ON FEDERAL PREEMPTION OF STATE SECURITIES REGULATION AND THE FUTURE OF CAPITAL FORMATION FOR SMALL BUSINESS – THE DAWN OF A NEW ERA AT THE SEC

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December 18, 2013 may well mark a historic turning point in the ability of a small business to effectively access capital in the private and public markets under the federal securities regulatory framework. On that day, the Commissioners of the U.S. Securities and Exchange Commission (SEC) met in open session and unanimously authorized the issuance of proposed rules[1] intended to implement Title IV of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act")—a provision widely labeled as "Regulation A+," whose implementation is dependent upon SEC rulemaking.[2] Title IV, entitled "*Small Company Capital Formation,*" was intended by Congress to expand the use of Regulation A—a little used exemption from full blown SEC registration of securities which has been around for more than 20 years—by increasing the dollar ceiling from $5 million to $50 million.[3] Both the scope and breadth of the SEC's proposed rules, and the areas in which the SEC expressly seeks public comment, appear to represent an opening salvo by the SEC. As a result, a fierce and long overdue battle between the Commission and state regulators will ensue, in which the SEC is determined to reduce the burden of state regulation on capital formation—a burden falling disproportionately on small businesses—while state regulators seek to preserve their autonomy to review securities offerings at the state level.

Specifically, Regulation A (in theory) has allowed private companies to raise capital, up to $5 million, through an abbreviated "mini-registration" process with the SEC. This allows public solicitation of both accredited and non-accredited investors and the ability to issue shares which are freely tradable. Regulation A has, as its advantages, such features as: (i) reduced disclosures to investors relative to a full SEC registration, including the ability to utilize "reviewed" financial statements instead of audited financial statements; (ii) limited SEC review; (iii) the ability to "test the waters" with investors prior to incurring significant upfront costs such as filing an offering memorandum with the SEC; (iv) the ability of an investor to receive free trading shares upon their issuance; and (v) the absence of post-offering reporting requirements, unless and until a company meets the threshold reporting requirements applicable to all companies under the Securities Exchange Act of 1934.[4]

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[1] Sec. and Exch. Comm'n Release No. 33-9497 (Dec. 18, 2013), https://www.sec.gov/rules/proposed/2013/33-9497.pdf.

[2] H.R. Con. Res. 3606, 112th Cong. (2012) (enacted).

[3] H.R. 1070, 112th Cong. (2012) (enacted).

[4] *See, e.g.,* Craig M. Lewis, U.S. SEC. AND EXCH. COMM'N, MIT Sloan Sch. of Mgmt.'s Ctr. for Fin. and Policy's Distinguished Speaker Series (Apr. 15, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370541497283#.U-qdMfldWfY.

Regulation A's relative non-use as a capital raising tool has been widely attributed to two factors—the offering costs relative to the dollar amounts being raised and the necessity of complying with blue sky laws in each state where the offering is conducted.[5] Some have argued that the $5 million limit on Regulation A is too low to provide an effective means of raising capital, after factoring in all of its attendant costs and burdens, including outsized disclosure costs. Others, including myself, have argued that the biggest culprit in the dysfunctionality of Regulation A is the need for a company to navigate a labyrinth of state blue sky laws, despite SEC review—adding both expense and delay. In some states, qualifying a federally reviewed and approved Regulation A offering was not even an option, under a blue sky regimen commonly referred to as "merit review."

Unlike the SEC registration process, whose talisman is full and fair disclosure to the investor, and is agnostic as to the quality of the investment, many states, in addition to a separate review process, have effectively closed the door to what they deem as investments too risky for the average retail investor. Often this has precluded entire industries, such as biotechnology, from utilizing Regulation A, as they typically generate little or no revenue in their early years and do not expect to be profitable under any scenario for at least three to five years. Other high tech development stage companies, with oversized valuations relative to benchmarks, such as tangible book value or earnings per share, have been similarly excluded under some state blue sky laws. And even for eligible companies who are otherwise able to reach out to prospective investors in more than one state, the prospect of qualifying an offering through a multi-state review is simply too daunting in terms of both time and money.

Title IV of the JOBS Act was intended to solve some of the perceived limitations of Regulation A. In solving these problems, Congress provided an annual dollar limit for Regulation A+ offerings of $50 million—subject to ongoing periodic reporting and conditions not required in financial statements audited under Regulation A. Such requirements are not unreasonable for companies seeking to issue publicly tradable securities where higher dollar amounts are being raised. And to eliminate the necessity of costly entanglement in the web of state blue sky regulation, Congress exempted two categories of securities issued under the *new* Regulation A+ (now Section 3(b)(2) of the Securities Act of 1933): (1) offerings limited to "qualified purchasers" and (2) securities offered and sold on a national securities exchange. Implementation of Regulation A+, including the definition of what a "qualified purchaser" is, was left to rulemaking by the SEC. However, Congress left untouched the pre-Title IV Regulation A, limited to $5 million (formerly Section 3(b) of the Securities Act of 1933, now re-designated Section 3(b)(1) of the Securities Act). This had the effect of appearing indifferent to easing capital formation for small businesses seeking to raise up to $5 million—many of whom could not be expected to meet the heightened audit and ongoing disclosure requirements required by new Regulation A+.

On December 18, 2013, 20 months after the enactment of the JOBS Act, the SEC seemingly blew the doors off of Regulation A+, giving much needed hope to small businesses seeking to raise capital to develop and expand their businesses. Notwithstanding the backlog of still unissued (and long overdue) regulations dictated by the Dodd-Frank Act, and the failure of the JOBS Act to provide any SEC rulemaking deadline for Title IV, the Commission issued a 387 page release

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[5] *See, e.g.,* GAO Report to Congressional Committees, "*Factors That May Affect Trends in Regulation A Offerings*," (July 2012), https://www.sec.gov/rules/proposed/2013/33-9497.pdf.

which was stunning in both its reach and breadth.[6] The Release proposed to exempt *all* Regulation A+ offerings over $5 million from state blue sky review. The Release immediately prompted a strong rebuke by William F. Galvin, Secretary of the Commonwealth of Massachusetts, in a formal comment letter submitted to the SEC on the same day the Release was issued.[7] The comment letter strongly opposed the proposed reach of the SEC in the Release's proposed rule, which would exempt virtually all securities issued under Regulation A+ from state blue sky regulation of offerings over $5 million:

> We are dismayed and shocked to see that the Commission's Regulation A-Plus' proposal includes provisions that preempt the ability of the states to require registration of these offerings and to review them. The states have tackled preemption battles on many fronts, but *never before have we found ourselves battling our federal counterpart*. Shame on the S.E.C. for this anti-investor proposal. This is a step that puts small retail investors unacceptably at risk. We urge the Commission to remove these provisions from the rule. [emphasis added; footnote omitted][8]

The hook that the SEC used to exempt Regulation A+ offerings over $5 million from state review was to deem all securities sold in a Regulation A+ offering over $5 million to be sold to qualified purchasers. From a legal point of view, Mr. Galvin argued that by providing an exemption from state registration for all Regulation A+ offerings over $5 million, this contravened the intent of Congress to have "qualified purchasers" defined on the basis of their sophistication and financial wherewithal, and not simply the type of transaction being conducted.

Perhaps even more significant than proposing to pre-empt Regulation A+ offerings over $5 million from state review, the December 18 SEC Release also solicited comments on the scope of the existing, pre-JOBS Act Regulation A (*i.e.* Regulation A offerings for $5 million and under). The Release proposed to denominate two classes of Regulation A+ offerings: Tier I—$5 million and under; and Tier II—$5 million to $50 million. Though not yet proposing any new rules in this regard, the Release solicited public comments on Tier I Offerings ($5 million and under), *including whether Tier I offerings should be exempt from state blue sky registration and review.* This came as a surprise to this writer, because Title IV, as enacted by Congress, left the pre-JOBS Act Regulation A (now designated Section 3(b)(1) intact and unscathed) continuing to leave small businesses as the neglected step child of the federal post-JOBS Act securities regulation framework.

Without jumping into the fray as to whether the SEC currently has the statutory authority to exempt all Regulation A+ offerings over $5 million from state blue sky regulation (by deeming every investor a qualified purchaser), suffice it to say that, from the point of view of the Title IV requirements, the proposed rules have pushed the edge of the envelope–if not outside the envelope itself–by designating *every* investor a qualified purchaser. The SEC's legal position is not without its supporters, notable among them being Rutheford B. Campbell, Jr., law professor at the University of Kentucky. Professor Campbell has publicly argued for the very position the SEC

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[6] Sec. and Exch. Comm'n Release No. 33-9497 (Dec. 18, 2013), https://www.sec.gov/rules/proposed/2013/33-9497.pdf.

[7] Letter from William F. Galvin, Secretary of the Commonwealth, Commonwealth of Massachusetts, to the SEC dated December 18, 2013, https://www.sec.gov/comments/s7-11-13/s71113-1.pdf.

[8] *Id.* at 1.

has taken in the Release, both in formal comments to the SEC and in published articles.[9] In his view, the SEC not only has the authority to exempt all Regulation A+ offerings, but it should exercise its discretion in the broad manner adopted by the SEC in the proposed rule—for offerings above and below $5 million.

Professor Campbell has summed up the crux of the dilemma on more than one occasion. Notably, in one article Professor Campbell stated:

> Regrettably, history shows an unwillingness on the part of the Commission to act in regard to expanding preemption of state authority over registrations. In both the legislations leading to the NSMIA [National Securities Markets Improvement Act of 1996] and the Dodd-Frank Act, the Commission failed to advocate for preemption.[10]

According to Professor Campbell, the victims of the SEC's tepid approach to curtailing state regulation—small businesses.

It seems that, to the dismay of NASAA[11] and Secretary Galvin, Professor Campbell drew a Royal Flush on December 18, when the SEC adopted the position of Professor Campbell, lock, stock and barrel. It remains to be seen, however, whether his luck (and the luck of small business) will hold out when the comment period ends and the dust settles on final rules.

In the face of strong opposition from state regulators such as Massachusetts Secretary of State Galvin and a host of consumer protection groups, I expect that there will be dark legal clouds looming over the SEC's position. It may well be that the proposed regulatory action by the SEC may turn out to be too little too late. Ultimately, it may take another act of Congress to settle the ensuing debate—something that might have been avoidable if the SEC joined the conversation at the Congressional table in 2012 with a strong hand and a strong voice—advocating the need for preemption of state securities regulation of Regulation A and Regulation A+ offerings. Though late to the party, it appears that the SEC may now be prepared to take its case to Congress, if necessary.

Indeed, it seems that, at long last, the battle that has been assiduously avoided by the SEC in recent decades, federal pre-emption of offerings involving non-accredited investors from state blue sky review, has finally begun. The decade's long posture of the SEC avoiding confrontation with state regulators and their national mouthpiece, the North American Securities Administrators Association (NASAA), has apparently given way to a long overdue demonstration of political and

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[9] *See* Letter from Rutheford B. Campbell, Jr., William L. Matthews Professor of Law, to the SEC dated November 13, 2012, http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-18.pdf (last visited Aug. 13, 2014); *see also* Letter from Rutheford B. Campbell, Jr., William L. Matthews Professor of Law, to the SEC dated January 30, 2012,http://www.sec.gov/rules/proposed/s72301/campbel1.htm (last visited Aug. 13, 2014); *see also* Rutherford B. Campbell, Jr., The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions, 66 BUS. LAW 919 (Aug. 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1971200.

[10] Campbell, *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, *supra* note 6, at 941.

[11] *See, e.g.,* Letter from A. Heath Abshure, President, North American Securities Administrators Association, Inc., to the SEC dated April 10, 2013, http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-25.pdf (last visited June 18, 2014).

institutional will by the SEC that seeks to forcefully advocate for a rational federal regulatory scheme, which would pre-empt the ability of states to impose review of smaller offerings to non-accredited investors. It appears that the SEC has come to the realization that passivity on its part, even in the face of strong opposition from state regulators or consumer advocate groups, will not properly serve the interests of small business capital formation.

The question is why the SEC is now seemingly taking a proactive approach to opening up new avenues of capital formation for small business—putting it on a collision course with many state regulators, if not NASAA itself, and what this may portend, both in terms of future SEC rulemaking and Congressional action in the form of "JOBS Act 2.x." Though post-JOBS Act Congressional oversight may have played a role, there appears to be other operative factors—stemming in large part from the SEC's failure to come to the table in Congress when the JOBS Act was being formulated. I believe the answer is largely explained by two factors: the changing of the guard at the SEC Chair level in 2013, and the fallout resulting from Congressional action in the form of the JOBS Act with the SEC largely absent from the legislative process.

I. WHAT IS NEW AND WHY?

2012 was marked by more than just the enactment of the JOBS Act. The year was also marked by a vacuum in decisive leadership at the SEC in spearheading necessary legislative and regulatory reforms. Indeed, according to the SEC's own website, the Commission was entirely absent from crafting the federal legislation now known as the JOBS Act.[12] The JOBS Act, once enacted, was initially met with deafening silence from the SEC as to key provisions intended to "Jumpstart Our Business Startups." By way of example, no one needs reminding of the 90 day Congressional deadline to enact Title II rules (public solicitation in private placements *a la* new Regulation D Rule 506(c)) and the 270 day deadline for the SEC to enact rules implementing the crowdfunding provisions of Title III—deadlines which unapologetically came and went.

But something seems to have changed at the SEC in 2013—the most significant catalyst being, in my opinion, the changing of the guard at the SEC Chair level, from Mary Jo Shapiro to Mary Jo White. The SEC, having stood on the sidelines as the JOBS Act legislation meandered through Congress, found itself as the not so proud owner of a regulatory scheme which in many respects is both incongruous and dysfunctional—especially in terms of meeting the needs of small businesses— sector widely viewed as the engine of job growth and economic prosperity. Indeed, far from being the "holistic" overhaul of securities regulation envisioned by at least one of the SEC commissioners,[13] SEC inaction while the JOBS Act was cobbled together by Congress left the Commission with a modified regulatory scheme that is "hole"-"istic"—not holistic. One does

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[12] The only Congressional testimony reflected on the SEC's website (www.sec.gov) relating to the JOBS Act, was on December 1, 2011, testimony on "Spurring Job Growth Through Capital Formation While Protecting Investors," before the Committee on Banking, Housing and Urban Affairs, Meredith B. Cross, Director, Division of Corporation Finance, and Lona Nallengara, Deputy Director, Division of Corporation Finance, http://www.sec.gov/news/testimony/2011/ts120111mbc.htm (last visited June 18, 2014). However, the testimony, while addressing many of the issues ultimately addressed by the JOBS Act, took no position on these issues.

[13] *See, e.g.,* Remarks at FIA Futures and Options Expo, Commissioner Daniel M. Gallagher, U.S. SEC. AND EXCH. COMM'N (Nov. 6, 2013), https://www.sec.gov/servlet/Satellite/News/Speech/Detail/Speech/1370540289361#.UscADrTl-70.

not need to scratch far beneath the surface of the JOBS Act and existing SEC regulations to see the incongruous mess that Congress has left to the SEC to either live with—or clean up. Judging by the approach taken by the SEC in the December 18 Release, it appears that the SEC is poised to clean up at least part of the mess—and take on the strong and vocal opposition at the state level—after years of avoiding this fight.

As Commissioner Gallagher recently remarked, though a careful review of the entire regulatory scheme may be a logical precedent for change in securities regulation in many instances[14], a pragmatic approach of addressing the regulatory scheme on a piecemeal basis is the likely path of least resistance at the Commission level. Currently on the front burner at the SEC awaiting implementation of final rules are two sectors, both aimed at "small businesses," Title III Crowdfunding and Title IV's Regulation A+. An examination of these areas, post-JOBS Act, provides some clues as to the dilemma the Commission faces following action by Congress in the form of the 2012 JOBS Act.

II. TITLE III (CROWDFUNDING) VS. REGULATION A

A. Is Title III Crowdfunding Crowded With Too Many Costs?

Let's start with the very bottom of the food chain—JOBS Act Title III crowdfunding—a financing model widely dismissed by the securities bar and others as both ill advised and unworkable. Title III attempted to create a new market structure whereby unlimited numbers of unsophisticated investors could invest in high-risk companies through an intermediary on the Internet. The statute limits the amount that an investor can put at risk, and a company may not raise more than $1 million in any 12-month period using this exemption. Though the company must incur the expense of preparing a detailed disclosure document for investors, there is no SEC or state blue sky review. The statute also requires that the issuer conduct investor solicitations on an Internet portal run by an SEC and FINRA licensed broker-dealer or funding portal.

The SEC, under its prior Chairman, turned its back on the concept of crowdfunding for profit as being inconsistent with the Commission's obligation to protect investors. Thus, it ought not to come as a surprise that the end product of Title III clashes with policies embedded in long standing SEC regulations governing other exemptions for higher dollar amounts, most notably Regulation A.

Title III mandates that companies raising between $500,000 and $1,000,000 provide investors with audited financial statements. This requirement adds a significant expense to startups and small, emerging companies. It is not clear what audited financial statements add to the investor information mix, relative to the cost of the audit itself—as opposed to "reviewed" financial statements—especially for companies with little or no revenue. The cost of an audit, when factored in with other Title III costs that must be borne by the issuer, will likely make the cost of a Title III financing unattractive, if not prohibitive. Particularly since these costs must be incurred up front, before there are any assurances of a successful capital raise.

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[14] *See* Remarks at the Second Annual Institute for Corporate Counsel, Daniel M. Gallagher, U.S. SEC. AND EXCH. COMM'N (Dec. 6, 2013), https://www.sec.gov/servlet/Satellite/News/Speech/Detail/Speech/1370540462287#.UscE-bTl-70.

Moreover, the impact on a small business of providing audited financial statements, not to mention extensive non-financial disclosure, does not end when the offering is successfully completed. Congress also mandated that the price a company must pay for a successful offering is to file fairly extensive ongoing periodic reports—at least until the company either buys back the offered the securities or goes out of business.

The picture is not much better for investment crowdfunding raised by small businesses that are under $500,000. These require the same detailed non-financial disclosure as well as reviewed financial statements for offerings above $100,000. Add to this up, front legal compliance costs and the cost of using an intermediary, and the excitement over the possibilities held out by investment crowdfunding quickly fades.

B. And What About Pre-JOBS Act (and Post-JOBS Act) Regulation A?

Contrast Title III's requirements for audited financial statements for offerings over $500,000, ongoing annual reports to investors, limitations on direct public solicitation, and one year of non-transferability of the crowdfunded securities—with requirements that are *absent* under the long standing Regulation A mini-registration for an offering of *up to $5 million.* Most of the irony is summed up in an introductory paragraph on page 9 of the SEC's December 18 Reg. A+ Release, addressing what the SEC now proposes to label as Tier I Regulation A ($5 million and under), an irony I am certain was not lost on the SEC's new Chair:

> Regulation A permits issuers to communicate with potential investors, or "test the waters" for potential interest in the offering, *before* filing the offering statement. . .Regulation A offering circulars are required to contain issuer financial statements, but the financial statements are *not required to be audited* unless the issuer otherwise has audited financial statements available. Qualification of a Regulation A offering statement does not trigger reporting obligations under the Exchange Act [*or any other ongoing reporting obligations*]. A Regulation A offering is a public offering, *with no prohibition on general solicitation and general advertising*. *Securities sold under Regulation A are not "restricted securities" under the Securities Act and, therefore, are not subject to the limitations on resale* that apply to securities sold in private offerings. [emphasis added; footnotes omitted][15]

To sum it up, Congresses' Title III crafted a framework for small, "bite-sized" companies which is not only ladened with costs relative to the amounts being raised, but places far greater burdens on those small businesses at the bottom of the food chain (up to $1 million). Parallel those provisions with a 20 year old exemption, like Regulation A, which allows capital raises up to five times greater than Title III crowdfunding.

Unfortunately, Congress did not *expressly* address the needs of small businesses seeking to raise up to $5 million through a Regulation A type offering—an option which would allow an issuer to reach out to both accredited and non-accredited investors in a cost effective manner—by exempting these smaller offerings from state blue sky review. Nor, in my view, did it clearly and cogently address head on the need to exempt all Regulation A+ offerings, big or small, from burdensome state regulations—something the SEC now appears ready to push through.

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[15] Sec. and Exch. Comm'n Release No. 33-9497, *supra* note 6, at 9.

III. TITLE IV REGULATION A+ – TIER I (REGULATION A) VERSUS TIER II OFFERINGS

The rules proposed by the SEC to implement Title IV's Regulation A+ created a two tier system: Tier I offerings up to $5 million, and Tier II offerings up to $50 million. As to the proposed Tier II rules, the SEC calls for registration statement type disclosure more onerous than current Regulation A, audited financial statements, and periodic disclosures to be filed with the SEC following completion of the offering. These burdens may well be appropriate for the higher dollar amounts between $5 - $50 million.

What is still missing from the equation is a viable alternative for small companies seeking to raise up to $5 million. Something that would at the least require the SEC, through regulatory action, or Congress through further legislation, to deem securities sold in any Regulation A offering as "covered securities" exempt from state merit review and registration under Section 18 of the Securities Act. It appears from the SEC's call for comment on whether these small offerings should be immune from state blue sky review, that it understands the importance of filling an important gap in Title IV of the JOBS Act—expressly addressing the needs of small businesses seeking to raise up to $5 million.

Some might say that answers for small business capital formation in the $5 million and under space have already been provided—in the form of a new and improved Rule 506(c) under Regulation D (courtesy of Title II of the JOBS Act). [16] Rule 506 allows companies to raise an unlimited amount of capital from "accredited investors" in a private placement without any particular type of disclosure. The new Rule 506(c) allows companies to engage in general solicitation and advertising, so long as all of the investors are accredited and the company takes measures reasonably calculated to ensure that all investors are in fact accredited. Since 1996, when Congress adopted the National Securities Markets Improvement Act of 1996 (NSMIA), offerings under Rule 506 have been exempt from state blue sky review. However, a company that wishes to take money from non-accredited investors (what President Obama has referred to in his April 5, 2012 Rose Garden speech as "ordinary Americans")[17] still may not engage in any public solicitation (unlike Regulation A and Regulation A+), and is required to provide the same type of disclosure as is required in a SEC registered offering, including audited financial statements. Though these limitations may suffice for companies willing and able to limit their investor base to accredited investors, they do not suffice for companies who either need or desire to include "ordinary" investors, or require liquidity in order to effectively market their shares.

Thus, depending upon final rulemaking by the SEC, the net effect of the current regulatory scheme may very well be to require small companies to either pursue a capital raise greater than $5 million—when such an offering is simply neither necessary or practical, limit their investor base to "accredited investors under Rule 506 (exempt from blue sky since 1996)," or navigate the maze of blue sky regulations which has proven to be a deterrent to its utility over the past 20 years. None of these options has worked particularly well for vast numbers of small businesses.

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[16] Sec. and Exch. Comm'n Release No. 33-9415, *supra* note 6.

[17] Press Release, Office of the Press Secretary, Remarks by President Barack Obama at the JOBS Act Bill Signing (Apr. 5, 2012).

A permanent solution to this problem may very well lie in the hands of Congress—who through further legislation could authorize the SEC to further modify Regulation A by making the issued securities "covered securities" under Section 18 of the Securities Act, thus freeing a company from the burden of complying with state blue sky regulations. If history is to be a guide, it is unlikely that this solution will come to fruition from the initiative of Congress absent strong advocacy on the part of the SEC —something lacking in 2012 under the tutelage of former Commissioner Shapiro (and her predecessors). However, the scope of the December 18 Release suggests that at least some at the Commission level, under the leadership of Chairman White, are able and willing to take on this task.

In the short term, the future of Regulation A (and A+) offerings may very well hinge upon the strength and volume of comments received in response to the SEC's December 18 call for comment on exempting all Regulation A (and A+) offerings from state review, regardless of the dollar amount. But the *sine qua non* for change will be the political and institutional will of the SEC to take on the state securities regulators, who are well organized and very outspoken.

IV. SOME HISTORY LESSONS

A. Banned in Boston

Though the U.S. history of federal and state securities regulation has not been kind to small business, it does present some valuable lessons to help place the issue of state securities regulation in perspective, albeit with some ironies.

The year was 1980. The headline in the Wall Street Journal on December 12, 1980 read *"Massachusetts Bars Sale of Stock as Risky."* It seems that the State of Massachusetts, in its zeal to protect investors, was one of a handful of states to bar "ordinary investors" from participating in what it viewed as a (too) hot IPO. Having raised the initial offering price to $22.00 per share, a company about to complete its IPO was told by the State of Massachusetts that its offering did not meet its stringent blue sky standards. In its opinion, the offering price was too high relative to its earnings and book value. The result—the offering was withdrawn from the State of Massachusetts—and was only made available to retail investors in 27 states.

Today the stock trades at over $500.00 per share. The name of the company was Apple Computer—whose market capitalization ultimately made it the most highly valued public company in the world.

Apparently, not too much has changed in Massachusetts since 1980, at least judging by Secretary of State Galvin's letter to the SEC of December 18, 2013.

Ultimately, Congress passed legislation which preempted state blue sky review for offerings that involved companies listed on a national securities exchange. Unfortunately, most small companies continue to be left out in the cold, unable to make the leap to a national exchange without some seasoning and additional capital.

B. The State of Kansas as the Thought Leader in State Blue Sky Regulation

Ironically, the first state in the Union to implement merit review was Kansas in 1911—to protect ordinary investors from falling victim to slick salesmen travelling the back roads of Kansas selling "blue sky" and snake oil to would be investors. A full century later, in 2011, Kansas became the first state to implement its own brand of investment crowdfunding for investment activities within its borders. It did so through regulatory action by its securities commissioner, without the necessity of state legislation.

Seems that the state securities regulators in the large majority of the other 50 states never got the memo.

C. Looking Ahead

2013 was the year that the deck was reshuffled at the Commission level at the SEC. 2014 may be the year when the deck is reshuffled in the upcoming Congressional elections. With strong, decisive leadership at the SEC, and the appropriate voices speaking out on behalf of small business, real change in the ability of small business to raise capital from the public may finally be at hand.

2014 may very well see the genesis of what might be called "CrowdFunding Plus"—a modified Regulation A exemption which will free Tier I offerings (under $5 million) from the entanglement of the current web of blue sky regulation. The modified regulation will be without more burdensome disclosure obligations, and the implementation of Tier II offerings, exempt from state blue sky review. And as part of what appears to be a long overdue shift in focus by the SEC from the interests of Wall Street to small business, it would not be surprising if this proactivity on the part of the SEC spills over to Title III crowdfunding—at least to engage Congress to correct some glaring incongruities.

If the SEC successfully continues down the path of pre-emption of state regulation, there will only be winners in this battle—and no losers. With a stronger economy will come a more robust tax base on the state and local level—resulting in more than ample resources for state regulators to put more "cops on the beat" to protect the investing public.