Written Testimony to the Securities, Insurance, and Investment Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs

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Mr. Chairman and honorable members, thank you for your kind invitation to speak before you today. I am Managing Partner for Practices at the law Firm of Kaplan Voekler Cunningham & Frank, PLC, headquartered in Richmond, Virginia. I am also the Firm's founder. As such, I am at heart an entrepreneur, and uniquely positioned to relate to the concerns, challenges and issues I hear communicated by members of the private business community related to current state of their access to the capital markets.

We are a boutique firm with one of our focuses being on securities and capital formation. Most of our attorneys, including myself, come originally from some of the largest law firms in the nation. Our practice includes public and private securities, and we represent clients in various capacities of all sizes – from multi-billion dollar enterprises to fledgling start-ups, but the bulk of our practice resides amongst companies in the lower mid-market or smaller (clients with $5MM to $150MM of revenue), "Main Street" businesses.

According to the Department of Labor, Bureau of Statistics, 65% of all net new jobs in the US created between 1993 and 2009 were created by businesses such as my firm represents.[1] It is VITAL that action be taken now to implement fully the JOBs Act.

The current situation can be reduced to the following:

1) To date, little movement has occurred to implement those aspects of JOBS Act that address the needs of the lower middle market and smaller "Main Street" businesses.
2) That lack of progress has resulted in a relative stagnation in the ability of smaller businesses in this country to raise capital and has placed further uncertainty into the broader economy.
3) "Main Street" suffers presently from a lack of viable options for capital raising.
4) Title IV of the Act, euphemistically referred to as "Regulation A+," presents the most potentially impactful legislation to aid "Main Street" and provides a rational balance between regulatory oversight and access to publicly formed capital.
5) The forms and procedures currently existing under Regulation A can be readily applied to A+, thus obviating the need for further delay in implementing Regulation A+.
6) The Securities and Exchange Commission ("SEC" or the "Commission") should adopt a workable definition of "qualified purchaser" which affords investor protection but eliminates unnecessary and obstructive layers of regulatory procedure.

[1] U.S. Dept. of Labor, Bureau of Labor Statistics, Business Employment Dynamics; Advocacy-funded research by Zoltan Acs, William Parsons and Spencer Tracy, 2008 (archive.sba.gov/advo/research/rs328tot.pdf).

7) SEC's rule making in this context should be balanced so as not to make Regulation A+ overly burdensome but foster issuer transparency and efficient dissemination of information to support a market for these securities.
8) Regulation A+, in turn, should provide greater investment options to the American public than what can be found now – with retail investors largely relegated to mutual or hedge funds or investment in private securities under Regulation D, which carry risks associated with being restricted and relatively non-transparent.

For lower mid-market and smaller businesses, options to capital are limited at best. Public registration is not a viable option in light of the enormous costs associated with an initial public registration and the ongoing regulatory burdens associated with reporting requirements, Sarbanes-Oxley and Dodd-Frank. These cost and regulatory factors have played a considerable role in narrowing the opportunity of utilizing public registration to companies well beyond the size of the mid-market and at deal sizes far past the needs of most "Main Street" firms.[2] That has, in turn, limited drastically opportunities for smaller investment banking, brokerage, legal and accounting firms to participate in public securities offerings, which creates an insulated market where expense associated with public offerings will remain inflated.

Alternatively, the viable audience for private securities of lower mid-market and smaller businesses is severely constrained presently. Changes to the accredited investor definition found in Rule 501 of Regulation D, have further narrowed the number of potential accredited investors available to invest in such offerings. Some estimates have put the reduction of the accredited investor audience as a result by at least twenty percent (20%).[3] Currently, the Commission is considering increasing the $1,000,000 requirement currently found under the net worth test for accredited investor status for individuals. GAO recently suggested that this number could be revised upwards to $2,300,000 to account for inflation since establishment of the test.[4] This is estimated to reduce the accredited investor pool by another sixty percent (60%).[5]

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[2] Median deal size for initial public offerings ("IPO") in 2012 was $124MM. *See* 2012 IPO Market Annual Review, Renaissance Capital, January 2, 2013. Median deal size for IPO's through 3rd quarter of 2013 is $101MM. *See* United States: Q3 2013 IPO Report, Wilmer Hale, October 24, 2013. We consistently see issuer's legal fees in these transactions disclosed at greater than $1,000,000, and accounting between $500,000 and $1,000,000. According to a 2012 report of PwC, an issuer can expect on average to spend $1MM in legal and $600K in auditors for an offering of $50MM or less. *See* Considering an IPO?: The costs of going and being public may surprise you, PwC, September 2012.

[3] *Alternative Criteria for Qualifying As An Accredited Investor Should Be Considered*, GAO 9-10 (July 2013), http://www.gao.gov/assets/660/655963.pdf.

[4] Id.

[5] Id.

Since 2008, the accredited investor market has dramatically reduced in size and activity. Many accredited investors have eschewed illiquid, restricted securities after being unable to exit failing investments during the recession. That same phenomenon resulted in an influx of FINRA arbitration related to failed investments. Many broker-dealers and investment banks who would potentially work with lower mid-market and smaller businesses have ceased handling private placements beyond institutional investments as a result. Others are precluded entirely from placing private securities due to the unwillingness of Errors & Omissions insurance carriers to insure them for such activities.

Rules promulgated by the Commission related to general solicitation under Rule 506(c), pursuant to Title II of the Act, and new "bad boy" prohibitions from use of Regulations D promulgated pursuant to Dodd- Frank have further "chilled" any potential market beyond institutional investment in professionally distributed private placements. Instituting Title II's requirement that reasonable steps be taken to ensure accredited status of all investors, Rule 506(c) creates an uncertain "facts and circumstances" test as to the reasonableness of the method undertaken to assure accreditation, subject to limited SEC prescribed safe harbors. We believe, and have seen borne out in our market experience, that the uncertain nature of a "facts and circumstances" test will push issuers and their distributors towards the prescribed safe harbors which predominantly involve intrusive requests for the financial and tax records of potential investors. These information gathering requirements increase the regulatory burdens on issuers and their distributors, frustrate potential investors and, consequentially, reduce the appeal of publicly solicited Regulation D offerings. Further, the Commission has proposed rules regarding pre-filing the Form D and general solicitation materials for an offering relying on Rule 506(c) and instituting draconian punishment of failures in administrative notice filings for all Rule 506 offerings. While these proposals have been met with significant negative commentary and our (and our clients) hope is that they will ultimately not be adopted, they have nonetheless created an environment of uncertainty surrounding public solicitation and the professionally distributed Regulation D market as a whole.

Added to these regulatory obstacles are the new "bad actor" rules instituted as required by Dodd-Frank. While we certainly agree with the intent of the "bad actor" rules, no one wants people previously convicted of securities fraud selling unregistered securities, it also cannot be argued that these rules add risk and uncertainty to the usage of Rule 506, especially in the context of an offering distributed through retail broker-dealers to multiple individual accredited investors. By visiting the sins of a single participant in an issuer's distribution network, or even potentially a single investor, upon the offering as a whole, the application of the "bad actor" rules can result in the loss of the Rule 506 exemption and severe consequences for the sale of unregistered securities by the issuer, its management and its distribution network. As a result, issuers and their distributors are forced to institute expensive and uncertain

compliance procedures, or narrow the scope of their capital raising to limit risk. This leads to a greater emphasis on institutional or very high net worth capital. Institutional investment generally comes with demands for large returns on invested capital to offset risk associated with longer holds in restricted securities and exacerbated by a the volume of competition seeking the same dollars. As a result, innumerable companies which might present solid investments, but cannot credibly show double-digit returns or exponential growth on a short term basis are ignored.

Regulation A+ can give much broader variety of issuers and businesses the ability to offer their securities to a much broader segment of the population. Regulation A+ can provide the opportunity for many issuers who, for example, have solid fundamentals and can reliably produce dividends, but perhaps not the ability to achieve the prodigious return rates sought by institutional capital, to reach a much broader segment of the population with performance goals that are realistic and achievable.

At the same time, however – and I should emphasize that this really goes to the cruxt of the opportunity under Title IV that has been overlooked for so long – Regulation A+ combines that opportunity for the issuer with a requirement that the issuer submit to a "right-sized" disclosure and reporting regime that is designed to insure standards for complete and illustrative disclosure and a current picture of the status of that issuer. Thus, the issuer is provided access to a broader investing audience with a more diverse set of investment priorities in exchange for compliance with the same conceptual regulatory discipline as registration, but streamlined to account for the relative size of the issuer and offering. This has a number of salutary effects for the investing public, as well as the issuers:

1) Transparency – standardized disclosure and reporting can insure that investors and shareholders enjoy efficient dissemination of material information concerning offerings and issuer performance.

2) Liquidity – Regulation A+ securities are freely tradable, which presents a major advantage of restricted securities where no market exists for most of these securities. As such, investors who can no longer tolerate risk associated with their investments or otherwise find themselves in a situation where they need to exit the investment can. With standardized disclosure and reporting, pricing can be arrived at with confidence. To be clear, for the foreseeable future, we believe the vast amount of any trading activity in these securities will be episodic at best, given the size of most issuers and deals, with the bulk occurring as trades by appointment. But the critical piece will be that investors, brokers and investment advisors will have information at hand to use to discern amongst investments and to establish a price as required, and have confidence in the same. This presents an enormous leap forward from the

restricted nature of most Regulation D securities with no information disseminated publicly and, thus, no market.

3) Investment Options – The average investor is relegated to public fund products (hedge, mutual, money market). Regulation A+ can give an investor the opportunity to invest in enterprises (such as those we typically represent) with confidence based on the information they can access and review with their broker or investment advisors. Because of the size of the issuers that we believe will utilize Regulation A+ consistently, we believe most deals will be distributed regionally, and the investor will see options presented in their own "backyard" by local and regional investment banks and brokerages, providing a further element of transparency as a result of local "word of mouth," but also those investment banks and brokerages being able to maintain contact with management and monitor status with relative ease.

We urge the Commission to implement Regulation A+ as soon as possible. The delay associated to date with its implementation has been somewhat baffling to us, as Form 1-A provides a readily useable framework for disclosure under Regulation A+. As to ongoing reporting, we believe a straightforward regime of simple disclosure associated with the annual audited financial statements to be filed with SEC, supplemental provision of unaudited, GAAP-compliant quarterly financials and requirements to report material events (analogous to a stripped down 8-k) make sense. Beyond this, until there is sufficient volume of deals created to understand the scope and activities of this marketplace have the real potential to become overly burdensome and counter the intent of Title IV.

The largest issues in our mind is updating some of the mechanics of the offering process and the interplay between the feds and the states. That said, we do not believe those issues would be cause for the implementation of Regulation A+ to have been delayed as it has.

Offering Mechanics

Electronic filing through EDGAR is mandated by Title IV and will be a logical and effective means to ensure dissemination of material information concerning Reg A+ issuers. That said, revisions to current Regulation A, if the same general framework is to be used in the context of Reg A+, need to be made to account for public access to all reporting through EDGAR. Currently, Rule 251(d)(2) requires physical delivery of the offering circular to the prospective investor, the need for which is obviated by having all disclosure related to an issuer generally available with the click of a button through EDGAR. In short, a Reg A+ analog to Rule 172 will be critical to furthering the JOBS Act's congressional intent.

Furthermore, it is our expectation that the vast majority of Reg A+ deals will be done on a continuous, best efforts basis. This will result in necessary updates to offering circulars. Currently Rule 253(e) requires any updated or revised Offering Circular to be filed with an amended Offering Statement and re-qualified with the Commission. This re-qualification requirement places an unnecessary burden on issuers engaged in such offerings, and one not seen in the context of a public registration where only information tripping the requirements of Item 512 of Reg S-K requires a post-effective registration statement amendment and other updates to the prospectus may be filed under Rule 424. For instance, in a recent offering filed by our firm the issuer simply desired to add another jurisdiction and update some ancillary business information – disclosures which would, arguably, require requalification with significant offering disruption but with little or no investor protective impact. Again, an analog for Reg A+ needs to be adopted.

Blue Sky and the definition of "Qualified Purchaser"

In enacting Title IV, Congress did express plainly its concern that 50 different regulatory schemes presently imposed on Regulation A would have a negative impact on the ability of small and mid-size businesses to raise capital in the future under Regulation A+ or otherwise.[6] It has been our firm's experience with current Regulation A to be **EXACTLY THE CASE**.

First, just conceptually speaking, the notion of up to 50 different regulatory regimes being applied to an offering which has just gone through a thorough process of review by the Commission seems excessive and fraught with opportunities for delay or missteps.

Our experiences with state regulators in conducting these offerings have been diverse to say the least, ranging from the cooperative and efficient to the downright abusive, or even nonexistent. Of course, if the goal is to create an efficient system for "Main Street" firms to form necessary capital, then the involvement of the states in the offering process must be assessed by their weakest performances.

For example, we have had multiple occasions where states have just simply failed to respond to filings. In one instance, a filing was made with the Commonwealth of Massachusetts in December of last year, and, to date, we have yet to hear any response. In another, an initial filing was made with the State of Ohio in June of this year – we have still heard nothing.

And in probably the most egregious example to date, we filed this summer a registration in the Commonwealth of Virginia. As part of the filing, we submitted a copy of the Form 1-A we filed with the

[6] *See* Section 402 of the JOBS Act requiring a study of the impact of state blue sky laws on offerings made under Regulation A.

SEC, as required by Virginia law. Form 1-A requires the registrant to list all affiliates of the registrant as well as any securities offerings of affiliates in the past 12 months. It is important to note that any securities transactions conducted by these affiliates were conducted amongst all accredited investors outside of the Commonwealth under Rule 506 of Regulation D, and, thus, specifically under applicable regulations, are exempt from any filing requirement in Virginia.[7] There has been no allegation or any intimation of suspected wrongdoing in any offering by any of these entities. Nevertheless, the result of attempting to comply with Virginia's registration requirements in the context of a Regulation A offering has been for the Virginia State Corporation Commission to institute an investigation into a number of entities affiliated with the registrant through its parent and "any other affiliates [undefined]," making vague and extremely broad requests for information related to the entities, while at the same time, making no visible effort to proceed with the registration of the securities of the registrant. I have attached a redacted copy of the letter notifying of the investigation and making the informational requests (Exhibit A- redacted). This process will likely cost my client tens of thousands of dollars to comply with the Commonwealth's demands all because of my client's attempt to comply with the law and also use an offering method which subjects it to greater transparency for the good of the investing public.

With the possibilities of such delays or the danger of arbitrary investigations which can be costly to an issuer, the state blue sky process stands right now as an enormous obstacle to the reliability of Regulation A+ as a credible channel for forming capital. Ironic, given that this fact could have the potential for issuers to remain focused on Regulation D, which is a largely unsupervised offering process presently at the state and federal level.

Nevertheless, I understand legislative reticence to completely preempt the states for a method of offering that has been largely underutilized in recent memory. Congress, therefore, struck a reasonable balance for the interim – by creating an additional class of "covered security," under NSMIA for Regulation A+ in situations where the securities are either listed on a National Exchange or sold exclusively to "qualified purchasers." In the latter instance, Congress specifically delegated to the Commission the authority to define "qualified purchasers" recognizing the Commission's expertise in balancing oversight and efficiency in capital formation.[8] To date, the Commission has not done so, nor have they provided the public any guidance as to their thinking on this.

We believe the "qualified purchaser" exemption, if defined appropriately, will be a reasonable and workable option to any number of small and mid-size issuers over other options that might not

[7] *See* 21 VAC5-45-20.
[8] 15 U.S.C. § 77r(b)(4)(D)

provide the regulatory oversight of disclosure, transparency, and the potential liquidity for investors that Regulation A and A+ can provide.[9] At the same time, such definition would not only provide a balanced approach to state investor protection issues, but also allow the Commission to observe a "critical mass" of activity within the Regulation A and A+ so that the Commission can have the ability to determine what further regulation (or changes to present regulations) might be necessary to accomplish Congress's intent without excessive risk to the investing public.

I believe that a definition can easily be tailored that can address state concerns related to investor protection, while having the intended effect of providing a meaningfully broader audience for businesses to go to for capital. Specifically, we have proposed to the Commission a definition of "qualified purchaser" which combines a net worth/income test with a cap on the amount of investment by an investor in any one issuance. A qualified purchaser would be defined as a purchaser having, excluding (in the instance of natural persons) the value of a purchaser's primary residence, either:

- a net worth of at least $500,000; or
- a gross annual income of at least $150,000 and a net worth of at least $250,000.

Further, the amount of investment by a natural person(s) who would be a qualified purchaser may not exceed 20% of the net worth of such natural person(s).

We would note that this definition is well in excess of NASAA's standard guidelines for minimum investor suitability and is designed to permit small issuers to reach a broader investor audience while addressing investor protection concerns – demanding a requisite amount of sophistication from the investor to review and digest disclosure drafted to requirements of the Commission designed to be accessible to investors in the public marketplace and that has been reviewed and qualified previously by the Commission, at the same time, it limits the exposure that an individual could have to a potential loss in any given instance.[10]

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[9] The GAO completed its required study in July 2012 entitled "SECURITIES REGULATION Factors That May Affect Trends in Regulation A Offerings," (the "GAO Study") and found that in fiscal 2010 and 2011 there were 8 qualified Regulation A offerings versus over 15,500 Regulation D offerings for $5 million or under, the vast majority of which were under Rule 506 with very limited oversight of disclosure. The GAO identified state securities law compliance as a factor in pushing issuers towards Regulation D and indicated that the GAO's research and conversations with securities attorneys and a small business advocate identified state securities registration requirements as time consuming and costly for small businesses. *See* pg. 17 of the GAO Study.

[10] Certain commentators have proposed the use of the "accredited investor" definition found in Rule 502 of Regulation D, if a net worth test for a qualified purchaser is to be adopted. We disagree adamantly with this suggestion. Given the need for audits, mandated forms of disclosure and periodic reporting under Reg A+, adopting such a definition would only have the result of causing issuers to default to Rule 506(c) of Regulation D, rather than adopting Reg A+, which provides for greater transparency and regulatory oversight, for the formation of capital.

Without a measured exemption here, we believe the current approach by the states, coupled with the current realities of our economy, could combine to subvert Congress's intent here to provide a meaningful apparatus for capital formation and job creation that is subject to the light of public disclosure.

To date, the regulation of capital formation under our securities laws has been premised on the stark dichotomy between private offerings, typically made available to a very narrow audience of investors, and public registration with its attendant costs and regulatory burdens. The genesis of the JOBS Act was the notion of finding reasoned approaches for businesses to form capital, balanced against the need to protect the investing public. Title IV presents the most impactful of the approaches presented in this legislation, supported by an existing mechanism to make these securities available to the marketplace. The Commission needs to act NOW. Thank you.

Exhibit A

RONALD W. THOMAS
DIRECTOR

THOMAS M. GOULDIN
DEPUTY DIRECTOR

COMMONWEALTH OF VIRGINIA

MAILING ADDRESS:
P.O. BOX 1197
RICHMOND, VA 23218-1197

WWW.SCC.VIRGINIA.GOV/SRF

STATE CORPORATION COMMISSION
DIVISION OF SECURITIES AND RETAIL FRANCHISING

October 4, 2013

CERTIFIED MAIL

Mr.

Re: LLC; LLC; LLC; LLC; DST; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; and other associated entities

Mr.

The Division of Securities and Retail Franchising is responsible for enforcing the provisions of the Virginia Securities Act. The Act requires people and entities that offer and sell securities to register with the Division or have an applicable exemption.

We are investigating whether or not you or the companies you are associated with offered or sold securities without registering with the Division or having an applicable exemption. In addition, the offers and sales of securities you, your companies, or its affiliates have made may be in violation of § 13.1-507 of the Act.

I am asking you provide the following items pursuant to § 13.1-518 A of the Act. In addition, I am requesting you serially number the pages of all documents and provide an itemized list of materials submitted.

1. Provide a detailed explanation why the following entities with principal addresses in Virginia, and which you appear to be associated with, are not filed with the Virginia Clerk's Office.
   a. , LLC
   b. , LLC
   c. , LLC
   d. , LLC
   e. , LLC
   f. LLC

g. , LLC

For each of the entities listed above, please provide the address where the books and records are maintained, the entities' incorporation or formation documents, and the name and address of each officer, director or managing member. Further, please state if any of the above referenced entities sold any type of investment and, if so, the details of the investment.

2. Provide a detailed explanation why the following entities with principal address in Virginia, and which you appear to be associated with, did not make any filings with the Division regarding their Securities and Exchange Commission filings:

a. , DST
b. LLC
c. , LLC
d. LLC
e. LLC
f. , LLC
g. , LLC
h. LLC

Please note, even if the above referenced entities did not offer investment opportunities to Virginia residents, §13.1-507 only contemplates the offer and sale, stating, "It shall be unlawful for any person to offer or sell any security…" Therefore if the business is located and transacting business in the Commonwealth, it is the Division's opinion that is sufficient to meet the requirements of §13.1-507.

For each of the entities listed above, please provide the address where the books and records are maintained, the entities' incorporation or formation documents, and the name and address of each officer, director or managing member. Further, include what exemption, if any, from registration each entity is claiming in Virginia.

3. A legible copy of all prospectuses, offering circulars, exhibits or other disclosure material in their entirety that have been presented or made available to prospective investors by all companies you are an officer, director, or managing member.

4. A legible copy of all signed notes, contracts, or other agreements, in their entirety, executed by investors of all companies you are an officer, director, or managing member.

5. The names, home addresses, e-mail addresses, and home phone numbers of all people or entities who were sold an investment opportunity by or through the companies you are an officer, director, or managing member. For each investor please provide:
   a. The date the investment was made;
   b. The amount invested, exchanged, or contributed by each person or entity;
   c. How many currently outstanding preferred and/or common shares each person or entity owns;
   d. If the stockholder is an entity, provide the names, home street addresses, e-mail addresses, and home phone numbers of the owners, officers, members and/or partners;
   e. The current state of the investment; and
   f. The full name and address of the selling agent involved.

6. A list of all loans made by any companies you are an officer, director, or managing member of to any current or former members (or any immediate family members) of the Board of Directors, officers, or management or any business associated with any current or former member of the Board of Directors, officers, or management (or any immediate family members). For each loan, include:
   a. The name of the person or entity the loan is being made to;
   b. The amount of the loan;
   c. The terms and condition of the loan;
   d. The date of the transaction and a list of payments on the loan;
   e. The current balance of the loan; and
   f. All corresponding loan documentation.

7. The names, e-mail addresses, home street addresses, home phone numbers, titles and dates of tenure of each and every officer, Director or managing member of every entity you are an officer, Director, or managing member.

8. All correspondence, faxes, and e-mails received from or sent to investors.

9. State what process you and the entities you are associated with undertook and implemented to determine whether a potential investor was "accredited" as defined by the Act.

10. State how , LLC determined the suitability standards described on Page 1 of the Offering.

11. Explain how on Page "iv" of the , LLC offering document LLC is listed as an affiliate but on Page 5 the same entity is listed as a predecessor.

If you are unable or do not intend to produce the records by Friday, November 1, 2013, you must provide me with a written explanation listing each item and detailing the reason each item cannot be produced by the deadline. We may refer this matter to our Office of General Counsel for formal action if you fail to comply or provide a written explanation by the deadline. I look forward to hearing from you. You may contact me at (804) 225-4419 or Marc.Bantel@scc.virginia.gov if you have any questions.

Sincerely,

Marc C. Bantel
Senior Investigator