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SUBMITTED ELECTRONICALLY

The Honorable Pat Toomey
Ranking Member,
U.S. Senate Committee on Banking, Housing and Urban Affairs
Washington, DC

Dear Senator Toomey and other distinguished Senators:

I am responding to your February 2, 2021 call for "Proposals to Foster Economic Growth and Capital Formation" by offering "proposals that will accelerate economic growth and spur job creation by encouraging more companies to become publicly traded, improving the market for private capital, and enhancing retail investor access to investment opportunities."

My Background

I am a retired corporate, securities, and M&A attorney who practiced for approximately 40 years in the Dallas-Fort Worth area. I have participated in billions of dollars of transactions. During the last half of my career, I had a tiny law firm in Fort Worth that worked primarily with small companies on capital formation and sales of businesses. In 2016 and 2017, I was a member of the Securities and Exchange Commission's Advisory Committee on Small and Emerging Companies. I remain active in the Federal Regulation of Securities Committee and the Committee on Mergers & Acquisitions of the American Bar Association's Business Law Section.

In 1980, I was a young lawyer working as underwriter's counsel for a small company IPO that raised $19.8 million ($62.9 million adjusted to present dollars). I recall this because, when serving on the SEC committee mentioned above, I described this IPO using the presently adjusted offering amount, and an investment banker told me that this size IPO would no longer be possible.

Facts You Probably Already Know, But Worth Repeating

- The airplane was invented by two bicycle mechanics from Dayton, OH, not by people with fancy degrees in engineering or finance. Silicon Valley began with Messrs. Hewlett and

Packard tinkering in the garage. Approximately 47% of all private sector jobs are in companies with 500 or fewer jobs.[1]

- Despite small business being the growth engine of the U.S. economy, government at varying levels have recently imposed strangling restrictions on many small businesses in the name of Covid 19 protection.[2]

- Regulation of small business capital formation is an excessively overdone mess, created by federal and state elected officials and regulators over decades. Many of these people, if not a majority, have less experience running a business than a 10-year-old with a lemonade stand.[3] Legislators, regulators, and officious intermeddlers point to "investor protection" as their motivation.[4]

- Securities regulation affecting small business are in three areas:

    - Disclosure requirements for small public companies

    - Requirements for private companies raising money in transactions exempt from the public company registration requirements

    - Requirements for so-called finders who want to be paid for finding investors, but are not registered with the SEC as securities brokers.

- The SEC's five commissioners historically are former Senate staffers, lawyers from large Northeast law firms or investment banks, former SEC staffers who are on their next revolution of the SEC's notorious revolving door and are returning to the SEC after some years on Wall St., or think tank alumni. Illogically, the regulatory body charged with overseeing the capital markets that finance America's private sector growth customarily has -0- members who have run a business or participated in a senior position is business finance.[5] Rare is the SEC commissioner from the flyover zone.

Threshold Comments

Only honest people worry about securities compliance. As in other areas of the law, there is no law that will prevent crooks from being crooks. Much of the current securities over-regulation punishes honest people for the sins of a few. A wiser approach starts with noting that there are over 50 agencies in the U.S. charged with chasing securities fraud, i.e., SEC, FBI, FINRA, exchanges, and each state's

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[1] This information was before the recent Covid 19 shutdowns.

[2] As a former owner of a small business (law firm), I feel that many of the restrictions seem designed to affect small businesses disproportionately.

[3] The Ranking Member's experience in finance and the restaurant business is acknowledged.

[4] Those calling for increased investor protect point to some very real and egregious anecdotes, but little or no statistical information is cited that the problem is widespread, or that increased regulation will fix the problem.

[5] The most recent past Chairman Jay Clayton was an exception.

securities enforcement body.[6] Plus, there is private litigation.[7] With all these resources devoted to securities enforcement, why do the regulators punish honest businesses with burdensome and unnecessary regulation if they are not the people committing the fraud?

Please remember this—there is nothing that a law or a securities regulation can require to be written on a disclosure document that will prevent those with evil intent from being crooks.

While they would dispute this, the efforts of state securities regulators in regulating both registered offerings and exempt transactions in their states are costly to businesses and do not offer a significant benefit. Shifting state resources from ineffective, but costly, oversight of offerings to pursuit of fraud in their states would be wise decision.

Disclosure Requirements For Small Public Companies

- Securities regulation of investment in businesses big and small, public or private, starts with the principle of tell all the material facts about the issuer to the investors, and they can make their own decisions whether to invest. [8]

- Most, if not all, of the SEC's disclosure requirements on large and small companies are based upon the *opinions* of those imposing the regulation, Congress, regulators, exchanges, and judges. I am not aware of any quantitative analysis of what facts are material and should be disclosed. Opinions reign supreme.

- Some disclosure requirements originate from extraneous political agendas. Examples include conflict mineral disclosure requirements, massive disclosure regarding executive compensation, and trending now disclosures about ethnicity and gender of management and directors, and environment, social and governance (ESG). Some requirements have no basis in specific legal requirements applicable to public company behavior but are intended to mandate politically correct behavior by shaming companies that flaunt PC "mandates".[9]

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[6] The SEC alone spends approximately $0.5 billion annually on enforcement. Where does that money go? For an interesting and depressing description of life inside the SEC, see Norm Champ, *Going Public: My Adventures Inside the SEC and How to Prevent the Next Devastating Crisis,* (McGraw Hill Education 2017). Mr. Champ was Director of Investment Management at the SEC.

[7] An interesting dissertation topic would be, "With all the securities "cops" on the beat, why is there any securities fraud?"

[8] In legalese the principle is written:

Securities Exchange Act of 1934 Rule 10b-5 Employment of Manipulative & Deceptive Devices
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
a. To employ any device, scheme, or artifice to defraud,
b. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
c. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

[9] These requirements can be found in SEC regulations, state securities laws, exchange rules for listed companies, and requirements by activist investors.

- Depending upon a multiple of variables, an IPO for a small company with an offering amount of $25 to $99 million can cost from roughly $2.6 to $13.4 million.[10] Once a small company that has completed an IPO, my experience is that annual public company compliance costs can be expected to be $1-2 million.

- Considering these factors, over-regulation largely killed IPOs by small businesses, such as the 1980 IPO I described above. You have to be a big small-company to bear that cost.

Small Companies Fled To Exempt Offerings

- The end of small company IPOs means that virtually all privately-held companies raise their needed capital in small transactions exempt from the registration requirements of federal laws. In many cases, the SEC exemptions are followed by state securities regulators, but there is no uniformity.

- In 2012, the JOBS Act provided some regulatory relief, particularly in providing relaxed requirements for financings exempt from registration with the SEC (i.e., non-IPO financings), most particularly Rule 506 of SEC Regulation D and SEC Regulation A. Even after these changes, capital formation for small businesses remains technical, requiring professional fees of attorney, accountants, and possibly others. Many small businesses find compliance with exempt financing to be unaffordable, and a significant number choose to ignore securities laws during their capitalization.

- During the Trump Administration, the SEC made limited and incomplete progress in exempting small, unregistered brokers, also known as finders, from the onerous registration requirements of the SEC, FINRA and state securities regulators.[11] No doubt that unregistered finders are a fertile area for abuse, but legitimate finders serve a useful purpose in finding qualified investors, particularly in small urban and rural locales. Despite decades of bureaucratic stalling and omphaloskepsis at the SEC, I and many others wonder if the current SEC will relax the excessive controls. This has been an area where non-compliance is common, and I predict that scofflaws will remain common.[12] [13]

- While lawmakers and regulators can point to no widespread securities scams in private placements, only anecdotes of isolated fraud, they want to "protect" investors by imposing burdensome rules on private placements and honest small businesses. Again, crooks largely do not bother with securities compliance. So additional burdens only penalize honest businesses without reducing fraud.

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[10] Taken from "Considering an IPO? First, understand the costs", https://www.pwc.com/us/en/services/deals/library/cost-of-an-ipo.html, accessed February 28, 2021.

[11] A similar exemption topic is merger brokers. Since merger brokers are the subject of proposed legislation, I will largely ignore them here.

[12] Widespread non-compliance with the securities laws is lamentable. However, sound public policy calls for laws that make compliance feasible for those to whom it is addressed.

[13] The SEC has assigned administrative jurisdiction of federal regulation or exemption of finders to its Division of Trading and Markets, a poster child for bureaucratic foot-dragging. Top staffers in that division seem totally unconcerned about the challenges of finding investors in Middle America.

Recommendations For Legislative Change

I believe that these recommendations will help achieve the goal outlined in your February 2 request.

- The securities laws should require that at least two of the five commissioners have at least five years' experience running a business or in a senior finance position in the private sector.[14]

- Congress should direct and fund an objective, empirical study by analytic professionals to determine what disclosures *investors* consistently consider material and what it not material. This should not be a study conducted by law school professors or other academics, as these persons almost always have no senior business experience. Also, today, too many academic studies start with the conclusion and develop the "facts" to support the conclusion. After a scientific, objective study, Congress and the SEC would have real information to use in governing securities regulation.

- Congress should state unequivocally for the SEC and all others that the purpose of securities disclosure is to inform investors of material information about issuers. Disclosure is not a tool for implementing social policy.

- Congress should compile a list of what securities disclosures requirements are driven by political correctness, anti-business animosity, regional bias, industry bias, ethnic and gender quotas, ESG, issues de jour of fleeting importance, and other factors not relating to business purposes.[15] These requirements should be eliminated. [16]

- Congress should amend the Securities Exchange Act of 1934 to exempt private placement finders and also merger brokers from broker registration requirements.[17]

- The SEC should be required to include in its annual report the type of quantitative information and analysis included in a public company's Management's Discussion and Analysis (MD&A). For example, what is the average SEC's average annual expenditure on an enforcement action?[18] What is the estimated amount at issue in each fraud case brought? Does the SEC choose to ignore small enforcement actions to pursue the big headline cases? Do issues de jour and Congressional concerns overly influence SEC enforcement efforts?

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[14] I am not recommending legislation on this, but an interesting question for administrations would be, "Why are people who live in the flyover zone never smart enough to be nominated to be SEC commissioners?" For example, since I was admitted to the Texas Bar in 1977, I do not recall a SEC commissioner from Texas, now the second most populous state. Perhaps my memory is faulty.

[15] These non-business, social policy disclosures and requirements are an indirect tax. My list may seem long, but I can provide examples of each.

[16] Doubtless, different members of Congress will have different opinions on this.

[17] This topic has been the subject of foot-dragging for two decades. There are legions of reports and analyses, and any suggestion of more studies is further dithering. The Congress just needs to adopt a self-executing exemption not dependent on SEC rulemaking. The SEC has proven itself unwilling or incapable of adopting rules in this area.

[18] This disclosure will require sophisticated accounting, but it is done in the private sector, so the SEC can do it also.

- Also, the SEC should be required to compile, total and average, and report in its annual report the costs for all public companies conducting public offering during the reported year.[19] Likewise, each public company should be required to include in its annual report (e.g., Form 10-K) a summary for the reported year of securities laws compliance and related costs such as exchange compliance costs.[20] Again, this information should be aggregated and averaged for disclosure in the SEC's annual report.[21]

- Congress should exempt all securities transactions, whether registered under the Securities Act of 1933 or exempt from registration under that act from registration requirements of state securities laws (i.e., preempt state regulation of sellers in securities transactions). Not focusing on transaction registration or exemption will free state securities officials to concentrate on securities fraud and securities professionals, where they do an important job.

- The year 2023 will be the 90th anniversary of the Securities Act of 1933. This will be an excellent reason for rewriting that dinosaur law.

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Thank you for your interest in America's much abused small businesses. I hope that this letter is helpful. I will be happy to answer any questions.

Sincerely yours,

Patrick A. Reardon

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[19] This information is already available in the registration statement a company (issuer) files with the SEC. This is simply a matter of compiling information already in the files of the SEC. The triggering date for inclusion would be did the issuer's registration statement become effective during the reported year?

[20] In the metaphysics of securities laws, this information may have to be deemed not "filed" because it will include some estimated or allocated costs. Some companies may complain about compiling this information, but I think overall managements will be happy that someone is in Washington is being forced to look at these costs.

[21] Each year, this information will give to the Congress and the public information on the costs of being a public company. I predict that the information will be eye-opening.