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October 9, 2007

Re: **File No. S7-18-07**

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Dear Ms. Morris:

We are writing in response to the Commission's request for comments on proposed new Rule 507 under the Securities Act of 1933 (the "**Securities Act**"), proposed revisions to the definition of "accredited investor" and other proposed revisions of Regulation D under the Securities Act ("**Regulation D**") as well as the Commission's request for further comment on proposed new Rules 216 and 509 under the Securities Act.[1] The Proposed Rules would, among other things, (i) raise the requirements for natural persons to qualify as accredited investors in connection with the offer and sale of securities under Regulation D or Section 4(6) of the Securities Act of interests in certain privately offered investment pools (the "**Proposed Accredited Natural Person Rules**"),[2] (ii) create a new exemption from the registration provisions of the Securities Act for offers and sales of securities to "large accredited investors" through the creation of new Rule 507, which would also permit an issuer to make use of limited advertising in such offerings (the "**Proposed Large Accredited Investor Rules**"),[3] (iii) add an alternative investments-owned standard to the current definition of "accredited

[1] REVISIONS OF LIMITED OFFERING EXEMPTIONS IN REGULATION D, Securities and Exchange Commission Proposing Release No. 33-8828; IC-27922; File No. S7-18-07, proposed August 3, 2007 (hereinafter referred to as the "**Proposed Rules**"). Page references to the Proposed Rules herein are to the Proposed Rules as released in Commission Proposing Release IC-27922.

[2] Proposed Rules at 47-51.

[3] *Id.* at 9-29.

investors" under Regulation D,[4] (the "**Proposed Accredited Investor Revisions**"), (iv) shorten the Rule 502(a) safe harbor for the integration of offerings under Regulation D from six months to ninety days (the "**Proposed Integration Safe Harbor Revisions**")[5] and (v) apply disqualification provisions for issuers under proposed Rule 502(e) to all offerings made under Regulation D (the "**Proposed Disqualification Rules**").[6]

We appreciate the opportunity to comment on the Proposed Rules.[7] We note that, in our letter to the Commission dated March 9, 2007, we have previously commented on the Proposed Accredited Natural Person Rules, and wish to reiterate our concerns in this letter. Fundamentally, we believe that the Proposed Accredited Natural Person Rules are inconsistent with the Congressional intent underlying Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 (the "**Investment Company Act**") and therefore are beyond the scope of the Commission's authority. If the Commission determines that the Proposed Accredited Natural Person Rules should be adopted, we respectfully submit that an alternative accredited investor standard be implemented, since we believe that the standard currently proposed will, in many instances, effectively eliminate the distinction between Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act.

With respect to the proposed Large Accredited Investor Rules, we support the Commission's efforts to allow private issuers of securities to make use of limited advertising in offers to sophisticated investors. However, we believe that the Commission should also extend this right to issuers making offerings of interests in private investment funds that rely on Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. As to the Proposed Accredited Investor Revisions, while we generally support adding an investment-owned standard to the definition of "accredited investor" under Rule 501, we question the amendments concerning "joint investments" in the Proposed Rules; specifically, we believe that treating marital investments differently from income earned and assets owned in conjunction with one's spouse in other parts of the Rule would create undue confusion for investors and issuers. We also respectfully suggest further amendments to the definition of "accredited investor" and, if the Proposed Rules are adopted, to the definitions of "large accredited investor" and "accredited natural person" to clarify that persons who meet the definition of "qualified purchaser" under Section 2(A)(51) of the Investment Company Act also fall within such categories under Regulation D.

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[4] *Id.* at 29-44.

[5] *Id.* at 51-61.

[6] *Id.* at 61-72.

[7] The opinions expressed herein represent those of the undersigned and not necessarily those of our clients.

With respect to the Proposed Integration Safe Harbor Revisions, while we support the Commission's efforts to shorten the period of the integration safe harbor under Rule 502(a), we believe that the Commission should shorten the safe harbor period to thirty days rather than the proposed ninety days. Finally, regarding the Proposed Disqualification Rules, we are opposed to the general disqualification of issuers under proposed new Rule 502(e), as we feel that the issuer's general obligation to disclose material facts related to an offering provides adequate protection to investors.

## I. The Accredited Natural Person Standard

### *A. General Comments*

We again acknowledge the Commission's desire to protect natural persons investing in private pools,[8] but we believe raising the accredited investor standard in the manner proscribed in the Proposed Accredited Natural Person Rules is inappropriate in light of Congressional intent underlying the framework of investor protections that have been established under Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act.

As we previously stated in our March 9, 2007 letter, the legislative history indicates that while the Section 3(c)(7) exclusion was designed to provide a two-step process for determining qualified purchaser status based on investor sophistication, Section 3(c)(1) was intended to be relatively free of these requirements; rather, Congress viewed the 100-investor limit itself as a reasonable limit to federal regulation of funds. Section 3(c)(1) was designed to exclude from the definition of investment company any fund with 100 or fewer beneficial owners, without regard to investor sophistication (as long as the fund satisfies the standards for private placements in order not to be engaged in a general solicitation). Thus, the only sophistication requirement that Congress imposed on private investment pools via the Investment Company Act were with respect to funds offered in reliance on Section 3(c)(7) ("**Section 3(c)(7) funds**").

Again, we believe the Proposed Accredited Natural Person Rules confuse the basis under which Congress established the exclusion created under Section 3(c)(7), which specifically deals with investors' sophistication, with the basis under which Section 3(c)(1) was established, which does not. Accordingly, if the Proposed Accredited Natural Person Rules were to be adopted, the specific intent of Congress in creating two separate exclusions would be ignored. Grafting stringent eligibility requirements to Section 3(c)(1) is beyond the scope of what was intended to be an exclusion available to companies whose investors are limited in number, but not limited based on sophistication. We also believe

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[8] *See* PROHIBITION OF FRAUD BY ADVISERS TO CERTAIN POOLED INVESTMENT VEHICLES; ACCREDITED INVESTORS IN CERTAIN PRIVATE INVESTMENT VEHICLES, Securities and Exchange Commission Proposing Release No. 33-8766; IA-2576; File No. S7-25-06, proposed December 27, 2006 (hereinafter referred to as the "**Private Pooled Investment Vehicle Release**"). Page references to the Private Pooled Investment Vehicle Release herein are to the Private Pooled Investment Vehicle Release as released in Commission Proposing Release IA-2266.

Congress did not consider private investment vehicles to be subject to more investment risk than other issuers of securities, including certain operating companies. We believe that the Proposed Accredited Natural Person Rules are based on the Commission's judgment that private investment vehicles present greater risks than other types of securities, which results in unfairly disparate treatment of private investment vehicles while other arguably riskier securities can be sold to investors without enhanced sophistication requirements. We would urge the Commission to engage in further study regarding the risks associated with private investment vehicles, since we believe that these vehicles are often managed with the objective to reduce volatility of returns to a level below that of the broad market indexes.

*B. Alternative Accredited Natural Person Standard*

In the Private Pooled Investment Vehicle Release and again in the Proposed Rules, the Commission has requested comments regarding the appropriate investment asset test applicable to accredited natural persons under the Proposed Accredited Natural Person Rules.[9] We believe that if the Commission, despite the arguments noted above, raises the accredited investor standard with respect to private investment vehicles offered in reliance on Section 3(c)(1) of the Investment Company Act (a "**Section 3(c)(1) fund**"), the new standard should not be the one proposed but should rather be consistent with the "qualified client" standard set forth under Rule 205-3 under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**").[10] Rule 205-3 under the Advisers Act prohibits advisers from collecting performance-based fees from anyone other than qualified clients. Among the methods of qualification is a net worth test: a natural person who has a net worth of $1.5 million or more is a qualified client.[11]

In the proposing release for Rule 205-3, the Commission stated that the test used for qualified clients was designed to "adequately ensure the rule would be limited to advisory contracts with clients who are capable of understanding and bearing the increased risks which may be associated with incentive fee arrangements."[12] Advisers who are registered under the Advisers Act must already comply with the qualified client requirements in order to charge performance-based fees. Therefore, creating a new test for "accredited natural persons" is unnecessarily confusing when it is intended to establish investor sophistication – which is also the intent behind Rule 205-3. If the Proposed Accredited Natural Person Rules are adopted, advisers will have at least three and

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[9] Proposed Rules at 49-51, Private Pooled Investment Vehicle Release at 22-23, 25.

[10] *See* Private Pooled Investment Vehicle Release at 25.

[11] Rule 205-3(d)(1)(i)(A) under the Advisers Act.

[12] CONDITIONAL EXEMPTION TO ALLOW INVESTMENT ADVISERS TO CHARGE FEES BASED UPON A SHARE OF CAPITAL GAINS UPON OR CAPITAL APPRECIATION OF A CLIENT'S ACCOUNT, Securities and Exchange Commission Proposing Release No. IA-961, ¶14 (July 15, 1998).

frequently four different standards for investor protection to which they must conform (the "qualified purchaser," "accredited natural person" and "qualified client" standards as well as those applicable under CFTC regulations). Adding this different standard seems unnecessary and costly, and we believe the "qualified client" standard set forth under Rule 205-3 is a worthy alternative to raising the accredited investor standard to the level set forth in the Proposed Accredited Natural Person Rules.

Additionally, if the Commission decides to proceed with the Proposed Accredited Natural Person Rules, we respectfully suggest the following modifications and clarifications to the Proposed Accredited Natural Person Rules and their implementation.

*(i) Grandfather existing accredited investors.*

Under the Proposed Accredited Natural Person Rules, an existing accredited investor who no longer qualifies under the new standard would not be allowed to make further investments. We believe these investors have already gained meaningful exposure to investing in private investment vehicles and should be considered sophisticated enough to continue to do so. Further, we are concerned that smaller private investment vehicles' potential investor base would dwindle under the Proposed Accredited Natural Person Rules because many of their current investors would no longer qualify as accredited natural persons. We believe they should be allowed to offer additional interests to such existing investors. Hence, we suggest a grandfather clause be incorporated into the new rules such that all current investors in a Section 3(c)(1) fund who qualify as accredited investors under existing regulations would continue to qualify with respect to future additional investments in such fund.

*(ii) Knowledgeable employees should be carved out from the accredited investor standard.*

Under the current Rule 3c-5 of the Investment Company Act, "knowledgeable employees" as defined in Rule 3c-5(4) are excluded from being counted as a beneficial owners of a private investment vehicle under the Section 3(c)(1) 100-investor limit and may invest in Section 3(c)(7) funds even if they do not otherwise satisfy the definition of "qualified purchaser."[13] However, as stated in the Private Pooled Investment Vehicle Release asking for comments on this issue, knowledgeable employees are not currently excluded from the definition of "accredited investor" under the Securities Act. Therefore, in order for a private investment vehicle to have a valid private placement under the Securities Act, knowledgeable employees must either be accredited investors or the private investment vehicle must satisfy one of a limited number of exemptions from the Securities Act that may be relied upon in connection with offers to

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[13] *See* Rule 3c-5(b) of the Investment Company Act.

unaccredited investors.[14] Each of these exemptions has some difficulty (as described in our March 9, 2007 letter) and raising the requirement for accredited investors will result in fewer knowledgeable employees being permitted to invest in their funds.

We believe exempting knowledgeable employees from the accredited investor standard is consistent with the Commission's goals. Investor protection concerns are absent in a carve-out of knowledgeable employees because such individuals possess the necessary sophistication and have access to more information than a typical investor. In the adopting release of the revision to Rule 205-3 under the Advisers Act regarding performance fee contracts, the Commission wrote: "The Commission agrees that employees who actively participate in the investment activities of the adviser are likely to be sophisticated financially and do not need the protections of the performance fee prohibition."[15] Knowledgeable employees are defined as those who participate in the investment activities of the fund[16] and hence possess the sophistication to invest and deserve an exemption under the Securities Act.[17]

Further, we believe a carve-out adding knowledgeable employees[18] to the list of accredited natural persons would facilitate knowledgeable employees investing their own money along with those of clients, thus further aligning the incentives of employees and clients. We believe this modification of the Proposed Accredited Natural Person Rules would support the Commission's goals of increasing investor protection without imposing unnecessarily burdensome requirements on private investment vehicles.

*(iii) The definition of venture capital fund should be expanded.*

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[14] Outside of qualifying as an accredited investor, the Proposed Rules note three options: (a) rely on Rule 506 of Regulation D, (b) make an offering pursuant to Section 4(2) of the Securities Act or (c) rely on Rule 701 of the Securities Act. Proposed Rules at 26.

[15] EXEMPTION TO ALLOW INVESTMENT ADVISERS TO CHARGE FEES BASED UPON A SHARE OF CAPITAL GAINS UPON OR CAPITAL APPRECIATION OF A CLIENT'S ACCOUNT, Securities and Exchange Commission Adopting Release No. IA-1731 at 18 (July 15, 1998).

[16] In a Commission interpretation letter concerning Rule 3c-5, the Commission states, "Rule 3c-5 generally defines a 'knowledgeable employee' … to include certain executives … and non-executive employees who, in connection with their regular functions or duties, participate in the investment decisions of the Fund…. Rule 3c-5 is intended to cover non-executive employees only if they actively participate in the investment activities of the Fund." American Bar Association Section of Business Law, Securities and Exchange Commission Interpretation Letter, File No.132-3, April 22, 1999 at 10-12.

[17] For substantially the same policy reasons as stated in this section, we also support a carve-out of the "qualified client" requirement for investment adviser fees in Rule 205-3 under the Advisers Act for knowledgeable employees.

[18] We suggest the definition of "knowledgeable employee" concur with the definition in Rule 3c-5 of the Investment Company Act.

Venture capital funds are excluded from the Proposed Accredited Natural Person Rules, and they are defined to have the same meaning as that of "business development company" in Section 202(a)(22) of the Advisers Act.[19] The Commission requested comments on whether the definition should be modified to include other funds.[20] Rather than using the "business development company" definition, we suggest that the definition of a venture capital fund not be limited to funds organized under the laws of and having a principal place of business in the United States. Instead, we propose that companies organized and/or operating offshore and companies that invest in foreign securities should be included in the definition. While venture capital funds and business development companies are alike in many aspects of capital formation, venture capital funds have a wider scope, and their ability to seek out and drive business development that is both domestic and foreign is essential to their business. We believe this wider scope should be captured in the Proposed Rules.

## II. The Large Accredited Investor Standard

We again support the Commission's efforts to allow limited advertising in connection with offerings through certain sophisticated investors under new Rule 507. New Rule 507 would allow issuers offering securities to "large accredited investors" to publish a "limited announcement of an offering." Such announcement would be required to state that the offering is only being made to large accredited investors, that the offering has not been registered with the Commission and that no consideration is being solicited or will be accepted through the offering. The announcement may also contain (i) the name and address of the issuer, (ii) a brief description of the business of the issuer, (iii) the name, number, price and amount of securities being offered, and a brief description of the securities, (iv) a description of what large accredited investor means, (v) any suitability standards and minimum requirement for purchasers and (vi) the issuer's contact information.[21]

While we support the Commission's allowance of limited advertising by certain issuers, we also feel that the restrictions on advertising should be relaxed in a similar manner for investors in Section 3(c)(1) funds and Section 3(c)(7) funds. The Commission is proposing new Rule 507 under Section 28 of the Securities Act as opposed to Section 4(2), which, as the Commission noted,[22] thereby precludes pooled investment vehicles relying on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act from taking advantage of limited advertising under the Proposed Large Accredited Investor Rules, as such funds are required, pursuant to the exclusions under the Investment Company Act, to sell securities in transactions not involving a public offering and generally rely on

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[19] Private Pooled Investment Vehicle Release at 30.

[20] *Id.* at 31-32.

[21] Proposed Rules at 19-20.

[22] *Id.* at 27.

Section 4(2) under the Securities Act for such offerings. In the Proposed Rules, the Commission stated that the higher income thresholds of the Proposed Large Accredited Investor Rules would provide increased assurances of the ability of investors in offerings that utilized such an exemption to "fend for themselves."[23] However, the standards under the Proposed Large Accredited Investor Rules – $10 million in investments for entities and $2.5 million in investments for individuals – remain lower than the thresholds required for qualified purchasers in Section 3(c)(7) funds under the Investment Company Act. Additionally, were the Commission to adopt the Proposed Accredited Natural Person Rules, the investment-owned thresholds for investors in Section 3(c)(1) funds would be equivalent to the standards under proposed new Rule 507.

If the Commission is willing to allow issuers who offer securities to "large accredited investors" to make use of limited advertising, we believe that the Commission should make use of their general authority under Section 6(2) of the Investment Company Act to provide issuers of Section 3(c)(1) or Section 3(c)(7) funds the ability to make use of limited advertising as well, or provide similar no-action relief. As we stated in our March 9, 2007 letter, we believe Congress, in adopting and amending the Investment Company Act, did not consider private investment vehicles to present greater risks than other issuers of securities. Many types of securities and issuers that would be able to make use of proposed new Rule 507 are far more complex and have greater risks than interests in private investment vehicles, as even investing in single operating companies may present more risk than investing in a private fund that holds a diversified range of investments. In addition, an investor who makes a direct investment in a complex security such as a derivative has less protection under the securities laws than if he invested in a pooled vehicle, since such direct investments are not being actively managed by an investment adviser. Yet, the Proposed Large Accredited Investor Rules would not allow private investment vehicles offered in reliance on Sections 3(c)(1) and 3(c)(7) of the Investment Company Act to make use of limited advertising. As with the Proposed Accredited Natural Persons Rules, the Commission is seemingly making a judgment that investments in private investment vehicles present greater risks to investors than investments in other securities. We again believe this premise is incorrect and leads to undue restrictions on private investment vehicles.

In its 2003 Staff Report to the SEC, "Implications of the Growth of Hedge Funds," the Commission staff recommended lifting the prohibition against general advertising and general solicitation for Section 3(c)(7) funds, which would go beyond the limited advertising permitted under proposed new Rule 507.[24] At the time, the staff was reluctant to make the same recommendation for Section 3(c)(1)

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[23] *See Id.* at 14.

[24] The report noted "there seems to be little compelling policy justification for prohibiting general solicitation or general advertising in private placement offerings of Section 3(c)(7) funds that are sold only to qualified purchasers." IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS, Staff Report to the United States Securities and Exchange Commission, 100 (September 2003), *available at* http://www.sec.gov/news/studies/hedgefunds0903.pdf.

funds because "such an arrangement could increase the level of risk" for "less wealthy investors."[25] However, if the Proposed Accredited Natural Person Rules were to be adopted, those concerns would be mitigated. If interests in private investment pools are sold solely to a limited group of investors under the Proposed Accredited Natural Person Rules or solely to qualified purchasers under Section 3(c)(7) of the Investment Company Act, the availability of broader information regarding such investment pools would be entirely consistent with the Commission's regulation of such vehicles. Ultimately, we believe that permitting advisers in private investment pools to make use of limited advertising with respect to Section 3(c)(1) funds and Section 3(c)(7) funds would encourage capital formation without raising significant investor protection concerns.

## III. The Proposed Accredited Investor Revisions

### *A. Treatment of Joint Investments*

Among other changes, the Proposed Rules would add an investment-owned standard to the definition of "accredited investor" under Rule 501(a) as an alternative to the existing net worth and income tests. While we support the Commission's addition of an investment-based standard, we question the Proposed Rules' treatment of "joint investments" across Regulation D. The Commission initially proposed this revised standard for the purpose of the accredited natural person definition in the Private Pooled Investment Vehicle Release, and the Proposed Rules now seek to apply this standard to the calculation of joint investments under Regulation D generally. Under the Proposed Rules, an investor, without the signature of the investor's spouse, may only include for the purposes of the calculation fifty percent of (i) investments held jointly with an investor's spouse and (ii) investments in which the investor shares a community property or similar interest with the investor's spouse. As we stated in our March 9, 2007 letter, we believe that this treatment of "joint investments" would add undue complications to the regulation of private securities offerings.

This treatment of "joint investments" under the Proposed Rules differs from the treatment of similar interests under Section 3(c)(7) of the Investment Company Act. Under Section 3(c)(7), a natural person investing on his or her own behalf may include in the calculation of "investments" all of such person's investments held jointly with that person's spouse and any investments in which that person shares a community property or similar shared ownership interest with that person's spouse. In drafting the revised definition of "investments" under the Proposed Rules, the Commission has based its revisions on the definition of "investments" under the Investment Company Act,[26] thereby establishing consistency across the statutes for this key term, which we believe to be greatly beneficial for both issuers and investors. It would seem to undercut such efforts, however, to force investors, when calculating the value of their "joint

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[25] *Id.* at 101.

[26] See Proposed Rules at 36.

investments" for the purpose of the accredited investor definition under Regulation D and the qualified purchaser definition under the Investment Company Act, to apply conflicting methodologies, especially as Section 3(c)(7) funds generally rely upon Regulation D. We believe that this disparate treatment would add an additional layer of complication to an already complicated regulatory system by requiring joint investments and community property to be treated one way under the qualified purchaser standard, while being treated in another more stringent manner under the proposed accredited investor standard.

Additionally, it seems unduly complicated to treat spousal "investments" in a different manner under Regulation D than spousal net worth and income are treated under Regulation D. The net worth test for accredited investor status under Rule 501(a)(5) allows an investor to include marital assets in such calculation, while the income test under Rule 501(a)(6) allows an individual to include the income of the individual's spouse to reach the threshold income levels. Forcing prospective investors in Regulation D offerings to calculate their "joint investments" by using an entirely different methodology than is used to calculate spousal assets and income again seems to be unduly confusing. We do not believe the change in terminology from "joint net worth" to "aggregate net worth" under Rule 501(a)(5) and from "joint income" to "aggregate income" under Rule 501(a)(6) under the Proposed Rules would greatly reduce the confusion inherent in this dual standard. We do not believe that the Commission, in either the Private Pooled Investment Vehicles Release or the Proposed Rules, has provided justification for this new treatment of "joint investments." In addition, regarding the signature requirement, we believe that the Commission has failed to recognize that there may be legitimate reasons for a married couple to maintain separate legal ownership of marital assets. We therefore urge the Commission to calculate "joint investments" consistently under Regulation D and the Investment Company Act.

*B. Additional Categories of Accredited Investors*

The Proposed Rules would also amend Regulation D to clarify that limited liability companies, Indian tribes, labor unions, governmental bodies and similar legal entities qualify as accredited investors under Rule 501(a)(3). We support the Commission's amendment of the accredited investor standard, and respectfully suggest that the Commission further amend Regulation D so that any individual or entity that meets the definition of a "qualified purchaser" under Section 2(51)(A) of the Investment Company Act would automatically qualify as an accredited investor and, if the Proposed Rules are adopted, as a "large accredited investor" and an "accredited natural person" (in the case of an individual qualified purchaser) as well.

We believe that such an amendment of Regulation D would have several benefits. First, it would clarify that certain types of entities that are qualified purchasers under the Investment Company Act would also qualify as accredited investors under Regulation D. As we stated in our March 9, 2007 letter, in drafting the qualified purchaser standard, Congress intended to create a category

of more sophisticated investors to whom interests in Section 3(c)(7) funds could be offered, thereby going beyond the investor sophistication requirements of the Investment Company Act. Again, many Section 3(c)(7) funds are offered in reliance on Regulation D and thus prospective investors must be both "accredited investors" and "qualified purchasers." Generally, these requirements are not an issue, as in most cases, it is clear that an individual or entity that is a "qualified purchaser" is also an "accredited investor." However, in some instances it is not entirely clear that an entity that has qualified purchaser status would also qualify as an "accredited investor." Specifically, Section 2(A)(51)(iii) of the Investment Company Act includes as a qualified purchaser a trust that would not qualify as a "family company" under Section 2(51)(A)(ii) of the Investment Company Act where both the trustee (or other person authorized to make decisions on behalf of the trust) and the settlors (or other persons who contributed assets to the trust) are themselves "qualified purchasers." However, it is not clear that such a trust would qualify as an accredited investor under Rule 501. For example, if such a trust had under $5,000,000 in assets, it would not qualify as an accredited investor despite the fact that its trustee and settlors are all qualified purchasers. Therefore, by amending Regulation D to clarify that every person that is a qualified purchaser under Section 2(A)(51)(iii) of the Investment Company Act would also qualify as an accredited investor under Rule 501, the Commission would eliminate such confusion, while remaining consistent with the Congressional intent behind the adoption of Section 3(c)(7) under the Investment Company Act.[27]

Additionally, this proposed change to Regulation D would eliminate a dual standard and prevent undue repetition of efforts for investors in private funds offered under Section 3(c)(7) of the Investment Company Act. Again, as the Commission notes, interests in most Section 3(c)(7) funds are offered under Section 4(2) of the Securities Act.[28] As such, prospective investors in Section 3(c)(7) funds are generally required to complete subscription forms stating that they are both accredited investors for the purposes of Regulation D and qualified purchasers under the Investment Company Act. As discussed above, most qualified purchasers qualify as accredited investors and would also qualify as "large accredited investors" were the Commission to adopt the Proposed Rules. Adopting a rule stating that every qualified purchaser is also an accredited investor would simplify the subscription process (especially if the Commission were to adopt the treatment of "joint investments" promulgated in the Proposed Rules) without harming prospective investors.

Finally, if the Commission adopts the Proposed Accredited Natural Person Rules, further amending Regulation D to clarify that each individual classified as a qualified purchaser is also an accredited investor would also eliminate an

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[27] We note that the Advisers Act takes a similar approach, as Rule 205-3(d)(ii)(B) includes as a qualified client any individual who is "a qualified purchaser as defined in Section 2(a)(51)(A) under the Investment Company Act."

[28] Proposed Rules at 27.

inherent problem in the current form of the Proposed Accredited Natural Person Rules. As we discussed in our March 9, 2007 letter, the Proposed Accredited Natural Person Rules will eventually impose a higher wealth threshold for married couples than is necessary for such couples to invest in Section 3(c)(7) funds. Again, under the Proposed Accredited Natural Person Rules, the treatment of investments which a natural person may own jointly or with the investor's spouse that are part of a shared community interest differs from the treatment of similar interests under Section 3(c)(7) by only allowing a natural person to include in the investor's calculation of investable assets fifty percent of the investments owned jointly, or investments in which ownership is shared with that person's spouse. Consequently, the new accredited investor standard would also require a married couple to own $5 million in joint investments and community property in order for each member of the couple to meet the $2.5 million threshold.[29] While the accredited natural person standard for such married couples is currently equivalent to the qualified purchaser standard for such couples, the accredited natural person standard is adjusted for inflation under the Proposed Rules while the qualified purchaser standard is not. Therefore, the accredited natural person standard will eventually require a higher investment-owned threshold for married couples than the qualified purchaser standard, making it more difficult for such couples to invest in Section 3(c)(1) funds than in Section 3(c)(7) funds. For the reasons stated above and in our March 9, 2007 letter, we do not believe that Congress intended this outcome. Therefore, if the Proposed Accredited Natural Person standard is adopted, we respectfully suggest that the Commission should also amend Regulation D to provide that a qualified purchaser will automatically qualify as an "accredited natural person," a "large accredited investor" and an "accredited investor."

## IV. Proposed Integration Safe Harbor Revisions

We applaud the Commission for proposing to amend the safe harbor for the integration of Regulation D offerings under Rule 502(a). As the Advisory Committee noted, the current six-month time frame for the integration of offerings under Regulation D may serve to inhibit issuers from meeting their financing needs. While we believe that the reduction of this period in the Proposed Integration Safe Harbor Revisions from six months to ninety days will be beneficial to issuers without causing undue harm to potential investors, we believe that the Commission should shorten the integration safe harbor even further.

We agree with the Advisory Committee on Smaller Public Companies (the "**Advisory Committee**")[30] that the integration safe harbor should be shortened to thirty days. As the Advisory Committee stated, this shorter safe harbor would

[29] *See* Proposed Rules at 28.

[30] FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, April 23, 2006 (the "**Advisory Committee Final Report**") at 94.

strike "a more appropriate balance between the financing needs of smaller companies and investor protection, while preserving both investor protection and the integrity of the existing registration/exemption framework."[31] We believe that a thirty-day safe harbor under Rule 502(a) is sufficient to protect the non-public nature of the offerings under Regulation D. By way of comparison, Rule 155(c)(3) under the Securities Act provides that an issuer that withdraws a registration statement filed with the Commission can conduct a valid private placement within thirty days of such withdrawal. If the Commission has determined that thirty days from the withdrawal of a registration statement is a sufficient "cooling off" period to protect the private nature of the subsequent offering, it would seem to follow that the same thirty-day period would be a sufficient gap to prevent the integration of two offerings under Regulation D.

In the Proposed Rules, the Commission stated that it was concerned that adopting a thirty-day safe harbor under Rule 502(a) would allow issuers to make monthly exempt offerings under Rule 506 to up to thirty-five non-accredited investors. While we do not believe that the majority of issuers making non-public offerings under Regulation D regularly offer securities to non-accredited investors, we recognize the Commission's concern as to such potential abuse of the integration safe harbor. As the Commission suggests, one possible solution would be to place an annual limit on the number of non-accredited investors to which an issuer may offer its securities. We would also suggest that the Commission only make the thirty-day integration safe harbor available to any issuer that takes reasonable measures not to solicit non-accredited investors. If an issuer chooses to offer securities to non-accredited investors, the ninety-day safe harbor under the Proposed Rules may be more appropriate.

## V. The Proposed Disqualification Rules

We recognize the Commission's interest in limiting the ability of recidivist "bad actors" to take advantage of the protections offered under Regulation D. However, we feel that in proposing to prevent an issuer from relying on Regulation D if the issuer, or certain of the issuer's affiliates, committed specified misdeeds, the Proposed Disqualification Rules are unnecessarily harsh to issuers.

As the Commission has noted, exempt offerings under Regulation D provide a vital source of capital for many issuers. This remains true for smaller companies in particular, as Regulation D offerings allow them the means to access the necessary capital without the time and expense required to undertake a registered offering. We feel that proposed new Rule 502(e), if adopted, would unduly harm certain issuers by restricting their ability to access the capital markets. In particular, we are concerned about situations where an issuer may be disqualified due to the unauthorized actions of certain employees or other affiliated individuals. While proposed new Rule 502(e)(ii) provides that the Proposed Disqualification Rules will not disqualify any issuer that "establishes that it did not know, and in the exercise of reasonable care could not have known"

[31] Proposed Rules at 96.

of such disqualification, it is not clear that this provision would go far enough. It appears that proposed new Rule 502(e)(ii) merely absolves the issuer that did not know, and could not have known of such disqualification at the time of the subsequent offering, and does not prevent an issuer from being disqualified from offerings under Regulation D by virtue of previous “bad acts” by an affiliated person where the issuer was not, and could not have been, aware of such actions or omissions at the time that they occurred.

We also find it problematic that proposed new Rule 502(e) includes the actions of any beneficial owner of 20 percent or more of any class of securities, which, in the context of private funds, may be a person who owns 20 percent or more of a class of equity securities but does not have any voting rights or any other ability to control the actions of the issuer. This problem becomes particularly acute in the case of private funds that make regular offerings of securities to new and existing investors, as the identities of 20 percent or more of any class of the issuer’s securities may regularly change. Taken as a whole, new Rule 502 would require private pooled vehicles to conduct extensive and continuous diligence on their investors in order to guarantee that the fund is not disqualified from making offerings in reliance on Regulation D. We know of no other instance where an issuer is made culpable for the actions or omissions of its passive investors, and we do not believe that the Commission has provided justification for why the Proposed Disqualification Rules should be extended to such circumstances.

Additionally, we do not believe that the Commission has demonstrated that such disqualification provisions are necessary. In the Proposed Rules, the Commission has not presented any empirical evidence on the prevalence of recidivist “bad actors” that make offerings of securities under Regulation D. Furthermore, issuers have general obligations to disclose material facts to investors upon the offering of securities. If issuers fail to disclose previous “bad acts,” the Commission has enforcement authority to deal with such recidivists on a case-by-case basis, thereby eliminating the need for the potentially over-inclusive Proposed Disqualification Rules.

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We appreciate the opportunity to respond to the Commission's request for comments and we hope that these comments and observations contribute to the important work of the Commission. If you have any questions with respect to the matters raised in this letter, please contact any of the undersigned.

Very truly yours,

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