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March 22, 2007

John W. White, Director,
Division of Corporation Finance,
Securities and Exchange Commission,
100 F Street, N.E.,
Washington, D.C. 20549.

Re: Securities Act of 1933 -
Private Offering Reform

Dear John:

In June 2005, following a monumental effort over a number of years, the Commission adopted amendments to its rules and forms relating to registered public offerings. The rules modernized and streamlined the public offering process and, especially for larger public companies, brought it into line with the realities of modern market practices and communications technologies – all without compromising the protection of investors. In fact, new Rule 159 relating to communication of information to investors by the time of sale and the use of free writing prospectuses have improved the protection of investors. Since these changes went into effect in December 2005, we believe they have worked very well and have been embraced by the corporate and investment banking communities.

The American Bar Association's Committee on Federal Regulation of Securities[1] is writing to request that the Commission embark upon a similar project to review, update, simplify and clarify on a comprehensive basis the requirements applicable to non-public (or private) offerings that are not subject to the registration requirements of the Securities Act and bring these requirements into line with modern market practices and communications technology. For many decades, the law applicable to private offerings has been vague and unclear and, in many respects, has been more the subject of lore than law. Although lore and market practices have changed, it is not clear that changes in the law have kept pace. For example, while a variety of safe harbors have been adopted, changes in market practices have caused these safe harbors to become out of date in important respects. As a result, lawyers are hard pressed to know and advise as to the line between permissible private offerings and public offerings that must be registered. We believe that the changes we suggest will add clarity and efficiency and can be accomplished without adversely affecting protection of investors.

We believe that this request is particularly timely in light of the recommendation of specific changes in private offering requirements contained in the Final Report of the Advisory Committee on Smaller Public Companies to the SEC (Apr. 23, 2006). We also believe that a comprehensive approach, which would address

1 This letter is provided by the Committee on Federal Regulation of Securities of the American Bar Association's Business Law Section. It does not represent an official position of the American Bar Association or the Section, nor does it necessarily reflect the views of all of the Committee members.

all relevant aspects of unregistered offerings, would be preferable to addressing discrete issues or recommendations on a piecemeal basis.

I. Overview

Since the 1930s, the boundary between offerings to the public required to be registered and private offerings not required to be registered has been a shifting no-man's land. Safe harbors adopted over the years have illogical inconsistencies. For example, under Regulation D unlimited offers are permitted as long as purchases fall within the limits of the Regulation and there is no "general solicitation" or "general advertising" (very imprecise terms), whereas under Rule 144A, "offers" to non-QIBs are not permitted. The risk to issuers and sellers of getting a private offering wrong is that purchasers have a one-year put under § 12(a)(1) of the Securities Act for violation of § 5. In theory at least, for example, there is risk that a court applying the exemption literally and technically could conclude that an offer to an ineligible offeree who does not purchase and thus suffers no harm can result in the loss of an exemption from § 5 for the entire offering and give all purchasers a one-year put, even if those purchasers are limited to eligible ones and the disclosure is unassailable.[2]

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[2] This Committee has previously expressed a contrary view about the appropriate application of the exemption in such a case: "[We] believe that a court should, and probably would, either find the exemption available vis-a-vis [a non-disqualifying] plaintiff, or find some other basis for denying the plaintiff the right to rescind his transaction." 31 The Business Lawyer 493-4 (Nov. 1975).

We believe that the current rules for unregistered offerings have led to the following problems:

- Uncertainty as to whether unregistered offerings run afoul of § 5, with the potential draconian liability of a put right held by purchasers, even in the absence of any harm to investors.

- Restricting communications in ways that hamper legitimate offering techniques and, in some cases, are unworkable given modern technologies and communications practices.

- Impeding secondary market activities in ways that adversely impact private offerings.

- Restricting the ability to conduct private and public offerings that are proximate in time.

Each of these issues adversely affects the costs and complexity of capital formation, which often fall disproportionately on smaller companies.

The time has come to take a fresh and comprehensive look at the private offering exemption, identify and state the underlying rationale in a principles-based fashion in the light of today's information and communications technologies and market realities, bring clarity to the area and protect conduct that does not adversely affect investors or offerees. We believe that the following basic changes are needed:

- Re-examine the definition of investors not needing the protection of the registration requirements of the Securities Act and reduce the disparity among definitions in the securities laws for such investors.

- Focus the protections on those who purchase and in effect deregulate all offers to offerees who do not purchase. Offerees who do not purchase do not need the protection of registration. Eliminate the vague concepts of "general solicitation" and "general advertising," which are wholly inconsistent with today's information and communications technologies. Any misconduct in making offers would still be subject to § 17(a) of the Securities Act and § 10(b) of the Exchange Act and Rule 10b-5 thereunder.

– Identify more clearly, through a presumptive definition, control persons whose sales require registration. Where a control person is treated as an "issuer" under § 2(a)(11), it should be entitled to the same safe harbors as issuers.

– Replace the current five factors relating to integration of offerings, which do not work and are largely ignored, with a more meaningful and useful set of factors, and adopt meaningful safe harbors where appropriate. Eliminate the restrictions on public and private offerings that are proximate in time where the restrictions serve no public interest in protecting investors or markets.[3]

– Re-examine the time periods for holding securities and separating offerings in light of today's volatile markets and make those periods more consistent under similar circumstances.

II. History[4]

The Statute. The Securities Act was enacted almost 75 years ago. The approach to offerings by issuers not requiring registration was incredibly simple. In what is now § 4(2),[5] it simply exempted "transactions by an issuer not involving any public offering". As the U.S. Supreme Court said 20 years later:

> "The Securities Act nowhere defines the scope of § 4([2])'s private offering exemption. Nor is the legislative

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3 See, for example, the staff position cited in fn. 12 below.

4 This is not a complete chronological recitation of the requirements from time to time of a non-public or private offering. Rather, it is an attempt to sketch the evolution of the changing concepts through the years that have shaped views of the scope of the private offering exemption.

5 Throughout this letter we shall refer to statutory provisions by their current numbering.

> history of much help in staking out its boundaries." SEC v. Ralston Purina Co., 346 U.S. 119, 122 (1953).

The other relevant provision of the Securities Act was § 2(a)(11), the definition of "underwriter". In a backhanded way, this definition (coupled with the exemptions in §§ 4(1) and 4(3), which are not available to underwriters) limited the scope of § 4(2) by preventing indirect public offerings by issuers and "control" persons through third parties:

> "The term 'underwriter' means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any securities …. As used in this paragraph, the term 'issuer' shall include … any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer."[6]

The term "distribution" is not defined in the statute but has always been understood to be synonymous with a public offering, i.e., an offering in which the securities end up in the hands of the public.[7] The term "control" is not defined in the statute either. It is, however, defined in Rule 405:

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6 Interestingly, and as becomes relevant below, the statutory concept of underwriter does not turn on a person's status as a dealer under the Securities Act or a broker or dealer under the Exchange Act.

7 "'Distribution' ... comprises the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public...." In re Oklahoma-Texas Trust, 2 S.E.C. 764, 774 (1937).

A purchase with a view to a resale that is registered or exempt does not violate § 5. See Newwirth Inv. Fund v. Swanton, 422 F.Supp. 1187 (S.D.N.Y. 1975), and Berckeley Inv. Group Ltd. v. Colkitt, 455 F.3d 195, 215 (3d Cir. 2006) (collecting cases). Thus, anyone may buy from an issuer with a view to resale in

> "The term 'control' (including the terms 'controlling', 'controlled by' and 'under common control with') means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

The Commission and its staff have always taken a very expansive view of "control", presumably to maximize the reach of the Securities Act's registration requirements. But, interestingly, in other statutory and regulatory contexts the term is not viewed so broadly. Thus, in the Investment Company Act of 1940:

> "'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company.
>
> "Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such company. Any person who does not so own more than 25 per centum of the voting securities of any company shall be presumed not to control such company. A natural person shall be presumed not to be a control person within the meaning of this title. Any

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a registered offering (e.g., underwriters in a conventional public offering and holders of registration rights), in a Rule 144A offering or in an offering outside the United States meeting the requirements of Regulation S. See Preliminary Note 7 to Rule 144A. See also SEC amicus curiae letters in In re Safety-Kleen Bondholders Litigation (Aug. 9, 2001) and In re HealthSouth Securities Litigation (Nov. 28, 2006).

"Distribution," as used in the Securities Act, is to be distinguished from "distribution" as used for the purpose of Regulation M and the trading rules. See Regulation M, Rule 100.

> such presumption may be rebutted by evidence. …"
> § 2(a)(9)[8]

Early Opinion of SEC General Counsel (1935). In January 1935, in an effort to clarify the application of § 4(2), the SEC's General Counsel issued a letter[9] discussing the factors to be considered in determining the availability of the § 4(2) exemption. After noting that the office had previously expressed the opinion that under ordinary circumstances an offering to not more than approximately 25 persons is not an offering to a substantial number and presumably does not involve a public offering, the General Counsel said that "what constitutes a public offering is essentially a question of fact, in which all surrounding circumstances are of moment." He then went on to discuss the following factors as bearing on the existence or non-existence of a public offering:

– Number of offerees – not the number of actual purchasers but number of persons to whom securities are offered for sale – any attempt to dispose of a security to be regarded as an offer

– Relationship of offerees to each other and to the issuer, e.g., offering to class of high executive officers who should have special knowledge of the issuer is less likely to be a public offering

– Number of units offered – large minimum denomination

– Size of offering – exemption intended to be applied chiefly to small offerings

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8 See also Exchange Act Rule 10A-3(e) (relating to independent directors for audit committee purposes), which provides a safe harbor that one person shall not be deemed to be in control of another person if the former (a) is not the beneficial owner, directly or indirectly, of more than 10% of any class of voting equity securities of the latter and (b) is not an executive officer of the latter.

9 Securities Act Release No. 285, 1 CCH Fed. Sec. L. Rep. ¶ 2740 (Jan. 24, 1935).

– Manner of offering

The General Counsel went on to say that if the initial purchaser had purchased with a view to distribution, the initial purchaser would be an underwriter, and sales of securities bought from such initial purchaser by a dealer "would, as a general rule, not be exempt until at least a year after the purchase of the securities by the dealer (Emphasis added.)."[10]

Rule 152 (1935). In 1935, the Commission adopted a rule to the effect that an otherwise lawful attempted private placement is not retroactively rendered illegal by the fact that the issuer subsequently "decides to make a public offering and/or files a registration statement". Although there is little of help in the adopting release,[11] it would appear that the Rule was designed to facilitate and encourage registration.[12]

Ralston Purina. The leading case interpreting § 4(2) came approximately 20 years after adoption of the Securities Act and remains the leading case more than 50 years later! In retrospect, it is curious that such an important case was decided 6-2, with a majority opinion that took little more than seven pages (one page being the most

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10 See also In re Brooklyn Manhattan Transit Corp., 1 SEC 147 (1935); Securities Act Release No. 603 (1935); and Throop & Lane, Some Problems of Exemption under the Securities Act of 1933, 4 Law & Contemp. Probs. 89 (1937).

11 "The rule allows those who have contemplated or begun to undertake a private offering to register the securities without incurring any risk of liability as a consequence of having first contemplated or begun to undertake a private offering." Securities Act Release No. 305 (Mar. 2, 1935).

12 See Verticom, Inc. (avail. Feb. 12, 1986), reversing LaserFax, Inc. (avail. Sept. 16, 1985). The staff has construed Rule 152 to prevent a privately offered security from being sold to the original offeree pursuant to a registration statement without an intervening period of at least a year.

important) and without a dissenting opinion. The Court stated that it had granted certiorari based on “an apparent need to define the scope of the private offering exemption”. The Court declined the Commission’s request to hold that “an offering to a substantial number of the public” is not exempt under § 4(2) (at p. 125). “[T]he statute would seem to apply to a ‘public offering’ whether to few or to many. … There is no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation.” (At p. 125.)

Instead, the Court chose to interpret the exemption in light of the statutory purposes of the Securities Act. The availability of the exemption

> “should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering’”. (At p. 125.)

The Court stated that an offering to “executive personnel who because of their position have access to the same kind of information that the Act would make available in the form of registration statement” may come within § 4(2). (At pp. 125-126.)

Law, Lore and Legal Advice – Issuer Offerings. All things considered, the guidance of the SEC General Counsel and the Supreme Court did not do much to define the boundary between private and public offerings. As a result, the securities bar applied a case-by-case “facts and circumstances” analysis, focusing on the following factors:

– Number of offerees

– Financial sophistication of purchasers or their investment advisers

– Ability to bear economic risk of a loss of their investment

– Information about the issuer or access to such information

– Investment intent – did the investor intend to invest?[13] – but a purchase may be with view to resell in a registered or exempt transaction. See fn. 7.

Law, Lore and Legal Advice – Sales by Control Persons and Holders of Restricted Securities. The § 4(2) exemption, by its terms, is available only to issuers and, presumably, their agents. It does not address sales by control persons, who are "issuers" for purposes of § 2(a)(11), or resales by non-control persons of securities acquired without registration from issuers and control persons. Based on staff "no-action" letters, patterns developed as to the likelihood of being deemed a "control person" and the holding periods and changes in circumstances following a purchase from an issuer or a control person that would negate underwriter status. Following a holding period of two to three years or an unforeseen "change in circumstances," a holder of privately placed securities could resell without registration. Absent relief under the "no-action" letters, and based on §§ 4(1) and 4(3) and by analogy to issuer private offerings under § 4(2), the

13 The staff has taken the rather arbitrary position that a broker-dealer can never purchase with the requisite investment intent and, therefore, regardless of any holding period is always an underwriter. See fn. 6 above. It sometimes also has applied this position to affiliates of broker-dealers who may not have had any involvement in the transaction other than as a purchaser. In other areas of the securities laws the presence of informational and operational barriers between a broker-dealer and its affiliates might preclude the treatment of affiliates as "affiliated purchasers" for purposes of Regulation M, or the attribution to both a broker-dealer and its affiliates of beneficial ownership for purposes of Regulation 13D/G.

securities bar concluded that non-public sales of those securities were permissible.[14] These private sales or resales are frequently referred to as "§ 4(1½)" sales.

Resale Safe Harbor I (1972). In 1972 the Commission adopted Rule 144, a non-exclusive safe harbor for (a) sales by "affiliates" (defined in terms of control) and (b) resales of "restricted securities" by non-affiliates. "Restricted securities" include securities acquired, directly or indirectly, from the issuer or an affiliate in a transaction or chain of transactions not involving a public offering. The Rule, based on an interpretation of § 2(a)(11) (the definition of "underwriter"), made three important changes in the law of private offerings. First, it established bright-line holding periods after the first of which (originally two years and now one year) the seller could sell limited amounts of the securities in accordance with the limitations of the Rule (designed with the definition of "underwriter" in mind) and after the second of which (originally three years and now two years) it could freely sell unlimited amounts of the securities as long as it was not an affiliate of the issuer. Second, it defined the circumstances in which successive holders could tack their holding periods[15]. Third, it stated in the adopting Release that the Commission would no longer consider "investment intent" and "change in circumstances" in determining whether a seller is an "underwriter" and would no

14 See Resales by Institutional Investors of Debt Securities Acquired in Private Placements, 34 Business Lawyer 1927 (July 1979); and The Section "4(1½)" Phenomenon: Private Resales of Restricted Securities, 34 Business Lawyer 1961 (July 1979).

longer issue no-action letters addressing whether a person was or was not an underwriter based on those concepts.[16] The Rule addressed equity securities that could be sold into public trading markets. For privately placed debt and preferred stock, the Rule has never really worked during the three-year/two-year holding period – the Rule's volume and manner-of-sale limitations and the absence of public trading markets for these securities combine to make the safe harbor essentially unavailable.

Issuer Safe Harbor (1982). Ten years later the Commission promulgated Regulation D, which defined a variety of situations in which an issuer could offer and sell securities without registration. Rules 501-03 and 506 addressed offerings intended to be exempt under § 4(2). Regulation D is not by its terms available to persons other than issuers. These Rules (as they have been amended) made a number of changes in conventional wisdom regarding private offerings:

– Eligibility of offerees. While there were requirements applicable to purchasers and their "purchaser representatives", offerees did not have to meet any eligibility requirements.

– Number of offerees. Subject to the limitation on manner of offering, the number of offerees in and of itself was not important.

– Manner of offering. The only limit was a prohibition of "general solicitation" or "general advertising". Rule 502(c). In addition to

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15 Originally, the Rule suspended the holding period as long as and to the extent the holder had a short position in the securities, but the Commission later eliminated that provision. See fn. 22.

16 Securities Act Release No. 5223, Adoption of Rule 144 (Jan. 11, 1972). Inasmuch as the Rule is non-exclusive, this does not mean that the letters issued before adoption of the Rule no longer have any validity (except to the extent they involve the repudiated "change-in-circumstances" doctrine).

any policy bases for this limitation, the Commission may have been concerned that at the time it had the power to define terms used in the statute but not to grant exemptions from the requirements of the statute. Accordingly, it could not read “offers” entirely out of the statute.

– Number of purchasers. Except for purchasers that did not meet specified qualifications, the number of purchasers was no longer important. There could be an unlimited number of “accredited investor” purchasers. Rule 501(e)(1).

– Information. In the case of “accredited investors”, access to information was sufficient. In the case of purchasers other than “accredited investors”, reporting issuers were required to “furnish” documents filed under the Exchange Act, and other issuers must furnish similar information. Rule 502(b)(2).

– Limitations on resale. Whereas it had been common practice, at least in the case of equity securities, to legend stock certificates, issue stop transfer instructions to the transfer agent and perhaps even require opinions of counsel that resales could be effected without registration, the new Rule required simply that the issuer exercise reasonable care to assure that the purchasers were not “underwriters”, which could be demonstrated (non-exclusively) by (a) reasonable inquiry to determine whether the purchaser was purchasing for himself or herself or another, (b) prior written disclosure that the securities had not been registered under the Securities Act and could not be resold unless registered or sold in accordance with an available exemption from registration, and (c) legending the certificate or other document evidencing the securities stating that the securities had not been registered and setting forth or referring to “the restrictions on transferability and sale of the securities”.[17] Rule 502(d).

Staff Study. In 1986, in an address to the Federal Regulation of Securities Committee, Linda Quinn, then Director of the Division of Corporation Finance, advised

[17] Since the adoption of Regulation D, and with the Commission’s active encouragement, securities of publicly-traded companies have largely been dematerialized or immobilized in DTC. As a result, legending, stop transfer instructions etc. are increasingly impractical for these companies.

us that the Division was attempting to articulate a fundamental definition of a public offering or distribution requiring registration.[18]

Resale Safe Harbor II (1990). In 1990, the Commission adopted Rule 144A, a much more relaxed safe harbor for resales of securities by persons other than issuers to a new class of investors known as "qualified institutional buyers" or "QIBs". Rule 144A is a mirror image of Regulation D in that it is not available by its terms to issuers. Issued as a definitional rule under §§ 2(a)(11), 4(1) and 4(3) (a partial codification of § 4(1½)), it reflected a significant relaxation from Rule 144 and, for our purposes, is interesting in a number of respects:

– Offers and offerees. While Regulation D placed no limits on offers beyond those implied by the limitations on "general solicitation" and "general advertisement", Rule 144A prohibits offers to persons who are not QIBs.

– Number of purchasers. As in the case of Regulation D, there are no limits on the number of QIB purchasers.

– Information. If the issuer is a reporting issuer under the Exchange Act, exempt from reporting by virtue of compliance with Rule 12g3-2(b) or a foreign government eligible to register under Schedule B, there are no requirements. Access to the information is considered adequate. Otherwise, the issuer need only agree to furnish on request relatively limited specified information.

– Limitations on resale. The seller need only take reasonable steps to ensure that the purchaser is aware that the seller may be relying

18 Some of us recall that she said specifically that the staff was considering the possibility of deregulating "offers", but we cannot find that in the text of her address as released by the Commission. Linda C. Quinn, "Redefining 'Public Offering or Distribution' for Today", Address to ABA Fed. Reg. of Secs. Comm. (Nov. 22, 1986). See also Quinn, "Reforming the Securities Act of 1933: A Conceptual Framework," Insights, vol. 10, pp. 25-29 (1995).

> on Rule 144A. Having done so, the seller's exemption is not affected by the purchaser's subsequent actions.

Because of the absence of limitations on volume and manner of sale and the presence of limitations on fungibility with NYSE or NASDAQ-traded securities, Rule 144A has been more useful for resales of debt and preferred stock (convertible or not) than for common stock.

Whether intended or contemplated by the Commission at the time of proposing and adopting Rule 144A, the Rule led to what has become a very important way of raising capital without registration under the Securities Act. Investment banks (individually or in small or large syndicates) purchase securities from issuers in transactions exempt under § 4(2), pursuant to purchase agreements that look very much like underwriting agreements, and resell to QIBs in accordance with Rule 144A, using offering memoranda that look very much like prospectuses used in registered public offerings. The limitations of the definition of QIB have led to side-by-side resales to institutional accredited investors (IAIs) in accordance with "§ 4(1½)." Some lawyers require that the portion sold to IAIs be certificated and held outside DTC. Also, following the adoption of Regulation M, sales to IAIs have meant that the exemptions from Regulation M for Rule 144A offerings are not available.

Rule 144A has led to two further developments. Pursuant to no-action letters,[19] issuers may register new securities identical to those privately placed and

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[19] SEC No Action Letters <u>Exxon Capital Holdings Corp.</u> (avail. May 13, 1988) and <u>Shearman & Sterling</u> (avail. July 2, 1993).

exchange them for the privately placed securities, and the new securities are freely resaleable by the exchanging holders. In the case of U.S. issuers, the no-action relief is limited to nonconvertible debt and investment grade non-convertible preferred stock. In the case of non-reporting foreign private issuers, they may also use this technique for convertible securities or common stock, and many foreign private issuers have done so as a more convenient way of entering the U.S. market. The second development was the PIPE transaction in which promptly after the investment bank obtains binding purchase commitments from QIBs, the issuer registers the securities for resale by the QIBs. The development of PIPE transactions is discussed further below.

Although the initial transactions by the issuer must comply with Regulation D or § 4(2) and Rule 144A restricts offers to QIBs, the rating agencies rate many Rule 144A securities and publish their ratings, and the media cover the offerings. There are electronic trading systems in which the Rule 144A securities are traded. Although we understand these trading systems are often accessible to any subscriber, it is thought that most subscribers are dealers or QIBs. When Rule 144A was first proposed (and even before), the American Stock Exchange planned to establish a trading market known as SITUS for the institutional trading of what have become Rule 144A securities. When the Commission staff objected to publication of trading data with respect to transactions in Rule 144A securities and insisted on restrictions that were not applicable to upstairs trading in these securities, the plans for the SITUS market collapsed.

Rule 135c (1994). An issuer's decision to execute a substantial Rule 144A or other private offering is often itself material market-moving information.

Because issuers found it difficult or impossible to impose obligations of confidentiality on prospective offerees, issuers found it necessary to notify markets of the fact that they had embarked on an unregistered offering and took the position that they were not thereby offering the securities but simply complying with their duty to disclose material information to their securities holders and the marketplace. In 1994, the Commission adopted Rule 135c to regularize this practice.

Proposed Rule 135d (1995). In 1995, the Commission published for comment a proposed rule that would allow issuers contemplating initial public offerings to solicit indications of interest in their companies prior to the filing of a registration statement – "testing the waters". The Commission never acted on this proposal.

Wallman Report (1996). While the Report of Commissioner Wallman's Advisory Committee on the Capital Formation and Regulatory Processes was addressed to reform of the public offering process, it did recommend that, at least in the case of reporting issuers, restrictions on resales by affiliates be limited to the CEO, inside directors, holders of 10% of the voting power who had at least one director representative on the board and holders of 20% of the voting power. (At p. 24.)

Securities Act Concept Release (1996). Partially in response to the Wallman Report, the Commission issued a release entitled "Effect of 1933 Act Concepts on Capital Formation".[20] The Commission acknowledged an "erosion of distinctions between public and private transactions" and said it was "considering whether certain

[20] Securities Act Release No. 7314 (July 25, 1996).

distinctions between public and private offerings remain necessary and how the increasingly institutional nature of investors should be reflected in the regulatory framework." The Commission invited comments on the possible expansion of Rule 144A, including eliminating or easing restrictions on securities "fungible" with securities traded on a national securities exchange or quoted in NASDAQ and restrictions on the buyers that may participate. It also invited comment on shortening the holding period under Rule 144. It wondered out loud whether the possible changes would eliminate enough of the complexity of the "restricted versus unrestricted securities" and "private versus public offering" dichotomies or simply move the line of demarcation. Referring to a 1995 speech of Linda Quinn identified in fn. 18, it referred specifically to modernizing the regulatory framework governing the process by, among other things, (a) focusing on the nature of purchasers as one of the factors considered in defining the regulation of registered offerings and (b) exempting offers from registration. It requested comment on whether Rule 152 should be revised with a view to permitting a company to switch from a private offering to a public offering without an intervening termination of the private offering. Finally, the Commission requested comment on a relaxation of general solicitation prohibitions on offerings made under Rules 505 and 506.

<u>Proposed Revision of Rules 144 and 145 and Form 144 (1997)</u>.[21] In 1997, the Commission proposed to amend Rule 144 to:

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[21] Securities Act Release No. 7391 (Feb. 20, 1997).

– Exclude from “affiliate”, for purposes of Rule 144, all persons who would not be “insiders” under Exchange Act § 16 (whether or not applicable), i.e., are not the beneficial owner, directly or indirectly, of more than 10% of any class of equity securities of the issuer, are not an officer (as defined in Exchange Act Rule 16a-1) of the issuer, and are not a director of the issuer. 10% holders, officers and directors could attempt to prove on the basis of facts and circumstances that they were not in a “control” position.

– Eliminate manner-of-sale requirements

– Increase thresholds for filing Form 144

– Further reduce holding periods

– Increase volume limitations

The Commission also proposed to eliminate the presumptive underwriter and resale provisions of Rule 145(c) and (d). Finally, the Commission invited comment on a number of possible regulatory approaches to hedging transactions.[22]

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[22] In its 1997 proposals regarding Rule 144, the Commission requested comment as to whether the provision that the holding period under Rule 144 was tolled during periods that the holder was short, which was eliminated at the time of adoption of Rule 144A in 1990, should be reinstated. As noted, no action has been taken on any of the 1997 proposals, including this one. The tolling period was introduced at a time when there was no derivatives market. Reinstating tolling would interfere with the liquidity of the resale market for Rule 144A securities (and other privately sold securities held in DTC). This may explain the elimination of tolling when Rule 144A was adopted. With tolling, each security could have a different effective holding period under Rule 144 depending on short positions. There would be no effective way of knowing short positions of prior holders or of distinguishing within DTC which securities of an issuer had which Rule 144 holding periods. At the extreme, the result would be the inability of any holder to take advantage of Rule 144.

In addition, since the original adoption of Rule 144, and indeed since 1990, a derivatives market has developed, and liquidity of the resale market for private securities includes activity in both the physical market and the derivatives market. This activity, like activity in the derivatives market generally, has virtually

The Commission has not acted on any of these matters.

The "Aircraft Carrier" (1998). In Securities Act Release No. 7606A, the Regulation of Securities Offerings (Nov. 13, 1998), the Commission limited its proposals regarding private offerings to the issue of integration of registered and unregistered offerings. See Part X.

Rule 155 (2001). In 2001, the Commission, acting on the proposals in the Aircraft Carrier relating to integration, adopted Rule 155 providing non-exclusive safe harbors for (a) abandoned private offerings followed by registered offerings and (b) abandoned registered offerings followed by private offerings. It did not amend Rule 152.

Proposed Rule 146(c) (2001). In 2001, the Commission proposed to adopt a definition of "qualified purchaser" to implement a provision of the National Securities Markets Improvement Act of 1996, as a result of which sales of securities to such persons would be exempt from registration requirements under state securities laws. The definition was modeled on the definition of "accredited investor" in Regulation D. The Commission has not acted on this proposal. The Advisory Committee on Smaller Public

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uniformly been found to be a positive development for markets and for investors. Reinstatement of this tolling period would have adverse consequences for the derivatives market and therefore the liquidity of the resale market. In effect, investors that availed themselves of the derivatives market might find their activities in the physical market limited. Such a consequence would be inconsistent with the direction of market developments and current market practice. This could in turn affect capital formation, while there has been no indication that the elimination of the tolling provision in 1990 has damaged markets or investors.

Companies has requested that the Commission define the term “qualified purchaser” for this purpose. See Recommendation IV.S.11.

Hedging. In recent years the Commission has instituted a number of actions involving PIPEs transactions and has attacked certain hedging practices as violating § 5 of the Securities Act. In a recent order instituting and settling such a proceeding, the Commission stated:

> “Many PIPE investors ‘hedge’ their investment by selling short the PIPE issuer’s securities before the resale registration statement is declared effective. There is nothing per se illegal about ‘hedging’ a PIPE investment by selling short the issuer’s securities. Such short sales do not violate the registration provisions of the Securities Act if, among other things, the investor closes out the short position with shares purchased in the open market. An investor violates Section 5 of the Securities Act, however, when it covers its pre-effective date short position with the actual shares received in the PIPE. This is because shares used to cover a short sale are deemed to have been sold when the short sale was made.” In the Matter of Spinner Asset Management, LLC, pp. 2-3 (Dec. 20, 2006).

Regulation D – Hedge Funds (2006). The Commission has recently proposed to amend the definition of “accredited investor” to provide that in connection with offers and sales of securities issued by a “private investment vehicle” (other than a “venture capital fund”), a natural person must own not less than $2.5 million in “investments” (adjusted for inflation on April 1, 2012 and every five years thereafter).[23]

[23] Investment Advisers Act Release No. 2576 (Dec. 27, 2006).

Conclusions. A number of conclusions can be derived from this brief history:

– The boundary between private and public offerings is unclear.

– The boundary has moved over the years.

– There is a fair amount of inconsistency, such as multiple definitions of sophisticated investors who do not require the protection of registration and different time periods to avoid integration.

– In the case of offerings not requiring registration, the Commission has made numerous proposals and concept releases – relating to both the safe harbors and the general law of private offerings. It has solicited and received comments on a number of proposals over the years, some of which mirror the recommendations, yet has not adopted them.

III. Extrinsic Developments

A number of things have also happened over the years that affect and should inform the Commission's decisions in the area of private offering reforms:

– In October 1996, Congress gave the Commission authority to exempt persons, securities and transactions from the Securities Act. § 28 – "to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." Accordingly, the Commission's ability to accommodate the Securities Act to new conditions is no longer required to be exercised through interpretation or defining terms.

– The Commission has developed and substantially strengthened over time an integrated continuous disclosure system. It has substituted for episodic discrete disclosures under the Securities Act continuous reporting and disclosure under the Exchange Act. It has accelerated the filing of annual and quarterly reports and expanded and accelerated current reporting on Form 8-K. It has forced disclosure out into the open through Regulation FD. Certification and controls requirements have made the regulatory environment in respect of ongoing disclosure more robust.

- The Commission has enhanced very substantially its review of registrants' periodic and other reports under the Exchange Act.

- Filings are readily available through the Commission's electronic reporting system and increasingly on company websites and financial portals.

- The Commission has increasingly relied on access to information on file with it as sufficient communication of information – starting with Forms S-7, S-16 and S-3, continuing with Regulation D and Rules 144 and 144A, in the recent public offering reform and finally in recent amendments to the proxy rules.

- A revolution has taken place in information and communications technologies. Indeed, the Commission acknowledged the effects of this revolution as an important part of its reasons for adopting public offering reform. Among the consequences for private offerings are the following:

  - Private offerings are the subject of coverage in news services, newspapers and the media – frequently on the basis of information or misinformation received from offerees or from abroad.

  - The viability of prohibitions such as those on "general solicitation" and "general advertising" is therefore increasingly open to question.

  - Information as to trading in restricted securities is accessible to persons who are not "accredited investors" or "QIBs".

  - Rating agencies and other information services are publicizing the ratings assigned to privately offered securities and holding conference calls to which they invite the media.

- There has been a nearly complete migration from physical certificates representing securities to dematerialized securities or immobilized securities in DTC. Transactions are effected by book entry, and investors rarely, if ever, see physical certificates. Indeed, the Commission and other regulators seek to discourage or eliminate physical securities.

- A derivatives industry has developed that provides investors with flexibility and risk mitigation techniques that cannot be provided in

> the physical securities markets. This industry provides investors with, among other things, the ability to hedge the risk of their securities holdings, including their holdings in privately purchased securities. Private offering reform should not interfere with continued availability of legitimate hedging as a source of liquidity and a risk management technique in the private securities market.

In April 2006, the Advisory Committee on Smaller Public Companies recommended a number of changes to improve the private offering process:

– Adopt a new private offering exemption that does not prohibit general solicitation and advertising for transactions with purchasers who do not need the protection of registration.

– Relax the prohibitions on general solicitations and advertising in Rule 502(c) to parallel the "test the waters" model in Rule 254.

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

– Define "qualified purchaser" in Securities Act § 18 and make NASDAQ Capital Market and OTCBB stocks "covered securities" under NSMIA.

– In the case of private offerings to raise capital to fund IPOs, clarify or amend Rule 152 to permit IPO registration statements to be filed after all conditions within the control of private investors have been satisfied or expired.

IV. Priority Recommendations

As a result of reflecting on the foregoing and our own experience in advising clients, we make the recommendations set forth below. We believe that any reform proposal should at one and the same time be comprehensive but proceed from the existing structure. We believe that public offering reform was successful in part because it followed those dual approaches. We believe that, to be successful, specific proposals should address a number of general subjects, including the following:

- Draw clearer lines between public and private offering activity.

- Eliminate restrictions on activities, such as general solicitation and offers not followed by sales, that do not meaningfully contribute to investor protection and where modern technology and communications simply preclude effective regulation. We believe full protection can be provided by effective regulation of purchases.

- Clarify the integration doctrine and relax restrictions on private offering activity based on proximity in time to registered offerings or other connections that do not meaningfully contribute to investor protection and impair capital formation activity. We fully support the classic integration concerns that nominally private offering activity should not be permitted where on an overall or "integrated" basis it amounts to a public offering. But where private offering activity in its entirety would be permissible and public offering activity in its entirety would be permissible, the combination of the two should not make either one impermissible.

- Preserve liquidity in the private securities market, which is necessary to make the private market viable.

We recognize that many, perhaps most, of these topics are not new. Indeed, the Commission has already solicited and received comments on some of the proposals.

Regulation D. Regulation D should be retained because it provides an important avenue for raising capital for non-public companies and for public companies that are not tapping only the institutional marketplace. But it needs to be updated, streamlined and improved (at least with respect to Rule 506):

- The limitations on manner of offering – "general solicitation" and "general advertising" – should be eliminated. They are unrealistic in today's communications environment and, as in the case of offers to non-QIBs under Rule 144A not followed by sales, result in victimless offenses. Moreover, there is no harm if only accredited investors purchase, regardless of the method of finding them. Given the Commission's exemptive authority, these limitations can now be eliminated. Instead of regulating the manner of offering, the regulation should focus on identifying appropriate purchasers for these exempt offerings.

- Control persons as well as issuers should have access to the safe harbor – since they are treated as “issuers” for the purpose of § 2(a)(11).

- Broker-dealers should be able to act as intermediaries in a principal or agency capacity. Broker-dealers should thus be permitted to purchase from issuers or control persons and resell to “accredited investors” as well as to act as agents.

- Regulation D should be extended to resales of restricted securities that do not qualify for exemption under Rule 144A but satisfy the conditions of Regulation D. Thus would provide “bright line” certainty for most of the § 4(1½) transactions not covered by Rule 144A.

- In the case of non-reporting issuers, audited financial statements should not be required if they are not available in order to make sales to the permitted limited number of non-accredited investors. Consideration should be given to whether the kind of information currently contemplated by Rule 144A(d)(4) would be adequate.

- Eliminate the notice of sale requirement. Since many private offerings are conducted in compliance with all the requirements of Regulation D but for the filing of Form D, that requirement does not serve even a data-collection purpose. And, in the case of reporting issuers, the information is available in the issuer’s Exchange Act reports. It just adds expense without enhancing investor protection.

Rule 144. Rule 144 should be liberalized to enhance liquidity for investors while retaining a suitable period to ensure they are not acting as conduits for the issuer (or control person):

- Reduce holding periods for securities of reporting issuers from one year and two years to six months and one year – in light of the increased volatility of today’s marketplace, holding periods of six months and one year represent greater economic risk than they did when the current holding periods were adopted, and they are more than long enough to ensure that a purchaser has assumed the economic risks of investment. (Canadian provinces generally permit free resales of securities of reporting issuers after four months.) In the case of non-reporting issuers, consider permitting free sales after a one-year holding period.

– Eliminate the manner-of-sale requirements. Given trading practices today, where block activity is much more prevalent, complex and well regulated than at the time of Rule 144's adoption, the limitations on manner of sale have no investor protection purpose, are much less effective than they used to be as lines of demarcation between "ordinary trading transactions" and more concerted selling efforts (ordinary secondary blocks are now accompanied by more concerted selling activity) and do little other than raise compliance concerns and compliance costs.

– Eliminate the volume thresholds for sales by non-affiliates, and increase the volume thresholds for sales by affiliates.

– If volume thresholds are not eliminated generally for sales by non-affiliates and increased generally for sales by affiliates or if manner-of-sale limitations are not generally eliminated, then the utility of the Rule in the fixed income market requires their elimination at least for fixed income securities. The manner of sale for fixed income securities should not be limited, because there is generally only one manner of sale for these transactions in the market – a dealer transaction where the dealer seeks buyers for securities to fill sell orders. The weekly trading volume test is meaningless in these markets. Because each offering of fixed income securities generally creates a new "class," one percent of the class is generally effectively one percent of the original offering, which is much too small for effective resale activity.

– Eliminate the Notice of Sale (Form 144) requirement. This form is an anachronism and to our knowledge performs no positive function in investor protection or in informing the market. Moreover, given the change to two-day reporting under § 16 of the Exchange Act pursuant to Sarbanes-Oxley, if the definition of control is amended as we suggest below, almost all selling activity by affiliates will be promptly captured by § 16 reports. This form can be eliminated without any adverse effect on markets or investors.

– Clarify that "restricted security" does not include (i) securities offered and sold pursuant to a registration statement (e.g., Form S-8) and (ii) securities sold outside the United States in accordance with Regulation S (other than Category 3 equity securities of U.S. issuers).

– The Commission should not reintroduce the tolling of the holding period for short positions as this would make it a practical impossibility to determine when Rule 144A securities are freely saleable under Rule 144(k). See fn. 22.

Rule 144A. Rule 144A should be streamlined:

– The restriction on "offers" should be eliminated[24]. This would be consistent with the absence of a prohibition of offers in Regulation D and would improve efficiency and reduce costs with no impact on investor protection. Moreover, it brings the regulatory regime closer to today's technological and communications realities. An offer to a non-QIB that does not purchase is a victimless offense. The offeree suffers no damage. An offer to a non-QIB who does not purchase should not give QIBs who do purchase a one-year rescission right under §§ 12(a)(1) and 5. While offers would not be subject to § 5, offers would still be subject to § 17(a) and Exchange Act § 10(b) and Rule 10b-5.

– Substitute for QIB the concept of "qualified purchaser" as defined in Investment Company Act § 2(a)(51)(A) and Investment Company Act Rule 2a51-2 for purposes of § 3(c)(7). This is a more comprehensive and better definition of the sophisticated investor who does not need the protection of the registration provisions of the Securities Act or Investment Company Act. It includes very wealthy individuals, the absence of whom is a serious shortcoming in other definitions of sophisticated investors. It also reduces the number of different definitions of a sophisticated investor. It will reduce or eliminate the need for side-by-side offerings to "institutional accredited investors".

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24 Consistent with the elimination of the focus on offers, the Commission should also consider eliminating the restriction on "directed selling efforts" under Regulation S. In today's communication environment this restriction is too hard to apply and unnecessarily and unfairly restricts the careful.

– Reconsider the need for the "fungibility" limitations. We believe that the fungibility limitations were introduced in Rule 144A as originally adopted more as a result of concerns regarding market structure (i.e., the potential development of side-by-side private and public markets) than traditional concerns regarding private offerings (i.e., whether investors in the securities in question were capable of "fending for themselves" and thus did not need the protections of registration). The Commission should reconsider whether the market structure underpinnings of the fungibility limitations remain valid, including for convertible securities and warrants currently excluded from eligibility for Rule 144A resales as a result of those limitations. Limited examples of side-by-side markets exist today, and we are not aware of any adverse market impact.

– Eliminate the information-furnishing requirement. As in the case of accredited investors in Regulation D, qualified purchasers have the ability to fend for themselves.

Control. Clearer lines demarcating private and public offerings require a clearer concept of "control". We believe that the application of the law of private placements would be simplified without diminution of investor protection (and legal costs would be reduced) by adopting a definition of "control", at least for the purposes of § 2(a)(11). Consideration might be given to using the definition from the Investment Company Act. Failing that, the Commission may wish to consider the no-action letters the staff issued on this subject before they discontinued such practice, the suggestion in the Wallman Report and the Commission's own proposal in Securities Act Release No. 7391. We would recommend that there be a rebuttable presumption of control at (a) beneficial ownership of a 20% or more voting interest, including shares acquirable by conversion of securities or exercise of warrants within one year,[25] or (b) beneficial ownership of a 10% or more voting interest (with a similar inclusion) plus the ability to nominate one or more members of the board of directors, unless, in either case, another holder holds a larger voting interest and the two are not acting in concert. Absent presumptive control as described above, there should be a rebuttable presumption of non-control. Contractual rights vis-à-vis corporate actions or management of business might be evidence rebutting the presumption. Under this proposal, outside (non-employee) directors and employees other than executive officers would not be control persons unless part of a group as above.

To extend the reach of "control person" to other persons serves no useful purpose. The suggested definition clearly prevents evasion of the registration requirements of the Securities Act. Other persons are usually not in a position to compel registration of securities they hold. Realistically, they are not in a position to control the issuer's disclosure. In the case of most SEC-reporting companies, any registration statement will simply incorporate by reference the disclosure in the issuer's Exchange Act reports, resulting in no meaningful additional disclosure or further investor protection. Insider trading liability will deter sales based on undisclosed material

[25] See Exchange Act Rule 13d-1(f), which since 1998 has expanded the availability of short-form Schedule 13G to a broader class of "passive investors" who lack control intent so long as their beneficial ownership does not equal or exceed 20% of a class of equity securities.

information. See Rule 10b-5 and Exchange Act § 16. The use of the proposed definition will eliminate restrictions on trading that serve no useful purpose.

Private Offering Interpretative Release. Notwithstanding the modernization of the various safe harbors, there will nonetheless be a need to make sales that are not clearly within the safe harbors. Accordingly, it would be useful for the Commission to issue an interpretation setting forth the principles that the Commission believes to be currently relevant in determining whether an offering is private or public, including addressing the following points:

- Availability of information
- No limit on manner of offering?
- Offerees
  - No eligibility requirements for offerees who do not purchase
  - No limit on number of offerees
- Purchasers
  - Financially sophisticated or have access to sophisticated financial advice
  - Ability to bear risk of loss of investment
  - No limit on number of purchasers meeting the above two standards
  - No need for prior relationship
- Restrictions on resale? Notice to purchasers that securities are "restricted securities" enough?
- Application of restrictions to immobilized and dematerialized securities. Where securities are not distinguishable, seller may designate which securities are being sold for what purpose, as is the case for tax purposes.

Interpretive Guidance Regarding Integration. Factors relating to integration of (a) private offerings with other private offerings and (b) private offerings with public offerings need to be revisited, updated and promulgated with respect to all offerings, not just Regulation D offerings or in connection with Rule 152. We fully support the classic integration concerns that nominally private offering activity should not be permitted where on an overall or "integrated" basis it amounts to a public offering. But where private offering activity in its entirety would be permissible and public offering activity in its entirety would be permissible, the combination of the two should not make either one impermissible. Distinguishing factors would seem to be:

- Different issuers
- Dissimilarity of securities, e.g., non-convertible debt or preferred stock v. convertible debt or preferred stock v. common stock
- Different methods of distribution
- Different classes of purchasers
- Different consideration paid
- Different use of proceeds
- Separation in time
- Use of book entry facilities irrelevant.

The applicable integration periods should be standardized at 30 days and the safe harbor should be expanded to cover private offerings under § 4(2) and reduce the integration period from six months to 30 days. Given the increased volatility of the marketplace, 30 days today is equivalent to six months when Regulation D was adopted.

The fact that Rule 144A offerings, Regulation S offerings and registered offerings of the same security may take place concurrently without integration should be reconfirmed.

V. Other Recommendations

Rule 145. The presumptive underwriter and resale provisions of paragraphs (c) and (d) should be eliminated. See Securities Act Release No. 7391 (Feb. 20, 1997). There is little justification for restricting persons who do not become affiliates of the acquirer from selling securities received under a registration statement just because they were affiliates of the acquired company. In the case of significant shareholders and insiders (directors and officers) of a target company that agree (prior to the filing or effectiveness of a registration statement relating to a Rule 145 transaction) to vote in favor of the transaction, they should be similarly free to resell securities received in the transaction. (We recommend corresponding changes to the proxy and tender offer rules.)

Rule 152. The following staff interpretations, which do not protect investors or markets and which unnecessarily impair capital formation activities, need to be reviewed and withdrawn or revised:

– Issuer may not attempt private placement, give up and immediately file registration statement. Div. Corp. Fin., Current Issues and Rule-Making Projects § VIII.A.9 (Nov. 14, 2000). This seems contrary to Rule 152 and is bad public policy so long as the private placement was not a sham to test the waters before filing the registration statement (see also "Testing the Waters" below).

– Private offering cannot be completed as a registered sale; rather both the offer and sale must be either private or registered.

- Compliant private offering must be complete before a resale registration statement may be filed, i.e., contract of purchase without conditions within control of purchasers. No investor protection interest is furthered by delaying the filing of the resale registration statement.

- Incomplete compliant private offering followed immediately by registration of offering is gun-jumping without regard to the nature of the offerees. Seems to be contrary to Rule 152 and unnecessary.

- Abandoned public offering creates "general solicitation" taint with respect to subsequent private offering that is not resolved by Rule 155(c), which has retained the "offeree" concept originally jettisoned in Reg. D. Consistent with the elimination of the general solicitation requirement, this position should be reversed.

- Securities issuable within one year upon conversion or exercise of privately placed convertible securities or warrants may not be registered for sale to private purchasers. As long as purchasers will receive a prospectus before their investment decision, no investor protection goal is furthered by this requirement. (Note that the staff has "waived" this one-year rule for employee option holders, without regard to their management status.)

Registered Resales. Certainty regarding the resale status, and therefore the liquidity, of securities purchased in an exempt unregistered offering is an important factor in an issuer's ability to complete the offering without unnecessarily increasing its cost of capital. Therefore, consideration should be given to the factors that affect resales in the registered context. First, the Commission should explicitly provide for the availability of Form S-3 (as well as Rule 415) for all resale registrations, whether or not the issuer is listed on an exchange or eligible to use the form for primary offerings. The Commission should also define narrowly the limited circumstances when a resale will be treated as a primary offering, including avoiding treating resales as a primary offering solely because the sellers are affiliates. Second, the Commission should limit the circumstances under which sellers are deemed to be underwriters just because they are affiliates of broker-dealers or because they are broker-dealers themselves where the securities being registered for sale by the broker-dealer were acquired in the secondary market in the ordinary course of their dealer activity.

Particularly in light of securities offering reform and the elimination of required delivery of paper prospectuses, requiring a long-form S-1 registration statement for resales is anachronistic. As to treating broker-dealers who purchase in the secondary market, or treating affiliates of broker-dealers, automatically as underwriters, such an approach is, as noted above, not supported by the definition of underwriter. Further, in today's markets, where many integrated financial institutions have principal investing businesses that are no different from any other investors, the current approach distorts capital-raising activity. For example, the private equity affiliate of a broker-dealer should be treated like any other private equity investor.

As an additional step to address concerns over a resale registration being a primary offering, the Commission should consider expanding the availability of primary shelf registration for smaller issuers for sales at the market, at least where there are appropriate limits (such as percentages of the existing capitalization). The changes to Rule 144 we suggest above also would help avoid unnecessary impediments to resale liquidity and mesh with expanded shelf registration availability.

Testing the Waters. Consider extending testing the waters beyond Rule 163 (WKSIs only) and Rule 254 under Regulation A. See Final Report of the Advisory Committee on Smaller Public Companies, Recommendation IV.P.5.

Regulation S. Consistent with the elimination of the focus on offers, consider eliminating restriction on "directed selling efforts". In today's communication environment it is too hard to apply and unnecessarily and unfairly restricts the careful. The proper focus and the regulatory restrictions on unregistered sales of securities in foreign offerings would, of course, continue.

Securities Act § 18. Consider the interaction of private offering requirements (as revised) and § 18's exemption from the registration requirements of state securities laws. See Report of Advisory Committee on Smaller Public Companies, Recommendation IV.S.11.

Hedging. The Commission should take no action that would interfere with existing legitimate derivatives and other hedging activity. The Commission should confirm in the interpretative release the general applicability of the statements with respect to permissible hedging contained in the Spinner Management order.

VI. Reasons for Reform

The current private offering safe harbors, while useful as far as they go, are not as usable as they should be and, accordingly, are not used as much as they could and should be. This unnecessarily deters or defers transactions and increases the cost of transactions that do occur. Outside the safe harbors, the current status of the law of §§ 4(2) and 4(1½) is unclear. The one-year risk of rescission under § 12(a)(1) for violating § 5 is unreasonable. It is time to adjust the law of non-registrable sales to modern realities.

We believe that the recommended changes can be effected in a manner that does not adversely affect the protection of those investors that need the protection of the registration provisions of the Securities Act, which is the acid test of § 4(2) as construed by the Supreme Court in Ralston Purina over 50 years ago.

In the case of reporting issuers, purchasers will have the protection of the improved reporting regime. All purchasers will still have the protection of Rule 10b-5. Offerees who do not purchase need no protection. Purchasers should not be able to assert rescission rights on the basis of offers to ineligible persons who do not purchase.

There may be some concern that improvement of the law relating to private offerings, as it affects issuers, control persons, broker-dealers and investors, will reduce the use of registered offerings. We believe that Rule 144A has already resulted in a bifurcation of the institutional and retail markets and that this bifurcation will not be exacerbated by reform of the law applicable to private offerings. At the same time, we think that the improvements in the shelf offering process effected by public offering reform has already resulted in more issuers choosing the registered markets when that suits their needs. In fact, assuming the Commission believes (as do we) that the WKSI shelf registration process has worked well, the Commission should consider making it available to a broader class of reporting issuers and thereby further reduce the need to resort to private offerings. In any event, as long as appropriate standards – such as those suggested in this letter – are in place, we think issuers should be free to choose whether to access the registered or exempt markets without unnecessary and arbitrary regulatory hurdles and burdens.[26]

We urge the SEC and its staff to pursue a comprehensive "no holds barred" re-examination of the private offering regulatory regime of the same type that resulted in the very successful reform of the public offering process. In that connection, we have provided the foregoing recommendations, which we hope will be helpful and seriously evaluated.

We would be pleased to meet with members of the staff and Commissioners to explain our concerns and recommendations and to engage in a dialogue on the best course to pursue for meaningful reform. We are available to assist the Commission and the staff in developing a regulatory initiative that modernizes the non-public capital-raising process in light of the continuing development of technology

[26] We believe that registered offerings would be used more if Regulation M were amended to extend the Rule 144A exemption to include offerings (whether registered or not) exclusively to purchasers that would be eligible to purchase under Rule 144A.

and communications and recognizes further global competition for our capital markets and economy and the need to maintain effective investor protection.

Respectfully submitted,

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