Public Investors Arbitration Bar Association

April 11, 2012

Via Email Only
michael.allen@asm.ca.gov

Honorable Assemblymember Michael Allen
State Capitol
P.O. Box 942849
Sacramento, California 94249-0007

Re: AB 2081

Dear Assemblymember Allen:

The Public Investors Arbitration Bar Association (PIABA) is a national association of more than 400 attorneys who represent victims of investment frauds and stockbroker and financial planner misconduct in securities industry arbitration forums and the courts. On a daily basis in our practices, we see devastating losses resulting from violations of investor protection laws and regulations that govern the securities industry and issuers of securities. Disproportionately, those losses fall on elderly and vulnerable savers and investors. We believe that further deregulation of securities offerings would be a mistake. PIABA believes that allowing general solicitation and advertising of exempt securities offerings diminishes investor protection and likely will lead to future losses for California investors.

We invite your attention to a recent Bloomberg News column authored by Susan Antilla. Ms. Antilla critiqued the JOBS Act, a similar attempt to deregulate the securities markets that is likewise believed to open the door to new types of securities fraud. The link is: http://tinyurl.com/7j6ncvo

PIABA supports growth and capital formation – but not at the risk of harming the investing public. It is important to recognize that the enterprises raising capital under the proposed exemption will likely fit one of two molds:

(1) those small or start-up companies that may be making good faith attempts at building new, growing enterprises but which are too risky for traditional capital sources to be willing to invest in them; and

(2) companies whose key personnel believe that the real money is made by putting investment deals together, not by putting years of hard work into growing the companies after the capital is raised.

With respect to the former, while finding capital for those risky but potentially promising businesses might seem a laudable goal, one might well question whether business should be permitted to target the life savings of senior citizens and retirees who cannot replace the savings they lose. The latter group are often repeat purveyors of cookie-cutter investment programs with no societal value. There simply is no justification for exposing California's seniors, retirees or anyone else to their sales efforts. The exemption, as drafted, applies equally to both categories of issuers of securities. The exemption eliminates the proper oversight necessary to prevent predictable financial disaster and assure basic fairness to investors. It is critical that the types of offerings contemplated be qualified with the Commissioner of Corporations to ensure that what is being advertised is in fact delivered to investors.

PIABA has reviewed AB 2081's proposed new Corporations Code § 25102(r) exemption in the context of existing exemptions, most notably § 25102(n). While we might well question § 25102(r)'s permission to cold call persons viewed as prospects for investment pitches (many or most of whom will be seniors and retirees) in their homes, a correction to that problem would require modification of both of those subsections of § 25102. While modifying that aspect of existing § 25102(n) might be desirable, it is not the issue before us today.

Rather, the focus of this comment letter is the additional securities deregulation that will be occasioned by § 25102(r). Comparing proposed §25102(r) with existing § 25102(n) reveals that the additional deregulation primarily takes the form of a substantial broadening of the type of advertising permitted. In contrast to existing §25102(n)'s permission for very limited announcements in the nature of tombstone ads, proposed § 25102(r) would allow and *require* general solicitation and general advertising. The provision that would do so appears in the first two sentences of § 25102(r).

We note that the kind of general solicitation and general advertising that is *required* by proposed § 25102(r) is the very kind of advertising that is *prohibited* in offerings that are exempt under SEC Regulation D. Proposed § 25102(r) exempts *[a]ny offer or sale of a security by an issuer using any form of general solicitation or general advertising* ***as specified in Rule 502(c) of Regulation D under the Securities Act of 1933*** *(17C.F.R. 230.502(c)), ...* [Emphasis added.][1] [2]

---

[1] The full text of Rule 502 (17 CFR 240.502) can be found at http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=7e84e8d0b0983879ddb3df797693f651&rgn=div8&view=text&node=17:2.0.1.1.12.0.42.175&idno=17 .

[2] Rule 502(c) states:

> (c) *Limitation on manner of offering.* Except as provided in §230.504(b)(1), neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following:
>
> (1) Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and

The words "as specified in" leave the reader with the false impression that the advertising permitted by 25102(r) is the same kind of advertising that is permitted by SEC Rule 502(c). The reality is the opposite: "as specified in"really means "prohibited by." The proposed exemption permits the very forms of solicitation and advertising that are forbidden by the SEC rule it cross-references. The permission for general solicitation and general advertising in AB 2081 really does represent a dramatic rollback in the longstanding protection of California's savers and investors.

Thus, the 25102(r) exemption, as currently drafted, would allow the full range of print, radio, television and in-person seminar advertising. This type of advertising will put large numbers of Main Street investors at risk. One's status as an "accredited investor" is based primarily on an outdated computation of net worth. It offers no guarantee or even likelihood of investment sophistication or the ability to evaluate risky but legitimate startup ventures, let alone the highly speculative capital formation programs that will no doubt spring up to take advantage of the new exemption.

Because it indicates far less about investment sophistication than it does about assets, accredited investor status correlates best with age. Elderly retirees make up a disproportionately large percentage of people who meet the definition of accredited investors simply because their property has had longer to appreciate, their savings have had longer to accumulate, they have taken rollovers or lump-sum payouts of pension assets that have accumulated through decades of hard work and, sadly, many are widowed and hold the proceeds of their spouses' life insurance policies. The funds they lose cannot be replaced. They have neither the time nor the employment prospects to do that.

Aggressive advertising is very effective when directed at non-professional investors, who will be the vast majority of offerees under the proposed exemption. The initial sales pitch drives the yes-or-no decision regarding an investment. An advertisement that makes promises is likely to be relied upon, even though the inches-thick already-filled-out official documents in the stack of paper that the investor is required to sign will disclaim the representations made in the ads. That

---

(2) Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising; *Provided, however,* that publication by an issuer of a notice in accordance with §230.135c or filing with the Commission by an issuer of a notice of sales on Form D (17 CFR 239.500) in which the issuer has made a good faith and reasonable attempt to comply with the requirements of such form, shall not be deemed to constitute general solicitation or general advertising for purposes of this section; *Provided further,* that, if the requirements of §230.135e are satisfied, providing any journalist with access to press conferences held outside of the United States, to meetings with issuer or selling security holder representatives conducted outside of the United States, or to written press-related materials released outside the United States, at or in which a present or proposed offering of securities is discussed, will not be deemed to constitute general solicitation or general advertising for purposes of this section.

reality is why Regulation D and existing § 25102(n) allow only tombstone-style announcements – bare-bones factual announcements that, in and of themselves, are unlikely to have investors clamoring to risk a substantial chunk of their savings.

In the current market especially, with interest rates on savings at all-time lows, large numbers of seniors and retirees are particularly vulnerable to promises of higher returns. The money they lose is, in many cases, unrecoverable. They suffer not just financially but emotionally and physically as well when they lose the nest-egg that they have accumulated over a lifetime. To be put at that kind of risk so that their capital can be made available for ventures too risky to merit bank or traditional venture capital financing is inappropriate. To allow their savings to be lost in cookie-cutter deals devoid of social value is worse still.

PIABA believes that money lost by investors in these deals as a result of wrongdoing is likely never to be recovered. First, there is a collectability issue. By the time bilked savers or investors sue, and certainly by the time they obtain a judgment or award, there often is no defendant with funds to pay it. Second, even when the funds might exist, securities litigation is so expensive that it may be impossible or impractical to pursue the matter. Much of this is due to the high cost of expert witnesses in these cases. Thus, a $150,000 loss, which may be devastatingly large to a senior, might well be too small to pursue due to the high cost of securities litigation. Sadly, PIABA's members have seen this scenario play out far too many times. The likely futility of attempts to remedy these losses after they occur makes it imperative that laws designed to prevent the losses be allowed to operate unimpaired by the proposed exemption.

PIABA believes that leaving the broad, permissive advertising provision in the first sentence of proposed § 25102(r) unchanged will invite large-scale financial carnage, with seniors vastly overrepresented among those harmed. Changing that advertising provision to allow only a more restrictive tombstone-style of advertising will leave proposed § 25102(r) so similar to existing § 25102(n) that its adoption won't add much to the law besides unneeded complexity. Thus, PIABA's preference would be to see the section not adopted. But if it must be enacted, we hope that general solicitation and general advertising will be prohibited and that, if any advertising is to be permitted at all, it will be limited to tombstone-style advertising of the kind described in SEC Rule 135c.

We as a people have a long history of learning and relearning the harsh lessons of the past. We are being battered mercilessly this time around for forgetting repeated lessons about the dangers financial industry deregulation, including the lessons of the 1920s and 1930s. Continuing efforts at further deregulation of financial and securities markets should be resisted. We instead should remember and move back toward the regulatory environment that, for the approximately six decades that ended in the mid-1990s, imbued U.S. capital markets with a level of honesty and transparency that made them the envy of the world. And closer to home, we should maintain for California's savers and investors, and for seniors and retirees in particular, the level of protection that currently exists.

Thank you for your consideration of our concerns about AB 2081.

Very truly yours,

Ryan K. Bakhtiari
Aidikoff, Uhl & Bakhtiari
9454 Wilshire Blvd., Suite 303
Beverly Hills, California 90212
Telephone (310) 274-0666
Fax (310) 859-0513
rbakhtiari@aol.com

cc: Kathleen O'Malley
Assembly Banking Committee
Via Email Only kathleen.omalley@asm.ca.gov

David Miller
Via Email Only david.miller@asm.ca.gov

Scot Bernstein
Via Email Only swampadero@sbernsteinlaw.com