NASAA

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VIA EMAIL: rule-comments@sec.gov

Nancy M. Morris
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

**Re: Exposure Draft of the Advisory Committee on Smaller Public Companies**
**File No. 265-23**

Dear Ms. Morris:

By this letter, the North American Securities Administrators Association, Inc. (NASAA),1 offers its comments on the Exposure Draft of the final report of the Advisory Committee on Smaller Public Companies (the "Committee"). Preliminarily, NASAA thanks the Committee for the cordial reception of our representative, Jack Herstein, who acted as an Official Observer and participant. While recognizing that the Exposure Draft is not final, we nonetheless appreciate this opportunity to comment on its contents. We will provide further comments to the Commission should it pursue the recommendations set forth in the Exposure Draft. The comments contained in this letter pertain to selected recommendations on Capital Formation, Corporate Governance, and Disclosure contained in Part IV of the Exposure Draft.

NASAA commends the significant effort the Committee spent on the issues set forth in the Exposure Draft and the Committee's recommendations to increase capital formation and disclosure on many different fronts. NASAA comments on the Exposure Draft out of concern that certain recommendations, as currently drafted, will erode existing protections for investors in small business issuers. These recommendations suggest significant changes to the existing regulatory framework for securities issued by small businesses. While NASAA commends efforts to facilitate small business capital formation and promote uniform state securities regulation, any actions taken to advance these goals must not jeopardize investor protection – the primary goal of securities regulation.

1 The oldest international organization devoted to investor protection, NASAA was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grassroots in[redacted]tion and efficient capital formation.

Our comments are set forth below in response to selected recommendations contained in the Exposure Draft.

**Recommendation IV.P.5:**

**Adopt a new private offering exemption from the registration requirements of the Securities Act that does not prohibit general solicitation and advertising for transactions with purchasers who do not need all the protections of the Securities Act's registration requirements. Additionally, relax prohibitions against general solicitation and advertising found in Rule 502(c) under the Securities Act to parallel the "test the waters" model of Rule 254 under that Act.**

**NASAA would not oppose a new federal exemption allowing general advertising and solicitation if appropriate standards and safeguards were part of the exemption.**

The Advisory Committee has recommended the adoption of a new private offering exemption that would allow general solicitation for transactions with certain "eligible purchasers." As it regards general solicitation, the recommendation reflects the impact that the Internet, e-mail, and evolving electronic communications are making on the historical notion of "offers" and "offerings." We note that combining limited offerings with certain forms of general solicitation is an established concept.2 Updating the exemption regulations to make workable rules consistent with the investor protection mandate of state securities laws is appropriate.

We would not oppose the general concept of the Advisory Committee's recommended exemption if the following conditions were in place:

***The new exemption should be promulgated under § 28 of the '33 Act.***

Section 28 of the '33 Act appears to be the most appropriate enabling provision under which to adopt the new exemption. Promulgating the new exemption under § 4(2) could pose substantial unanticipated consequences to the interpretation of "not involving any public offering." The meaning of this phrase plays a prominent role in state civil, criminal and administrative actions as well as SEC and SRO enforcement actions. State regulators, courts, and the SEC have for decades held public advertising is "incompatible with a claim of a private offering."3 NASAA notes that none of the existing rules that allow limited public solicitation in an exempt offering (Rule 1001, Regulation A "testing the waters," and the MAIE) were drafted to coincide with § 4(2).

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2 NASAA's Model Accredited Investor Exemption (MAIE) and the SEC's Rule 1001, for California offerings, and Rule 254, the "testing the waters" provision under Regulation A, are examples. The Model Accredited Investor Exemption has been adopted in over 30 states. The text of the MAIE is available on NASAA's website at http://www.nasaa.org/content/Files/Model%5FAccredited%5FInvestor%5FExemption.pdf. A NASAA project group is updating the MAIE based on its experience to date.

3 SEC Release No. 33-4552 (Nov. 6, 1962), *available at* http://www.sec.gov/rules/final/33-4552.htm; *Hill York Corp. v. Am. Int'l Franchises, Inc.*, 448 F.2d 680, 689 (5th Cir.-OLD 1971). *See also* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATIONS § 3-C-7 (3d ed. 2004) (citing a House committee report referring to § 4(2) as permitting "an issuer to make a specific or an isolated sale of its securities to a particular person").

NASAA notes that the new exemption could also be promulgated under § 3(b) of the '33 Act. Furthermore, as suggested in the Exposure Draft, the new exemption could be incorporated into Regulation D.

***"Eligible Purchasers" should be meaningfully defined.***

NASAA believes the standards for the definition of "eligible purchaser" should be sufficiently high to ensure that the only investors included in the definition are those who are presumptively financially sophisticated and capable of assuming risk. NASAA proposes a definition that would apply to an individual with:

$1,000,000 in investments and a net worth of $2,000,000 exclusive of the investor's primary residence; provided, that the amount of required investments and net worth will be increased every five years based on the accumulated annual percentage change, if any, in the Consumer Price Index for all urban consumers, as published by the Department of Labor.4

We believe that objectively defining "eligible purchasers" based on ownership of investments as well as net worth avoids the uncertainty and weaknesses inherent in the present definitions in Regulation D. The seriously eroded income and net worth standards of Regulation D, and the subjective standard of "sophistication," have proven a mismatch for defining a class of investors "able to protect themselves." State securities regulators receive many complaints concerning private placements sold to accredited and supposedly sophisticated investors. A significant portion of these complaints demonstrate that the investors are not financially sophisticated in the investments they have acquired. Sophistication itself appears to be in the "eye of the sales agent." Many of the investors merely meet the net worth test, primarily due to their family home, and are not financially sophisticated and have not previously purchased securities. Requiring "eligible purchasers" to already be substantial securities holders brings greater assurance that they will be sophisticated purchasers. Congress indicated its agreement with this "investments under management" approach when enacting § 205(e) to the Investment Advisers Act of 1940 and § 2(a)(51) of the Investment Company Act of 1940.

With regard to investments by legal entities, NASAA notes that inflation has eroded the threshold for assuring their qualification and protection as well. As a consequence NASAA believes that entities should be treated as "eligible purchasers" only if they satisfy the definition of "institutional investor" set forth in § 102(11) of the Uniform Securities Act (2002).5 Adopting the USA definition would have the advantage of fostering a single federal and state standard.

***There should be specific disclosure requirements.***

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4 *See generally* Letter from Joseph P. Borg, President of NASAA, to Jonathan G. Katz, Secretary of the SEC (Mar. 1, 2002) (concerning proposed adoption of rule defining "qualified purchaser" under § 18(b)(3)) *available at* http://www.sec.gov/rules/proposed/s72301/borg1.htm [hereinafter Joe Borg Letter]. *See also* Recommendation IV.S.11, *infra*, discussing "qualified purchaser."

5 The definition of "institutional investor" in the Uniform Securities Act (2002) parallels SEC Rule 501(a) in updated, modernized language and with $10 million, rather than $5 million, thresholds.

The perils for purchasers of private placement securities do not end with their qualifications. State regulators receive many complaints in which investors received a deficient disclosure document or did not receive a disclosure document at all. For this reason, NASAA would expect the new exemption to require the issuer to provide investors with an appropriate disclosure document.

***The content of advertising should be properly limited.***

NASAA would support a new exemption permitting public solicitation of eligible purchasers if the content of advertising is limited in a manner substantially similar to the information specified in the Model Accredited Investor Exemption (MAIE).6 Following this model, any advertising under the new exemption would include a statement that the offering is limited to eligible purchasers and would permit the inclusion of a brief description of the business of the issuer. We believe the MAIE advertising model would be a better fit for the new exemption recommended in the Exposure Draft than following Rule 135(c), which applies to reporting companies. NASAA is in the process of amending the MAIE to address allowable disclosures.

***The integration safe harbor should conform to Regulation D.***

The Exposure Draft recommends that the new exemption contain an integration safe harbor similar to that included in Rule 701.7 NASAA believes it would be confusing and unfair to investors to use this approach to integration in a private offering exemption. A Rule 701 offering of securities is for compensatory purposes, not for raising capital.8 Thus, it generally makes less sense to integrate a Rule 701 offering with, for instance, a Regulation D offering that has a different plan of financing and a different general purpose.9 However, this rationale would not apply to the new exemption recommended in the Exposure Draft.

Further, the Rule 701 approach contemplated in the Exposure Draft would create an inappropriate quagmire: an issuer could conduct an offering under the new exemption using public solicitation without fear of integration while simultaneously conducting an offering under an exemption that prohibits public solicitation, such as Rule 504, Rule 505, Rule 506, or § 4(2). The new exemption would, in effect, permit issuers to circumvent the restrictions on public solicitation in private offerings simply by conducting a concurrent offering under this new exemption. It is unclear how courts would handle such issues. Consequently, if a traditional private offering made sense for a business, we suspect that many prudent practitioners might rightly question the utility of the Committee's recommended exemption.

We would recommend an approach to integration similar to that in Rule 502(a).

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6 *See* note 2, *supra*, for an internet link to the text of the MAIE.
7 Rule 701(f) provides that securities offered in connection with compensatory benefit plans that are exempt under Rule 701 will be "deemed to be part of a single, discrete offering and are not subject to integration with any other offers or sales, whether registered under the Act or otherwise exempt from the registration requirements of the Act."
8 Rule 701, Preliminary Note (5).
9 *See*, *e.g.*, Release No. 33-4552, *supra* note 3.

***There should be disqualification provisions.***

NASAA would expect that the new exemption contain at least disqualification provisions like those contained in Rule 505(b)(2)(iii) of Regulation D, Rule 1.B of the NASAA Uniform Limited Offering Exemption (1983), and § D of the MAIE. Following the theme of the recent Securities Offering Reform Releases,[10] we would expect that development stage companies that do not have a specific business plan or purpose would be ineligible for this new exemption as well.[11] We believe these disqualification provisions are necessary to mitigate the risk of public harm in an exempt offering that involves public solicitation.

***There should be clear and functional restrictions on resale.***

Restrictions on resale like those contained in Rule 502(d) of Regulation D should also be incorporated into any new exemption. NASAA believes that the restrictions in Regulation D, following Rule 144, are sufficiently usable and clear to securities issuers, practitioners, and the industry and that restricting the securities mitigates the risk of public harm created by permitting public solicitation.

***There must be a regulatory filing with the states.***

NASAA's support of a new exemption permitting limited public solicitation of certain purchasers is contingent upon preservation of state authority to require a notice filing as with Regulation D offerings. A notice filing is essential to preserve the ability of the states to effectively enforce state securities laws, screen those involved in risky exempt offerings, and provide basic information in response to local inquiries.

Should the Commission decide to pursue adoption of a new private offering exemption as suggested in the Exposure Draft, NASAA respectfully requests the Commission fully consider the comments contained in this letter and our inclusion in the rule making process.

**NASAA opposes any relaxation of the restrictions on public solicitation applicable to the existing exemptions contained in Regulation D.**

NASAA opposes any relaxation of the restrictions on public solicitation applicable to the existing exemptions contained in Regulation D. The Exposure Draft has not presented persuasive reasons for such a drastic alteration of the structure of Regulation D. The Exposure Draft suggests that applying the prohibition on public solicitation has become complex, subjecting issuers to "draconian risks" concerning the availability of an exemption and effectively prohibiting issuers from utilizing the Internet to communicate with potential investors.

10 SEC Release Nos. 33-8591, 34-52056, and IC-26993; 2005 SEC LEXIS 1789 (SEC 2005).
11 *See* Rule 504(a)(3) *and* MAIE § B.

What constitutes public solicitation has always been complex and case-specific.12 The prohibition on general solicitation in exempt private offerings is an appropriate safeguard against widespread public harm inflicted by promoters of unproven, highly speculative businesses, which history has shown are responsible for a substantial share of securities fraud.13 The Internet has made it easier to perpetrate many types of frauds. The Exposure Draft does not offer a reason to deny the public protections from harm that promoters of speculative businesses can cause.

The Exposure Draft suggests that the restrictions on public solicitation in Regulation D should be relaxed to parallel the "testing the waters" model under Rule 254 of the Act. Without more detail, NASAA is unsure whether "testing the waters" is an appropriate model for an exemption. The "testing the waters" model contemplates that, if investors indicate sufficient interest in the offering, the issuer will actually qualify the offering prior to completing any sales14 and register the offering in any state where actual sales will be made.15 The qualification and registration of the offering prior to any sales is a safeguard not present in Regulation D nor contemplated in the Exposure Draft.16 It is unclear at this time how the Advisory Committee envisions using the "testing the waters" model for exempt offerings.

The Exposure Draft recommends that the "testing the waters" amendment to Regulation D be adopted under § 4(2). As discussed above, an exemption authorizing public solicitation does not fit with the common understanding of a transaction "not involving any public offering." Additionally, this would deny the protections afforded by state registration requirements to local offerings that involve advertising to non-accredited investors, who may need these protections.

**Recommendation IV.P.6**

**Spearhead a multi-agency effort to create a streamlined NASD registration process for finders, M&A advisors and institutional private placement practitioners.**

**A. NASAA agrees to meet with the SEC and the NASD regarding finders.**

NASAA recognizes that finders act as financial intermediaries primarily in private placements and mergers and acquisitions.17 NASAA has appointed a Finders Project Group to explore the issues relating to finders and welcomes the opportunity to meet with the SEC and the NASD on these issues.

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12 *See*, *e.g.*, *SEC v. Sunbeam Gold Mines Co.*, 95 F.2d 699 (9th Cir. 1938) (holding that whether an offering is public or private depends on the circumstances and that an offering may be public although not made to the public at large).
13 LOSS & SELIGMAN, *supra* note 3, at § 3-C-6a.
14 Rule 254(a).
15 *See* NASAA Resolution Regarding the Testing the Waters Exemption, adopted Apr. 24, 1993, *available at* http://www.nasaa.org/content/Files/Resolution.Testing.pdf.
16 We note that the Exposure Draft suggests that if a testing the waters model were adopted under Regulation D, a suitability determination would be made prior to any sales. If we understand the recommendation correctly, we applaud the Committee for suggesting suitability requirements in Regulation D offerings.
17 Task Force on Private Placement Broker-Dealers, ABA Section of Business Law, *Report and Recommendations of the Task Force on Private Placement Broker-Dealers*, 60 (3) BUS. LAW. 959, 960, 966 (2005).

**Recommendation IV.S.2:**

**Make public information filed under Rule 15c2-11.**

**NASAA would support a more meaningful disclosure system for investors in over-the-counter securities if there are appropriate safeguards.**

In general, NASAA supports the concept of providing more meaningful disclosure to investors who purchase over-the-counter securities through, and at prices quoted by, broker-dealer market makers. Current public information regarding issuers with securities traded over-the-counter on inter-dealer quotation systems is very limited and, if available, much of the information is either not from credible sources or may be biased. It is a common practice for over-the-counter issuers to pay individuals to recommend the company stock in different media, such as newsletters, television and radio shows. So-called investor relations firms, in collusion with the company or groups of investors, put out press releases artificially moving the market. The low level of liquidity of securities traded over-the-counter tends to make share prices extremely sensitive and volatile. The risks associated with these securities are compounded by the fact that issuers are not held to any benchmark or minimum listing standard.

While we also support the concept of issuer liability for disclosures, particularly when the issuer is entering the securities markets, we note that the recommendation to "place the burden of disclosure on issuers" by requiring postings on issuer websites raises concerns about fraud and manipulation. Internet posting of false or misleading information about businesses is an easy, cost-efficient, anonymous, and market-wide way to perpetrate pump-and-dump, market manipulation, and similar frauds.[18] It is not uncommon to find that issuers and insiders are behind "pump and dump" schemes.[19] Entrusting issuers to be the repository of this information raises substantial public policy questions. We also note that the *broker-dealer*, not the issuer, files the Form 211 with the information the *broker-dealer* has collected and used in support of the *broker-dealer's* price quotes.

Given the high risk nature of these investments, it is important that public investors have as much tangible information as possible to make informed decisions. Public availability of the company information required by Rule 15c2-11 should make readily accessible basic information for public investors to review before making investment decisions. NASAA encourages the Commission to pursue this recommendation to enhance disclosure and make available an orderly and reliable system to disseminate Rule 15c2-11 information.

**Recommendation IV.S.4:**

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18 Richard H. Walker & David M. Levine, *"You've Got Jail": Current Trends in Civil and Criminal Enforcement of Internet Securities Fraud*, 38 AM. CRIM. L. REV. 405 (2001) (compiling Internet fraud SEC actions, including pump-and-dump cases by large holders and those pretending to be the issuer).

19 *See, e.g.*, SEC, Microcap Stock: A Guide for Investors (Aug. 2004), available at http://www.sec.gov/investors/pubs/microcapstock.htm (modified Feb. 22, 2006); SEC, Pump and Dump, *available at* http://www.sec.gov/answers/pumpdump.htm (modified Mar. 12, 2001).

**Allow companies to compensate market-makers for work performed in connection with the filing of a Form 211, with full disclosure of such compensation arrangements.**

**NASAA opposes payments to market-makers for quoting prices.**

Paying market makers for quoting prices may create conflicts of interest by influencing a broker-dealer's decision about whether to quote a price, and the prices to quote, for the issuer's securities. The extent and impact of the conflict can be difficult to investigate, requiring significant devotion of regulatory resources. These types of payments should not be allowed under any circumstances. Furthermore, this recommendation is in direct conflict with NASD Rule 2460 and long-standing policy.20

**Recommendation IV.S.5**

**Evaluate upgrades or technological alternatives to the EDGAR system so that smaller public companies can make their required SEC filings without the need for third party intervention and associated costs.**

**NASAA supports upgrades to EDGAR.**

NASAA supports upgrades or technological alternatives to the EDGAR system that would allow smaller public companies to make their required SEC filings without the need for third party intervention and associated costs. We agree that significant technological advances have occurred since the EDGAR system was established in 1993 and that, incident to the announced EDGAR modernization project, Internet standards (XBRL) and protocols (web services) should be used.

The Exposure Draft states that many companies, especially smaller companies, find the EDGAR system unnecessarily complex and often engage costly third party vendors to file their reports with the SEC. NASAA agrees that complexity and cost may create unnecessary burdens on capital formation for smaller public companies. We also note that the current online display of SEC filings through EDGAR impairs readability.

In addressing these issues, we would urge the Commission to look to SEDAR, the Canadian version of EDGAR. As the SEC is aware, SEDAR enables public company filers to submit required filings in a format that enables regulators, as well as public investors, to review materials online in the same form as print versions of the reports. Making the online display of these filings more reader-friendly is important to the goal of a more informed investing public.

**Recommendation IV.S.7:**

**Increase the disclosure threshold of Securities Act Rule 701(e) from $5 million to $20 million.**

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20 *See*, *e.g.*, NASD Notices to Members 75-16 (Feb. 1975), 92-50 (Oct. 1992), and 97-46 (Aug. 1997); SEC Release No. 34-39478 (Dec. 22, 1997).

**NASAA opposes the Committee's recommendation not to require risk factor and financial information disclosures in Rule 701 offerings below $20 million.**

NASAA opposes the recommendation to increase the Rule 701 disclosure threshold from $5 million to $20 million. The Committee's rationale relates to the desire of private issuers "to maintain the confidentiality of their financial information for competitive reasons." First, this provides no reason to withhold the summary of the plan or the risk factors from employee-investors. Second, the Commission, which did not originally propose a threshold,21 set the current $5 million threshold in 1999 fully aware of this concern:

Some commenters expressed concern that requiring a private issuer to deliver disclosure documents, particularly financial statements, to employee-investors could result in serious harm to the company if the information were to come into possession of its competitors. In view of the substantial amounts of securities that may now be issued under Rule 701, we believe that a minimal level of disclosure consisting of risk factors and Regulation A unaudited financial statements is essential to meet even the lower level of information needed to inform compensatory-type investors such as employees and consultants. Private issuers can use certain mechanisms, such as confidentiality agreements, to protect competitive information. Alternatively, an issuer could elect to stay below the $ 5 million threshold to avoid these disclosure obligations.22

Noting that many businesses choose to provide these disclosures, perhaps for anti-fraud reasons, and the large amount of securities that may be sold under the exemption, the Commission further opined that "mandatory disclosure is necessary for investor protection."23 This Commission rationale remains persuasive.

We agree with the Committee that any set dollar standards must be adjusted periodically to reflect inflation. The $5 million threshold here is a relatively recent monetary standard set by the SEC. Whatever mechanism the SEC devises to address older financial thresholds, such as those described in the 2002 Joe Borg Letter,24 should also be applied prospectively to this area.

**Recommendation IV.S.9:**

**Shorten the integration safe harbor from six months to 30 days.**

**NASAA opposes altering current integration rules, particularly when neither the SEC nor the states receive filings to mark the beginning and end of offerings the issuer desires as separate.**

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21 The proposed amendment made the disclosure obligation generally applicable, and the Commission requested comment on whether to set a disclosure threshold, such as $1 million to coordinate with Rule 504. *See* SEC Release No. 33-7511, 63 FR 10785, 10792, 10788 (Mar. 5, 1998).
22 SEC Release No. 33-7645, 64 FR 11095, 11097 (adopting amendments to current Rule 701).
23 *Id.*, 64 FR at 11099-11100.
24 Joe Borg Letter, *supra* note 4.

NASAA opposes any alteration to the current rules for integration. Any changes to these well-established rules would create uncertainty and significant enforcement concerns.

The Committee has recommended substantially changing the existing integration rules for "the entire universe of private offering exemptions." The Committee justifies this recommendation on the reasoning that integration issues create uncertainty and that the current guidance lacks clarity. The Committee, however, does not identify the exemptions to which it would like such a rule to apply, or which exemptions currently lack certainty or clarity. Given the numerous safe harbor rules that apply to various private offerings, the Committee's argument appears somewhat exaggerated. *See, e.g.*, Rule 502(a) (six-month pre– and post-offering safe harbors for all exemptions); Rule 147(b)(2) (same, intrastate offerings); Rule 155 (30 days after abandoned 4(2), 4(6), or 506 offering, integration safe harbor for registered offering; 30 days after withdrawn registered offering, safe harbor for 4(2), 4(6), or 506 offering); Rule 251(c) (Reg. A, no integration of prior offerings or offerings six months after Reg. A offering); Rule 701(f) (no integration for certain exempt employee benefit plans). There will also be no integration of various offshore and foreign offerings with domestic offerings. *See, e.g.*, Release No. 33-6863 (April 24, 1990); Rules 801 and 802. *See also* SEC Release 33-7943, 66 FR 8887, 8891 n. 48 (Feb. 5, 2001) (SEC "traditionally looks to the six-month non-integration safe harbor of Regulation D even if the private offering does not rely on Regulation D for an exemption").

The Advisory Committee's remaining argument is that the safe harbor in Regulation D lacks flexibility "as it requires that as much as a full year elapse between offerings." While the Advisory Committee has not explained the particular circumstances where such a result might occur, it is hard to imagine a circumstance under current law where an issuer would be unable to conduct multiple securities offerings in a year using current integration safe harbors.

Ultimately, the Advisory Committee recommends a 30-day integration safe harbor that is unprecedented in its brevity. Particularly without filings at the beginning and end of such private offerings, which would assist regulators, investors, and the issuer itself in knowing the extent and timing of the offering activities, NASAA opposes this recommendation.

**Recommendation IV.S.11:**

**Increase uniformity and cooperation between federal and state regulatory systems by defining the term "qualified investor" in the Securities Act and making the NASDAQ Capital Market and OTCBB stocks "covered securities" under NSMIA.**

**NASAA strongly opposes defining "qualified purchaser" as an "accredited investor."**

The Committee has recommended that the SEC define "qualified purchaser" for the purposes of § 18(b)(3) of the Securities Act, and that this term be defined to mean "accredited investor" as it is used in SEC Regulation D. NASAA urges that defining "qualified purchaser" in this manner would dangerously undercut investor protection by preempting state securities registration with respect to a group of retail investors who specifically need the protections of state securities regulation. These investors do not by virtue of their total net worth have sufficient bargaining power to gain access to the information they need to make investment decisions. Additionally, many investors who meet the net worth or income thresholds do not have financial or investment sophistication such that they should be denied the protection of securities registration.25

Furthermore, using "accredited investor" as the basis to define "qualified purchaser" appears contrary to congressional intent as reflected in NSMIA. NASAA notes that when NSMIA was passed, Congress had the opportunity to use the term "accredited investor" in § 18(b)(3), as it did in § 4(6), but it chose not to do so. We do not believe this approach is "consistent with the public interest and the protection of investors." § 18(b)(3).

NASAA proposes that "qualified purchaser" be defined, as Congress may have intended, in the same manner as Congress defined the term "qualified purchaser" in § 2(a)(51) of the Investment Company Act of 1940. This would set the standard to include individual investors who own at least $5 million in investments as defined by the Commission, certain trusts holding adequate investments, and other persons acting for their own account or for the accounts of other qualified purchasers who in the aggregate own and invest at least $25 million.

**NASAA strongly opposes making OTCBB securities "covered securities."**

The Committee's recommendation to designate securities traded on the Over the Counter Bulletin Board ("OTCBB") as "covered securities" under § 18(b)(1)(B) of the '33 Act is contrary to the requirements of NSMIA.26 Section 18(b)(1)(B) plainly limits the "covered securities" designation to securities that are "listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule are substantially similar to the listing standards applicable to securities" that are listed or authorized for listing on the NYSE, AMEX, or the Nasdaq NMS. The OTCBB is an electronic quotation system that displays price information for unlisted securities; it is not a securities exchange and has no listing standards, let alone standards "substantially similar to" the major exchanges.27

NASAA also notes that a company listed on the OTCBB needs only to be current with its ongoing Securities Exchange Act reports; it need not meet any qualitative standards. We note that many of the junk e-mail and stock spams that we have seen have involved

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25 *See* Joe Borg Letter, *supra* note 4 (also noting the effects of 20 years of inflation on the definition). *See also* note 5, *supra*, and accompanying text.

26 With respect to the Committee recommendation that Nasdaq Capital Market (NCM) securities should have the status of covered securities, we note that NCM recently filed a petition with the Commission to be recognized as a securities exchange under § 18(b)(1)(B). *See* Petition to Amend Rule 146(b) to Designate Securities Listed on the Capital Market as Covered Securities for the Purpose of Section 18 of the Securities Act of 1933, SEC File No. 4-513 (Feb. 28, 2006). NASAA notes that the petition did not include OTCBB securities. The petition is beyond the scope of the comments contained in this letter.

27 *See, e.g.*, SEC, OTC Bulletin Board (OTCBB), *available at* http://www.sec.gov/answers/otcbb.htm (modified Mar. 1, 2005).

companies that are quoted on the OTCBB. Moreover, the over-the-counter market is widely noted to include shell companies and illegally manipulated stocks.

**Recommendation IV.S.12:**

**Clarify the interpretation of or amend the language of the Rule 152 integration safe harbor to permit a registered initial public offering to commence immediately after the completion of an otherwise valid private offering the state purpose of which was to raise capital with which to fund the IPO process.**

**NASAA questions the recommendation to amend Rule 152.**

It is not clear to NASAA that the markets are confused about Rule 152 or that rule changes are otherwise necessary or appropriate at this time. We have not found a request for a no-action letter referencing the rule since 1998 (and only two in the past decade). We do, however, question the Committee's characterization of the law, supported only with a cite to the Verticom no-action letter. The Advisory Committee claims that SEC staff will interpret Rule 152 to allow "an issuer [to] concurrently plan[] a private placement and registered offering."

Loss & Seligman disagree:

[T]he Commission staff has insisted that the subsequent public offering not be planned before or simultaneously with the earlier private placement. . . . There is no general principle of not integrating simultaneously planned public and private offerings.[28]

Loss & Seligman cite the Verticom no-action letter for the proposition that "[t]he Commission staff, however, has permitted a subsequent public offering to be 'contemplated' as long as it is not 'planned' in a more formal sense."[29]

We agree with Loss & Seligman on the status of the law. We also question the need for the SEC to dedicate rulemaking resources to this area in light of current practices.

**Conclusion**

The comments in this letter have been limited, as mentioned, to selected recommendations of the Committee. NASAA has not had sufficient time to study other recommendations and parts of the Exposure Draft and, therefore, reserves comment on these to a later time.

Thank you for your consideration of NASAA's views on these issues. If you have any questions regarding the comments contained in this letter, please do not hesitate to contact Rex Staples, NASAA General Counsel, at rs@nasaa.org or 202-737-0900, or Mike Stevenson, Director of the Washington Securities Division and member of

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28 LOSS & SELIGMAN, *supra* note 3, at § 3-C-1.
29 *Id.*, at § 3-C-1, n. 27.

NASAA's Corporation Finance Section Committee, at mstevenson@dfi.wa.gov or 360-902-8797.

Sincerely,

Patricia D. Struck
NASAA President and
Wisconsin Securities Administrator