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An Introduction to the Federalist Society's Panelist Discussion Titled 'Deregulating the Markets: The Jobs Act'

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AN INTRODUCTION TO THE FEDERALIST SOCIETY'S PANELIST DISCUSSION TITLED "DEREGULATING THE MARKETS: THE JOBS ACT"

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At its 2012 National Lawyers Convention in Washington, D.C., the Corporations, Securities & Antitrust Practice Group of the Federalist Society for Law and Public Policy Studies hosted a panel discussion

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**Juris Doctor, Widener University School of Law, Wilmington, Delaware; Wolcott Fellow to Delaware Supreme Court Chief Justice Myron T. Steele. I dedicate this Article to my father, John Tsolfias. May his memory be eternal (January 24, 2013).
titled "Deregulating the Markets: The JOBS Act." The panel members were the Honorable Daniel M. Gallagher,1 Joseph H. Kaufman,2 Joanne T. Medero,3 Professor Robert T. Miller,4 and Professor Robert B. Thompson.5 The Honorable Frank H. Easterbrook6 moderated the discussion.

This Article begins with a cursory overview of the Jumpstart Our Business Startups Act (the "JOBS Act" or "Act") provisions discussed by the panelists. It then summarizes the positions expressed by each of the panelists with respect to those provisions. This Article concludes with the Authors' own commentary on the panelists' discussion.

I. JOBS ACT PROVISIONS RELEVANT TO THE PANELIST DISCUSSION

After receiving atypical bipartisan support,7 President Barack Obama signed the JOBS Act into law on April 5, 2012.8 The Act's enactment represents the culmination of President Obama's laudable objective to help entrepreneurs succeed by, among other things, "reducing the disproportionately high costs that small companies face when going public."9 The theory underlying the Act's enactment is that making it easier for small business to access capital would result in the creation of more jobs (hence the Act's wishful acronym).10 Ostensibly, the Act represents a legislative response to the high costs imposed by federal securities regulations, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")11 and the

1 Commissioner, U.S. Securities and Exchange Commission.
2 Partner, Simpson Thacher & Bartlett LLP.
3 Managing Director, BlackRock.
4 Professor, The University of Iowa College of Law.
5 Peter P. Weidenbruch Jr. Professor of Business law, Georgetown University Law Center.
6 Chief Judge, U.S. Court of Appeals, Seventh Circuit.
7 Note that some Senate Democrats unsuccessfully attempted, at the eleventh hour, to pass a "watered down" version of the bill. See 1 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 1:61 (2013).
Sarbanes-Oxley Act of 2002 ("Sarbanes Oxley"). Critics of the JOBS Act, including members of the SEC and investor protection groups, generally submit that the Act creates fertile grounds for effectuating fraud because it repeals essential consumer protection laws.

A. Crowdfunding

Consistent with President Obama's objective, Title III of the JOBS Act adds a new exemption—"crowdfunding"—to the registration requirements imposed by the Securities Act of 1933 (the "33 Act"). "Crowdfunding is the practice by which a company raises capital through a large number of small individual investments." Once implemented, this exemption permits entrepreneurs to sell up to one million dollars in securities to the general public, subject to certain limitations. By allowing startup companies to solicit funds from the general public, crowdfunding is intended to provide entrepreneurs with a quick and inexpensive method of raising necessary early stage capital. This benefit is designed to appeal to entrepreneurs who find it increasingly difficult to procure bank loans or to find angel investors and venture capital firms willing to invest in riskier startup companies.

As noted above, the JOBS Act imposes certain limitations on crowdfunding. First, individuals' annual investments are limited based on "monetary thresholds." Specifically, investors with less than $100,000 in annual income or net worth can invest up to the greater of

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16 Bader, supra note 12, at 3.
17 JOBS Act § 302(a), 126 Stat. 315.
19 See id.
20 Id. at 2.
21 Id. (citing JOBS Act § 302(a), 126 Stat. 315).
$2,000 dollars or 5 percent of their annual income or net worth.\(^{22}\) Investors with more than $100,000 in annual income or net worth may invest up to 10 percent of their annual income or net worth, subject to a $100,000 maximum investment.\(^{23}\)

Second, crowdfunding must be effectuated through crowdfunding intermediaries, such as registered brokers or "funding portals."\(^{24}\) Funding portals, which the JOBS Act created, are broker-like intermediaries.\(^{25}\) These intermediaries facilitate crowdfunding by allowing investors to contribute funds in return for nominal gifts or equity.\(^{26}\) These intermediaries also display information relating to those startup companies seeking funds.\(^{27}\) The JOBS Act exempts crowdfunding portals from broker-dealer registration and the fees, disclosure requirements, and rules triggered by this registration.\(^{28}\) Notwithstanding this exemption, crowdfunding portals are required to register with the SEC and any self-regulatory organizations (such as the Financial Industry Regulatory Authority, or FINRA).\(^{29}\) Upon registering as funding portals, these intermediaries are subject to certain limitations prescribed by the Act and must comply with a number of disclosure and due diligence requirements.\(^{30}\) These requirements are directed at ensuring that potential investors understand the risks that come along with crowdfunding investments, generally, and the companies listed by the intermediaries, specifically.\(^{31}\)

Third, startup company issuers must disclose certain information to the SEC, crowdfunding intermediaries, and potential investors.\(^{32}\)

\(^{22}\) Powers, supra note 18, at 2 (citing JOBS Act § 302(a), 126 Stat. 315).
\(^{23}\) Id. (citing JOBS Act § 302(a), 126 Stat. 315).
\(^{24}\) JOBS Act § 302(a)(6)(C), 126 Stat. 315.
\(^{25}\) Powers, supra note 18, at 1.
\(^{26}\) Id.
\(^{27}\) Id.
\(^{29}\) JOBS Act § 302(b), 126 Stat. 315-17.
\(^{30}\) Id. at 126 Stat. 316-17.
\(^{31}\) Powers, supra note 18, at 3.
\(^{32}\) JOBS Act § 302(b), 126 Stat. 317-18. Disclosures include, without limitation:

1. Name, legal status, address and website of the issuer;
2. Names of officers, directors and 20 percent holders of the issuer;
3. Business of the issuer and anticipated business plan;
4. Description of the financial condition of the issuer, with financial information and financial statements that vary based upon the target offering amount (combined with other offerings of the issuer under the exemption within the preceding 12 months);
5. Use of proceeds;
Finally, issuers utilizing crowdfunding may only direct investors to crowdfunding intermediaries; they may not advertise the terms of their offering.33

The JOBS Act mandates that the SEC adopt rules implementing the crowdfunding exemption by December 31, 2012.34 Startup companies, brokers, and prospective funding portals may not rely on the exemption until the SEC adopts these rules.35 Notably, there are websites, such as Kickstarter.com, which currently operate as crowdfunding intermediaries, but have avoided broker-dealer registration.36 They have done so by either prohibiting investors from receiving an equity interest in the companies listed on their websites, by not charging service fees, or by not recommending investments in listed companies.37

The JOBS Act requires that self-regulatory organizations create a separate set of rules to regulate funding portals.38 The SEC and FINRA have requested public comment on their proposed crowdfunding intermediary rules.39 As of the time this Article is being written, however, the SEC has proposed but not yet promulgated rules to implement the crowdfunding exemption.40

6. [T]he target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount (This formulation implies that every offering must have a target offering amount).

7. Price to the public or method for determining price, providing that prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;

8. A description of the ownership and capital structure of the issuer, including (very generally and without limitation) the terms of the securities, description of how the exercise of rights held by principal shareholders of the issuer could negatively impact the investors, the name of 20 percent holders, valuation methods, and risks to purchasers of a minority investment in the issuer.


33Wolff, supra note 32.

34JOBS Act § 302(c), 126 Stat. 320.


37Powers, supra note 18, at 2.

38JOBS Act § 304(b), 126 Stat. 322.

39Powers, supra note 18, at 3.

B. "Access to Capital for Job Creators"

Although several JOBS Act provisions are directed at making it more desirable to go public, Title II provides an incentive to stay private. Title II of the JOBS Act, titled "Access to Capital for Job Creators," substantially changes private offerings under SEC Rules 506 and 144A.41 This change arguably represents a legislative response to practitioners' criticisms about private offering rules, particularly their ban on general solicitation.42

Rule 506 of Regulation D exempts private offerings from registration under the '33 Act.43 However beneficial this exemption has been, its use has been limited due to its prohibition of general solicitation and advertising in connection with the offerings it exempts.44 Violators of this general solicitation and advertising ban are subject to a "cooling off period"—meaning they cannot issue securities for a period of time after the alleged violation.45 This prohibition has been the subject of much criticism over the years, in part because the SEC has broadly interpreted the ban's reach.46 Rule 144A provides a safe-harbor exemption from registration of resale transactions.47 This exemption, however, is limited to securities sold to a purchaser that the seller reasonably believes is a "qualified institutional buyer."48

Title II of the JOBS Act substantially changes Rules 506 and 144A by requiring the SEC to promulgate rules lifting the general solicitation and advertising prohibition in the private offerings context.49 Specifically, section 201(a) of the Act allows general solicitation and advertising in connection with private offerings, so long as these offerings are made to accredited investors.50 The issuer, however, is required to take "reasonable steps" to confirm that the potential investor is an "accredited investor."51 Similarly, section 201(a) expands Rule

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41Wolff, supra note 32 (citing 17 C.F.R. §§ 230.506, 230.144A (2013)).
42Id. at 2.
44Bader, supra note 12, at 2.
45Wolff, supra note 32.
46Id.
48Id.
49JOBS Act Title II (§ 201 et. seq.), 126 Stat 313-15.
50JOBS Act § 201(a)(1), 126 Stat. 313.
51Id.
144A's reach by exempting resales of securities, even through general solicitation and advertising, to purchasers who are not qualified institutional buyers.\textsuperscript{52} The seller must reasonably believe, however, that the purchasers are qualified institutional buyers.\textsuperscript{53}

The changes made by Title II of the JOBS Act were not effective until the SEC adopted rules implementing them.\textsuperscript{54} Although the SEC did not do so within the Act's deadline of ninety days from enactment (\textit{i.e.}, July 4, 2012),\textsuperscript{55} it issued proposed rules on August 29, 2012,\textsuperscript{56} and adopted final rules on July 13, 2013.\textsuperscript{57} As adopted, those rules reflect a combination of flexibility and specificity with regard to what "reasonable steps" an issuer must take to confirm "accredited investor" status of persons purchasing securities in the exempt offering: on one hand, the final rules preserve open-ended authority for issuers to take steps that are "reasonable" in the circumstances; on the other hand, the final rules supply "a non-exclusive list of methods that issuers may use to satisfy the verification requirement for purchasers who are natural persons."\textsuperscript{58} Those non-exclusive methods include:

- Review of the purchaser’s income tax returns for the two most recent years, and "obtaining a written representation by the purchaser that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year;"

- Review of bank statements, brokerage statements, certificates of deposit, and independent appraisal reports, with respect to assets, and a report from a consumer reporting agency, with respect to liabilities; and

- Receipt of a written confirmation from a broker-dealer, registered investment adviser, attorney, or certified public accountant that

\textsuperscript{52}JOBS Act § 201(a)(2), 126 Stat. 314.
\textsuperscript{53}Id.
\textsuperscript{54}Wolff, \textit{supra} note 32.
\textsuperscript{55}Id.
\textsuperscript{58}Id.
“such person has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor.” 59

Simultaneously with adopting these final rules, and in light of the widely shared view that elimination of the prohibition against general solicitation is likely to have a significant impact on the market for private securities offerings, the SEC also proposed other rules that would elicit additional information in connection with such offerings. 60 Specifically, the proposed rules contemplate a variety of additional requirements, including:

- The filing of Form D at least 15 days in advance of use of general solicitation in an offering under new Rule 506(c);
- Inclusion of a legend in all written general solicitation materials, alerting recipients that, among other things, the securities may only be sold to accredited investors;
- At least temporarily, the filing of written general solicitation materials with the SEC, albeit on a non-public basis. 61

C. Changes in the Reporting Threshold

Before the JOBS Act was enacted, section 12(g) of the Securities Exchange Act of 1934 (the ’34 Act) required a company with a class of equity securities held by 500 or more shareholders of record and having more than $10 million in assets to register with the SEC and become a reporting company. 62 The risk of this five hundred shareholder threshold

61 Proposed Reg D Rules, supra note 60 (setting forth proposed new Rules 509 and 510T, and amendments to Rules 503 and 507).
62 17 C.F.R. § 240.12g-1 (2013).
was that a company could become a publicly reporting company earlier than it anticipated. The JOBS Act purports to mitigate this risk by raising the shareholder threshold. For most companies, the Act raises the shareholder threshold to the lesser of 2,000 shareholders of record or 500 nonaccredited investors. The Act excludes from the count of shareholders of record employees who receive shares as part of a compensation plan. The same applies for persons whose shares are procured through crowdfunding. The revised numerical shareholder thresholds are currently in effect and the SEC has issued answers to frequently asked questions pertaining to this provision.

D. Relief for Emerging Growth Companies—The IPO On-Ramp

Arguably in response to a significant decline in the number of United States IPOs, Title I of the JOBS Act amends the '33 Act and '34 Act to provide relief for Emerging Growth Companies ("EGCs") seeking to go public. An EGC is an issuer with annual gross revenues of less than one billion dollars during its most recently completed fiscal year. This amount is to be adjusted every five years for inflation. An issuer retains its EGC status until the earliest of the following events: (1) the last day of the fiscal year after the five-year anniversary of its IPO; (2) its total annual revenue exceeds one billion dollars; (3) the EGC issues, over a three year period, one billion dollars in nonconvertible debt; or (4) it becomes a "large accelerated filer"—that is, its equity securities held by non-affiliates are cumulatively worth seven hundred million dollars or more.

The relief the JOBS Act provides EGCs, which took effect upon the Act's enactment, is referred to as the "IPO On-Ramp." It is estimated that approximately 90 percent of all companies going public

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64JOBS Act § 501.
65*Id.*
66Pollner, *supra* note 63, at *6 (citations omitted).
67*Id.*; JOBS Act § 303(a) (adding '34 Act § 12(g)(6)).
69Bader, *supra* note 12.
70JOBS Act Title I.
71Bader, *supra* note 12.
72Pollner, *supra* note 63, at *1.
73Bader, *supra* note 12.
74Id. at *6.
75*Id.* at *1.
will be termed EGCs and, therefore, entitled to IPO On-Ramp benefits. The Federalist Society's panelists discussed four noteworthy IPO On-Ramp benefits. One such benefit is sometimes referred to as the "testing the waters" provision. The JOBS Act amends section 5 of the '33 Act by allowing EGCs, and their underwriters, "to make oral and written offers to qualified institutional buyers and institutional accredited investors both before and after the EGC files its registration statement." The purpose of allowing these communications is to allow EGCs to gauge investor interest before expending the high cost of conducting an IPO.

Second, the JOBS Act allows EGCs to submit drafts of their IPO registration statements and amendments to the SEC for confidential review. The Act requires, however, that all confidentially submitted drafts and amendments be publicly filed at least twenty-one days before the EGC's traditional IPO "roadshow." The purpose of this confidential review is to allow EGCs to start the strenuous SEC review process without facing public scrutiny (including disclosing commercially sensitive information), before the EGCs are confident that they will be able to successfully complete their IPOs.

The third noteworthy benefit comes in the form of relaxed financial disclosure requirements. Under the Act, EGCs are only required to disclose two, rather than three, years of financial statements in their IPO registration statements. EGCs are also exempt from Sarbanes Oxley's requirement to provide auditor attestation of internal control over financial reporting. EGCs are further entitled to reduced executive-compensation disclosures, and relief from Public Company Accounting Oversight Board requirements.

The last notable IPO On-Ramp benefit is directed at easing
securities analysts' ability to publish research on the EGCs they analyze. Specifically, the JOBS Act amends the '33 Act, allowing investment banks (even those participating as underwriters) to publish their reports on an EGC both before and after an EGC's IPO. Due to concerns over potential liability, however, it is difficult to determine whether investment banks will make use of this benefit.

II. PANELIST DISCUSSION OVERVIEW

A. Crowdfunding—Discussion by Professor Robert T. Miller

Professor Robert T. Miller, discussing the crowdfunding exemption, begins his commentary by referencing Puzzlebox Orbit, a company that successfully raised startup capital on Kickstarter. Puzzlebox Orbit only sought to raise $10,000 for its project but, with the help of Kickstarter, was offered $14,000. Professor Miller commends Kickstarter, and other crowdfunders for assisting capital formation by startup companies such as Puzzlebox Orbit. He notes that it would be futile for small companies to publicly offer their securities due to the high cost of going public. Notably, in order to avoid registration, Puzzlebox Orbit was unable to offer investors ownership in its company. Rather, Puzzlebox Orbit gave nominal gifts in return for invested funds. Professor Miller asserts that, by allowing companies to offer its stock in exchange for funds, the JOBS Act creates "a viable funding tool for small businesses." Because the SEC has not yet implemented disclosure regulations, however, Professor Miller fears that the SEC can conceivably weaken this potentially valuable funding tool by mandating unnecessarily prolix (and, therefore, expensive) disclosures.

Professor Miller recognizes, however, the danger of minimal
disclosures, terming this danger "crowdfrauding." According to Professor Miller, the SEC has a justifiable incentive to be concerned with minimizing fraud. Notwithstanding this incentive, Professor Miller asserts that fraud in the crowdfunding market is not problematic for a number of reasons. Specifically, the economic theory supports the proposition that crowdfunding portals have the "strongest incentive" to eradicate fraud. Professor Miller notes that currently existing crowdfunding portals, which are not operational until the SEC implements necessary regulations, are already taking measures to stamp out fraud. For example, "Wefunder.com" conducts background checks and other market checks of the individuals listing securities on their portal. Wefunder also requires individuals to link their securities offerings to their Facebook page. As a result, an individual's entire Facebook network will be made aware if the individual commits "crowdfraud."

B. "Access to Capital for Job Creators" —Discussion by Joanne Medero

Joanne Medero is a proponent of the JOBS Act's provisions that lift the ban on general solicitation and advertising in certain contexts. This provision, according to Medero, allows companies to be more responsive to investors by permitting companies to better explain their businesses without running the risk of being prohibited from engaging in private placements.

Medero notes that lifting the ban on general solicitation and advertising represents a major culture shock for the SEC and FINRA. This is because the two agencies have taken an expansive view on what constitutes solicitation and advertising. Medero argues that the broad interpretation of these terms has resulted in numerous purportedly

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100 Id.
101 Id.
102 Id. at 483-84.
103 Federalist Society Transcript, supra note 91, at 483-84.
104 Id.
105 Id.
106 Id. at 485-84.
107 See Federalist Society Transcript, supra note 91, at 483-84.
108 Id. at 485-88.
109 Id. at 485-86.
110 Id.
111 Federalist Society Transcript, supra note 91, at 485-87.
112 Id.
inadvertent actions falling within their definitions. Although Medero concedes that broadly interpreting these terms discourages fraud, she argues that issuers frequently worry about accidentally tripping over SEC rules when speaking to the public. According to Medero, broadly defining these terms does not make sense because "real" harm only occurs when securities are actually purchased, which is where the SEC should focus its limited resources.

Medero notes that the SEC’s August 29, 2012 proposed regulations track the statute and legislative intent. She further observes that several interest groups, such as consumer protection agencies, have opposed the SEC’s proposed regulations. Medero questions these interest groups' motivations, deeming them paternalistic and disingenuous.

C. Changes in the Reporting Threshold—Discussion by Professor Robert Thompson

Professor Robert B. Thompson notes that a fourfold increase in the record shareholder threshold before a company must enter the ’34 Act periodic reporting system seemingly represents a substantial deregulatory change. He notes that there are three ways a company's ’34 Act obligations can be triggered. The first occurs when a company makes a registered public offering. The second trigger manifests when the company is listed on a stock exchange. The third arises if and when the company attains 2,000 shareholders and $10 million in assets. In light of these triggers, Professor Thompson submits that only a small handful of companies will actually use the added shareholder threshold increase.

But Professor Thompson then predicts changes to capital-raising practice—changes that result in "[d]eregulatory securities nirvana." He
asserts that companies will avoid regulation by conducting an initial issuance, pursuant to Rule 506 of Regulation D, to accredited investors, such as venture capital and private equity firms. Then, Professor Thompson suggests that resales will occur without public registration and in accordance with Rule 144. And the practice of street name registration means that it will be rare to reach the level of 2,000 shareholders of record necessary to trigger '34 Act reporting obligations. This deregulatory result, Professor Thompson argues, brings our nation back to pre-1964, when a number of companies traded shares in the secondary markets with no disclosure.

D. Relief for Emerging Growth Companies—Discussion by Joseph Kaufman

Joseph Kaufman discusses four of the JOBS Act provisions that help EGCs in the IPO process. First, Kaufman notes that the goal of the "testing the waters" provision is to help EGCs determine whether it would be beneficial to bear the costs of going public. Although Kaufman agrees with the theory underlying this provision, he questions this provision's practical utility. Based on the feedback he has received, Kaufman contends that institutional investors are less inclined to engage in theoretical discussion; they would rather be approached when companies actually conduct their IPO. Next, Kaufman argues that the confidential review process will likely be the most beneficial JOBS Act provision in the long term. Kaufman submits that this provision shortens the time a company's IPO filing is publicly available (and, therefore, subject to public scrutiny). It also allows a company to wait until market conditions strengthen before going public.

Third, Kaufman indicates that the Act's provision permitting reduced disclosures in EGC's IPO prospectuses has not been greatly used to date. This is because most companies have already prepared their

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126 Id.
127 Federalist Society Transcript, supra note 91, at 490-91.
128 Id. at 489-91.
129 Id. at 492-97.
130 Id. at 492-93.
131 Federalist Society Transcript, supra note 91, at 493-94.
132 Id. at 493-94.
133 Id.
134 See id.
135 Federalist Society Transcript, supra note 91, at 493-94.
136 Id.
137 Id.
disclosures. He further submits that lifting the internal controls certification requirement for EGCs is "very helpful" to these companies. Finally, Kaufman notes that analysts have been reluctant to release their reports—as the JOBS Act now authorizes—due to liability concerns.

Kaufman agrees that the Act's provisions are helpful to EGCs and would push for an extension of these provisions to larger companies. He warns that, although the JOBS Act has reduced the cost of going public for EGCs, Congress continues to promulgate requirements that increase the cost of staying public—such as the Conflict Minerals Rule.

E. What is Going on at the Commission?—Discussion by Hon. Daniel M. Gallagher

In addition to responding to the other panelists' comments, SEC Commissioner Daniel M. Gallagher discusses the steps the Commission had taken to implement the JOBS Act as of the convention's date, November 15, 2012. Gallagher recognizes that the Act's deadlines have passed; however, he indicates that the SEC wants to ensure that it completes the rulemaking correctly. Gallagher notes, for example, that although the general solicitation provisions are seemingly the least complicated, these rules will be extremely complicated when finished. Reluctantly, Gallagher indicates that the SEC's priority is not on the JOBS Act; rather, the SEC is currently working on the Dodd-Frank rulemakings, of which the SEC has completed roughly 30 percent. Gallagher, along with several others at the Commission, is pushing to make the JOBS Act a greater priority for two reasons. First, Gallagher submits that he wants to effectuate Congress' intent—i.e., to create more

138 Id.
139 Federalist Society Transcript, supra note 91, at 493-94.
140 Id. at 494-95.
141 Id. at 495-96.
142 Id.
143 Federalist Society Transcript, supra note 91, at 495-97.
144 Id. at 497-502.
145 Id.
146 Id. at 498-99.
147 Federalist Society Transcript, supra note 91, at 499-500.
148 Id. at 500-01.
jobs by easing access to capital.\(^{149}\) Second, and most important to Gallagher, he wants our nation to regain its competitive edge in the financial markets.\(^{150}\) Gallagher argues that, on a global scale, the United States is being outpaced in IPOs, which is a strong indicator of capital market health.\(^{151}\) He warns that if this nation maintains an atmosphere of hostility towards IPOs or private funding, it will slowly see capital and human talent migrate overseas.\(^{152}\)

### III. COMMENTARY ON THE JOBS ACT AND THE PANELIST DISCUSSION

#### A. Crowdfunding

The JOBS Act's crowdfunding exemption offers an attractive mix of financial populism and deregulatory philosophy. We suspect, however, that the crowdfunding exemption will be underused and, therefore, may in the end not justify the expenditure of SEC and FINRA resources needed to create the system for regulating and overseeing crowdfunding.

A few months after the JOBS Act's passage, Pepperdine University conducted a study that found only 3 percent of business owners believe the JOBS Act's crowdfunding provision will increase their likelihood of raising capital.\(^{153}\) This inevitably invites a question: if so few business owners feel the crowdfunding exemption will increase their capital raising ability, do the costs attributed to this exemption outweigh its benefits? Although investors should have the right to invest in risky startups (if properly informed), and startups should certainly have access to these funds, the costs of creating the structure to regulate and monitor crowdfunding may outweigh its benefits.\(^{154}\)

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\(^{149}\) Id.

\(^{150}\) Id.

\(^{151}\) Federalist Society Transcript, supra note 91, at 500-01.

\(^{152}\) Id.


\(^{154}\) See Bader, supra note 12.
The benefits are obvious as a conceptual matter: crowdfunding could provide small entrepreneurs a quick and inexpensive capital-raising tool. Logically flowing from an increase in capital is job creation—the purpose underlying the JOBS Act’s enactment. A few companies, like Puzzlebox Orbit, have already benefitted tremendously from crowdfunding-like portals such as Kickstarter.

The JOBS Act, however, imposes a number of costly rules on crowdfunding. As detailed above, the Act, among other things, establishes constraints on investors and requires crowdfunding intermediaries and startups to comply with disclosure and due diligence obligations. It is axiomatic that with these compliance costs come oversight costs imposed directly on the SEC, FINRA, and crowdfunding intermediaries. Additionally, the JOBS Act gives investors a private right of action against issuers and certain others for fraud attributable to crowdfunded offerings.

The JOBS Act also mandates that the SEC adopt rules implementing this exemption. These mandates are necessary because companies using crowdfunding will be capable of reaching less sophisticated investors. Although Professor Miller correctly notes that the SEC could eliminate this capital raising tool’s viability by imposing overly restrictive (and, therefore, overly costly) rules, the SEC must keep investor protection at the forefront. This is especially imperative

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155Powers, supra note 18, at *1.
156Jumpstart, supra note 10.
157Federalist Society Transcript, supra note 91, at 481-82; Powers, supra note 18, at *1-*2.
158Bader, supra note 12.
159Id.
160Constance Gutske, Crowd-Funded Investing: Risky for Joe Six-Pack?, FOX BUSINESS (April 18, 2013), http://www.foxbusiness.com/personal-finance/2013/04/17/crowd-funded-investing-risky-for-joe-six-pack/ (last visited August 28, 2013) (noting that the SEC must review offering documents but expressing the belief of another commentator that there are "zero" SEC resources to police crowdfunded offerings).
161Wolff, supra note 32 (citing JOBS Act § 302(b), adding § 4A(c) to the '33 Act).
162See id. (citing JOBS Act § 302(c)).
163Bader, supra note 12.
164See Federalist Society Transcript, supra note 91, at 481-82; see also Hearing, supra note 153, at 58 (statement of Prof. John C. Coffee, Jr.) (noting that brokers may avoid crowdfunding altogether because the SEC is required to develop mandated disclosures and procedures for each step of the crowdfunding process).
165As noted by the SEC’s new chairman, Mary Jo White, "[i]f you don’t pay sufficient attention to them [investor protection concerns] the investing public won’t have sufficient confidence in an enterprise to invest in it and provide capital . . . ." Ronald D. Orol, SEC’s White: Investor Protection Key to JOBS Act, MARKET WATCH (May 01, 2013), http://www.marketwatch.com/story/secs-white-investor-protection-key-to-jobs-act-2013-05-01
in these economically turbulent times when investor confidence is dwindling.\textsuperscript{166} Although not yet promulgated, the SEC's rules will likely impose additional costs on businesses using the crowdfunding exemption.\textsuperscript{167} For example, the Act obligates the SEC, at virtually each step of the crowdfunding process, to develop required disclosures and procedures.\textsuperscript{168} Specifically, the Act mandates that the SEC adopt rules to make clear that investors understand they are risking the loss of their entire investment.\textsuperscript{169} This "red flag" to investors will undeniably cost startups business and may be one reason why so few business owners feel the JOBS Act will prove beneficial. There will also be increased litigation costs to the extent that plaintiffs challenge offerings that fail to comply with the new rules.\textsuperscript{170}

Although we agree with Professor Miller's assessment of economic theory (that funding portals have the strongest incentive to eradicate fraud),\textsuperscript{171} we must discount this position given the realities of crowdfunding. The crowdfunding exemption is directed at small startup companies.\textsuperscript{172} As noted by a number of commentators, these small startups generally lack access to venture capital funds, underwriters, broker-dealers, and legal counsel necessary to help them comply with the JOBS Act's rules and regulations.\textsuperscript{173} Further, we must recognize that most small businesses fail—a fact that is particularly noteworthy considering the startups that will likely utilize crowdfunding are generally riskier than other startups (as evidenced by their inability to

(last visited August 28, 2013). The SEC’s description of the crowdfunding rules it has proposed succinctly summarizes the tension between facilitating raising capital by crowdfunding, on one hand, and protection of investors, on the other: Rules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses.

Crowdfunding Release, supra note 40, at 13.

\textsuperscript{166}See Hearing, supra note 153, 47-49 (statement of Prof. John C. Coffee, Jr.) ("The greatest enemy of job creation today is not overregulation, but the loss of investor confidence.").

\textsuperscript{167}Bader, supra note 12.

\textsuperscript{168}Hearing, supra note 153, at 58 (statement of Prof. John C. Coffee, Jr.).

\textsuperscript{169}Wolff, supra note 32 (emphasis added).

\textsuperscript{170}See Bader, supra note 12.

\textsuperscript{171}Federalist Society Transcript, supra note 91, at 483-84.

\textsuperscript{172}Powers, supra note 18, at 1.

\textsuperscript{173}See, e.g., Hearing, supra note 153, at 58, 61 (statement of Prof. John C. Coffee, Jr.) ("The required disclosures . . . appear likely to chill most issuers from relying on this exemption."); see also Gutske, supra note 160 ("Regulators also worry that many crowd-funded companies may be the weakest of startups, since they couldn't get funding elsewhere. They may have shopped around for funding venues, such as venture capitalists, angel investors or banks, and were turned down . . . ").
obtain traditional investment funds). Thus, crowdfunding risks might be so great that investors (whose confidence in the markets is already flagging) will not invest in these startups notwithstanding future (and past) efforts by crowdfunding intermediaries and the SEC to stamp out fraud.

In light of the foregoing, we assert that, although conceivably a viable capital raising device, crowdfunding seems unlikely to offer a reliable source of capital for most businesses. Because we anticipate that crowdfunding will be used sparingly, SEC and FINRA resources used to implement and, once implemented, regulate and oversee crowdfunding will be spent without a significant social and economic return on investment.

B. Access to Capital for Job Creators

In regards to the elimination of the general solicitation ban, we agree with Joanne Medero, and applaud the SEC’s adoption of final rules implementing that elimination. By lifting the ban on general solicitation, the SEC has eliminated a source of persistent uncertainty and impediment to legitimate capital raising. Moreover, the SEC improved upon what Congress adopted in this area. The JOBS Act left open the question of what constitutes "reasonable steps" that a business must take to confirm it is soliciting only accredited investors. In its final rules, however, the SEC has supplied useful clarity by articulating a non-exclusive list of specific steps an issuer can take to satisfy its obligation to determine whether purchasers in offerings under new Rule 506(c) are "accredited."

174 See Deborah Gage, The Venture Capital Secret: 3 Out of 4 Start-Ups Fail, WALL STREET JOURNAL (Sep. 19, 2012), http://online.wsj.com/article/SB10000872396390443720204578004980476429190.html (last visited August 29, 2013) ("Overall, nonventure-backed companies fail more often than venture-backed companies in the first four years of existence, typically because they don't have the capital to keep going if the business model doesn't work . . . ."); Nate C. Hindman, Three Out Of Four Startups Fail: Report, HUFFINGTON POST (Sep. 9, 2012), http://www.huffingtonpost.com/2012/09/21/your-startup-will-probably-fail_n_1904919.html (last visited August 29, 2013) ("About three out of four new firms that take venture capital fail to deliver projected returns. . . ."); Charlene Jimenez, Why 11 Out of Every 12 Startups Fail (Apr. 26, 2012), http://agbeat.com/entrepreneur/why-11-out-of-every-12-startups-fails/ (last visited August 29, 2013) (stating that, "only one in twelve startups actually succeeds"); Gutske, supra note 160 ("More than half of all small businesses fail,' says Bob Webster, a spokesman for the North American Securities Administrators Association. 'Going into a crowd-funded investment, assume that it, too, will fail.").

175 Hearing, supra note 153, at 53 (statement of Prof. John C. Coffee, Jr.).
The controversy over exempt private offerings is hardly over, however. As former SEC Commissioner Elisse B. Walter noted, by the end of the comment period on the proposed rules, more than two hundred and twenty comment letters were submitted. She noted that "[c]ommentators were sharply divided in their views." A number of the commentators, such as the Chamber of Commerce, expressed general support for the proposal, touting it as a capital-formation device. Commentators in opposition to the SEC's proposal generally expressed consumer protection concerns—indicating that, if the proposal was adopted it "would result in an increase in fraudulent securities offerings . . . ." These commentators, which primarily consisted of consumer protection groups, urged the SEC to consider additional safeguards to alleviate their concerns.

So even as the SEC has conditionally eliminated the ban on general solicitation, it has continued the controversy with its proposed rules strengthening disclosures in connection with offerings exempt under new Rule 506(c). As the SEC considers those new proposed rules, we hope and expect that it will remain cognizant of at least two factors as it continues to implement Title II of the JOBS Act. First, imposing too many requirements on companies will vitiate the utility of the JOBS Act's reform. Second, with the clear majority of U.S. equity held by accredited investors, the chances of a company's general solicitation or advertisement reaching, let alone causing significant damage to, non-accredited investors is relatively low. Concerns about fraud, and the allocation of regulatory resources, ought to focus on those who suffer actual harm from the purchase of securities. On the other hand, we encourage the SEC to respond to consumer protection concerns by

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177 Id.
178 Id.
179 Id.
181 Id.
182 See Federalist Society Transcript, supra note 91, at 483-84; see also Hearing, supra note 153, at 58 (statement of Prof. John C. Coffee, Jr.).
moving forward, as it has undertaken to do, with a comprehensive review of the definition of who an "accredited investor" is.184

C. Changes in the Reporting Threshold

Increasing the '34 Act's shareholder threshold (which requires a company to register with the SEC) to 2,000 shareholders of record or 500 nonaccredited investors is extremely problematic for two reasons.185 First, this amendment allows a potentially vast number of companies to avoid periodic reporting requirements, thereby creating breeding grounds for effectuating fraud. The Act provides a fourfold increase in the shareholder threshold and, alarmingly, retains a "shareholders of record" standard.186 Under this standard, a single nominee holding shares for several investors will be counted as one record holder.187 Further exacerbating the problem of too many companies avoiding registration requirements, the JOBS Act excludes persons whose securities are received through use of the crowdfunding exemption, and those receiving shares pursuant to certain employee compensation plans.188 Accordingly, these exclusions allow a number of shareholders to avoid being counted for the shareholder of record determination.189 By enabling an excessive number of companies to remain private, and therefore trade on pink sheets, the JOBS Act undermines the very purpose underlying the '34 Act—protecting investors through disclosure.190

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184Proposed Reg D Rules, supra note 60, at 44829-44830.
185Bader, supra note 12 (citing JOBS Act.).
186Pollner, supra note 63, at *6; Federalist Society Transcript, supra note 91, at 489.
188Wolff, supra note 32 (citing JOBS Act §§ 502, 303).
189Id.
190Bloomenthal & Wolff, supra note 187. Discussing the purpose of the '34 Act, Bloomenthal & Wolff inform:

The keystone of the entire structure of Federal securities legislation is disclosure . . . . Because too little was known about the over-the-counter market in 1934 to enable Congress feasibly to devise provisions as specific as those relating to listed securities, it resorted in the original section 15 of the [34] Act to a grant to the Commission of rulemaking power in relation to the over-the-counter market. In doing so it expressly declared its purpose to be "to insure" to investors in over-the-counter securities "protection comparable" to that provided investors in listed securities. The sanctions made available, however, proved inadequate and as a result there are currently vast differences in the degree of investor protection in the two markets.
Second, as a practical matter, this increase creates an onerous burden on corporations charged with determining whether they have over 2,000 shareholders of record and how many shareholders are nonaccredited.191 Shares trade on a daily basis and, as indicated by Professor Robert Thompson and other commentators, shares issued to accredited investors in private placements can be resold to nonaccredited investors.192 Further, as discussed above, the Act excludes persons receiving securities through certain employee compensation plans and crowdfunding.193 What's more, the JOBS Act does not specify when and how often corporations must make these factual determinations.194 The Act also fails to inform whether (and to what extent) corporations can rely on their stock ledgers to reach these conclusions.195 It seems likely, however, that the stock ledger would hardly suffice to supply the requisite data concerning even a record shareholder’s accredited status, let alone data that would permit a determination about the status of a nominee for multiple beneficial owners.

D. Relief for Emerging Growth Companies

Providing relief to EGCs is a step in the right direction. Unlike the provision increasing the shareholder threshold, the IPO On-Ramp encourages businesses to go public by removing many of the disproportionately high costs small business face when going public.196 While we recognize the importance of disclosure, we submit that Congress struck the right balance in determining which disclosures were (and were not) necessary for EGCs.197 We also commend Congress for


191Hearing, supra note 153, at 62 (statement of Prof. John C. Coffee, Jr.).

192Federalist Society Transcript, supra note 91, at 491; Hearing, supra note 153, at 62 (statement of Prof. John C. Coffee, Jr.).

193Wolff, supra note 32 (citing JOBS Act §§ 502, 303).

194See Hearing, supra note 153, at 62 (statement of Prof. John C. Coffee, Jr.).

195See Shaw v. Agri-Mark, Inc., 663 A.2d 464, 469 (Del. 1995) (recognizing the "the long-established rule that a corporation may rely on its stock ledger in determining which stockholders are eligible to vote . . . ."); Preston v. Allison, 650 A.2d 646, 649 (Del. 1994) ("T]he corporation generally is entitled to rely on its own stock list and recognize votes . . . only when initiated by the stockholder of record."); Berlin v. Emerald Partners, 552 A.2d 482, 494 (Del. 1988) ("Delaware law expressly recognizes the right of the corporation to rely upon record ownership, not beneficial ownership, in determining who is entitled to notice of and to vote at the meetings of stockholders.").

196See Latham & Watkins, supra note 79, at 1-7.

197Id. at 3 (discussing the disclosures eliminated for EGCs through the JOBS Act's IPO On-Ramp).
permitting EGCs to go through a confidential review process prior to filing.\textsuperscript{198} We agree with Joseph Kaufman that this is likely the most beneficial provision because it shortens the time commercially sensitive information is publicly available and enables companies to wait until market conditions peak.\textsuperscript{199} Although few EGCs have taken advantage of these JOBS Act provisions,\textsuperscript{200} we submit that the roughly 90 percent of companies that qualify as EGCs will frequently take advantage of these provisions in the future.\textsuperscript{201}

E. Overall Assessment

Especially in light of the skepticism expressed by the panel members about the utility of the crowdfunding, general solicitation, and reporting threshold provisions of the JOBS Act, and given the lack of success to date in "jumpstarting" U.S. IPOs, there is certainly cause to wonder whether the JOBS Act was well calculated to achieve its stated purpose of promoting capital formation in the interest of U.S. job creation. We look forward to watching, however, as the capital markets and the SEC digest and give effect to this important legislation.

\textsuperscript{198}Id. at 2-3 (discussing the confidential review process).
\textsuperscript{199}Federalist Society Transcript, supra note 91, at 493-94.
\textsuperscript{200}Gabrielle Karol, \textit{Will 2013 Prove the Success of the JOBS Act?}, \textsc{Fox Business} (April. 5, 2013), http://smallbusiness.foxbusiness.com/finance-accounting/2013/04/05/will-2013-prove-success-jobs-act/ (last visited August 29, 2013) (indicating that IPOs are down 21 percent since the JOBS Act's passage and that most companies have not taken advantage of the IPO On-Ramp provisions).
\textsuperscript{201}See Pollner, supra note 63, at *1 (noting that 90 percent or more of all companies going public qualify as EGCs).
JUDGE FRANK EASTERBROOK: The JOBS Act stands for the, quote, "Jumpstart Our Business Startups Act," close quote. Like many a legislative title designed to support a catchy acronym, it's inaccurate in every particular.

[Laughter.]

JUDGE FRANK EASTERBROOK: The legislation isn't limited to startups. It covers trading companies with as many as 2,000 public
investors. And it isn't about jobs. It's about the cost of capital for smaller firms. A firm could produce no jobs at all and still be covered. Political actors care about jobs because people vote, but from the economic standpoint the goal is efficient production, rather than production that requires a lot of labor.

The legislation was enacted last spring with bipartisan support, a real rarity these days. It responds to the fact that existing regulation imposes many fixed costs on public firms. They have to file registration statements with the SEC in order to raise capital. And then, once they're trading, they have to produce quarterly and annual reports. Their financial statements have to be audited in ways that comply with federal standards.

The larger the firm, the more these steps cost. But there are substantial fixed or unavoidable costs no matter how small the firm. Every document must cover prescribed subjects. Printing costs alone can be substantial. And the firm has to pay for hundreds or thousands of hours work by accountants and lawyers.

In the mid-1990s, students of the subject estimated that in order to raise $1 of capital, small firms had to pay about 20 cents for federally required activities. While the largest firms had access to methods such as shelf registration that cost less than 1 cent per dollar raised, large IPOs could be conducted for 10 cents on the dollar or less. That's a huge disadvantage for smaller firms, and the disadvantage continued through the years of periodic reporting that follows initial registration.

The Sarbanes-Oxley Act, enacted a decade ago, raised those costs in response to revelations that accounting firms provided little value and failed to catch flagrant frauds. Congress required—are you ready for this? Congress required that firms purchase additional accounting services.

[Laughter.]

JUDGE FRANK EASTERBROOK: The act doubled or tripled outlays for accounting, which again disfavored smaller firms. The original estimate for the annual cost of complying with one part of the statute, the notorious Section 404, was given by the SEC at $34,000 per firm, and by an accounting board at $91,000 a firm. The actual cost turned out to be in the millions.
The cost has been whittled down over time but, again, it acts as a regressive tax, hitting smaller firms harder per dollar of revenue. The JOBS Act promises some relief. Whether it delivers and whether the benefits are worth the other effects of the changes, is the subject of today's panel. The statute has several parts and the panel won't cover them all, but it's worth a minute or two to tick off a few of the most important.

One, the law increases the number of shareholders a company may have before being required to become a public reporting company that must file periodic reports and satisfy other obligations under the Securities Exchange Act of 1934 and the SEC's regulations. Previously this happened once a company's assets reached $10 million and it had 500 shareholders of record. The new act changes this so that the threshold is reached only if the company has more than 500 unaccredited shareholders, or 2,000 shareholders total.

The act provides a new exemption from the requirement to register public offerings with the SEC. It authorizes Internet funding portals, sometimes called crowdfunding. One condition of the exemption, though, is new regulation sets up a yearly aggregate limit on the amount each person must invest. And that turns out to be a fairly complicated limit.

The act relieves some companies—which it calls "emerging growth companies"—from regulatory and disclosure requirements when they go public and for five years afterward. The most significant of those is Section 404, the Sarbanes-Oxley Act. Previously new issuers had only a two-year phase-in.

The act rescinds the former ban on general solicitation and advertising in particular kinds of private placements of securities, and it raises the limit for securities offerings exempted under Regulation A from $5 million to $50 million. I mean, there are a bunch of other things—and we may discuss some of them, and I bet that we don't discuss all of those I have listed—but that's the general kind of change that we will be discussing today.

And now for a brief introduction of the panel. I'm going to introduce all of them at once. There are longer versions of their bios in the program. I'll introduce them in the order in which the will speak. Each will give a
brief presentation. An exchange among the speakers will follow, and then I'll open it up to discussion from the floor.

Robert Miller is a professor of law at the University of Iowa College of Law. Before entering academia, he was an associate of Wachtell, Lipton, Rosen & Katz in New York. His scholarship concerns corporate and securities law, the economic analysis of law, and the philosophy of law.

Joanne Medero is a managing director at BlackRock, with responsibilities for government relations and public policy. Ms. Medero's service with BlackRock and its predecessor, Barclays Global Investors, dates to 1996. Before that, she was a partner with Orrick, Herrington & Sutcliffe, specializing in derivatives and market regulation. She also has served as general counsel of the Commodity Futures Trading Commission.

Robert Thompson is the Weidenbruch Professor of Business Law at Georgetown, where he specializes in, well, business law, corporate and securities law in particular. He has produced casebooks on corporations and on mergers, treatises on close corporations and limited liability companies, and more than fifty articles.

Joseph Kaufman is a partner at Simpson Thatcher, specializing in corporate and securities law. In 2011, the National Law Journal dubbed him one of the three most influential lawyers in the Finance and Capital Markets category. His law degree is from the University of Chicago. I mention this in a bit of hometown favoritism.

[Laughter.]

JUDGE FRANK EASTERBROOK: Our final speaker is Daniel Gallagher, who has been a commissioner of the Securities and Exchange Commission since last year. For five years before that he had been counsel to two other commissioners, and a senior member of the Division of Trading and Markets. Commissioner Gallagher began his career in private practice, advising clients on broker-dealer regulatory issues, and has had several returns to the private sector, interwoven with stints at the agency.

Professor Miller.
PROFESSOR ROBERT MILLER: So, Title III of the JOBS Act is entitled "Crowdfunding." And if you're like me, which is to say you're over 40 years old, you probably never heard this word except in connection with the JOBS Act. Maybe the first time you heard it was when Judge Easterbrook said it a minute ago.

So what is crowdfunding? Crowdfunding is raising a lot of money on the Internet by taking small amounts from a very large number of people. And even prior to the JOBS Act it existed in certain forms. So if you go on the Internet to a site called Kickstarter, Kickstarter is probably the largest existing crowdfunder.

On Kickstarter, people who create projects, known as "creators" in Kickstarter lingo, find people known as "backers" who want to provide them money. And the projects might be artistic or theatrical or musical or the invention of videogames, or the invention of certain kinds of products, usually high-tech products.

So the featured product on Kickstarter this morning is something called Puzzlebox Orbit. And Puzzlebox Orbit is developing a mind-controlled toy helicopter. I kid you not. It comes with a headset that you put on that reads your brainwaves, which it talks to a laptop computer, which then uses infrared rays to control a toy helicopter. And if you concentrate hard enough, the helicopter lifts up and you can control where it flies around the room. And I know that this works because there's a video on Kickstarter actually demonstrating a working prototype.

And if you like this idea; you approve of mind-controlled helicopters, you can help out Puzzlebox Orbit by giving them some money. They'll take anything from a dollar onwards. If you give them $10, they'll make sure you get thanked in some website of theirs. If you give them a little more they'll send you a t-shirt, which has a stenciled mind-controlled helicopter on it. It's very becoming.

If you send them $89 they'll send you the simplest version of their mind-controlled helicopter when it comes out in commercial production, and they have an estimated date for that. Send them $249 and then you get the deluxe version of the mind-controlled helicopter, which comes with all the paraphernalia, also when it finally comes out in commercial production.
Now, like me—again, if you're over 40 years old—this probably sounds ridiculous to you. Who would pay for this? The answer is Puzzlebox Orbit wanted $10,000 for this project, and already they've received offers to give them $14,000 for this project. They are fully funded. And Kickstarter, in the couple of years that it has existed, has raised more than $350 million from more than 2.5 million people, for 30,000 projects. This works very well apparently.

Now, the one thing you can't get on Kickstarter—what you get are "rewards" in their lingo—the one thing you can't get as a reward is an interest in the company. Now you can't get stocks. You can't get any other kind of securities. And the reason for that is prior to the JOBS Act, Section 5 of the Securities Act basically prohibited you from doing this. Section 5 says, as most of you know, that it is illegal to sell securities in interstate commerce unless you either register the sale with the Securities and Exchange Commission, or else qualify for one of the many exemptions.

And as Judge Easterbrook was just saying, registering with the Securities and Exchange Commission is very expensive. You have to prepare a prospectus. It has to include audited financial statements for the last few years. That's a very, very expensive proposition, clearly takes several million dollars' worth of accounting and legal fees. And if you're like Puzzlebox Orbit and you only want $10,000, this is obviously a nonstarter for you. So you might start asking about the exemptions from the registration requirement. And there are many different ones, and they're very confusing and complex and they overlap in various confusing ways.

So the first thing you would need to do would be hire a securities lawyer to tell you about them, and he's going to end up charging you more than $10,000 too, probably. And even worse, when you finally sort out what all the exemptions mean, the basic theme that runs through all of them is that if you wanted to engage in a general solicitation going out to the world generally and saying, please invest in my mind-controlled helicopter, you had to prepare not a prospectus but something that looks a lot like a prospectus, an offering circular or a private placement memorandum, and that got really expensive too. So if you wanted to build mind-controlled helicopters and you need $10,000 to do it, you are not going to be able to use one of these exemptions either, realistically speaking.
Title III of the JOBS Act changes all that. The basic concept in Title III is that we're going to create a new kind of financial intermediary called a funding portal. The funding portal is the investing analogue of Kickstarter. On the funding portal, people who want to sell securities to the public will first convince the funding portal to list them as an issuer. On the funding portal they'll provide certain information about the securities they want to sell, and potential investors will come and look at the funding portal and look at the vast number of opportunities they will have, and will choose to invest any amount, probably with something like a $100 minimum. That would be up to the funding portal. And you can use your credit card to sign up. If the target funding that the issuer wants is reached, then everybody's credit cards are charged and the deal closes. If the funding target is never reached, then nobody is charged and the deal fails.

Now, the statute itself provides certain limits on this. If you are on the issuer side, you could only raise up to a million dollars every 12 months doing this. So you can't sell loads and loads of securities, only a million dollars every 12 months. If you're on the investor side, there are limits as well. They're somewhat complicated, but the basic idea is that you could only invest 5 [percent] or, if you're wealthy, or 10 percent of your annual income in all crowdfunding issues together, not per issue but total crowdfunding issues. All of your crowdfunding investments together can't exceed 5 [percent] or, if you're wealthy, or 10 percent of your annual income.

Well, what kind of information are you going to get when you look on the crowdfunding site and want to invest? Well, we don't know for sure, but the statute says that, if the offering is under $100,000, which is by far going to most likely be where most of the offers are, the required disclosure will be tax returns from the issuer and some kind of certification from its chief financial officer saying, “these are our financial statements and I certify they are correct.”

For offers between $100,000 and $500,000, you're going to get financial statements that are reviewed by an accountant, but not audited. And exactly what "reviewed" means the commission is going to have to specify by rule. And for offers over $500,000 but less than $1 million, you're going to get audited financial statements. In addition, the statute authorizes the SEC, by implementing regulations, to require whatever other disclosure it thinks is appropriate, and we don't know what that is yet. Those regulations are due out in January.
So the hope is, if you think this is a good idea, that the SEC will not add up so much new disclosure, that the disclosure required for crowdfunding looks like what would go into an offering circular or private placement memo, because if it does that, you've just basically closed down crowdfunding as a viable funding tool for small businesses.

So what's the danger here? Well, the danger here goes under the name of "crowdfrauding," namely securities fraud on the Internet. And you can imagine that the SEC is deeply worried about that. Now, of course the SEC is always worried about fraud. They have institutional incentives not only to be worried about fraud but to be over-worried about fraud. When a large securities fraud occurs, the SEC is blamed, fairly or unfairly—usually unfairly in my opinion—and the people at the SEC get hauled before Congress. The very self-righteous congressmen tell them what a terrible job they did implementing laws that the congress people have never read and don't understand.

And if you work for the SEC you don't want that to happen, so you have strong incentives to make sure fraud doesn't occur. And in fact, you have incentives to even put in over-restrictive laws to make sure fraud doesn't occur, because the harm from that is there's lots of good businesses who can't access the capital markets. But those people are largely invisible. They're not like fraud victims who are beating down your door and complaining to your congressmen.

So how big a problem will fraud be in the crowdfunding market? I'm here to tell you today it's not going to be a big problem at all, and there are several reasons for this. The first is there's all the support in the world in economic theory to think that this is not going to be a large problem. Why? Because what we have in crowdfunding is one person, the crowd portal, the crowdfunding portal, who makes a market between the potential investors and the potential issuers.

The way the crowdfunding portal makes money is it takes a small cut of each deal. It therefore has the strongest incentive to make this market as large as possible so it makes as much money as possible. It therefore has the strongest incentives to stamp out fraud. Why? Because if there's a lot of fraud on a crowdfunding portal, its whole market disappears. Investors don't want to come to that market because they know that all the fraudsters are on that market, and issuers don't want to come to that market because they don't want to be associated with the fraudsters.
either. So you should expect that the crowdfunding portals themselves will do quite a lot to prevent fraud.

That's not just economic theory. It turns out that there is already a crowdfunding portal that's not quite in operation yet because it would be illegal for it to be in operation until those implementing regulations come out, but you can look at a site called Wefunder.com. Wefunder is already in beta, which means that it is taking issuers who want to issue securities and it is taking backers or investors who want to invest in them, and the deals won't close until it becomes legal for the deals to close, hopefully sometime early in 2013.

Are people signing up for this? Yes, actually they are. Backers on Wefunder, more than 10,000 people, have already signed up to invest more than $28 million in 150 businesses. How is Wefunder preventing fraud? They're doing some very traditional things, like they're going out and doing background checks on the people who want to list their securities there, and they're doing some kind of very obvious sort of market checks things as well.

So for example, Wefunder is taking its fee in part in equity in every person who closes a deal on Wefunder. So Wefunder invests alongside the investors on exactly the same terms they get, which of course gives them good incentives to prevent fraud. And they're doing things like if you want to fund on Wefunder, you have to have at least one accredited investor already signed up. This means that some sophisticated person has probably looked over the deal fairly carefully, and in addition, the investors on Wefunder buy in at the same valuation that the accreditor-investor got. So you get some protection on the valuation of the securities.

Even more important than that, Wefunder requires that if you want to raise money on Wefunder, you link your securities offering to your Facebook page.

[Laughter.]

**PROFESSOR ROBERT MILLER:** Now, why is that important? Suppose you live in a really small town. Is it easy to get away with fraud there? No, because if you commit fraud, everybody knows about it and then you're stigmatized and bad things happen to you. Just ask David Petraeus about that kind of stigma.
On Wefunder, if you commit fraud on Wefunder, your whole social network is going to know about it. Your future employers will know about it when they check your Facebook page. That cute girl you met in the bar is going to know about it when you and she "friend" each other on Facebook. Your entire life on Facebook, which occurs in public, is now linked to your securities offering. Those of us who are over 40 and have thought that it's ridiculous that our teenage children live their whole lives in public are right about that in many respects, but there's one good thing about living your life in public: It's very hard to commit securities fraud doing it.

[Laughter.]

PROFESSOR ROBERT MILLER: And if the SEC hasn't figured this out yet, there's a reason for that. They're all over 40. Thank you.

[Laughter.]

[Applause.]

JOANNE MEDERO: Well, I thought I would talk a little bit about Title II of the JOBS Act, which is called "The Access to Capital for Job Creators." And what it does is it mandates the SEC to make rules to lift the prohibition on general solicitation and advertising under the private placement rules, some of you know as 506 or Reg. D. This is one of the exceptions to registration under Section 5, so long as the purchasers are accredited investors. So basically now it would be okay to offer, so long as the sale only occurs to accredited investors.

What the statute said—Congress sometimes imposes deadlines on agencies—asked the SEC to produce final rules 90 days after the passage of the statute, which meant that the rule should have been final by July 4th. Now, I don't think anybody realistically expected that the SEC would move that quickly, but without any deadline at all they may not have moved at all because this is a very big cultural shift for the SEC. Anyway, the deadline was missed but we do have a proposed rule that came out on August 29th, I believe, and that proposal is still out there pending.

Now, why is this such a significant change? Well, the SEC and FINRA, or its predecessor the NASD, which is the self-regulatory organization for broker-dealers, has taken over the years a very expansive view on
what is a solicitation and what is advertising. So for example, if a broker-dealer sends the same letter to 10 or more persons saying, "Gee, you know, we think Microsoft is a good deal," that's advertising. And a solicitation could be something as simple as an issuer being on some kind of media talk show program who mentions the name of their company or, closer to my world, the name of their fund, and what its strategy is. And that would be considered to be a solicitation.

And this is when your compliance people then come to you and say, "Guess what? You cannot make any sale—offers or sales of your fund for a cooling off period." And it's always a very difficult conversation with your business people because they keep saying, "But that makes no sense." And it doesn't, and that's one reason why there was a big effort to change this rule, because really the only harm that can occur, right, is if you actually purchase something. So the fact that you are offered something, or you see an advertisement about something, it should not be any harm, but traditionally the SEC has wanted to regulate offers as well as sales. The statute basically tells them that's what they're supposed to be doing.

Now, for the funds industry, of which I'm a part, what these broad interpretations of solicitation and advertising do also prevents funds—hedge funds, private equity funds—let's think about Bain Capital—actually responding to press inquiries or even correcting misleading information that's out there in the media. Otherwise you're afraid you're going to trip over either the solicitation or advertising rules. So some of the popular view of private funds—hedge funds, private equity funds—is driven from the fact that they actually can't be as transparent as they would like.

Now, the other thing is that—and I think it helped provide some support for the changes in Reg. D that we saw in the JOBS Act—is that there's a number of commentators over the years that have simply said that the SEC should be using its limited resources on policing purchases, and not offers. And again, because that's where the harm can occur.

Now, it's important to understand this is a big cultural shift for the SEC. I don't think anybody else mentioned it, but the JOBS Act moved very rapidly. It had been kind of kicking around the house for a while, and then President Obama, in his State of the Union address, endorsed it. It collected a few more pieces soon after that but actually went and was passed in about a six-week timeframe.
The SEC did not—at least in any visible way—participate in the legislative effort in the House, but when it got to the Senate and it looked like it was going to pass, they got very engaged and opposed it, or at least significant parts of it, including this particular change. And the interesting thing is, is that there's nothing in the statute that said that they couldn't have made some of these changes themselves. And in fact, there was a petition from the funds industry asking them to make this particular change that had been pending at the SEC but they were unwilling culturally to make that move, to make that big shift. So Congress told them that they needed to, on a bipartisan basis.

Now, it may surprise you, given the cultural shift here, that the SEC's rule proposal tracks the statute, and pretty much what I think anyway to be the legislative intent. So you would think that's fine and this is really good news and the agency is taking appropriate direction, which they are. But there's actually a lot of controversy coming up on this rule proposal, and it's coming from consumer and investor protection groups, some of the state securities administrators, and even, believe it or not, one financial services trade group, the Investment Company Institute, and they oppose the rule as proposed.

And because they are concerned about investor protection, they think that lifting the ban needs to have further conditions in order to protect people who receive offers. They are trying to, in my view, hamstring issuers in how they determine whether or not an investor is accredited. There are established practices today and they are seeking to impose, or asking the SEC to impose, more constraints on how one confirms that you have an accredited investor.

They would like to see a change in the accredited investor rules. Even though the SEC has recently reviewed those under Dodd-Frank and has made changes, they would like to see more. And the other subtext in all of this, that comes out is, this fear that less scrupulous issuers will advertise and solicit potential investors, and then not follow through with the rule that says you may only sell to accredited investors. Well, that happens today because if you're going to violate the law, you're going to violate the law. So more rules here I don't think is going to change any of that.

Now, what's motivating investors protection groups I think is what I would consider to be kind of the usual paternalistic motivations—that they
don't think that investors, accredited investors, can manage on their own. They are worried about investors who are not eligible to purchase being confused. And the ICI's objections I think are mostly motivated by competitive concerns because registered investment companies, mutual funds—which is their constituency—are registered and are subject to a lot of rules, just like any other issuer, and a lot of costs. And my conversations with them have always gone along the lines of, well, why don't you try to see what you can get to get your costs reduced rather than imposing costs on other parts of the industry?

Now, in my view, both sets of people who are opposed to the rule as proposed are not actually considering the likely behavior of the issuer. You're not going to see people going out and, you know, running Super Bowl ads saying, buy my hedge fund, because what you're trying to do is gather leads for investors who could actually purchase. And so we think what you're going to see, if you see any general advertising at all, will be very targeted and very trade-specific publications where you're most likely to—you know, where have you spent your money—you're most likely to get something that's useful.

And what this will do is will allow people to be more responsive and be more able to explain their businesses without running a risk that they somehow have made, you know, a solicitation or an advertisement, where their counsel is going to tell them that they can't engage in a private placement for a period of time. Now, it's important to keep in mind that this part of the JOBS Act does nothing about the antifraud provisions, and so if there is fraud in the sale of the securities, all those remedies, including the SEC's enforcement capabilities, are still there. So what we are in the industry hoping for is that the SEC will move to finalize its regulations in pretty much the form as proposed.

Thank you.

[Applause.]

PROFESSOR ROBERT THOMPSON: The JOBS Act is the biggest deregulatory statute in the history of American securities regulation. That's not a high barrier to cross.

[Laughter.]
PROFESSOR ROBERT THOMPSON: But nevertheless, as you've already heard, it's something of a cultural change that Joanne has talked about. There are two entirely new exemptions—crowdfunding, that Robert has already told you about, and another one that will come down the aisle a little bit later called "Regulation A Plus" for under $5 million. That's two new exemptions in which the history—we don't have those very often. We have two new ones in one year. Plus 506, the private placement exemption, which is the most important exemption, is going to grow dramatically because of the changes that Joanne has talked about.

I want to talk about—so those are three on the '33 act. I want to talk about the two big changes on the '34 act. One that I'll just mention is what Judge Easterbrook began with, the "on-ramp." This is letting emerging growth companies have an ease—ease their way onto publicness obligations by letting them exempt the biggest, most expensive ones for the first five years. This will be a dramatic change for the '34 act reporting companies.

The other change also mentioned by Frank was the 12(g) threshold that says, when do you have to take on publicness obligations? You have to do it, as he said, if you have—it used to be 500 shareholders. Now it is 2,000 shareholders. Now, a fourfold increase in the threshold before you have to undertake the obligations of being a reporting company would seem like a large deregulatory change. And had it been in effect a year ago, Facebook may well not have gone public. Think of the pain that would have been saved if that had occurred.

[Laughter.]

PROFESSOR ROBERT THOMPSON: But the change is not as big as it seems because there are three ways into the '34 Act obligations. There are three thresholds, any one of which will trigger your obligation to spend all the money that Frank talked about.

The first is if you make a registered public offering you have to satisfy reporting obligations as a public company. Second, if you're listed on the stock exchange, you have to satisfy reporting obligations. Third, it used to be 500 shareholders, $10 million in assets; now 2,000 shareholders, $10 million in assets, you have to satisfy the '34 act. Any one takes you into the act, so that flipping that, you can only avoid—you can only stay in the deregulated space if you avoid all three.
Now, what does that mean in economic terms? It means that the only time you can use this new space from the JOBS Act is if you can raise needed capital without going public, and if you can get the liquidity for your shareholders without going to the stock exchange, and if you stay under now 2,000 shareholders. Now, who can satisfy all three? Cargill? Koch Industries? But once you get beyond those two, there aren't very many recognizable names.

So the point is, is that most companies can't give up the capital-raising avenue and the liquidity avenue that publicness brings. But that may change. Why? Many of you probably know that venture capital and private equity provides a much larger share of capital raising than it did a generation ago. So we are finding 506s now bigger than the amount raised in private offerings, bigger than the amount raised in IPOs. So the calculus has changed on capital raising.

On liquidity for your shareholders, there are things like SecondMarket and SharesPost. Have you dealt with that at all? Anybody? SecondMarket and SharesPost are platforms that provide a way to trade stock outside of an exchange. Facebook traded in the millions, billions of dollars before it went public. So this is a dramatic change. This means it is possible that, as we go forward the next Facebook, who doesn't want to share information with its competitors, who can get its capital from venture or private equity, who can get liquidity from SharesPost or SecondMarket, will not go public. And so we will have many more companies occupying this non-'34 Act space.

And there's another way out. The 12(g) threshold is phrased as 2,000 record shareholders. Now, if you're older than 40, if you're older—you have to be older than 70 to remember why we have record shareholders. It dates from 1964. That was the criteria, 500 record shareholders. Well, immediately, within five years, we had the back-office crisis on Wall Street and we jettisoned, practically, record shareholders and we went to street name.

And so what it means is once you go public no one has record—no one uses record owners. Everyone is in street name. And that keeps the number of record owners down. What it means: 12(g) will not be a bonding constraint. So what we are looking at is the possibility—not today but in the foreseeable future—that because you can raise capital from venture and private, because you can get liquidity from
SecondMarket and SharesPost, and because you can avoid 2,000 by only counting record shareholders, no one will have to come under the '34 act. That would be an amazing change.

Now, one last point that I want to tie in to the discussion of 506: Lifting the ban on general solicitation, which will come soon, will increase the number of investors who get their shares via a private placement without the disclosure of a registered public offering. So there will be a lot more shares out there for which there has not been disclosure in the first transfer from issuer to investor.

Those investors, employees, others, will then want to resell their shares because we all have change in our life and we need liquidity from time to time. When they resell, they will then come within this deregulated '34 act space. There will be no '34 act disclosure for those people. In this sense this is a return to pre-1964, when we had a large number of companies in which there was regular secondary trading of their shares and there was no disclosure; '64 changed that. We are going back to that point.

Let me just paint one picture, putting the two together. Given that 506 is going to grow and it's already bigger than IPOs, private placement for the raising of capital—and this is to accredited investors. So when you raise money to an accredited investor, there is no mandate disclosure, there is no limit on the amount of money you can raise, there is no limit on sophistication, there is no antifraud provision—12(a)(2) doesn't apply. You get to raise capital in 506 through accredited investors with practically no regulation. That's the initial sale.

Then, when your sellers get ready to resell their shares, because you're under 2,000 and because you haven't registered on a stock exchange and listed on a stock exchange and you haven't done IPO, the resale occurs without any periodic 10-K, 10-Q disclosure for the resale market. The only cost is Rule 144, that I taught just before I came over here, that is incomprehensible to understand but it basically requires you to hold your shares for one year if you're a nonreporting company before you sell. Absent that limitation, this is what we have. You have the initial issuance pursuant to 506, to accredited investors with no regulation, and then you have the resale with no regulation. Deregulatory securities nirvana has arrived.

[Laughter.]
JOSEPH KAUFMAN: Thanks. I'm going to talk about Title I of the JOBS Act, which is, as mentioned, the IPO on-ramp, although, based on the prior speakers, I'm not sure why anybody would want to actually do an IPO with all the exceptions there.

Just a cautionary tale to any of you students out there: Pay attention in class because you never know when, 20 years from now, you'll be giving a presentation on securities regulation with your securities regulation professor sitting right next to you.

JOSEPH KAUFMAN: The good news is what I'm going to talk about is all new regulation, so if I forgot any of the things I learned, they're different.

So in addition to all the wonderful things that the JOBS Act does with respect to private offerings and enabling companies to stay private, there are some substantial provisions that do change the landscape with respect to actually conducting IPOs. To the extent that you qualify as an emerging growth company, there are different tests but the basic standard is if you have less than $1 billion of revenue in your last-completed fiscal year, you're likely going to qualify as an emerging-growth company, and be able to access some very helpful provisions in terms of being able to decide whether or not to proceed with an IPO and then to get the IPO done.

Obviously that billion-dollar threshold is pretty high. It's estimated that probably—certainly the vast majority, probably close to 90 percent of eligible companies to do an IPO, would qualify under that standard, but there are some, such as Facebook and others, that would still stay above, and I may talk a little bit at the end as to whether or not some of these provisions should be extended to the larger companies.

So if you're an emerging-growth company, what are the provisions of the JOBS Act that help you out in terms of an IPO process? Well, there really are four that I'll talk about. One is testing the waters. The second is a confidential SEC review. The third is reduced disclosure in your IPO prospectus. And then, finally, an ease on limits on analysts' reports
for securities analysts that are affiliated with the underwriters and the IPO.

One of the great golden rules of the Securities Act of 1933 was the "gun-jumping" provision that said that you could not engage in any communications with respect to your IPO before a registration statement was on file with the SEC. And then after you have it on file, there are limited communications, certainly with respect to written communications, until you actually launch a road show and have a preliminary prospectus with a price range that's included.

Well, the JOBS Act provisions really throw a lot of that out of the window, and says that if you are an emerging-growth company, before you go on file you can actually have communications with certain institutional investors, and talk about your company and actually have a conversation about valuation and whether or not that investor might be interested in buying your IPO, and the goal being that maybe to get more information about whether investors might be receptive to your IPO, will give a better indication as to whether or not this might be an appropriate time to move forward with the cost and expense of going public.

In theory that's a terrific provision. In practice so far—now, this is Title I. Unlike some of the other provisions of the JOBS Act, Title I is in effect now and some companies have begun to utilize it. But there are still concerns in practice about how much testing of the waters will actually get done. The SEC has requested a connection with any filing that if you do provide any written materials in a testing-the-waters communication, they'd like to review it.

There is always the potential for liability on those materials. And frankly, the feedback so far from institutional investors, are they're a little bit tired of engaging in these theoretical discussions and they really only want to talk to a company when it's time to do a road show and actually get down to business as to how much the stock is actually valued at. But in theory, if a company is on the fence debating whether or not to move forward, that's certainly a possibility you could engage in, a testing-the-water communication.

The second, which I think is probably, long-term, going to be the best provision here, is the confidential review process, which means that you can actually submit your IPO registration statement confidentially with the SEC, and nobody needs to know that you are on file, and work
through the process with the SEC staff of resolving their comments and getting ready to be in a position to actually launch your offering.

You may be aware that currently an IPO process can last three or four months, even in good market conditions, because you file your registration statement; it's public; there's a 30-day waiting period until you get your first round of comments from the SEC. And it can often take two or three months to resolve comments to be in a position actually to launch your offering.

And you're sitting out there for a very long period of time. You've got information that competitors are interested in, and you're really very limited in terms of your ability to actually move forward, or even respond to media inquiries in a very high light. I mean, you can see what happened, for instance, in the Facebook offering. When that IPO was initially filed, actually the SEC's EDGAR system crashed for a few minutes because everybody was racing to review that right away.

Now you can do that confidentially and then 21 days before you're actually looking to launch the road show, you can then do a public filing and it really shortens the period, and it also enables you to get ready to go but not make a decision to come out into the light until it looks like market conditions will be strong, and really shortens the period that you're subject to that scrutiny.

Reduced disclosure. In the IPO prospectus, if you're an emerging-growth company there's certain provisions that say you don't have to provide as much information. A lot of it relates to accounting, that typically you'd have to provide three years of audited financial statements and an additional two years of unaudited or five-year selected period. The JOBS Act says that if you're an emerging-growth company you only have to provide two years, rather than the three or three-plus-two there, which obviously will reduce the costs of being able to do it.

You may have seen, there was an article in the Wall Street Journal today talking about companies who have utilized the JOBS Act provisions to date, and there actually really hasn't been a lot of movement towards reducing the number of years presented. And if you think about it for a second, it does make sense. If a company already has those financials prepared, if it's showing a positive trend line, then you've got all of you underwriters in the company who really want to put in that third year to show how much the company is growing.
And if it shows not such a great trend line, then you've got lawyers like me saying, you know what? You better put in that third year because it could be misleading otherwise to be ignoring that information. So what we're seeing is unless there's a really good reason why you're not presenting that third year of audited financials, that this provision to date has not been utilized.

A provision relating to executive compensation, on the other hand, very helpful. A few years ago the SEC included additional disclosure requirements with respect to executive compensation, including the dreaded Compensation Discussion and Analysis section, or CDNA, which can go on for 20 pages, or more. It's painful to read. I assure you it's painful to write. And if you're an emerging-growth company, you don't have to include one at all. So I think that you will certainly see people taking advantage of that quite significantly.

And then finally, it was mentioned that there is a requirement to certify your internal controls, and if you're an emerging-growth company, you do not have to have an outside attestation of your internal controls or that certification at least for the first few years after becoming a public company. So all of those provisions are very helpful.

And then finally, the last thing: analyst reports. There were concerns that the restrictions imposed on having analysts come out with their research, either during or following an IPO, was impairing the aftermarket for IPO securities. And so what the JOBS Act did is basically take away a lot of those restrictions, and said that even if you're affiliated with an underwriter, if you want to put out your research report during an IPO or immediately after an IPO, you can, and there won't be any restriction.

This is one that I think so far the experience has been people are a little reluctant—again, I think concerns about liability during a pending IPO of having a research report from an underwriter in the IPO saying how great the stock is has led to some concerns, but we may see some liberalization going forward.

So what are the takeaways from the on-ramp experience so far? I think it's hard to say whether these provisions have encouraged more companies to file for IPOs. There certainly have been a number of companies that have made that confidential submission. The SEC staff
has advised that so far there have been over a hundred companies. But of those one hundred, only about a third of them have actually gone forward and filed publicly and moved forward towards an IPO. Now, it may be a little difficult to determine in the short term because this year has not been great in terms of marketing for IPOs, but we will see whether more companies actually do take advantage of the provisions.

I mentioned earlier one thought that I certainly had is, while this is helpful for emerging-growth companies, I would certainly like to see at least some of these provisions extended to larger companies as well, particularly the confidential review. I think that certainly when you get a very high-profile IPO, it is only helpful to limit the hype period before the IPO. And I can only think that, you know, perhaps the Facebook experience could have been a little bit better had they been able to file confidentially, and waited until much closer to the period of time when they were actually launching their marketing, instead of having it sit out there for months and months and months and just having people continue to speculate.

And then finally, while these rules are certainly helpful, you can't look at the JOBS Act in a vacuum compared to all of the other securities regulation and disclosure rules out there. And while the JOBS Act certainly has been a help in reducing disclosure requirements, there are other rules that continue to be adopted that effectively increase the cost of staying public. They legislate through disclosure, so to speak, by actually requiring companies to talk about more and more in their public filings.

And a great example of this is the Conflict Minerals Rules that were just approved by the SEC, stemming from—I will note it was not an SEC initiative but it stemmed out of the Dodd-Frank Act, and will require extensive cost for companies who do any sort of production involving certain metals—including gold and tin, to go up their supply chain, try to get certifications, have to potentially file reports—reports that will need to be certified by independent auditors in terms of the production of—the source of minerals and whether or not they origin from the Central African nations where there have been big conflicts.

This applies not only to domestic companies, but also to foreign private issuers. And my sense is that when you look at that regulation and other disclosure requirements, especially in light of the number of ways that you can avoid going public and still being able to access capital markets,
I think it will be a disincentive for companies to decide to access public markets, particularly here in the United States. Thank you.

[Applause.]

**DANIEL GALLAGHER:** Well, it's great to be here. Venues like this are very important, unfortunately on this topic, for me to learn about the JOBS Act, because I've been a little bit busy with things like conflict minerals over at the SEC, which, don't worry, it will create jobs for Joe and others.

[Laughter.]

**DANIEL GALLAGHER:** Anyway, so at this point I should give the standard disclaimer: My remarks today are my own, and don't necessarily reflect those of the commission or other commissioners. And especially events like this I like to give that disclaimer with a follow up because I'm also a minority commissioner, so I have no real authority. So anything I say, don't get too excited.

[Laughter.]

**DANIEL GALLAGHER:** So I though I would like to set the stage here with a little bit of context, because I think the panel has expertly teed up the issues presented to the commission by the JOBS Act. And so the presentation, though, is lacking one critical piece: How are we going to tackle this stuff at the commission? And what's going on at the commission? What are the priorities of the commission and how will this stuff—the rulemakings that are necessary to implement the JOBS Act, to give effect to the goals of Congress and the JOBS Act, how are they going to be rolled out? And so we need to take a step back and understand metrics, just simple metrics about what the commission is up to right now.

The Dodd-Frank Act, which was July 2010, was over 2,000 pages long. And to put that in context, depending on which version you get—I realize I play a little bit around with the numbers there—compared to the Sarbanes-Oxley act, which was 66 pages long, the Dodd-Frank Act is a tremendous amount of work for the SEC. Within the Dodd-Frank Act, the commission has 100 mandated rulemakings, 20-plus mandated studies.
And in a year, especially an election year where you've heard a lot on the campaign trail about Dodd-Frank, Wall Street being reined in, given the title, you know, the Wall Street Reform Act, it's simply not true. We have 70 percent of the rulemakings left to complete under the Dodd-Frank Act. But folks like to pay attention to the proposed rules because there was an early flurry of activity at the commission and other agencies to issue proposed rules in an effort—you know, a far-fetched effort, I think—to meet the intense deadlines set by Dodd-Frank, a lot of which—most of which were one-year deadlines. So by 2011, a large chunk of these rules were due.

Well, blissfully we've blown through a lot of those deadlines. And I really mean it because, you know, to me it's like getting in your homework. You know, no need to get it in the next day if it's not done right. So since we've missed the deadline, I hope and expect that the commission can take a deep breath and reprioritize—focus on things that are actually important within Dodd-Frank—which raises another issue: What in Dodd-Frank is important?

There are 2,100 pages that are supposedly—reportedly responsive to the financial crisis, and admittedly some pieces are responsive at least. Whether they resolve issues seen is another question, and simply a whole slew of other provisions just aren't. And Joe has already teed up one of them. And again, I'll get back into metrics here to give you a sense of how we do things at the commission.

The Conflict Mineral Rules were accompanied by what's called the Extractive Resources Rules. Both of these rules—1502, 1504—of the Dodd-Frank Act have very laudable humanitarian goals. They have absolutely nothing to do with the SEC's mission. What do they have to do with the federal securities laws? That was the mechanism that Congress chose to drive through this reform in an effort to cure humanitarian issues completely outside the United States, not having anything to do with U.S. investors except the burden of the cost.

And so these were mandates in Dodd-Frank. They were mandated to be completed in a year. We missed that deadline obviously by about 13 months. The rules are now complete. As a commissioner I've now been here—back to the commission for a year and a week. This was done, I think, in my 10th month. It took up about 20 percent of my time. So if you think about priorities and how we spend our time, I spent 20 percent of my time on those two rules, again very laudable in their goals, but
having nothing to do with U.S. investors, the financial crisis, and indeed nothing to do with jobs.

Now, as you all know and you've heard here, in April, there was huge bipartisan support for a JOBS Act. I think people have been, despite minor SEC bashing—which is what I get for playing cleanup here; I have to address the SEC issues—I think people have been very polite. Most of the JOBS Act could have been done by the SEC over the last 30 years in one way or the other with existing statutory authority, exemptive or otherwise.

General solicitation in particular, that Joanne was talking about, that's something that's been on the block for over 20 years. It's been recognized by the career staff, even folks who have more of a regulatory bent than others, as an area where technology has really just superceded the rule set and we needed to pay attention to it. In fact, what folks didn't see is that prior to April, we actually had the staff prepare a concept release on general solicitation, removing the ban.

Now, the debate at that time, between January and April, within the commission, was some of us wanted it to be a proposed rule, and others wanted it to be a concept release. A concept release is a precursor to a rule, less actionable—not actionable at all, quite frankly, under the APA. So that was the debate and of course Congress came in, gave us the mandate to get rid of the ban. We thought that would have provided clarity. The deadline, as was pointed out, was in July. As we've grown accustomed to because of Dodd-Frank, we blew right by it, and all with a mind towards, at the end of August, issuing what we call an interim final rule, a rule that is—and the judge is laughing—

[Laughter.]

DANIEL GALLAGHER: It hopefully would have passed his muster, but I'll tell you, the intent was to have a final rule in hand, on which we would still get comment, but as to which there would be no confusion as to its applicability. That had been the promise. That had assuaged some of the concern amongst at least two of us as to the delay. And of course at the last minute, like Charlie Brown with the football, the football was pulled away and what we ended up with was a proposal, a very good proposal substantively but a proposal nonetheless.
And as Joanne and Joe and others have talked about, we just finished our comment period on that rule, and we are already getting much agitation from various quarters that portends, I think, to diminish the strength of the proposal, as it came out in August. And so it's very much a question what the final rule is going to look like. I hope it will be done by the end of the year. It's critical for the commission to give effect to the JOBS Act. General solicitation I think was the one rule that we had with the shortest time frame. It is a pretty simple statutory mandate, as they go. If you took a look at it, you'd be surprised that it's this complicated. It simply isn't, but it's going to get very complicated before it's done.

And at the same time, as you've heard about the discussion on crowdfunding, crowdfunding on the House side was self-effective, which is, as I've learned now in my one year of pulling my hair out at the commission on certain mandates, it's the way to go. I've encouraged every congressman I've met to not mandate rulemakings anymore because, you know, if they really want to get something done and get it done timely, replacing our rules by legislation—if they're just going to mandate that we be scriveners for them anyway, they might as well do the hard work for us.

So crowdfunding is not now self-effective because at the last minute, in the Senate version and with in the conference, the whole paradigm of crowdfunding was completely changed. Now it's dependent on rulemaking—and rulemaking which I don't even have on my desk yet. So that 270-day deadline from April seems much in peril. And the scope of what we're going to see too is very much a question mark.

And so it pains me to say that the priorities of the SEC right now aren't geared towards the JOBS Act. We just left our small business roundtable, our annual roundtable, where we all say nice things about small business and then get back to things like conflict minerals.

[Laughter.]

DANIEL GALLAGHER: And so you can feel warm and fuzzy about it, but if you're not in charge of the agenda, if you can't get things done on your own—which of course I can't and others can't—we can't guarantee the timeliness of the situation.

So, on last point as to the evolution of the bill. And Joanne said something that made my ears pop up, in that oftentimes when the
chairman of the SEC acts, it's reported as the commission. The SEC and elsewhere, especially in the press, folks view the chairman's acts as those of the commission. The opinions of the chairman with respect to the JOBS Act I can tell you, diverge dramatically from at least two of us on the commission.

There was a letter sent to Jack Reed the night before the bill was passed that the chairman sent—the commission did not; that doesn't mean a majority of the commissioners wouldn't have signed off on it—that represented views I personally disagree with, and at least one other commissioner I know does too, and that's often viewed by folks as the SEC weighing in against the JOBS Act. I can tell you there's a very vocal minority that's very for the JOBS Act, and we're trying to push to make this a higher priority on our agenda.

It's not only to give effect to the congressional goal of creating jobs, but for me personally, one of the things I have a concern with is the competitiveness of the U.S. financial markets. And IPOs have been raised—Joe was talking about the market this year. Obviously it's doing a little better in the U.S. than the last three years, but if you look at IPO numbers, which I do, not because they're just an easy proxy to use, but because I personally believe they're indicative of the health of capital markets generally, for the last three years we have just been absolutely getting killed on IPOs, in particular to Mainland China and Hong Kong.

Now, many, I think rightfully, question the quality of those issuances and I think there's good reason to do so. However, the numbers speak for themselves, and what they're indicative of are vibrant capital markets outside the United States, outside of the EU. The New York-London debates are long gone, folks. Just look at the numbers coming out of Europe. Just look at our own numbers. Asia really is rising. The capital markets are vibrant. The IPO numbers eclipse ours. And so long as our atmosphere here is hostile to IPOs or even private funding, I think we're going to see a migration of capital and human talent there, and that would be quite a shame.

And on that last point that Joe made, which was a good segue initially, that Conflict Minerals is going to be extremely expensive by way of disclosure. And where we take away on the IPO on-ramp lots of burdens for emerging-growth companies as they try to become public companies—as I've been saying internally, the Lord giveth and the Lord taketh away, because in Conflict Minerals we've just added an extremely
expensive disclosure regime. And not only that, an audit requirement that if it takes off on a trajectory like that of 404(b), which the JOBS Act specifically eliminated for a five-year period, could result in the same net effect and cost as 404(b).

So anyway, I'm looking forward to the discussion. Thanks.

[Applause.]

JUDGE FRANK EASTERBROOK: There has been some talk here about difficulty in complying with deadlines. Douglas Adams, the author of The Hitchhiker's Guide to the Galaxy, was famous for not following deadlines. And he had a phrase that I think is well respected in Washington. Adams' phrase was, "I love deadlines. I love the sound they make as they go whizzing by."

[Laughter.]

JUDGE FRANK EASTERBROOK: Our five speakers all addressed different aspects of the JOBS Act, and I'll refrain from talking about the parallel to describing an elephant. I will offer each of them a brief—and I emphasize "brief"—opportunity for a second round in which they may have a word or two to say about an aspect of the JOBS Act that somebody else talked about. And then I want to reserve time, which we have about 40 minutes as of now, for questions from the floor.

So, Professor Miller.

PROFESSOR ROBERT MILLER: So I guess I'll stay on the topic of deadlines whizzing by. I said that Wefunder is up in beta, meaning that they are accepting pledges to invest, but of course they can't actually accept any real investments until those regulations implementing the JOBS Act come out, implementing the crowdfunding sections come out. That's due for January. Now it looks like that's not going to happen. I'm not too surprised. But you have a lot of disappointed 20-somethings, Commissioner.

[Laughter.]
JOANNE MEDERO: Well, what I'd like to say—and actually I went to a roundtable at Stanford soon after the act was passed, and I realized that Silicon Valley had actually gotten together and done a lot of the drafting in the IPO on-ramp. And their lawyers, their counsel was very smart to make it self-effectuating.

And I agree with Commissioner Gallagher, is that I think the future, if I were to be asking Congress for something and asking the SEC or my old agency, the CFTC, to change something, I would probably make it self-effectuating. That's probably the way to go. As much as Congress likes to defer to the expert agency, sometimes, if they've already made up their mind what they want the agency to do, they should just do it.

PROFESSOR ROBERT THOMPSON: Apart from the self-effectuating part, Congress put into the JOBS Act any number of things that the SEC has to do that will cost money. Crowdfunding has a large number of regulations, including the portal requirement, including a requirement about disclosure and even about audits, that Robert mentioned.

They put into crowdfunding a large number of regulations. A Plus, which we haven't talked about, has a large number of regulations. Those are put in by Congress. Conflict Minerals, which is a terrible rule from a securities professor's standpoint, was put in by Congress. The SEC's not doing this. And so the SEC gets a lot of grief, but all of what we're talking about, including the delayed deadline, came from Congress, not from the SEC dragging its feet. So we have to push—we have to take that into account and recognize that there's always a balance, and the regulation that's required came in large measure from Congress.

JOSEPH KAUFMAN: A lot of the focus of the JOBS Act in what we talked about here is on equity securities, but as people well know, there's another part of the capital balance sheet, which is debt. And I just wanted to take a minute and talk about how this JOBS Act may continue to impact the debt capital markets, which are a very important part of our job as securities lawyers as well.

In particular, because of the loosening of the restrictions regarding the number of securities holders and being able to stay as a private company, in addition to the increased burden of becoming a public company on the disclosure front, we're continuing to see more and more large bond offerings that have moved from what used to be called 144A, which is a
securities exemption that would have back-end registration rights, so basically you sold to large institutions and then conducted a backend exchange offer, which wound up having that debt registered and having a company being public to what's now referred to as 144A for life, which means that you sell to institutions, they can only resell usually to institutions, but you never actually go that next step and have the company be a reporting company.

And what's been interesting in the last, you know, five years, and I think has accelerated a result of the JOBS Act is more and more companies are really pushing and even willing to pay a slightly higher interest rate to incur debt on the 144A for life basis so as not to have to deal with Conflict Minerals and the other disclosure regulations and the costs related to them.

DANIEL GALLAGHER: Just to jump on two points I heard on the other side of the panel, which are the expertness and independence of the SEC, two very important things for all of us. I mean, for many of us you might scratch your head and try to figure out what independent agencies really are. Some might question their constitutionality, but that's been done years ago, and so this is what we have. And in a situation where you have a hundred mandated rulemakings under the Dodd-Frank Act, where you have several—I don't know the exact number—under JOBS Act, you really do have to start questioning the role of the independent agency, and whether the agency is really independent.

You know, where is the expertness if the mandates go nine-tenths of the way? And what is the role of the agency in influencing the legislation? Why did the SEC end up with 1502 and 1504 in Dodd-Frank if it has no place in federal securities laws? Why didn't the SEC tend its own garden, its own rulebook, you know, giving rise to the JOBS Act to fend off and to bring in-house the ability to change these rules in the way that the expert staff and the commissioners thought best suited? So I'll throw that out.

And one little positive point, because I think I've been a downer—

[Laughter.]

DANIEL GALLAGHER: —is that the 20-year-olds are there and they're alive. And they were in my office yesterday, about eight of them, and they're ready to roll. They are. And they have these platforms; they
just need the funding. And, you know, whereas when I read Title III, I thought, it's over; there goes the game, I think they're still going to make a go of it. It's fantastic to see that spirit is alive and well.

**JUDGE FRANK EASTERBROOK:** Thank you very much.

We have 30 minutes for questions from the floor. I hope we have somebody with a mic. Yes we do, in the back. Let's see, anybody who wants to ask a question—we don't have a mic stand, do we?

**ATTENDEE:** Yeah.

**JUDGE FRANK EASTERBROOK:** Do we? We have a mic stand in the middle? Okay. Go to the mic stand, and when your time comes, ask a question. Now, I know that that seems strange, but I hope whatever you do will be in the form of a question and will have a reasonable end—

[Laughter.]

**JUDGE FRANK EASTERBROOK:** —to bring it back to the panel for answers. Just tell us who you are. I'm going to have a hard time seeing you because there are pretty bright lights up here. So, yes, please.

**BONNIE WACHTEL:** Well, I'm a little intimidated by that preface, but I'll do my best. My name is Bonnie Wachtel and I'm the CEO of Wachtel & Co., Inc., which is a small broker-dealer here in Washington, D.C. Quick comment, then a question.

Commissioner Gallagher, so delighted to see you here. Let me posit, by the way, that the avalanche of new regulation, really a reign or terror in the brokerage industry, is part of the reason why you see financing down through traditional venues, and why Congress is so desperate to go to nontraditional sources. That's the comment.

From what I read about the JOBS Act, at least crowdfunding, from industry stuff, is that the states have decided—they're ready with a campaign of massive resistance, because if this is going to go forward, basically it makes you wonder why we've got half of the securities regulation on the books, and everything else that they do.

However, I do think that when you look at the thoughts of Mary Schapiro and people that have spent a lot of time in securities regulation, what
they're really looking at is, you know, most ordinary people do not make money investing in risky situations. And we've seen that in the Internet bubble and other bubbles. You know, the only thing they want to invest in is stuff that's all hyped and they get all excited. And I think that's part of what they're concerned about, is this is an experiment that's going to blow up and be even worse for the capital markets.

They really want suitability. They want an intermediary that will look at suitability. That's my read. I wonder if anybody could speak to this from the standpoint a little more of that concern about investor behavior.

**DANIEL GALLAGHER:** Can I take it?

Well, it's great to hear from you. Nice to know small broker-dealer CEOs are attending these events. It's great. And just think if Dodd-Frank had actually paid attention to your industry. You'd be in real trouble.

[Laughter.]

**DANIEL GALLAGHER:** You'd have that in addition to everything else. You guys got out relatively clean.

**BONNIE WACHTEL:** [Inaudible.]

**DANIEL GALLAGHER:** Yeah, me neither.

So, you know, I think that there's sometimes confusion between the notions of investor protection and risk-taking, right? There's, quite frankly, an anti-state instinct at the commission to protect investors by depriving them of choice. And I think that you're seeing that come out with respect to crowdfunding in particular.

You know, I was reading a statistic in a Forbes article earlier today that $145 billion a year in lottery tickets are sold. Do the math on the chances of hitting it big there versus investing in markets, right, including $50-100,000 a time in crowdfunding.

And so I do think you're right. I think that, generally speaking, regulators are well intended. They're the government and they're there to help. But the problem is, in this quest to help, so often, in particular with respect to retail investors, that means: We're here to deprive you of
choices. We're here to de-risk the capital markets for you because you can never understand it, and that's a big problem.

**PROFESSOR ROBERT MILLER:** Yeah, one comment on the crowdfunding. I just divided the amount of money that Wefunder has already had pledged, about $28 million, by the number of projects involved in that, about 150. So you're talking roughly $20,000 per project. These are really small projects, right? If you look at the fraud rate on what might be occurring there, if the fraud rate went above 1 percent this market would clearly collapse. You can't tolerate a fraud rate that big.

So if you are something like Wefunder, here's a prediction for how your business model is going to work out: It's going to work out like eBay. eBay is in the same kind of business. They make a market between people who want to buy and people who want to sell. And the way eBay works now, is eBay ensures people on eBay against fraud. If you are ultimately defrauded on eBay, in eBay returns your money and eBay takes it up with the fraudulent seller.

So, prediction: Once crowdfunding actually gets going, you'll have large, large numbers of transactions, with a very small fraud rate and small amounts of money at issue in any particular securities issue. I bet the funding portal assumes the fraud risk, and will protect the market against fraud. If someone commits fraud on the crowdfunding site, I bet Wefunder will ultimately return their money. They won't ensure the investment prospers but they will ensure you against the fraud risk.

**BONNIE WACHTEL:** Just to point out, the losses will not be coming from fraud. [Inaudible.]

[Laughter.]

**DANIEL GALLAGHER:** No, that's very true.

**ATTENDEE:** Hi, my name is Ben Pugh [ph] from Orange County, California, the state where all business is fleeing from.

[Laughter.]

**BEN PUGH:** I just had a quick question. In this new regime of lots of small businesses raising lots of small capital with no disclosure requirements, presumably no Regulation FD, where do prohibitions on
insider trading fit into this smaller paradigm, or are we going to have any prohibitions on insider trading on these secondary markets that are sure to develop outside the main stock markets, or main exchanges at this point, or is that something that Mr. Gallagher is going to work on when he's done with his conflict minerals?

[Laughter.]

PROFESSOR ROBERT THOMPSON: Nothing has to be done. Insider trading rules remain as they are; 10b-5 has not changed. Insider trading has not changed. It applies to any purchase and sale of securities, and it will apply to the small as well as the big.

JUDGE FRANK EASTERBROOK: Though perhaps I should add, since very few people in the securities area seem to be taking this up, when the Supreme Court, in O'Hagan, sustained the approach to inside trading—the prevailing approach to inside trading—they did it as a matter of property rights; that is, of enforcing people's rights in information. And that implies that any company that wanted to raise its hand and say, we're allocating rights and information to our insiders and they're perfectly free to trade, under O'Hagan is perfectly free to do that.

The interesting question is, what will companies do? In a world of vibrant competition you would expect to see some companies authorize their insiders to make their money by inside trading, while other companies are paying them salaries and bonuses. It will be very interesting to see what develops in young, new markets.

JOANNE MEDERO: You know, I've noticed a lot of focus on disclosure in people talking about the fact that you will not be making—these issues will not be making certain disclosures. And if you look at all the behavioral finance literature, what you'll find is nobody reads them. So what it becomes is a liability document when something goes wrong, and then your lawyer reads them, and tells you what you missed.

So, you know, I'm less worried and less concerned about these changes that result in less disclosure, because I really think it's become a rote exercise, and you'll find the same disclosures in virtually—you know, risk factors, for example, become more and more identical. So I'm not that worried about less disclosure that we were going to see out of the JOBS Act because I question its usefulness today—speaking for myself and not my company.
JUDGE FRANK EASTERBROOK: Those of you who know that I do tend to be interested in the Chicago approach to economics, also may remember that one of the things that is generally done in thinking about financial markets is to distinguish thickly traded markets from thinly traded markets. In thickly traded markets where there are—you know, there's a lot of liquidity and there are a lot of traders, it just doesn't matter whether any investor reads the papers. All that matters is that two or three professional investors know what's going on. You trade and all the amateurs get the same price as the pros get when they trade among themselves, and that process protects the amateurs.

In a market with only amateurs—and that's one of the possibilities that's being set up by the JOBS Act, that we'll have very thinly traded markets with only amateurs—those are the markets where the lack of professionals to mediate this information and set a price that the amateurs get is, most important. And again, we're running an experiment. All life is an experiment, but one common prediction is that the price in these markets will be not dominated by fraud, but simply less accurate generically than the price in the large and thickly traded markets.

Yes?

JULIE AXELROD: Hi, my name is Julie Axelrod. And I'm currently a nonprofit lawyer in D.C., but I used to be a corporate attorney in California. I'm one of the people who fled the state—

[J laughter.]

JULIE AXELROD: —because of its bad climate, business climate. But my question is about the new rules that make it more attractive and possible not to be a public company even if you have 2,000 shareholders, and just the speculation that a lot of companies won't be public. And the other side of this is that do any of you see the public being frozen out from making money in the markets, and it sort of becoming something that only sophisticated people have the opportunity to do? Or do you think I'm just worried for nothing about that?

DANIEL GALLAGHER: I can't resist again. I'll jump in real fast.
I think that, sort of picking up on the last thought in response to the first question of, you know, the intent often coming from the government, especially the SEC, in implementing the JOBS Act mandates is a good one. It's investor protection. Who can argue against it? But the net result of it oftentimes is a reduction in choice. One of the best ways to help protect investors, is to allow them the opportunity to choose how to put their capital at risk and to succeed or fail. And in lieu of fraud, that should be the types of markets that we want to have.

And unfortunately, to the extent that becoming a public company, despite the best efforts of Title I of the JOBS Act, is too much for companies, and because we've hedged nicely by making it easier to stay a private company, what we've done is to say, yes, for those investors who have a certain level of sophistication, however artificially we define that, they have all of these wonderful opportunities. Everyone else, you know, go compete with all these high-speed trading firms on the New York Stock Exchange and see how you do. And I think that that's not the choice set we want to provide to investors. I think there is a real risk of that, picking up on part two of your question.

**JULIE AXELROD:** That was the only question, just whether this is risk that will have sort of—

**DANIEL GALLAGHER:** It's a huge risk.

**JULIE AXELROD:** —freeze out regular people.

**DANIEL GALLAGHER:** Well, and just think about what's going on right now, especially right now. Zero percent interest rate environment, which, as we learned yesterday, might be extended to eternity given the way the jobs numbers came in today, right, if the Fed is going to tie it to the unemployment rate. Investors, retirees in particular, chasing yield wherever they can find it. You can't find it necessarily in the equities markets right now.

Where are they chasing it? High-yield bonds, structured products, other things that are unfairly setting investors up, I think, to fail, especially at the worst time of their life, during retirement, when in fact we haven't gotten crowdfunding rules out that, lord knows, you know, today's crowdfunding startup could be tomorrow's Zynga or Facebook or lord knows, and that person can retire a wealthy person. So, it's a real risk. It's something to pay attention to.
PROFESSOR ROBERT THOMPSON: One of the great things about the American market over time as compared to Europe and actually Asia generically, is that it's very democratic. It has a greater spread of investors among all economic classes, and has over time, and we are losing some of that.

So how might we respond? In an article that I've done with my colleague Don Langevoort, we suggest that the time has come to have two levels of publicness. One level of publicness would be with reduced regulation, which would be the traditional disclosure—10Ks, 10Qs—in a financial sense.

And then a second level that would have a much higher breakpoint that would apply for those firms for which we have non-investor concerns—I mean, one thing that came out of the financial crisis was we had systemic risk. We had externalization of big firms putting burdens on society to make us pay for their errors. I think Conflict Minerals ends up in that bucket. But in any event, if we went to a two-tiered level, we could be more responsive and lose some of the diminution that we've had in the last few years and the last two rounds of reform.

RACHEL PEREZ: Hi. Rachel Perez. I'm with the New York Lawyers Chapter.

I think, interesting just to note that, people have been mentioning that it's, you know, unsophisticated people that are involved here when, you know, when the accredited investor standard basically puts the people that can participate in these 2,000-person offerings like in the 1 percent, according to, like, the Obama administration's estimation of what makes you in the 1 percent. That's completely unrelated to my question but I—

[Laughter.]

RACHEL PEREZ: My question is very pointed to Mr. Gallagher, and just asking someone in the commission who's involved in the rulemaking, where do you see the intersection between the general solicitation rules and the—with the CFTC, one of the prongs of being exempt from being a commodity, a registered commodity trading advisor by not holding yourself up to the public as a commodity trading advisor, and how those allowing general solicitations could then kind of get you into the CFTC's regime, obviously if you trade in commodities and futures and things?
DANIEL GALLAGHER: The good news is you don't have to worry about it because Gary Gensler has already taken care of that by rolling out a CFTC regulation to a wide pool of investment advisors already in their Rule 4.5, which I'm sure Joanne, having been general counsel over there, has followed. And so, basically—

JOANNE MEDERO: This is actually a fallout of Dodd-Frank, right, because traditionally one thought one was a commodity trading advisor when you talked about investing in commodities, and even to a certain extent commodity futures. And all of you in the room probably think you know what that is, which is, you know, gold, silver, oil, wheat, whatever.

But when Dodd-Frank decided to redefine "commodity interest" to include swaps and the arm-wrestling went—advantage—to the CFTC, so almost everything is within the CFTC's jurisdiction, very little left with the SEC, all of a sudden you have a lot of entities who never thought what they were holding themselves out as doing had anything to do with commodity interests. And pleas of various parts of the industry to the CFTC to at least modify some of their regulations in this regard are falling on very deaf ears.

And so, in fact, although we've been talking about the burdens that the SEC has been directed by Congress to impose on the financial industry, actually the bigger burdens, in my view, are going to come from the CFTC. And I'm not in private practice anymore, so I don't have to sell my time, but I will tell you that a lot of people are very surprised to find that their particular thing that they do is now subject to an agency that they've never heard of. So it's just part of the pendulum swing that we saw as a result of the financial crisis.

DANIEL GALLAGHER: And I think, just to close it out, I mean, it may be that there's a limited pool of folks who wouldn't otherwise have been affected by the Dodd-Frank changes, but now because of general solicitation and their activities in the futures space might pique the interest of the CFTC, but I think the slice would be pretty narrow now, given the fact that the CFTC has already invaded this space in a big way.

I'll note also—

JOANNE MEDERO: There's pending litigation.
DANIEL GALLAGHER: That's what I was going to note, Joanne.

JOANNE MEDERO: There's hope.

DANIEL GALLAGHER: The judiciary might come to the rescue here. All of our faith is in the judiciary.

[Laughter.]

JUDGE FRANK EASTERBROOK: We can make the rules even more complicated.

[Laughter.]

DANIEL GALLAGHER: Or you can make them go away, Judge.

JUDGE FRANK EASTERBROOK: I don't see anybody at the mic. Any further questions out here? Well, any further exchanges on the panel? Any closing comments? [Inaudible.]

ATTENDEE: To the gentleman who was talking about how it's going to be easy now to not be public, I'm old enough to remember the 1970s, and there was a big issue then about going private. There are plenty of companies where they don't need to raise capital. They're very nicely profitable. And you hearken back to the continuing war between management and the shareholders.

So if you're going to go private, which is something where there's a direct conflict of interest between management and the shareholders, mediated by some valuation expert, the first step they do is get off the exchange and you register so your price goes down. So I'm just wondering if you've given any thought to that, because I'm thinking through my own portfolio and I can certainly see some part of that coming.

PROFESSOR ROBERT THOMPSON: You're right, there have been any number of waves back and forth the last four or five decades. HCA has gone public and gone private, several times both directions. Burger King just went public after being private. You know, it goes back to—just to tie up to a closing comment in terms of did the JOBS Act produce jobs? I mean, ultimately that's the policy question we ought to ask.
[Laughter.]

**PROFESSOR ROBERT THOMPSON:** Now, the subpoint was, well, did it produce more IPOs, because certainly Silicon Valley cared about that and I think many people cared about it. Did it produce more jobs? Well, it's early, as Joe said. This is not a great year for it but we need to ask, do we have more IPOs that are producing jobs? What have we had? We've had Manchester United and its soccer business. Is that producing jobs? I don't think so.

And so knowing what produces jobs is hard as heck. I mean, it's not an easy thing to do and so we've got to take our best shot, but we don't know whether it has or not. But the difference in the 1970s is that we have had a financial revolution and part of it's connected to commodities and futures and derivative and technology and computers. But we trade things a lot different, and so it is possible—there are new marketing avenues that we can raise money in different ways. But raising money in different ways just means different problems.

I mean, I'm not a commodities person, but one of the things that has surprised me: Who's doing physical commodities trading? Well, it turns out that Morgan Stanley has a big business and—

**JOANNE MEDERO:** The "Wall Street refiners."

**PROFESSOR ROBERT THOMPSON:** "The Wall Street refiners," Goldman Sachs, JPMorgan Chase.

**JOANNE MEDERO:** But there's provisions in the Dodd-Frank Act which are going to change that too. The just haven't gotten around to doing the rules on them.

**PROFESSOR ROBERT THOMPSON:** This is a different world and it's constantly changing. I mean, I teach budding lawyers every day, but what I tell them is that technology and changes in market creates new space. And a lawyer who is successful is someone who occupies that new space and, perhaps more pejoratively, who can elbow Commissioner Gallagher and his associates out of that space—

[Laughter.]
PROFESSOR ROBERT THOMPSON: —and says, this is deregulated space. So there's this constant push between technology generating new innovation in space and private parties wanting to occupy that space, and the regulators saying, wait a minute; this is just doing the same thing we've been doing and we've got to adapt, and it goes back and forth. And that's why it's good for all of us in a sense, but that's why it's so hard to figure out what the right solution is.

JUDGE FRANK EASTERBROOK: And if we don't get the solution right on either regulation or deregulation, the brain-powered helicopter will take all the deals to Hong Kong or—

[Laughter.]

JUDGE FRANK EASTERBROOK: Go ahead.

JOSEPH KAUFMAN: If I could add something, because I do a lot—I work with a lot of companies who do going private transactions and take companies public again.

I think that there will be—to the extent that financing is available, there will be additional incentives, as a result of the costs of being a public company, to deciding to go private. One of the things that will be weighed into the modeling is if you have a certain amount of costs that you're going to have to expend every year with respect to having to comply with these regulations. If there's a management group or a private equity group that's looking to take a company private, it certainly will be one of the things they'll model in terms of being able to improve the returns on the margins.

On the other hand, with the larger of these companies, you certainly have to be able to finance that buyout. And it goes back to the comment I made about 144A for life. It used to be that with these larger buy-outs, by all means you would continue to be in SEC registration because that helped with respect to the debt financing. Now I think a lot of companies are just going to say: We don't want it. It's just too much of a burden, and at least while we're private on the equity side, we'll provide bond holders on the side with audited financial statements, but we want nothing to do with conflict minerals. We want nothing to do with compensation discussion analysis. And by the way, the bond holders want nothing to do with those things either.
I do think that eventually those companies do need to go public again at some point or they get sold to other companies within their industry. But when we take the step back and think, you know, never before have we had so much technology available for ordinary investors to be able to access information about companies and to have access to capital markets, yet we have rules that are in effect that are basically encouraging people not to be able to put those things together. It's really unfortunate. I would hope that it's something that the SEC would be thinking about in their ongoing rulemaking.

**JUDGE FRANK EASTERBROOK:** Any final comments on the panel?

Please join me in thanking our speakers.

[Applause.]