Committee on Securities Law
of the Business Law Section of the
Maryland State Bar Association

October 9, 2007

Via email to rule-comments@sec.gov
Nancy M. Morris
Secretary
U.S. Securities & Exchange Commission
100 F. Street, NE
Washington, D.C. 20549-1090

RE: File No. S7-18-07

Dear Secretary Morris:

This letter expresses to the Securities and Exchange Commission (the "Commission") the comments of the Committee on Securities Law of the Business Law Section of the Maryland State Bar Association (the "Committee") with respect to the rules proposed in Release No. 33-8828, 72 Fed. Reg. 45116 (August 10, 2007) (sometimes referred to herein as the "proposing release"), relating to proposed revisions of the limited offering exemptions in Regulation D.

In general, we support the Commission's proposed revisions to the limited offering exemptions in Regulation D. However, we have comments on the following matters detailed below.

I. Proposed Rule 507

A. "Large Accredited Investor"[1] Standard

We generally agree with the categories of persons and entities that would qualify as "large accredited investors" under the proposed definition. We also believe that the inclusion of an "investments owned" standard is appropriate. However, we have some specific concerns about the proposed definition that we address below.

1) Alternative Income and Investment Tests

We agree with the Commission's proposal to adopt alternative investment and income tests in the definition of "large accredited investor." As the Commission states in the proposing release, an investments owned only standard would unnecessarily favor

[1] Our committee has been referring to the proposed offerees as "HALOs" ("highly accredited or large offerees"), rather than "large accredited investors" as proposed by the Commission. Since most individuals who would meet the new Rule 507 test would likely be considered "angel" investors, we felt that the use of this defined term and acronym would be especially apt.

older persons who have had time to build their investment portfolios. We believe that the $400,000/$600,000 with spouse income tests are sufficiently high to limit the pool of large accredited investors who would qualify under this test to persons who are financially sophisticated and not in need of all of the protections of the Securities Act of 1933 (the "Securities Act"). The figures the Commission cites in the proposing release – that under the proposed definition only 1.64% of U.S. households would qualify as large accredited investors, supports this position.

Further, we believe that the existence of an income test for qualification as an accredited investor but not for qualification of a large accredited investor would be unnecessarily confusing. The marketplace, issuers and their advisors have become comfortable with the categories of accredited investors under the current rules. We believe a definition of "large accredited investor" that basically tracks the definition of "accredited investor" but for the numerical values is not only internally logical, but would be better understood by issuers, investors and practitioners and ease the understanding and use of the new exemption. Having an income test for one definition and not the other would, we believe, cause unnecessary confusion and make compliance with the Regulation D offering exemptions more difficult in practice.

For similar reasons, we support the Commission's proposal to add an "investments owned" standard to the definition of "accredited investor."

2) Investment Tests

We believe that the proposed investment thresholds for natural persons and entities are too high. With respect to entities and institutions, we note that the Commission proposes that the current $5 million in assets test for accredited investor status be changed to $10 million in investments for large accredited investor status. Since the required proposed numerical value is already doubling, we believe it is unnecessary that the assets test also be changed to investments. Further, we believe that a test that focuses on investments as opposed to assets will unnecessarily exclude large corporations and other entities that have a significant amount of assets and business and financial acumen but not a significant amount of investments. We believe that such entities do not need the protections of the registration provisions of the federal securities laws in connection with their investments and that such entities should be able to invest in Rule 507 offerings, yet they would be unable to so under the proposed rules.

As such, we believe that a $10 million in assets test would be more appropriate. If the Commission believes that an investment test is necessary, we suggest combining the $10 million asset test with a minimum $5 million investments test, which would ensure some level of investment experience but unnecessarily exclude fewer entities who would otherwise qualify.

We also believe that the $2.5 million investments test for natural persons is too high. We suggest that a $1 million test, which, as noted in the proposing release, is suggested by the North American Securities Administrators Association in its Model

Accredited Investor Exemption that the Commission's proposal is modeled after, is more appropriate.

B. Limited Advertising Permitted

1) Business Description – 25-Word Limit

We commend the Commission's efforts to implement a private placement exemption that would allow for some form of limited advertising. However, we believe that in some cases, the 25-word limit on describing the issuer's business may present problems. While we understand the Commission's goal of preventing the use of "inappropriately promotional and non-objective language to describe [an issuer's] business in the limited announcement," we believe that the 25-word limit will not only not consistently achieve this goal but also hamper some issuers' ability to accurately describe their business. An issuer with a straightforward business that could be described in a few words would have additional leeway under the 25-word limit to include language that could be viewed as "promotional" or otherwise objectionable. At the same time, an issuer with a particularly complicated business may not be able to accurately describe such business within the confines of the 25-word limit.

We urge the Commission to eliminate the 25-word limit from proposed Rule 507. Instead, we suggest that the Commission include an instruction to the proposed rule to clarify that the description of an issuer's business permitted in the limited announcement should be limited to just that, a clear, accurate, factual and impartial description of the business that avoids any "promotional" or "touting" language such as prospects, competitive position and future business lines. Such an instruction could indicate the Commission's belief that in most instances, the description should not exceed 25 words. This would make clear the type of disclosure that the rule would permit issuers to include in a Rule 507 announcement without hampering the ability of some issuers to fully and accurately describe their business within an absolute limitation on the number of words they can use to do so.

2) Retention/Filing of Advertisements

We strongly urge the Commission not to require that the announcements permitted under proposed Rule 507 be filed with the Commission. First, we do not understand the purpose of such a requirement. Would such filings be subject to Commission staff review? If so, would issuers have to file their proposed advertisements prior to publication so that the staff could note any objections and give the issuer the opportunity to review? If so, we believe that this level of staff involvement in unregistered offerings is unwarranted. If not, we do not believe there would be a substantial benefit to filing these announcements with the Commission. We note that one purpose of the proposed amendments to Form D (set forth in Commission Release No. 33-8814, 72 Red. Reg. 37376 (July 9, 2007)) is to ease the filing burdens of issuers conducting a private placement under Regulation D. We believe that adding an additional filing requirement for advertisements permitted under Rule 507 conflicts with

the Commission's overall goal of easing the filing burden with respect to exempt offerings.

Further, we believe that any concerns that come to light with respect to violations of the limited advertising provisions of the proposed Rule or the general anti-fraud provisions of the Securities Act can be reviewed based on copies of the advertisements that the issuer would have in its files. We believe that generally it is routine for issuers to retain any documentation in connection with their private placement offerings and that therefore requiring issuers to maintain such documents in their files would not be an additional burden in connection with a Rule 507 offering the way the filing of such documents would be. We therefore suggest that instead of requiring the filing of the limited announcements permitted in a proposed Rule 507 offering, the Commission require that issuers retain copies of such announcements for a period of at least five years and be required to provide copies to the Commission or applicable state regulators upon request.

3) Returnable Coupon; Follow up Calls

The proposing release asks "[s]hould we allow issuers, at their option, to include in a Rule 507 announcement a coupon, returnable to the issuer, indicating interest in the offering ..." We urge the Commission to adopt such a provision. We believe that allowing a returnable coupon would facilitate the ability of qualified, interested investors to receive additional information about the offering and of issuers to actually make contact with potential qualified investors. While the use of coupons would facilitate the process, it would have no impact on the type of investors that are solicited, the amount of permitted advertising or the nature of investors that may invest in the offering. In other words, from a Securities Act perspective, permitting a returnable coupon is in essence no different than allowing, for example, inclusion of a contact phone number for potential investors to contact the issuer. Therefore, it should have no impact on the analysis as to whether the participants in the offering need the protections of the Securities Act or whether the offering should be exempt from Section 5 of the Securities Act under Regulation D.

Further, we believe that an issuer should be able to contact by telephone potential investors that return such coupons indicating large accredited investor status, and that the investors' return of the coupon should be evidence of the issuer's reasonable belief that the investor qualifies as a large accredited investor assuming that the form of limited advertising explained what a large accredited investor is. We believe that issuers should be required to obtain additional evidence that an investor satisfies the requisite investor standard only prior to an investment in the offering.

C. Reasonable Belief of Large Accredited Investor Status

The proposing release asks "[s]hould the rule provide any guidance as to how an issuer may arrive at a reasonable belief that a prospective purchaser is a large accredited investor? Should it be permitted to form the belief entirely on the basis of responses to a

questionnaire?" We believe the answer to both these questions is a resounding "yes" and that the Commission should include provisions in its final rules that an issuer may accept a potential investor's written representation as to his, her or its large accredited investor status so long as (i) the representation is clear as to on what basis the investor so qualifies, and (ii) the issuer has no reasonable basis to believe that, notwithstanding such representation, the potential investor does not qualify as a large accredited investor. Further, we believe that the Commission should adopt this position as to an investor's status as an "accredited investor" as well.

First, we believe that the absence of guidance as to what constitutes a "reasonable belief" of a potential investor's status as an accredited investor is a flaw of the current Regulation D safe harbor. In the absence of such guidance, the practice has developed where issuers generally rely on an investor's affirmative representation as to such status in a questionnaire. We believe that definitive guidance in this area is appropriate, but do not believe that there would be any benefit to changing what has come to be viewed as a standard and accepted practice in conducting offerings under Rules 505 and 506 of current Regulation D.

Further, we believe that a potential investor is in the best position to determine whether he, she or it qualifies as an accredited investor or large accredited investor, and that an issuer is generally not in a position to conduct an inquiry into a potential investor's financial situation, nor is it appropriate for an issuer to do so. We believe that many natural persons would be unwilling to provide proof of their financial holdings, such as brokerage and bank statements, whether for privacy or other reasons. Further, we believe that situations involving difficult to value assets would present several problems. First, as a general matter, we believe that it is not appropriate for an issuer to substitute its own judgment for the potential investor's as to the value of such potential investor's asset, which could cause friction between the issuer and potential investor. Further, in most cases the issuer would not have the expertise to assign a value to such an asset, and the expense of hiring a qualified third party to do so would likely be prohibitive, particularly for the types of small companies that usually conduct offerings under Regulation D, and would unnecessarily delay consummation of the sale to the investor and the offering as a whole. Finally, we believe that it is reasonable to place responsibility on the investor who is making a representation that he, she or it satisfies the purchaser qualification requirements of a particular offering, and that an investor that misrepresents its status as an accredited or large accredited investor, even inadvertently, should not reap the benefit of such misrepresentation by having a rescission right with respect to any securities purchased in an exempt offering.

D. Insignificant Deviations

We believe that providing that a violation of Rule 502(c) is not an "insignificant deviation" in Rule 508 is appropriate when, as currently, any form of advertising or solicitation is prohibited (save for the limited Rule 504 provision) in connection with offerings under Regulation D, but that this provision would not be appropriate when, as in proposed Rule 507, limited advertising is allowed. We believe that, in keeping with

the spirit of Rule 508, insignificant deviations from the provisions of proposed Rule 507 that permit limited advertising should not result in the loss of the exemption from Section 5 of the Securities Act. We see no rational basis to hold proposed Rule 507 offerings to such a heightened standard, nor the value in the loss of an exemption for an insignificant deviation. Further, given human nature it is simply inevitable that minor and innocent mistakes will occur, and we believe that the pressure of having to be 100% "perfect" in complying with the Rule 507 exemption, particularly when issuers and practitioners are first learning to comply with the new rule, will unnecessarily limit its use with no attendant benefit to investors.

E. Authority for Exemption/Covered Security Status

The proposing release indicates that the Commission is proposing Rule 507 pursuant to its general exemptive authority under Section 28 of the Securities Act instead of pursuant to Section 4(2) under the Securities Act for transactions not involving a public offering. To that end, the Commission proposes to amend Rule 146 under the Securities Act to add a new paragraph (c) that would (i) define "qualified purchaser" under Section 18(b)(3) of the Securities Act as a large accredited investor in a Rule 507 offering and (ii) allow states to impose notice filing requirements with respect to such offerings that are substantially similar to those imposed by the Commission.

We urge the Commission to reconsider its position and adopt the new Rule 507 exemption under Section 4(2). While we understand the Commission's concern that any form of advertising could be viewed as at odds with the concept of a private offering, we note that the prohibition on general solicitation and advertising appears not in Section 4(2) of the Securities Act itself, but in Rule 502 of Regulation D that was adopted by the Commission. We believe that this issue can be addressed by clarifying in the rules that the limited advertising announcement permitted by proposed Rule 507(b)(2)(ii) does not constitute a general solicitation.

We believe that it is important that the offering exemptions provided by Rule 506 and proposed Rule 507, which are clearly intended to track one another save for the dollar thresholds in the investor qualification requirements and the limited announcement permitted in proposed Rule 507, be adopted under the same Securities Act exemption. We believe that their adoption under different exemptions, with attendant potential differences in the application of the exemptions, will only serve to confuse issuers and the marketplace and frustrate issuers' attempts to comply with applicable requirements of the rules. In particular, we are concerned that states may not be bound by the revisions in proposed Rule 146(c) that limit them to imposing filing requirements on offerings to qualified purchasers that are substantially similar to those filing requirements imposed by the Commission. While this language appears in Section 18(b)(4) of the Securities Act, Section 18(b)(3) imposes no such limitation. Further, we question the ability of the Commission to import into Rule 146 the provision that states may require such notice filings in connection with Rule 507 offerings if the securities sold in such offerings qualify as "covered securities" under Section 18(b)(3). Section 18(b)(3) permits the Commission to adopt rules that define an offer and sale to a qualified purchaser, but we

do not believe it has the authority to generally adopt rules and regulations with respect to the sales of securities to qualified purchasers under Section 18(b)(3). In passing Section 18 of the Securities Act, Congress permitted states to require notice filings in connection with sales of covered securities under Section 18(b)(4), but not Section 18(b)(3). Therefore, it does not appear that the Commission has the authority to allow states to require notice filings in connection with proposed Rule 507 offerings if the proposed rule is adopted under Section 28 of the Securities Act, or, similarly, to limit the states to requiring only such notice filings in connection with offerings under proposed Rule 507. We further believe that given this inconsistency, many states would not follow the proposed Rule 146(c) provision that limits their regulation of proposed Rule 507 offerings to notice filings. Adopting the proposed Rule 507 exemption under Section 4(2) would eliminate this concern as securities sold in such offerings would be "covered securities" under Section 18(b)(4) of the Securities Act, which specifically allows the states to require such notice filings.

Further, we note that when an issuer intends to conduct a Rule 506 offering but inadvertently fails to comply with a provision of the safe harbor, the offering may still qualify for an exemption from the registration requirements of Section 5 of the Securities Act if the offering otherwise qualifies as a private placement pursuant to Section 4(2) of the Securities Act. If Rule 507 is adopted as proposed, however, the implication, based on the language in the proposing release, will be that an offering that includes any form of advertising, including the limited advertising permitted by proposed Rule 507, could never qualify as a private offering under Section 4(2). As a result, if an issuer that intends to conduct a Rule 507 offering inadvertently fails to comply with all of the provisions of the Rule, the offering will have automatically violated Section 5 unless the issuer did not conduct any advertising and the offering otherwise qualifies for a Rule 506 or Section 4(2) exemption, unless the failure to comply is "insignificant" under Rule 508. Again, we do not believe that Rule 506 and proposed Rule 507 should be treated so differently, and we believe that an issuer that intends to conduct a Rule 507 offering but inadvertently fails to do so should have the same opportunity to qualify that offering as an exempt private offering under Section 4(2) as would an issuer that intends to conduct a Rule 506 offering but fails to comply with all of Rule 506's requirements.

II. Investments-Owned Standards

We have several concerns related to the proposed investments-owned standards of the proposed amendment to the definition of "accredited investor" and proposed definition of "large accredited investor."

A. Proposed Definition of "Investments"

The proposing release asks whether the proposed definition of investments is too complicated. We believe that it is, particularly because it asks potential investors to make artificial distinctions between investment and non-investment assets that in many cases individuals would consider investments. We further believe that the proposal defines "investments" too narrowly. We believe that a more principles-based definition that

gives examples of what is meant by investments (as suggested in the proposing release – cash and cash equivalents, securities, real estate, commodities, and commodity interests, net of investment indebtedness) and excludes, for example, primary residences, vehicles and other personal property and property used in the individual's trade or business, is more appropriate. We discuss some of our specific concerns in more detail below.

1) Real Estate Assets

Under the proposal, real estate assets would not be considered to be held for "investment purposes" if used for personal purposes. The proposing release indicates that the reason for this is that "these real estate assets … are not held for investment purposes." While we agree that an individual's primary personal residence or real estate used as a place of business should not be included in the definition of "investments," we believe that, like the value of a perquisite as disclosed in an issuer's executive compensation disclosure, an asset's treatment for tax purposes should not be dispositive of its treatment under Commission rules, and that other real estate assets should be considered "investments" under the proposed rule.

We do not believe that the treatment of a real estate asset under the Internal Revenue Code is an accurate assessment of an individual's investment intent with respect to real estate assets other than their primary residence. We believe that, in general, individuals consider homes other than their primary personal residences to be an investment even if used by them and certain related persons for personal purposes. In many cases the purchase of a second home is seen as another way to diversify an individual's investment portfolio. For example, in the early 2000s when the stock market was not doing that well but real estate was booming, many individuals took money out of the stock market or used funds they would have otherwise invested in traditional securities, and purchased vacation homes instead. While these individuals may have used such residences as vacation homes, they clearly considered such homes an investment. In other words, while an individual may use a second or other vacation home for personal purposes, we believe that in many if not most cases the purchase is motivated, at least in substantial part, by investment intent – i.e. the intention to sell the residence for a profit at some later date, even if they do not intend to use the home in a manner that would qualify as an investment for tax purposes, such as renting the home out. In light of the foregoing, we do not believe that an individual's decision as to whether to invest excess funds in traditional securities, certificates of deposits or a vacation home should be determinative of whether he or she would qualify as an accredited or large accredited investor.

2) Proposed Definition of "Joint Investments"

Under the proposal, an individual investing without their spouse could count only half of their investments owned with their spouse or in which they share a community property interest with their spouse. We believe that this approach is unworkable and would be confusing, and that an individual should be able to count 100% of jointly owned investments or community property in making the determination as to whether that individual qualifies as an accredited or large accredited investor. Again, we believe

that the proposal makes an artificial distinction that is at odds with the understanding of the typical investor. Generally, an individual would consider a joint investment over which he or she has rights to the economic benefits, the power to dispose of, or the power to otherwise make investment decisions with respect to, to be owned by him or her. In other words, in considering assets owned, an individual does generally not consider himself or herself to own only half of a jointly owned interest. Further, we do not believe that a married couple's decision with respect to how to title their investments (i.e. jointly or in one of their names) is determinative of whether they need the protections of the Securities Act.

In addition, we believe that the Commission should affirmatively clarify that the term "spouse" also includes an individual's same-sex partner in a civil union, domestic partnership, or other similar state-sanctioned legal union. We note that nine states[2] plus the District of Columbia allow either civil unions or registration of domestic partnerships. We believe that this number may very likely increase as other states continue to consider the issue of state-sanctioned recognition of same-sex partnerships. We believe that for the purposes of determining accredited or large accredited investor status, assets held jointly by same-sex partners in a legally recognized union should be includable to the same extent as assets jointly held by spouses in a traditional marriage.

III. Future Inflation Adjustments

A. Inflation Adjustments

We support the Commission's proposal to adjust for inflation the dollar-amount thresholds in the definition of "accredited" and "large accredited investor" on an ongoing basis. However, we suggest an alternative method. Rather than adjusting every five years in $10,000 increments, we believe that a larger figure (which would vary depending on whether income, assets/net worth or investments were involved) should be used, which would only be adjusted once the applicable inflation index caused the values to exceed the increment. For example, for individual income, we would suggest an increment of no less than $50,000, meaning that the individual income test would remain at $200,000 for an accredited investor (or $400,000 for large accredited investors) until the rise in wages indicated by the inflation index caused the threshold of $250,000/ $450,000 to be exceeded. Likewise, the test would remain at $250,000/$450,000 until the index caused the threshold to exceed $300,000/$500,000, etc. For net worth/ investments, we propose that the increment for individuals be no less than $250,000, and for the corporate, partnership and trust entities, that the assets/investments increment be no less than $500,000. The Commission could announce the increases to take place at the beginning of the next fiscal year following the publication of the index.

We believe that this would serve the basic purpose of keeping the threshold numbers relatively consistent in value over time, but avoid the need to check the indexes

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[2] These include California, Connecticut, Hawaii, Maine, New Hampshire (as of January 1), New Jersey, Oregon (as of January 1), Vermont and Washington.

to see if the threshold had caused the value to rise on a more frequent basis, and would also provide a measure of predictability that future changes would have to fall within a designated amount.

B. "Grandfather" Provisions Necessary

We believe that the proposed rules, as adopted, should make clear that investors that qualified as accredited or large accredited investors when an offering was conducted will so qualify in future offerings, even if the thresholds have since been adjusted for inflation and they do not satisfy the new thresholds, if the terms of the initial investment contemplated that additional investments may be called and the investor is investing in accordance with the terms of the original offering.

IV. Categories of Entities Included in List of Accredited and Large Accredited Investors

We suggest that the Commission take this opportunity to revise the list of accredited investors in Rule 501(a)(3) to include any "statutory business trust" instead of any "Massachusetts or similar business trust." We believe that this language would essentially cover the same class of entities without being unnecessarily limiting or confusing by referencing a specific type of business trust under one state's business code.

We support the Commission's proposal to add limited liability companies, Indian tribes, labor unions, governmental bodies and other legal entities with similar attributes to the list of accredited and large accredited investors and agree that it will reduce confusion in this area.

With respect to the addition of governmental bodies and entities with similar attributes, we think it may be useful to refer in any adopting release that investment funds sponsored by governmental entities or agencies thereof are intended to come within that definition. In Maryland, for example, the state, through the Maryland Department of Business and Economic Development (DBED), a cabinet-level executive state agency, has operated and funded the Maryland Venture Fund, an early-stage equity fund which makes direct investments in technology and life science companies and indirect investments in venture capital funds. Under current Rule 501(a), DBED does not fall within any specific accredited investor definition and practitioners have generally relied on no-action letters like Voluntary Hospitals of America, Inc. (cited at footnote 131 of the Proposing Release) and The Equitable Life Assurance Society of the United States (February 1, 1986), and have taken the position that DBED is the "functional equivalent" of a 501(c)(3) organization. A specific statement regarding these types of quasi-governmental bodies would be helpful.

We appreciate the Commission's consideration of the foregoing comments.

Very truly yours,

Committee on Securities Law of the Business Law Section of the Maryland State Bar Association

By: /s/ Kenneth B. Abel
Kenneth B. Abel, Chair

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