generally Applicable Questions on Title I of the JOBS Act*, SEC (Dec. 21, 2015), https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm [https://perma.cc/N4JF-AKSM].

[44] Pete Kasperowicz, *Cantor Says JOBS Bill Set for House Passage Next Week*, THE HILL (Mar. 1, 2012), http://thehill.com/blogs/floor-action/house/213613-cantor-says-jobs-bill-set-for-house-passage-next-week [https://perma.cc/FW8M-TM7M].

[45] H.R. REP. NO. 112-206, at 3 (2011).

[46] Press Release, Office of the White House Press Sec'y, Statement by the Press Secretary on H.R. 3606 (Apr. 5, 2012), 2012 WL 1133728.

[47] *See* Bonnie J. Roe, *IPO On-Ramp: The Emerging Growth Company*, AM. BAR ASS'N: BUS. L. TODAY http://www.americanbar.org/publications/blt/2012/05/04_roe.html [https://perma.cc/AX4F-DCV7].

[48] *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201(a) 126 Stat. 306, 313 (2012) (codified as amended in scattered sections of 15 U.S.C.).

The original Regulation A, which long predated the JOBS Act, addressed the capital needs of small businesses.[50] As discussed, however, the JOBS Act focused primarily on emerging growth companies and startups. The original draft of the JOBS Act did not contain Title IV or Regulation A-Plus.[51] Added after debate had commenced, Title IV would be shaped by the legislation into which it was inserted. While revisions to Regulation A were originally envisioned from a small business perspective, Regulation A's inclusion in an act targeting startups and emerging growth companies—distinct classes of companies with unique needs—resulted in a one-size-fits-all Regulation A-Plus. This revision departed from the original Regulation A in many key respects.

This lack of focus is reflected in the comments of the Regulation's creators. While the President referenced emerging growth companies,[52] members of Congress and representatives for the business community discussed small firms.[53] Unfortunately, these two distinct classes of business have unique needs and face their own unique problems. The Act defines an emerging growth company as "an issuer that had total annual gross revenues of less than $1,000,000,000 . . . during its most recently completed fiscal year."[54] By contrast, small companies are typically defined as those having fewer than 500 employees for manufacturing businesses or less than "$7.5 million in average annual receipts for many nonmanufacturing industries."[55] According to the Small Business Administration, small businesses were responsible for

---

[49] *See* Thaya Brook Knight, *A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis*, POL'Y ANALYSIS, May 3, 2016, at 1, https://object.cato.org/sites/cato.org/files/pubs/pdf/pa790.pdf [https://perma.cc/W49E-TNJL].

[50] It is worth noting that Regulation A was adopted specifically and solely for the purpose of helping small, not emerging growth, companies. U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-839, SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS 5 (2012) ("SEC has previously stated that the primary purpose in adopting Regulation A was to provide a simple and relatively inexpensive procedure for small business use in raising limited amounts of needed capital.").

[51] *Compare* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. at 306, *with* H.R. 3606, 112th Cong. (2011).

[52] *See* Press Release, Office of the White House Press Sec'y, *supra* note 46.

[53] *See* Jamie Farrell, *The JOBS Act: What Startups and Small Businesses Need to Know*, FORBES (Sept. 21, 2012), http://www.forbes.com/sites/work-in-progress/2012/09/21/the-jobs-act-what-startups-and-small-businesses-need-to-know-infographic ("The JOBS Act is designed to encourage small business and startup funding by easing federal regulations and allowing individuals to become investors."); *see also* Brief for Respondent, Lindeen v. SEC, 825 F.3d 646 (D.C. Cir. 2016) (Nos. 15-1149, 15-1150), 2015 WL 5676882, at *1–2 (in which the SEC stated that Regulation A-Plus was "intended to help small businesses obtain access to the capital markets").

[54] 15 U.S.C. §§ 77b(a)(19) (2012).

[55] *See Summary of Size Standards by Industry Sector*, U.S. SMALL BUS. ADMIN. (Feb. 26, 2016), https://www.sba.gov/content/summary-size-standards-industry-sector [https://perma.cc/G6MF-FDVC].

63.3% of all new jobs created between the third quarter of 1992 and the third quarter of 2013.[56] Other estimates put the figure at as high as 80%.[57] Most of this has been driven by small business expansion and growth, which depends on access to capital.[58] Generally, small businesses have a harder time raising capital than emerging growth companies, but also require smaller amounts of capital per raise.[59] Because the Act and its resultant Regulation seek to help both classes of companies, it fails to effectively help either.

### *B. The Failure of Regulation A*

Several mechanisms are available to companies seeking to raise capital, such as issuing equity in the form of stock.[60] Under current regulations, any new issuance of stock must be registered with the SEC.[61] This is often a very complicated and expensive process, which may be inappropriate for smaller companies with fewer resources and smaller capital needs.[62] Several exemptions to the registration requirement exist.[63] One exemption is found in Regulation A. Regulation A, authorized under Section 3(b) of the Securities Act of 1933, was not eliminated by the JOBS Act. Instead, the Act preserved Section 3(b), now Section 3(b)(1), and added Regulation A-Plus as 3(b)(2).[64]

Section (3)(b)(1) authorizes the SEC to "add any class of securities to the securities exempted" from registration but caps the size of such issues at $5 million.[65] The SEC promulgated this exemption as Regulation A. Though exempt from full-blown registration, companies that issue shares to the public under Regulation A are still required to jump numerous regulatory hurdles. Under the current structure, Regulation A-Plus, while deemed an exemption, requires companies to provide a host of

---

[56] U.S. SMALL BUS. ADMIN. OFF. OF ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2016), https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf [https://perma.cc/D83N-W3LF].

[57] *See* SEC, 2011 SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION FINAL REPORT 11 (2012), https://www.sec.gov/info/smallbus/gbfor30.pdf [https://perma.cc/G7ZS-TSG5].

[58] *See* Aguilar, *supra* note 1.

[59] *See id.*

[60] *See generally* TREATISE ON THE LAW OF CORPORATIONS § 16:13 (James D. Cox & Thomas Lee Hazen eds., 3d ed. 2016).

[61] 15 U.S.C. § 77f (2012); *see also* SCOTT BAUGUESS ET AL., CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF THE MARKET FOR UNREGISTERED SECURITIES OFFERINGS, 2009–2014, at 3 (2015).

[62] *See id.*

[63] *Id.*

[64] Securities Act of 1933, 15 U.S.C. § 77c(b) (2012).

[65] *Id.* § 77c(b)(1).

documents more often associated with registered offerings.[66] The company must file a Form 1-A offering statement for review and approval by the SEC.[67] This form, containing twenty-nine pages of questions and often requiring supplemental documentation and disclosures, is often met with requests for amendment or additional information by the SEC. In addition to this form, the company is required to distribute an offering circular to investors.[68] Once a share issuance is approved, sales are still limited to "qualified purchasers,"[69] who are viewed as more sophisticated.[70] Companies who issue shares under this rule are required to meet periodic reporting requirements in the form of annual audited statements.[71]

Even after these requirements have been satisfied, companies must still comply with state blue sky laws. State blue sky laws require companies to register stock with a state regulator before selling to any investors residing within the state.[72] All states require a qualification review, similar to that employed at the federal level. As a result, issuers may have to submit variations on the same paperwork multiple times to multiple regulatory bodies. A majority of states also conduct a merit review—a review of the "offering's fundamental fairness to investors."[73] Under the merit review process, states can invalidate a registration for any number of reasons including perceived unfair pricing or unreasonable risk expectations—regardless of whether these facts are disclosed.[74] The length of time a company must

---

66 "[U]nder the new Regulation A-Plus rules, companies are required to file with the SEC Regulation A-Plus offering statements consisting of basic business information, risk factors, plans of distribution, use of proceeds, liquidity and capital resources, results of operations, executive compensation, related-party transactions, and descriptions of the securities being offered." Rebecca G. DiStefano, *Reg D Versus Reg A-Plus, and How to Prepare for Offerings*, LAW360 (June 2, 2015), http://www.law360.com/articles/662162/reg-d-versus-reg-a-plus-and-how-to-prepare-for-offerings [https://perma.cc/9YG2-JZ4G]. This is in addition to the balance sheets and other financial information, which must be audited for Tier 2 issuers, that must be provided for the previous two years. *Id.*

67 *See* 17 C.F.R. § 230.251(d)(1) (historical as of 2011).

68 *See* 17 C.F.R. § 230.253 (2016). Prior to 1992, an offering circular was not required for smaller issuances. Rutheford B. Campbell, Jr., *Regulation A: Small Businesses' Search for "A Moderate Capital"*, 31 DEL. J. CORP. L. 77, 101 (2006). This change is one reason that Rule 504, another exemption which does not require an offering circular, "became more attractive . . . for small public offerings." *Id.*

69 *See* 15 U.S.C. § 77r(a)(1), (b)(3) (2012).

70 *See* PETER M. FASS & DEREK A. WITTNER, BLUE SKY PRACTICE FOR PUBLIC AND PRIVATE DIRECT PARTICIPATION OFFERINGS § 2:61 (2015).

71 *See* 17 C.F.R. § 230.257(b) (2016).

72 *See* UNIF. SEC. ACT, § 301 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2005).

73 Rick A. Fleming, *100 Years of Securities Law: Examining a Foundation Laid in the Kansas Blue Sky*, 50 WASHBURN L.J. 583, 586 n.21 (2011).

74 *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 50, at 8, 13–14.

wait before it can finally issue shares is often increased as the issuer struggles to comply with a host of state laws.[75]

Despite these hurdles, Regulation A enjoyed some initial success. From 1992 to 1997, following a revision to the rules which increased the size of potential raises from $1.5 million to its current $5 million and added a "test the waters" provision,[76] the number of companies that filed initial Regulation A paperwork rose from 15 per year to 116 per year.[77] However, following the rise in popularity of Regulation D,[78] the numbers began to fall.[79] There were only 8 Regulation A offerings in 2008, 3 in 2009, and only 1 in 2011.[80] As reliance on Regulation A declined more companies began using Regulation D, which by 2014 produced over 33,000 offerings and added $1.4 trillion to the capital markets.[81] This suggests that Regulation D, not a decline in capital raises generally, caused the decline in Regulation A's popularity.

The popularity of Regulation D was not the sole cause of Regulation A's failure. Some commentators argue that the $5 million ceiling is too low to justify the costly filing process.[82] This claim is somewhat suspect. Compared to their relative size, $5 million is a reasonably large amount of money for most small companies. Additionally, between 2002 and 2011, only a third of all Regulation A filings sought to raise $5 million, with the remaining two-thirds never intending to reach this ceiling.[83] This suggests that there is an active market for

---

[75] *See Corporation Finance Staffers Detail Rulemaking Progress*, WARREN GORHAM & LAMONT ACCT. & COMPLIANCE ALERT, Dec. 10, 2013 ("Reg A offerings have not been popular largely because, according to [senior special counsel at the SEC] Yu, 'without state law preemption, the offering exemption is not very usable for many companies.'").

[76] The "test the waters" provision permits companies to make informal offers to investors before filing with the SEC, gauging market interest before starting the Regulation A process. *See* Campbell, *supra* note 68, at 101.

[77] U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 50, at 8.

[78] *See* 17 C.F.R. 230.506(d) (2016).

[79] U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 50, at 9. Like Regulation A, Regulation D was promulgated by the SEC pursuant to Section 3(b) of the Securities Act of 1933. Pursuant to Rule 504 of Regulation D, companies can sell up to $1 million of stock by filing a Form D, which only requires cursory information about the company's "promoters, executive officers and directors, and some details about the offering" but not the extensive company specific information required for a Form 1-A. *See Regulation D Offerings*, SEC, https://www.sec.gov/answers/regd.htm [https://perma.cc/25GM-9VEZ] (last updated Oct. 28, 2014).

[80] *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 50, at 11 tbl.1.

[81] *See* BAUGUESS ET AL., *supra* note 61, at 2.

[82] *See* STUART R. COHN, SECURITIES COUNSELING FOR SMALL & EMERGING COMPANIES § 9:1 (2016) ("For most of its history, Regulation A has been more than a scarlet letter, it has been a dead letter. The relatively low ceiling for permissible offerings . . . led counsel and companies to select other exemptions . . . .").

[83] *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 50, at 9–10.

smaller capital raisings and that the source of Regulation A's failure lies elsewhere.

A second, and more satisfying, explanation is that Regulation A filings are too costly and time consuming, especially when compared to Regulation D.[84] As previously noted, companies seeking to use Regulation A must file a Form 1-A with the SEC, submit to multiple rounds of comments and amendments, create and distribute an offering circular, and comply with any additional requirements imposed by state blue sky laws.[85] This process is not only costly but also time consuming. On average, it takes 228 days for a company to get final approval of its Form 1-A.[86] For cash-strapped companies looking to take advantage of current opportunities, this is not an attractive option.[87]

### *C. An Attempt at Reform: Creating Regulation A-Plus*

Congress and the SEC were well aware of these concerns when they drafted Regulation A-Plus. The revised law seeks to address these flaws in several ways. Regulation A-Plus raised the offering limit to $50 million in any twelve-month period.[88] The regulation is divided into two funding tiers: Tier 1, encompassing capital raises under $20 million, and Tier 2, encompassing raises between $20 million and $50 million.[89] Both tiers allow general solicitation[90] and the use of online crowd-funding platforms.[91] Additionally, both now allow the sale of securities to "qualified investors," a less stringent definition than "accredited investors,"[92] although such purchases are limited to a relatively small percent of sales.[93] Tier 2 raises are exempt from state blue sky laws, although Tier 1 raises must

---

[84] *See* THEODORE S. LYNN ET AL., REAL ESTATE INVESTMENT TRUSTS § 12:28 (2015).

[85] *See supra* at pp. 1015–1016.

[86] *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 50, at 12.

[87] *See id.* (finding that 21% of companies that sought approval for a Regulation A offering ultimately withdrew or otherwise abandoned their filings).

[88] *See* 17 C.F.R. § 230.251(a)(2) (2016).

[89] *See id.* § 230.251(a).

[90] *See id.* § 230.255; *see also* LYNN ET AL., *supra* note 84, § 12:28 (noting that issuers are still permitted to "test the waters" through solicitations of interest before incurring the costs associated with filing).

[91] *See* Sherwood Neiss, *With the New Reg A+, What Type of Crowd Fundraising Is Right for Your Startup?*, VB (Mar. 25, 2015), http://venturebeat.com/2015/03/25/with-the-new-reg-a-what-type-of-fundraising-is-right-for-your-startup [https://perma.cc/E5P9-TFUP].

[92] *See* 15 U.S.C. § 77r(3) (2012).

[93] *See* Press Release, SEC, New Rules Provide Investors with More Investment Choices (Mar. 25, 2015), https://www.sec.gov/news/pressrelease/2015-49.html [https://perma.cc/4K7C-XYKA].

still comply with state laws.[94] Additionally, while both tiers must submit financial statements, only Tier 2 requires audited financials.[95] This reduces costs for the smaller Tier 1 raises. Finally, all raises will still undergo review and potentially comment from the SEC.[96]

Once the relevant requirements are satisfied, issuers can sell unrestricted securities to the public but must file annual audited financial statements and make periodic disclosures.[97] The principle differences between Regulation A and Regulation A-Plus, aside from the increased funding limit, are the preemption of state securities laws[98] and the right to sell to a larger number of nonaccredited investors.[99] These changes purportedly make Regulation A-Plus more attractive to small and emerging growth companies by streamlining the filing process and reducing both the aggregate cost of capital, thanks to reduced requirements, and the average cost of capital, due to the increased ceiling on raises. It seems unlikely, however, that Regulation A-Plus will benefit either category of company, as discussed in the following sections.

### *D. Placing Regulation A-Plus in the Larger Regulatory Landscape*

In order to fully understand the failure of Regulation A-Plus, it is not only important to understand which companies the Act sought to help, but also why help was needed. As previously discussed, the financial crisis created a lack of liquidity that in turn prevented business growth.[100] Title IV of the JOBS Act and the resulting Regulation A-Plus attempt to direct capital to small and emerging growth companies.[101] However, they are not the only capital raising mechanisms available. Initial Public Offerings (IPOs) and other Direct Public Offerings (DPOs), such as Regulation D, have traditionally provided access to capital. Regulation A-Plus, while often viewed as a DPO, might

---

94 *Id.*

95 *See* 17 C.F.R. §§ 230.252, 230.257 (2016).

96 *See* Neiss, *supra* note 91.

97 *See* LYNN ET AL., *supra* note 84, § 12:28.

98 *See* Press Release, SEC, *supra* note 93.

99 *See* Amy Wan*, A Comparison of Reg CF and Reg A*-Plus, LAW360 (Mar. 14, 2017), https://www.law360.com/articles/901763/a-comparison-of-reg-cf-and-reg-a-plus [https://perma.cc/Q5ZZ-JVWB].

100 *See* IMF, CRISIS AND RECOVERY, *supra* note 12, at 6–7, 32–38.

101 Jumpstart Our Business Startups Act, Pub. L. No. 112-106, tit. IV, 126 Stat. 306, 323–25 (2012) (codified as amended in scattered sections of 15 U.S.C.).

ultimately rest in a gap between these other options.[102] It is more affordable than a traditional IPO, and as such can be used by smaller companies, but shares issued via Regulation A-Plus are unrestricted and can be sold in a secondary market.[103] For public companies, the result is a mechanism that costs less than an IPO while offering greater liquidity than other DPOs. For private companies, the ability to sell directly into a secondary market offers a path to publicly traded status without complying with the usual formalities.[104]

Because companies may view this as an alternative to a formal IPO, it is worth examining the traditional IPO process. IPOs play an important role in capital formation. The ability of a corporation to transform into a publicly traded entity has serious implications for its ability to raise funds, although too often alternative paths are overlooked because of the reputation of the IPO.[105] There are four generally accepted reasons for going public: (1) to minimize the cost of capital, (2) to provide an exit for existing investors, (3) to attract potential mergers or takeovers, and (4) to increase public awareness and reputation.[106] The drafters of the JOBS Act sought to promote the first of these reasons by creating an IPO On-Ramp for Emerging Growth Companies.[107] However, because shares sold under Regulation A-Plus may subsequently be traded on an over-the-counter exchange, companies utilizing the exemption may seek to benefit

---

[102] *See* My Say, *How to Go Public Without Middlemen: Top 2 Options*, FORBES (Jan. 9, 2013), https://www.forbes.com/sites/groupthink/2013/01/09/how-to-go-public-without-middlemen-top-2-options/#6890828f2ab5.

[103] *See* Luis A. Aguilar, *The Need for Greater Secondary Market Liquidity for Small Businesses*, SEC (Mar. 4, 2015), https://www.sec.gov/news/statement/need-for-greater-secondary-market-liquidity-for-small-businesses.html [https://perma.cc/4S48-X4WC]; David Rodman, Note, *Regulation A+, the JOBS Act, and Public Offering Lite*, 90 DENV. U. L. REV. ONLINE 99, 99–100 (2013).

[104] *See* Samuel S. Guzik, *Regulation A+ Offerings—a New Era at the SEC*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 15, 2014), http://corpgov.law.harvard.edu/2014/01/15/regulation-a-offerings-a-new-era-at-the-sec [https://perma.cc/6B7U-AXBY].

[105] *See* David T. Shaheen, *Public Without an IPO—Strategies and Considerations*, BURK & REEDY, LLP, http://www.burkreedy.com/publications/DavidTShaheen/Public%20Without%20an%20IPO%20-%20Strategies%20and%20Alternatives.pdf [https://perma.cc/SD8D-49XH].

[106] *See* James C. Brau & Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 J. FIN. 399, 405–06 (2006).

[107] *See* Alexander F. Cohen et al., *JOBS Act Establishes IPO On-Ramp*, CLIENT ALERT, Mar. 27, 2012, at 1, https://www.lw.com/upload/pubContent/_pdf/pub4711_1.pdf [https://perma.cc/2M5K-Z3CR]. Title I of the JOBS Act permits Emerging Growth Companies to become publicly traded without committing to the full IPO process. *Id.* Companies which meet the statutory definition of emerging growth company will require "only two, rather than three, years of audited financial statements to go public" and will enjoy several other key exceptions for one to five years after they initially file. *Id.* This new mechanism is been dubbed the IPO On-Ramp. *See id.*

from any of the four. This is arguably a benefit of Regulation A-Plus. However, there is good reason to question whether this alternative use will result in more capital raising or simply change the form of capital raising, resulting in less regulation without increasing total volume.[108]

## II. WHAT REGULATION A-PLUS GETS RIGHT

### A. *Preemption of State Blue Sky Laws*

Before turning to Regulation A-Plus's many shortcomings and failures, some credit should be given to its drafters. The decision to preempt state blue sky laws, while insufficient to make Regulation A-Plus a success, is an important step and should be expanded to other areas of securities regulation. Securities sold pursuant to Regulation A-Plus, must be "covered securities."[109] As such, they are exempt from state registration, provided they are either sold on a national securities exchange or to a qualified purchaser.[110]

State blue sky laws, so called because they attempt to offer protection from "speculative schemes which have no more basis than so many feet of 'blue sky,'"[111] predate federal securities regulation.[112] Massachusetts passed its first law restricting the sale of securities in railroad companies in 1852.[113] The first true blue sky law was enacted in Kansas in 1911, with most other states following suit shortly thereafter.[114] As discussed above, state blue sky laws add an additional—and often costly—step in the registration process.[115]

While the actual content of state blue sky laws may vary, forty states have adopted, with minor variation, laws based on the North American Securities Administrators Association Uniform Securities Act. The Uniform Securities Act requires a registration statement, which must be accompanied by (1) a statement of eligibility, (2) background information on the issuer, (3) a description of the security, and (4) a prospectus.[116] As an

---

108 *See infra* Section III.B.

109 15 U.S.C. § 77r(b)(4)(D) (2012) (defining covered securities to include those exempt from registration under 15 U.S.C. § 77c(b)(2), authorizing Regulation A-Plus).

110 *See id.*

111 Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917).

112 *See* White & Palid, *supra* note 5, at 118.

113 *Id.*

114 *See* Opening Brief of Petitioners at 5, Lindeen v. SEC, 825 F.3d 646 (D.C. Cir. 2016) (Nos. 15-1149, 15-1150); Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 348, 359–61 (1991).

115 *See supra* Section I.B.

116 *Id.*

alternative, if a registration statement has been filed with the SEC, the Uniform Securities Act permits registration by coordination of the applications.[117] Coordination "streamlines the content . . . and the procedure by which a registration statement becomes effective, but not the substantive standards governing the . . . registration statement."[118] This has reduced, but not eliminated, the costs of compliance with state blue sky laws.

Due to the extra cost and time associated with compliance, many commentators have argued that state blue sky laws unnecessarily inhibit capital formation.[119] Preemption of state blue sky laws was one of the recommendations of the SEC's Thirtieth Annual Forum on Small Business Capital Formation, held in 2011.[120] At the forum, the SEC reaffirmed its commitment to protecting investors but still recommended preempting state law.[121]

Many state regulators have objected to the preemption of state blue sky laws, with Montana and Massachusetts going so far as to challenge Regulation A-Plus in court.[122] In their brief to the court, Montana and Massachusetts argued that preemption would "put[] vulnerable investors at unacceptable risk. . . . disrupt[ing] the nation's longstanding system of dual regulatory enforcement."[123]

> For certain Regulation A[-Plus] offerings up to $50 million in size, which are exempt from federal protection, the rule leaves investors exposed to the risk of fraud by broadly preempting state securities registration and qualification requirements. The states, which have reviewed securities offerings far longer than the federal government, are now barred from performing this essential role, even for offerings that are substantially sold in local-area markets.[124]

Secretary of the Commonwealth of Massachusetts William F. Galvin, in comments regarding Regulation A-Plus, said "[b]ecause many Regulation A-Plus offerings will be made by small and early-stage issuers, they will involve significant risks . . . . It is crucial not to sacrifice the protection of small

---

[117] *Id.*; *see also* UNIF. SEC. ACT § 303 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2005).

[118] *Id.* § 303 cmt. 1.

[119] *See* Roberta S. Karmel, *Blue Sky Merit Regulation: Benefit to Investors or Burden on Commerce?*, 53 BROOK. L. REV. 105, 107 (1987).

[120] *See* SEC, *supra* note 57, at 30.

[121] *Id.* at 15, 30.

[122] *See* Lindeen v. SEC, 825 F.3d 646, 648 (D.C. Cir. 2016).

[123] Opening Brief of Petitioners, *supra* note 114, at 1, 46–47; *see also SEC Backs Its New Capital-Raising Rule in Appeals Court Filing* Lindeen v. SEC, 21 WESTLAW J. DERIVATIVES 10, Oct. 22, 2015, at *2.

[124] Opening Brief for Petitioners, *supra* note 114, at 1.

investors in pursuit of regulatory speed and convenience."[125] Secretary Galvin went on to note that "lower-tier over-the-counter markets for stocks . . . are the biggest source of complaints about fraud," and that "abusive investor practices [might] gravitate to Regulation A-Plus offerings instead."[126] To bolster these claims, state regulators have pointed to prior attempts at reducing requirements for small offerings. One such example is Rule 504, which deregulated certain small offerings but, due to pervasive fraud, was revised only seven years later.[127]

The fear that preemption will lead to massive fraud is misplaced. The SEC has recognized the threat of fraud and has taken steps it feels will afford protection to investors.[128] First, while state blue sky laws have been preempted, state regulators retain the power to investigate fraud and retroactively protect local investors.[129] Second, despite the arguments of state regulators to the contrary, there are still substantial protections afforded to local investors. Issuers must still disclose material information, provide an offering statement and circular, and receive SEC approval prior to issuance.[130] These are not insubstantial protections. Third, preempted offerings are only available to "qualified investors" who have greater assets, are limited in the percentage of assets they may invest, have more investment experience, and are therefore better placed to protect their interests than ordinary investors.[131]

If fraud and abuse increase dramatically, small companies will come to be associated with a dirty market-place, hampering their ability to raise capital.[132] Such an outcome

---

[125] William F. Gavin, Secretary of the Commonwealth of Massachusetts, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act (Dec. 18, 2013), 2013 WL 6842757, at *1–2.

[126] Eric Hammesfahr, *Massachusetts Slams SEC's Regulation A-Plus Proposal*, CQ ROLL CALL, Feb. 3, 2014, 2014 WL 377709.

[127] *See* Amanda Maine, *Commissioner Stein Addresses ABA Committee About Recent SEC Initiatives*, SEC. & EXCH. COMM'N TODAY, Nov. 26, 2013, 2013 WL 11077286.

[128] *See* Aguilar, *supra* note 1 ("[T]he challenge is to develop a system that enables businesses to raise capital in a cost-effective way and, at the same time, provide ways to benefit and protect investors. After all, without investors, there can be no capital formation.").

[129] *See* LYNN ET AL., *supra* note 84, § 12:28.

[130] *See* 17 C.F.R. §§ 230.251–53 (2016).

[131] The states have argued that this will not be effective; "[b]y defining 'qualified purchaser' to mean 'any person' to whom these securities are offered or sold, the Commission disregarded the plain meaning of that term" and has failed to ensure only savvy investors are exposed to increased risk. *See* Brief for Petitioners at 1–2, Lindeen v. SEC, 825 F.3d 646 (D.C. Cir. 2016) (Nos. 15-1149, 15-1150).

[132] *See* Matthew Garza, *Commissioner Aguilar Focuses on JOBS Act in Remarks to Hispanic Business Group*, SEC. & EXCH. COMM'N TODAY, May 23, 2013, 2013 WL 11078071.

seems unlikely. SEC Commissioner Luis Aguilar acknowledged this concern and, while accepting the SEC's important role in facilitating capital formation, noted that the SEC "has no stronger mission than the protection of investors."[133]

It has also been argued that Regulation A-Plus will expose investors to greater risk by opening the doors to "qualified investors," an easier definition to satisfy than the traditional "institutionally accredited investors." Regulation A-Plus will permit smaller investors, who do not qualify as institutionally accredited under the SEC's guidelines, to participate.[134] However, this will not necessarily increase risk and is in keeping with a larger trend toward open capital markets to smaller investors, increasing the pool of available capital.[135]

Cleaning up the regulatory landscape by preempting state blue sky laws, and in the process, reducing the cost of raising money through stock issuances, represents one of Regulation A-Plus's rare successes.

### *B. Restrictions on General Solicitations*

Traditionally, the SEC has imposed a ban on general solicitation or advertising before approval of a private placement or public offering.[136] General solicitation and general advertising occur when a company, prior to receiving SEC approval to sell unrestricted shares of its stock, uses mass communication or advertising to alert potential investors that the company is pursuing investments.[137] This can be an effective way of attracting early investor attention and refining a corporate advertising and soliciting strategy. This sort of soft open can be very beneficial to issuers, but some have speculated that it will

---

[133] *Id.*

[134] "The Commission proposes to use its power to define 'qualified purchaser' under Section 18 of the Securities Act as a means to make Regulation A-Plus offerings transactions in covered securities." William F. Gavin, Secretary of the Commonwealth of Massachusetts, Comment Letter on Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act (Dec. 18, 2013), 2013 WL 6842757, at *3.

[135] For example, another key addition to the JOBS Act is the new Crowd Funding provisions. *See supra* Section I.C.

[136] *See Eliminating the Prohibition on General Solicitation and General Advertising in Certain Offerings*, SEC (July 10, 2013), https://www.sec.gov/news/press/2013/2013-124-item1.htm [https://perma.cc/62U4-R42S].

[137] *See* Tanya Prive, *General Solicitation Ban Lifted Today—Three Things You Must Know About It*, FORBES (Sept. 23, 2013), http://www.forbes.com/sites/tanyaprive/2013/09/23/general-solicitation-ban-lifted-today-three-things-you-must-about-it/#3a358 29635a3 (General solicitation "includes . . . , but [is] not limited to: 1. A mass newsletter/email[;] 2. A public profile on a startup investment platform[;] 3. A company, personal or third-party website . . . [;] 4. Public speaking engagements.").

harm investors by permitting the dissemination of unverified and inaccurate information.[138]

Long banned by the Securities Act of 1933, general solicitation is now available under Title II of the JOBS Act which relaxes the ban in several contexts, including Regulation A-Plus.[139] To benefit from this change, companies must file advertising and solicitation material with the SEC.[140] It is currently unclear how much control the SEC intends to exert over the content of this material. In most instances, the ban will only be lifted with regard to accredited investors, however in the context of Regulation A-Plus, it will be lifted for sales to qualified investors, a broader category.[141]

In addition, Regulation A-Plus contains a "test the waters" provision.[142] This provision lets companies approach investors to gauge interest even before they file initial paperwork with the SEC.[143] This is a valuable change in the law, which may make Regulation A-Plus a more attractive option to companies. By permitting companies to solicit interest in their securities before filing, companies will be able to reduce the total time lapse between the decision to issue and the actual sale of securities. The long delays in approval and ultimate sale were a major reason for the failure of the original Regulation A.[144] Additionally, companies may be less likely to withdraw their filings if they can accurately predict and anticipate the course of the intended capital raise.

Nonetheless, there is room for further improvement. The rules regarding general solicitation are not completely clear and may be limiting. First, it is unclear how much control the SEC will exercise over advertising material, although it is clear they will receive copies of all advertising materials.[145] Second,

---

[138] Ryan Caldbeck, *What Is General Solicitation, and Why Does It Matter to You*, FORBES (Oct. 28, 2013), https://www.forbes.com/sites/ryancaldbeck/2013/10/28/what-is-general-solicitation-and-why-it-matters-to-you/#37136c5375f8 (General solicitation, when used right, "will . . . allow[ ] entrepreneurs to raise capital more efficiently so they can get back to their day job of building their business.").

[139] *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, tit. 2, § 201, 126 Stat. 306, 313–15 (2012) (codified in 15 U.S.C. § 77d); s*ee also Eliminating the Prohibition on General Solicitation and General Advertising in Certain Offerings*, *supra* note 136 (noting the shifting regulatory landscape).

[140] *See* DiSefano, *supra* note 66.

[141] 17 C.F.R. § 230.251 (2016).

[142] *See* DiStefano, *supra* note 66; Securities Act of 1933, 15 U.S.C. § 77c(b)(2)(E) (2012).

[143] *See* 15 U.S.C. § 77c(b)(2)(E) (2012); *see also* DiSefano, *supra* note 66 ("Companies can 'test the waters' in Regulation A-Plus offerings prior to filing the required offering statements. Sales literature is also permitted.").

[144] *See supra* Section I.B.

[145] *See* DiSefano, *supra* note 66.

any statements made during this period will be subject to traditional antifraud provisions,[146] but it is unclear if companies will be able to cure errors before the actual sale.[147] Finally, there are certain provisions—such as the ban on sale to nonqualified investors—which are not clearly articulated or widely known.[148] This ambiguity may cause problems, especially since failure to abide by the Regulations carries a one-year fundraising ban.[149]

Additionally, companies that engage in general solicitation or advertising will be limited to Tier 2 offerings.[150] Smaller companies, already disadvantaged by the current structure of the rule, are less likely to have the need or ability to pursue such large capital raises and therefore will not benefit from the "test the waters" provision.[151] Another concern is that use of the "test the waters" provision may expose companies to liability if they later decide to utilize a capital raising mechanism that does not permit solicitation. By expanding this provision to all Regulation A-Plus offerings and assuring companies they will not accidentally run afoul of the law, the SEC can both reduce the cost of capital and give companies the tools they need to assess the potential costs and gains of issuing shares.

## III. MAKING REGULATION A-PLUS WORK

Regulation A-Plus's one-size-fits-all approach fails to help either small businesses or emerging growth companies. This part considers the funding needs of each type of company, as well as the ways in which Regulation A-Plus fails to meet those needs and how the rule could be improved.

### *A. Regulation A-Plus and Small Companies*

Among the many criticisms leveled against Regulation A, the most consistent was that the rule was prohibitively costly and time consuming. Thus, Regulation A-Plus was

---

146 *See* Michael Raneri, *Testing the Waters and Filing a Regulation A+ Offering with the SEC*, FORBES (May 26, 2015), http://www.forbes.com/sites/mraneri/2015/05/26/testing-the-waters-and-filing-a-regulation-a-offering-with-the-sec.

147 Some regulators have expressed concern that companies will be able to file false or misleading information, which will be used to generate excitement among regular investors, only to correct the information at the last minute when investors are unlikely to reread information they believe they already possess.

148 *See* Prive, *supra* note 137 ("In nine out of ten conversations with startups . . . entrepreneurs were not aware of what it means to generally solicit or the implications tied to doing so set forth by the [SEC].").

149 *Id.*

150 *See Regulation A+ and Testing the Waters*, CROWDCHECK BLOG, http://www.crowdcheck.com/blog/regulation-and-testing-waters [https://perma.cc/2ZC6-MUPY].

151 *See infra* Section III.A.

crafted with the expectation that reduced cost would prompt increased use.[152] The total cost reductions associated with Regulation A-Plus, however, are minimal at best.[153] Instead of seeking to reduce total cost, the SEC attempted to solve the problem by reducing the average cost of capital. This is because companies, formerly restricted to $5 million per twelve-month period, are now permitted to raise as much as $50 million without increasing application time or expense.[154] As a result, total cost, reflected in time and expense, will be unaffected but average cost will decrease. Unfortunately, this will provide little benefit to truly small issuers, who typically raise far less than $1 million in annual equity financing.[155]

The reduction in the average cost of capital afforded by the increased fundraising limit may be attractive to companies above a certain size, as discussed in Section III.B. Based on the foregoing analysis, however, it seems unlikely that true small companies, of the sort Regulation A-Plus should target, will pursue raises over $5 million. Companies with less than $1 million in assets will be unable to raise $5 million in investments. Even if they could attract such interest, the amount of equity required appears prohibitive. This leads to the conclusion that such companies will receive no cost savings and will likely continue to avoid Regulation A-Plus.

Rather than increasing the total capital limit associated with Regulation A, the SEC should expand efforts to reduce aggregate, rather than average, cost of capital while simultaneously reducing the period between initial filing and initial sale. Regulation A-Plus has begun this process by preempting state blue sky laws. It could further advance this goal, and in so doing increase small business access to capital, by streamlining the registration process at the federal level by

---

152 *See Commissioner Aguilar Focuses on JOBS Act in Remarks to Hispanic Business Group*, FED. SEC. L. REP., May 29, 2013, at 5, 6 (SEC Commissioner Aguilar predicts "companies will benefit from having less expensive methods to raise capital.").

153 *See* Mary Jo White, Chair of SEC, Remarks at SEC Open Meeting (Dec. 18, 2013), https://www.sec.gov/news/public-statement/2013-12-18-open-meeting-mjw [https://perma.cc/Q8UD-A23U] ("To ensure that the revised exemption will be a viable path for capital-raising, a calibrated preemption of state securities laws in connection with certain Regulation A offerings currently appears necessary."); *see also Corporation Finance Staffers Detail Rulemaking Progress*, *supra* note 75 ("[W]ithout state law preemption, the offering exemption is not very usable for many companies." (quoting Ted Yu, Senior Special Counsel at the SEC)).

154 *See* Hammesfahr, *supra* note 41 ("The Regulation A plus proposal would allow companies to raise as much as $50 million in capital over 12 months . . . , a change that industry participants say would greatly lessen the cost of offerings.").

155 *See* U.S. SMALL BUS. ADMIN. OFF. OF ADVOCACY, SMALL BUSINESS FINANCE FREQUENTLY ASKED QUESTIONS 1 (2014), https://www.sba.gov/sites/default/files/2014_Finance_FAQ.pdf [https://perma.cc/B8V6-794Y].

adopting a simplified form and expanding current test-the-waters solicitation provisions.

In addition to streamlining the filing and review process and simplifying forms used by companies, the SEC should give serious consideration to reducing the filing requirements, which are in sharp contrast to the minimal requirements for most other exemptions.[156] While these additional requirements may make sense in the context of a $50 million offering, that in some cases may take the place of a traditional IPO, it is unnecessary for smaller offerings of the sort most small companies are likely to pursue.

Another tactic would be to expand and clarify the rules on general solicitation so that companies can market and negotiate the sale of securities prior to approval of the registration statement. While no sales could be made prior to approval, this step would ensure that sale transactions are consummated almost immediately after registration. Regulation A-Plus has already taken a tentative step in this direction by easing restrictions on solicitation.[157] Expanding this provision so that it applies to all forms of solicitation on all raises conducted under Regulation A-Plus will make the exemption even more attractive. More importantly, it will attract capital from nontraditional investors—new funding sources—and direct it to companies that could not previously participate in the market. Further clarifying the rules governing marketing material, with an emphasis on granting corporations greater freedom of action, will also help encourage companies to pursue capital raises.

Some parties, including state regulators, have speculated that general solicitation will result in greater fraud and harm to investors. This fear is predicated on the notion that firms will submit overly optimistic initial registration statements and offering circulars, which will then be distributed to investors. Following SEC review, the company will be compelled to revise these documents. However, by the time revised documents are distributed to potential investors, they may have already mentally committed themselves to the investment and may be less likely to read the new material. There is some merit to this argument. However, it ignores existing limitations designed to prevent soliciting unsophisticated or unwary investors, who are more likely to conduct proper diligence. Additionally, blatant

---

[156] *See* 17 C.F.R. §§ 230.144A(d), 230.502–03 (2016).

[157] *See* LYNN ET AL., *supra* note 84, § 12:28 (noting that issuers are still permitted to "test the waters" through solicitations of interest before incurring the costs associated with filing).

bait-and-switch tactics might expose unscrupulous issues to civil liability. Ultimately, these risks are outweighed by the economic benefits of general solicitation.

### *B. Regulation A-Plus and Emerging Growth Companies*

Even for larger emerging growth companies, Regulation A-Plus's value is limited. Emerging growth companies may benefit from reduced average cost of capital not available to small businesses. In light of this, many commentators have speculated that companies will opt to use Regulation A-Plus rather than pursuing a more traditional IPO.[158] If this prediction is true, Regulation A-Plus may redirect capital raising efforts and in the process dramatically change the capital raising landscape without actually increasing the total amount raised annually.[159] Redirecting capital raising activities will not accomplish the Act's core goal of increasing capital raising activities.

Further, this redirection may be actively harmful. Notably, since the enactment of the JOBS Act, the number of IPOs under $100 million has decreased.[160] While this data predates the formal adoption of Regulation A-Plus, it points to the general effect of the Act itself. Georgetown Law School Professor Donald Langevoort is among those who believe that by providing a "safe harbor for small companies," the Act is actually "encouraging a private offer rather than pursuing an IPO."[161] Such a shift from IPOs to private offerings is undesirable from a public policy standpoint. The growth of the capital markets and the access to capital they afford publicly traded companies has played a critical role in economic development.[162] This expansion is closely tied to public trust in the marketplace, and in this respect, the SEC plays a crucial role in promoting investment

---

[158] *See* H.R. REP. NO. 112-206, at 3 (2011) ("Since the SEC set the Regulation A threshold at $5 million in 1992, issuers and market participants have pointed out that the offering threshold has been too low to justify the costs of going public under Regulation A."); *see also* Rodman, *supra* note 103, at 99–100 ("Regulation A[-Plus] may function less as a replacement for private placements and more as a substitute for public offerings. . . . In other words, Reg[ulation] A[-Plus] may properly be characterized as 'public offering lite.'").

[159] *See After Nearly Two Years, JOBS Act's Effects on Market Are Hard to Measure*, WARREN GORHAM & LAMONT ACCT. & COMPLIANCE ALERT, Dec. 30, 2013 ("[C]ompanies will have access to enough funds through Reg[ulation] A-Plus that some offerings will overlap with the low end of the IPO market.").

[160] *Id.*

[161] Amanda Maine, *DC Bar Panelists Discuss JOBS Act Impact on Investors*, SEC. & EXCH. COMM'N TODAY, June 26, 2012, 2012 WL 12353686.

[162] Luc Laeven, *The Development of Local Capital Markets: Rationale and Challenges* 3–4 (Int'l Monetary Fund Research Dep't, Working Paper No. WP/14/234, 2014).

and capital formation. The exhaustive IPO process is closely linked to this trust.[163] In many ways, being listed on a public exchange is seen as a sign of a company's worth.[164] This is contrasted with the less respected over-the-counter markets.[165] The public trust may be eroded, to the detriment of both firms and investors alike, by the diversion of companies away from traditional IPOs toward Regulation A-Plus.

Alternatively, businesses seeking to use Regulation A-Plus for its intended purpose—rather than as an abbreviated IPO—may unexpectedly find themselves subject to SEC reporting requirements. Companies with more than $10 million in assets and shares held by either 2000 individuals or 500 individuals who are not accredited investors are subject to the Securities and Exchange Act, even if they have not conducted a registered offering or listed their shares on a national exchange.[166] Because shares issued under Regulation A-Plus are not restricted, and thus are available for resale, it will be impossible for issuers to control or otherwise limit the number of shareholders. As a result, companies may accidentally trigger these thresholds.[167]

The collective effect is that Regulation A-Plus simultaneously risks being misapplied by companies seeking to avoid the IPO process, reducing market confidence without increasing access to capital, while simultaneously injury those emerging growth companies that sought to use the mechanism for its intended purpose.

## CONCLUSION

Access to capital plays a crucial role in promoting both economic growth and job creation. This is especially true for small businesses, which account for a significant portion of new job creation but often struggle to locate or access the funds necessary for survival or growth. By enabling these companies to access capital and to take advantage of growth opportunities, the SEC can play an important role in promoting job creation. The original Regulation A failed to accomplish this goal. The JOBS Act and Regulation A-Plus are poised for a similar failure

---

[163] *See* JASON DRAHO, THE IPO DECISION: WHY AND HOW COMPANIES GO PUBLIC 165 (2004).

[164] *See* 17 ILLINOIS PRACTICE SERIES, ESTATE PLANNING AND ADMINISTRATION § 62:4 (Robert S. Hunter ed., 4th ed. 2007).

[165] *See id.*

[166] Securities and Exchange Act of 1934 15 U.S.C. § 78*l*(g) (2012).

[167] *See* Richard A. Denmon & Carlos A. Mas, *JOBS Act Eases Requirements for Triggering SEC's Exchange Act Registration*, CARLTON FIELDS (June 15, 2012), http://www.carltonfields.com/jobs-act-eases-requirements-triggering-secs-exchange-act-registration.

because their focus has fallen on emerging growth companies, which already have access to capital through numerous functional mechanisms. Some aspects of this new legislation will likely prove effective. These include the preemption of state blue sky laws and the easing of restrictions on general solicitation.

These changes to the law do not do enough to reduce the cost of capital for small business. Regulation A-Plus's attempt to reduce the average cost of capital by encouraging larger raises will not benefit small business, who are incapable of attracting such large investments, and may create undesired incentives for emerging growth companies to bypass traditional and desirable mechanisms such as IPOs. The capital raise limit should be reduced to levels appropriate for small companies but low enough to discourage use by larger emerging growth companies. SEC should reduce existing review requirements and streamline through universal standardized forms. Restrictions on investors should be closely monitored and revised so as to allow the largest number of market participants without unduly increasing risk. By adopting these fundamental reforms and focusing on the capital needs of small businesses, Regulation A-Plus will be more likely to accomplish its goal of promoting economic and job growth.

*Zachary Naidich*[†]

† J.D. Brooklyn Law School, 2016; M.P.A. NYU Wagner, 2010; B.A. University of Rochester, 2005. Thank you to all the members of the *Brooklyn Law Review* and all the other students and professors who helped bring this note to publication. I would also like to thank my parents, Jocelyn and David, for constantly having faith in me, and to my amazing wife Madeleine, without whom none of this would have been possible.