ABA Section of
BUSINESS LAW
Practical Resources for the Business Lawyer

Defending Liberty
Pursuing Justice

AMERICAN BAR ASSOCIATION

Section of Business Law
321 N. Clark Street
Chicago, Illinois 60610
(312) 988-5588
FAX: (312) 988-5578
e-mail: businesslaw@abanet.org
website: www.ababusinesslaw.org

ASSOCIATION YEAR 2007-2008

CHAIR
Charles E. McCallum
900 Fifth Third Center
111 Lyon Street, NW
GRAND RAPIDS, MI 49503-2487

CHAIR-ELECT
Karl J. Ege
909 A Street
TACOMA, WA 98402-5111

VICE-CHAIR
Nathaniel L. Doliner
4221 West Boy Scout Boulevard
Suite 1000
Tampa, FL 33607-5780

SECRETARY
Lynne B. Barr
Exchange Place
53 State Street
Boston, MA 02109-2803

BUDGET OFFICER
Renie Yoshida Grohl
8300 Fox Hound Run NE
Warren, OH 44484-1774

IMMEDIATE PAST CHAIR
Linda Hayman
4 Times Square
NEW YORK, NY 10036-6518

SECTION DELEGATES TO
THE ABA HOUSE OF DELEGATES
Amelia H. Boss
Philadelphia, PA

Myles V. Lynk
Tempe, AZ

Maury B. Poscover
St. Louis, MO

Hon. Elizabeth S. Stong
Brooklyn, NY

COUNCIL
Stanley Keller
Boston, MA

Linda J. Rusch
Spokane, WA

Karol K. Sparks
Chicago, IL

Heidi M. Staudenmaier
Phoenix, AZ

Willard K. Tom
Washington, DC

Arthur N. Field
New York, NY

Kathleen J. Hopkins
Seattle, WA

Mary Ann Jorgenson
Cleveland, OH

Martin E. Lybecker
Washington, DC

Vincent I. Polley
Bloomfield Hills, MI

William H. Clark, Jr.
Philadelphia, PA

Donald W. Glazer
Newton, MA

Stephanie A. Heller
New York, NY

Dixie L. Johnson
Washington, DC

William B. Rosenberg
Montreal, QC

Mitchell L. Bach
Philadelphia, PA

Conrad G. Goodkind
Milwaukee, WI

Paul (Chip) L. Lion III
Palo Alto, CA

Timothy M. Lupinacci
Birmingham, AL

Jacqueline Parker
Seattle, WA

BOARD OF GOVERNORS LIAISONS
Don S. DeAmicis
Boston, MA

Karen J. Mathis
Denver, CO

SECTION DIRECTOR
Susan Daly
Chicago, IL
(312) 988-6244
suedaly@staff.abanet.org

October 12, 2007

By E-Mail to: rule-comments@sec.gov

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

Re: Revisions of Limited Offering Exemptions in Regulation D, Release No. 33-8828 (File No. S7-18-07)

Ladies and Gentlemen:

This letter is submitted on behalf of the Committees on Federal Regulation of Securities, Middle Market and Small Business, and State Regulation of Securities (collectively, the "Committees") of the American Bar Association (the "ABA"), Section of Business Law in response to the request of the Securities and Exchange Commission (the "Commission") for comments on Release No. 33-8828 (August 3, 2007), 72 Fed. Reg. 45116 (the "Proposing Release"). In this release, the Commission has proposed, among other things, to amend Regulation D in a number of respects, including to add as Rule 507 an exemption for offerings to a new category of investors, called "large accredited investors," for which limited advertising is permitted.

The views expressed in this letter have not been approved by the American Bar Association's House of Delegates or Board of Governors and should not be construed as representing policy of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committees.

For convenience, we include a table of contents. A summary of our comments begins on page 3.

Table of Contents

Page

Introduction and Overview 3
Proposed Rule 507 4
General Solicitation and Limited Announcements 4
Large Accredited Investor 7
Relationship to Other Offerings 9
Basis for Rule 507 10
Other Regulation D Changes 10
Accredited Investor Definition 10
Reduction in Safe Harbor Period 11
Expanded Application of Disqualification Provisions 12
Amendment to Rule 504 14
Interpretive Guidance on Public/Private Integration 15
Other Matters 16
Rule 144A 16
Regulation S 16
Rule 508 16
Qualified Purchasers 16
Pooled-Investment Vehicles 17
Need for Comprehensive Reevaluation 18
Overall Effect of the Proposals 19

Introduction and Overview

We support the Commission's initiatives, of which the Proposing Release is one, to reduce regulatory burdens on smaller issuers and others and to facilitate capital formation by these issuers without sacrificing investor protection. These initiatives pick up where Securities Offering Reform left off by addressing the capital-raising needs of issuers who obtained limited or no benefit from those reforms. They also respond, at least in part, to the recommendations of the Commission's Advisory Committee on Smaller Public Companies (the "Advisory Committee") and to suggestions from the Committee on Federal Regulation of Securities (the "Committee") contained in its letter dated March 22, 2007 to John W. White, Director of the Division of Corporation Finance (the "ABA 2007 Letter"). Although comment letters have been submitted on each of the relevant releases separately, and the Committees comment in this letter on the Proposing Release and the Regulation D revision and related proposals contained in it, we think it is useful to step back and evaluate the proposals as a whole, and we do so at the end of this letter. First, we comment on the specific proposals in the Proposing Release and then on the interpretive guidance regarding integration of public and private offerings included in the Proposing Release. We also offer some other comments on those proposals and on additional items that merit consideration.

Our specific comments on the proposals in the Proposing Release are summarized as follows:

- We support the Commission's effort to move away from the absolute prohibition on general solicitation and general advertising but believe that this is best done by eliminating the prohibition entirely or, at a minimum, for offerings to accredited investors.

- Should the Commission not be willing to follow that approach but instead to permit advertising only if the offering is limited to investors who satisfy standards higher than those for accredited investors, we believe this is best effected through use of a baseline definition of "accredited investor" with different financial thresholds for eligibility to participate in different types of exempt offerings.

- We do not favor the proposed limitation on the type of communication that can be used to seek out eligible investors.

- The relationship of offerings under Rule 507 to other offerings should be addressed to eliminate impediments to the utility of the rule.

- Rule 507 should be adopted also as a safe harbor under section 4(2) of the Securities Act, and we believe the Commission has the authority to do that.

- We support the addition of an investment test to determine accredited investor status and the reduction in the integration safe harbor period under Regulation D.

- We do not favor expanding the disqualification provisions in Regulation D beyond Rule 505 or adding new disqualifying events to the existing "bad actor" disqualifications because these changes would impose a significant burden on capital raising without increasing investor protection.

- We do not support making securities acquired under the solely accredited investor prong of Rule 504 restricted securities because that would be inconsistent with the underlying premise of Rule 504 to leave regulation of small offerings primarily to the states, and because the need for this change has not been demonstrated.

- We welcome the interpretive guidance on integration of public and private offerings and believe additional steps merit being taken.

- Although we support the incremental improvements that have been proposed, especially with our suggested modifications, we believe there is continuing need for a more fundamental and comprehensive reevaluation of the regulation of exempt offerings as described in the ABA 2007 Letter and we encourage the Commission to pursue that reevaluation.

Proposed Rule 507

General Solicitation and Limited Announcements

Proposed Rule 507 is the centerpiece of the proposed revisions of Regulation D. It would permit exempt offerings to a new category of "large accredited investors" who may be located through limited advertisements as defined in the rule.

We strongly support the Commission's effort to move away from the absolute prohibition on general solicitation and general advertising (which we refer to together as "general solicitation") contained in Rule 502(c) of Regulation D. We are pleased that the Commission is recognizing the realities of modern communication and the principle that there is no harm to prospective investors who never purchase in the offering, thus allowing the focus to be on the protections necessary for those who actually do purchase securities. However, we believe the Commission could go further in this direction without sacrificing investor protection. Moreover, we believe that some of the limitations under proposed Rule 507 will significantly limit its practical utility.

As the Advisory Committee and the Committee recommended, we believe the time has come to eliminate the prohibition against general solicitation under Regulation D in its entirety or at least in the case of offerings where purchasers are limited to "accredited investors." The Commission has already determined that accredited investors, without limitation as to number, do not need the protections of registration because they can fend for themselves. There is little purpose served in limiting the ability of companies in need of capital to reach this class of investors and, correspondingly, the ability of these investors to find investments of interest to them. As former Director of the Division of Corporation Finance Linda C. Quinn said more than 10 years ago in a speech to the Committee:

> Requiring offers to be registered is, in essence, simply a prophylactic. There is nothing inherently wrong, or counter to investors' interests, in telling them about a company and asking them if they'd be interested in buying its securities . . . . [U]nder such an approach [nonregistration of offers], public offers would not preclude reliance on the private placement exemption of Section 4(2) of the Securities Act. So long as the sale was to the qualified buyers, and resales to the public were restricted, general solicitation and advertising would no longer run afoul of Section 5 as unregistered offers and would not otherwise seem to warrant restrictions.[1]

What constitutes general solicitation is fraught with uncertainty and represents, perhaps, the greatest regulatory impediment to the ability of companies to raise money in offerings exempt from registration. Substantial legal time and costs are incurred grappling with this prohibition, and the consequences of being wrong can be devastating, resulting in the need to offer rescission rights to all who participated in the entire offering. In addition, based on staff interpretations, the prohibition creates an unlevel playing field because brokers, through the so-called "two-call rule," can circumvent the prohibition while companies dealing directly with investors cannot.[2] These problems persist in the name of a "prophylactic," when in fact there is no harm to investors from offering activity if the purchasers meet the required standards.

Moreover, as stated in the Committee's comment letter dated October 25, 1995 to the Commission (the "ABA 1995 Letter"), we do not believe there is an issue of authority to permit general solicitation in private offerings. The absence of general solicitation is but one factor in assessing the availability of a private offering exemption and is not an essential factor.[3]

---

[1] Linda C. Quinn, "Reforming the Securities Act of 1933: A Conceptual Framework," 10 Insights 25 (1996). See, also, the remarks of another former Director of the Division of Corporation Finance, Brian J. Lane, noted in the Advisory Committee's report at note 162, who said: "Why then prohibit a private placement as long as (1) it includes a warning that it will not sell to investors who do not meet the definition of an accredited investor and (2) does not, in fact, sell to unsophisticated investors: Who is harmed?" (Nov. 13, 1999), available at http://www.sec.gov/news/speech/speecharchive/1999/spch339.htm.

[2] The "two-call" rule, which arose under staff interpretations, permits a broker-dealer to establish a "pre-existing, substantive relationship" without offering the security and then to follow up with an offer of the security without its being a general solicitation. See E.F. Hutton Co. (Dec. 3, 1985); Bateman Eichler, Hill Richards, Inc. (Dec. 3, 1985); H.B. Shaine & Co, Inc. (May 1, 1987); see also, Woodtrails - Seattle, Ltd. (Aug. 9, 1982); IPONET (July 26, 1996); and SEC Interpretation: Use of Electronic Media, Release No. 33-7856 (Apr. 28, 2000), Section II.C.2. at notes 79-88.

[3] The ABA 1995 Letter, at pp. 11-17, discusses elimination of the ban on general solicitation generally and at pp. 13-15, the issue of the Commission's authority to do so. It notes that courts and commentators have consistently taken the position that the availability of a private offering exemption is based on a flexible analysis applying a number of factors, with particular factors not necessarily being determinative. If any factors are especially significant, they are the nature of the investors and their need for the protection of the Securities Act as made clear by the U.S. Supreme Court in SEC v. Ralston Purina Co., 346 U.S. 119 (1953), with the manner of offering not being determinative. See, e.g., SEC v. Universal Major Industries Corp., '75-'76 CCH Decisions ¶ 95,229, and Mark v. FSC Securities Corp., 870 F.2d 331 (6th Cir. 1989) (court found wide-ranging distribution scheme to require evidence as to each investor's access to information).

If the Commission took the approach of eliminating the ban on general solicitation, either entirely or for offerings limited to accredited investors, the need for yet another category of investors, as proposed for Rule 507, would be obviated. We discuss this further below.

If the Commission is not willing to go that far at this time, we support the proposal to allow advertising to find investors who satisfy standards higher than those for accredited investors. However, we believe the limitations proposed to be placed upon the nature and extent of the permitted advertising are inadvisable. We believe those limitations are unnecessary for the reasons noted above, are unrealistic in that they would lead to anomalous results as we will attempt to illustrate, and will impair the rule's utility and discourage its use. In addition, as noted above, retaining the ban on general solicitation as an override to the permitted limited advertising will leave in place the uncertainties surrounding what constitutes general solicitation and the resulting trap for the unwary with draconian rescission rights for getting it wrong.

Under the proposal, an announcement would be permitted, but only "in written form," and any description of the business would be limited to 25 words. The Proposing Release indicates that written form could occur in any written medium, such as in a newspaper or on the Internet, but radio or television broadcast spots would be prohibited. The Commission explains the limitation as "an effort to limit aggressive selling efforts." We do not find that a persuasive reason, especially given the restriction on the persons eligible to invest and the problems created by the limitation.

Rather than continuing to prohibit general solicitation and carving out limited announcements in connection with a Rule 507 offering, the Commission should eliminate the prohibition on general solicitation for offerings to these investors and, if it believes it necessary, just restrict those activities, such as radio and television broadcasting, which it considers problematic. Instead of seeking to control communications in an overly broad way, the Commission should rely upon the antifraud rules and its other enforcement powers to address any concerns.

The Commission's attempt to restrict the permissible communications in the manner proposed will lead to anomalous results, as illustrated by these few examples: Consider an issuer who makes an oral presentation before a university-sponsored investor forum open to a general audience. This presentation would run afoul of the prohibition on general solicitation and would not qualify for the limited announcement relief under Rule 507 because of its oral nature, even if the audience was made up solely of large accredited investors and actual sales were limited to these investors. This same issuer, however, could stand on a street corner and indiscriminately pass out handbills that comply with Rule 507 (limited, of course, to 25 words in describing its business), or even walk up and down with a billboard, so long as that person – like a street mime – did not engage in any form of oral communication. The issuer could not follow up by telephone with leads from persons with whom there is no pre-existing relationship, but

presumably it could do so by e-mail.[4] Also, the requirement to limit the description of the business to 25 words can raise antifraud concerns and be contrary to investor interests when more is required to adequately describe that business or if the issuer wishes to describe the risks of the business so that an investor will know what is involved before expressing interest. These examples illustrate the futility of trying to control communications in the way proposed.

If the Commission nevertheless decides to impose a limitation on the type of statements made about the business, a qualitative approach such as "a brief and balanced description of the company's business" would be preferable to a numerical limitation on words.[5]

We urge the Commission to take the opportunity to eliminate the prohibition on general solicitation entirely from Regulation D. If the Commission is not prepared to do that, then it should be eliminated from Rule 506 and Rule 507 or at least, in the case of Rule 506, for offerings limited to purchasers who are accredited investors. As a final alternative, the prohibition on general solicitation should be eliminated entirely for offerings under Rule 507, possibly with a prohibition on use of radio or television broadcasting.

Large Accredited Investor

If an exemption is adopted that permits a broader form of solicitation only if the purchasers meet standards higher than those for accredited investors, we recommend that, instead of creating a new category of "large accredited investor," the Commission use a baseline definition of "accredited investor," with different financial thresholds for eligibility to participate in different types of offerings. In this way, the Commission could avoid adding yet another definition to the multiplicity of eligible investor definitions that complicates the exempt offering process and increases the difficulties of compliance.

At the same time, the Commission could seek to rationalize the various categories of investors, for example, by tiering those "accredited investors" eligible to participate in an offering under Rule 507 and under Rule 144A, taking into account the definition of "qualified purchaser" in section 2(a)(51) of the Investment Company Act and the rules thereunder. If the Commission were to decide to proceed with the proposed rulemaking regarding pooled-investment vehicles, the category of investors eligible to participate in a Rule 507 offering and in an offering by a pooled-investment vehicle could be coordinated. In addition, the Commission could revisit and expand beyond qualified institutional buyers ("QIBs") the investors eligible to

---

[4] Although neither the Proposing Release nor the proposed rule expressly states it, we believe that, consistent with Securities Offering Reform, e-mail would be considered in written form. It would be useful for the Commission to confirm this.

[5] Rule 134 provides an example of limited permitted communication which may be instructive. We note that Rule 254 permitting "testing of the waters" under Regulation A does not contain any content limitations, although written communications are required to be filed with the Commission (but not as a condition to the exemption).

participate in a Rule 144A offering, for example, by using the Investment Company Act concept of "qualified purchasers."[6]

We have no problem in concept with the criteria for investors designated as "large accredited investors," subject to the following comments:[7]

- For ease of application and consistency, we believe that the definition of large accredited investor should parallel as much as possible the definition of accredited investor, only with higher thresholds. Thus, we would prefer that the definition of large accredited investor include both a total assets or net worth test and an investment test. We do not believe this change would impair investor protection and it would have the benefit of greater simplicity.

- Investments (as an alternative test as proposed for determining accredited investors) should include the investments of both the investor and the investor's spouse, whether they are individual or joint investments. There are many reasons for only one spouse to elect to invest, including available funds, portfolio diversity, tax position and estate planning. Thus, it is arbitrary to require both spouses to invest in order for the full amount of the investments to be counted. If the Commission believes greater control is truly necessary, and it has not articulated a reason for such need, the same result could be achieved by having the non-investing spouse consent to the investment being counted.

- The Commission is proposing to add more entities to the list of entities in Rule 501(a)(3) eligible to qualify based on a total asset test. Although we agree with the entities proposed to be added, we recommend that the Commission take a more principles-based approach by simply using the term "any legal entity" without specifying any particular types of entities.[8] We cite the addition of "Indian tribes" and "labor unions" as examples of over-specificity. There are entities left off the list and new entities may come to the fore, just as limited liability companies did after Regulation D was adopted.[9]

- Similarly, we recommend that the Commission take a more principles-based approach to describing governmental bodies, rather than providing a detailed definition.

---

[6] See note 8 below regarding issues surrounding which legal entities qualify as QIBs under Rule 144A.
[7] These comments also apply to the definition of "accredited investor."

[8] We note that the failure to take a principles-based approach to the concept of "legal entities" for purposes of the definition of QIBs under Rule 144A has led to uncertainty and unnecessarily restrictive interpretations.

[9] This broader approach was taken to some extent in the 2002 Uniform Securities Act in section 102(11)(O), which includes in the definition of "institutional investor" the following: "any other person, other than an individual, of institutional character" who meets a total assets test and "is not organized for the specific purpose of evading this Act."

- We also encourage the Commission to consider as well a more principles-based approach to the definition of "investments" in order to simplify the rule. In that connection, we question the exclusion of securities of controlled private companies. Ownership of such securities often evidences a high degree of business, financial and investment sophistication.

Relationship to Other Offerings

Rule 507 as proposed requires that all purchasers be large accredited investors. From that, the Commission reasons that an issuer may not conduct side-by-side Rule 506 and Rule 507 offerings (and presumably any other Regulation D offering that prohibits general solicitation). This does not necessarily follow. We believe more provision needs to be made for the relationship between Rule 507 and other offerings, including the following:

- Like Rule 701, Rule 507, given the nature of permitted investors and sales activity, should not be integrated with any other Regulation D offering to defeat the validity of the Rule 507 offering (i.e., an integration firewall). For example, a completed Rule 507 offering should not be affected by a subsequent Rule 506 offering, regardless of when it takes place.

- Whether a Rule 506 offering should lose its exemption because of a Rule 507 offering should depend on the facts and circumstances, especially whether the announcement under Rule 507 was the basis upon which investors under Rule 506 were found. For example, a company might do a Rule 506 offering with its existing investors while contemporaneously doing a Rule 507 offering to large accredited investors using permitted advertising. Thus, the Commission's interpretive guidance in the Proposing Release regarding the circumstances in which it would be possible to do a side-by-side Rule 506 offering and a registered offering should be equally applicable to a side-by-side Rule 506 offering and Rule 507 offering.

- Although not proposed to be adopted under section 4(2), a Rule 507 offering can be viewed as akin to a private offering and thus should be entitled to the same benefits of Rule 152 and Rule 155 as a private offering. In fact, because of its nature, the public-private integration concepts applied to a private offering (such as a private offer must be completed as a private sale and cannot be converted to a public sale) need not be applied at all to a Rule 507 offering.

- We are concerned that issuers using Rule 507 will fall into a trap if they are unsuccessful in finding sufficient large accredited investors for a successful offering and as a result of the advertising will foreclose other alternatives. This risk will discourage use of the rule. To avoid this, in addition to making any integration subject to the facts and circumstances, we believe a relatively short safe harbor period is needed following which an offering may take place without the advertising under Rule 507 being attributed to it. We suggest a 30-day safe harbor period. This period finds precedent in Rule 155, Rule 254 and the safe

harbor for communications before filing a registration statement under Securities Offering Reform (Rule 163A).

Basis for Rule 507

The Commission has proposed to adopt Rule 507 pursuant to section 28 rather than, like Rule 506, as a safe harbor under section 4(2). There are consequences to this approach, including the need to define large accredited investors as "qualified purchasers" in order to achieve "covered security" status, making safe harbor rules like Rules 152 and 155 unavailable unless they are amended, and excluding exempt pooled-investment funds from being able to use Rule 507.

We believe a more straightforward approach would be to adopt Rule 507 also as a safe harbor under section 4(2). We do not believe allowing advertising, whether limited as proposed under Rule 507 or more generally as we recommend, is inconsistent with the requirement for a section 4(2) exemption, as discussed above.

Other Regulation D Changes

Accredited Investor Definition

We support the Commission's addition of an investment test as a basis for qualifying for accredited investor status as an alternative to the existing total assets or net worth and income tests. We are pleased that the Commission has made clear that pension accounts qualify as investments inasmuch as this is an important part of the investment portfolio of so many individuals. We also are pleased that the total assets, net worth and income tests have been retained because they have been relied upon by issuers for some time now.

We do not take a position on the inflation adjustment in dollar thresholds that the Commission has proposed. At one level, it appears to make sense because it is designed to maintain the financial criteria for accredited investor status at a level that adjusts in real dollar terms, and its deferred phase-in will give issuers time to adjust.[10]

As noted above in commenting on the large accredited investor definition, we believe that it would be better to apply a principles-based approach to identifying entities and governmental bodies and that the investments of a spouse should count in applying the investment test without its having to be a joint investment.

---

[10] In assessing the need for the adjustment, the Commission might want to consider a number of countervailing considerations, including (i) there is an absence of data reliably establishing investor suitability at any particular level and no evidence that the current levels have created problems, (ii) adjustments to the levels will add complexity and added compliance burdens, and (iii) from a capital raising perspective, the effects of inflation tend to be self-adjusting in that increases in assets, net worth and income are offset by higher expenses, affecting the amount of disposable income available for investment and thus the pool of available investors, while at the same time the amount of capital required by companies from this pool of potential investors increases due to inflation.

We also suggest that the Commission take this opportunity to address the treatment of trusts as accredited investors. We believe that many ordinary trusts are placed at a distinct disadvantage to other forms of entities covered by Rule 501(a)(8) (which includes as accredited investors entities the equity owners of which are all accredited) simply because the trusts do not have "equity owners." This could be corrected by a revision to Rule 501(a)(7) to expand its coverage to encompass any trust, regardless of assets, provided that its investment decision is made by a trustee which is an accredited investor, or if each of the trust's beneficiaries is an accredited investor. Revocable inter vivos trusts for accredited investors have long been recognized by no-action letter as accredited under Rule 501(a)(8),[11] and considering that self-directed employee benefit plans with investment decisions made by accredited investors have been included in Rule 501(a)(1), we see no reason why other forms of trusts effectively controlled by accredited investors should not be treated in similar fashion to other entities, irrespective of their assets.[12]

Reduction in Safe Harbor Period

We support the Commission's proposal to reduce the period for the integration safe harbor from 6 months to 90 days. We believe this is a sufficient period for establishing separation of offerings in view of the increased volatility of securities markets. This will assist companies in need of raising capital without impairing investor protection. As noted above, we believe there are additional safe harbors that should apply to Rule 507 offerings, including a 30-day period to permit other Regulation D offerings after completion or abandonment of a Rule 507 offering. It would be helpful for the Commission to reaffirm that the specified period is only a safe harbor and that the facts and circumstances could permit an offering to take place during that period.

Also, we believe that the Commission should take the opportunity to clarify the language of the safe harbor under Rule 502 by changing the condition to read "so long as during the applicable six-month period" in place of the present "so long as during those six-month periods." This would confirm that the absence of offers or sales need only occur during the period for which the safe harbor is being used, which may be either six months before the start of the Regulation D offering or six months after the completion of the Regulation D offering and not during both periods as the present language, with its plural usage, might incorrectly suggest.

In addition, we believe that it would be a good time for the Commission to consider the length of time that affects offering activity under other rules. Thus, we recommend that the one-year distribution compliance period for Category 3 equity securities under Rule 903 of

---

[11] See, e.g., Herbert S. Wander, No-action letter (Nov. 25, 1983).

[12] For example, under current rules an individual accredited investor could organize a corporation with only $50,000 in assets, with himself as sole shareholder, and qualify that entity as an accredited investor, yet he could not create an accredited irrevocable trust for his child with only $1 million in assets, even though he is the sole trustee making investment decisions (and even if the child were accredited, too), unless he contributed over $4 million in additional assets to the trust. This disparity has created problems for many investors over the years, and should be corrected.

Regulation S be reduced to six months. The same rationale for reducing other restricted periods, including the increased volatility of markets, is applicable here.

Expanded Application of Disqualification Provisions

The Commission proposes to impose disqualification provisions for the first time on offerings made pursuant to Regulation D exemptions in addition to Rule 505, which is currently subject to "bad actor" disqualifications in Regulation D. This would affect most notably Rule 506 offerings and new Rule 507 offerings. Proposed new Rule 502(e) would bar any offering from relying upon any rule in Regulation D, including Rules 506 and 507, if the issuer or certain persons associated with the issuer ("covered persons") are disqualified.

We do not support imposing disqualification provisions beyond Rule 505 offerings for the reasons explained below. Our concern is that the Commission, by imposing these disqualifications as proposed, would be complicating the application of the most utilized exemptions under Regulation D and imposing additional burdens on capital formation without really strengthening investor protection. As proposed, the disqualification provisions would be overly broad and difficult to apply. No empirical data have been cited to indicate that there are abuses in need of correction. To the extent there are enforcement concerns, these are best dealt with under the Commission's enforcement powers, rather than burdening all capital-raising activity under Regulation D. In addition, we are concerned that these burdens would drive issuers toward using the statutory section 4(2) private offering exemption and lose the benefits of the safe harbor. We note that the Commission considered extending the disqualification provisions in 1987 and determined not to do so. It should reach the same conclusion today.[13]

The disqualification provisions now in place for Rule 505 raise numerous interpretive issues and are overly broad. These problems would be exacerbated if disqualification provisions were extended beyond Rule 505 to more widely used exemptions under Regulation D. Moreover, the disqualification provisions proposed to be added as Rule 502(e) go beyond those currently imposed on Rule 505 offerings. The list of covered persons includes such difficult to apply terms as "promoter" and "affiliated issuer." Also, the list is overly broad and difficult to apply because it includes a predecessor, parent, subsidiary, sister company and beneficial owner of 20 percent or more of any class of the issuer's equity securities. Many companies have equity owners at that level who have no vote or say in the management of the company. This can be the case with a relatively small ownership in a company with multiple classes of securities. Additionally, in an ongoing offering, various actions can result in an existing shareholder becoming a 20% holder or in different 20% holders after each closing, making compliance difficult.

The list of disqualifying events also includes a number of imprecise terms and events that are overly broad and not defined. For example, the terms "adjudication" and "determination"

---

[13] The Commission itself has not previously imposed disqualification requirements on Rule 506 offerings, presumably not deeming accredited investors plus a small number of unaccredited investors who must meet sophistication standards in need of protection. In contrast, the Commission did impose disqualification requirements on Rule 505 offerings, in which unaccredited investors who may not be sophisticated are permitted to particpate.

can have various meanings. The failure to file Form D is often inadvertent but could, if the proposals are adopted, be the reason an issuer becomes disqualified from being able to rely on Regulation D. Also, an administrative cease-and-desist order within the scope of proposed Rule 502(e)(1)(v) could be entered for a variety of technical reasons (e.g., for a failure to file a form or report in a timely fashion) and the meaning of "investment" and "finance" laws is unclear.

Moreover, including state cease-and-desist orders within the scope of proposed Rule 502(e)(1)(v) poses serious risks to companies that utilize registration exemptions available under Regulation D. Unlike orders issued by the SEC, state regulators can issue cease-and-desist orders without providing the subject company with notice and opportunity to be heard. This distinction is even more troubling given that, as noted above, a state can enter a cease-and-desist order for a variety of technical and minor reasons. Affording companies some level of due process is critical in situations where the state's imposition of a cease-and-desist order could effectively shut down a company. Such a harsh outcome would be particularly unjust where the cease-and-desist order is imposed not on the subject company but rather on covered persons affiliated with the company. Additionally, this outcome would be unjust where the cease-and-desist order is issued in reaction to conduct that is completely unrelated to securities activities – for example, the disqualification provision under the proposed rule would be triggered by a cease-and-desist order issued under state insurance, investment, banking or finance laws.

Although the Proposing Release indicates that deterring recidivists is the purpose of the addition of these disqualifications, we are concerned that the overly broad list of events would cover more than just serious securities law violators and impose an undue burden on, and act as a disincentive to, legitimate issuers. Additionally, serious securities law violators may simply rely on section 4(2), to which disqualification provisions would not apply, and there would then be no Form D notice filed with the Commission or states to assist in identifying possible recidivists. Inasmuch as Rule 506 is a safe harbor under section 4(2) and there is no disqualification from using that statutory exemption, we question the advisability of the Commission's imposing that requirement on the safe harbor.

Should the Commission determine to impose a disqualification provision beyond Rule 505, we recommend that the Commission consider defining more clearly and narrowly the persons related to an issuer who would be covered by the disqualification provisions and to restrict the disqualifying events to serious events, for example, felonies or civil judgments involving fraud. In addition, if, despite our strong views, the Commission were to include state administrative orders in the list of disqualifiers, it should be accompanied by the exclusions found in both the Model Accredited Investor Exemption and the Uniform Limited Offering Exemption (i) for parties that continue to be licensed or registered to conduct securities related business in the state whose order is the basis for the disqualification and (ii) where the applicable authority of the state to which the disqualification relates waives the disqualification.

Because of the costs and burdens of the diligence required to determine if the disqualifications apply, many issuers that are not actually disqualified, as well as those who are, may choose not to rely on Regulation D, but rather offer the securities in a private placement in reliance on section 4(2). The offering would not then have the benefit of the preemption of state

blue sky laws that is available to Rule 506 offerings, and without this preemption an issuer would need to comply with disparate private placement exemptions under applicable blue sky laws. This would subject the issuer to non-uniform filing, legend, holding period, disclosure, numerical limits on offerees or purchasers, and other substantive requirements, and run counter to the uniformity the Commission and the National Securities Markets Improvement Act of 1996 ("NSMIA") are seeking to promote.

The Proposing Release indicates that the impetus for imposing disqualification provisions on Rule 506 offerings was based on recommendations from some of the state securities regulators and the North American Securities Administrators Association. The Commission notes that, prior to NSMIA, Rule 506 offerings were subject to state "bad-boy" disqualification provisions and thus such offerings were restricted in that manner. However, not all states imposed disqualification provisions on private placements, so such provisions were by no means universal.

The Commission requested comment on the phase-in of any new disqualification provisions. If the Commission adopts new disqualifications, we believe that they should apply only to future disqualification events.[14] It would be unfair, for example, to impose new disqualification provisions on someone who, prior to adoption of these provisions, agreed to a cease-and-desist order as a part of a settlement without being aware of the newly created consequences. Applying the provisions prospectively would serve the deterrent function of the proposal and avoid imposing significant burdens on the Commission staff in having to deal with a large number of requests for exemptive relief.

Amendment to Rule 504

The Commission is proposing to amend Rule 504 to make securities issued under subsection (b)(1)(iii), the solely accredited investor prong of Rule 504 that permits general solicitation, "restricted securities" subject to resale restrictions. We believe this change would be inconsistent with the underlying premise of Rule 504 that relies on state law to address regulatory concerns. Essentially, Rule 504 is based on the principle that offerings in the limited amount permitted under Rule 504 do not raise a sufficient federal concern and therefore regulation of these offerings is best left to the states. The solely accredited investor prong of Rule 504 is designed to coordinate with the state Model Accredited Investor Exemption or similar state exemptions, as proposed in the ABA 1995 Letter. It should be left to each state to decide whether to adopt such an exemption and, if it does, the extent to which there are restrictions on resale. The Model Accredited Investor Exemption restricts resales within 12 months except pursuant to a registration statement or to accredited investors. There is no need to impose federal restrictions that apply across the board. Restrictions on resale have a significant impact on the ability of issuers to raise capital under the exemption and on the cost of that capital.

---

[14] We note that the definition of "ineligible issuer" in Rule 405 adopted in connection with Securities Offering Reform applies a prospective approach to certain of the disqualifying events.

If the Commission determines to impose restrictions on resale, it should provide expressly that resales to other accredited investors are permissible rather than leaving resales solely to the uncertainties of the so-called "Rule 4(1 ½)" exemption.[15]

Interpretive Guidance on Public/Private Integration

We welcome the interpretive guidance on issues surrounding the integration of public and private offerings and believe the Commission has taken a sensible approach that will assist companies in registration to raise needed capital pending completion of a registered offering. The Commission's guidance puts to its justly deserved rest the "presumptive general solicitation" concept arising from filing of a registration statement and allows the analysis to rest on facts and circumstances. This approach will permit companies to go beyond the limitations of the "Black Box" doctrine in doing a concurrent private offering during the pendency of a registration statement when the facts justify it. In addition, it is helpful to have the Commission confirm the staff interpretive position in Verticom[16] that a registration statement, whether primary or secondary, can be filed after completion of a private offering without being integrated even if the registration statement filing was contemplated. We see the underlying rationale of the interpretive guidance as consistent with questioning the need for a ban on general solicitation as a policy matter if sales end up being made only to investors who meet the applicable qualification standards.

As welcome as the interpretive guidance is, we believe there are additional related actions that should be taken. First, we believe it would be preferable for the Commission to amend Rule 152 itself to make clear its meaning. In this way, the correct meaning of the rule will be readily apparent on its face without resort to interpretive guidance in a proposing release. Also, Rule 152 by its terms is limited to private offerings. As noted above, we believe it also should apply to a Rule 507 offering, which, as a result of the Commission's approach to adopting it under section 28 rather than section 4(2), would not qualify. Moreover, we believe the time has come to extend the principle of Rule 152 to other exempt offerings, including those under Rules 504 and 505. We see no persuasive regulatory reason for not applying Rule 152 more broadly inasmuch as investor protection is fostered by encouraging registered offerings and the capital-raising needs of companies are the same whether the completed offering was a private offering or another type of exempt offering.

There are other staff interpretations relating to the integration of public and private offerings that deserve to be revisited and we urge the Commission to do so. Examples include the concept of when a private offering is "complete" and the availability of Rule 415 for delayed or continuous resale offerings which have been characterized by the staff under recent

---

[15] The ABA 2007 Letter, at p. 27, recommended that Regulation D should address resales more broadly.
[16] Verticom, Inc., No-action letter (Feb. 12, 1986).

interpretations as "disguised primary offerings."[17] Moreover, the general concept of integration, which is now based on the inadequate five-factor test, merits reconsideration and updating.[18]

Other Matters

Rule 144A

We support the need to amend Rule 144A to exclude advertising under Rule 507 from being improper offering activity under Rule 144A. However, as indicated in the ABA 2007 Letter, we believe a better approach, which is overdue, would be to eliminate in its entirety the restriction on offers to persons who are not QIBs. Since Rule 144A is premised upon sales solely to QIBs, we do not see the need to restrict offering activity in order to qualify for the rule's exemption.

Also, as noted above, we recommend revisiting the definition of QIBs and considering expanding the class of investors eligible to purchase in a Rule 144A offering.

Regulation S

As long as there continues to be a restriction on "directed selling efforts" under Regulation S, we believe it would be appropriate to amend that regulation to exclude advertising under Rule 507 from that restriction.[19] This would permit side-by-side Rule 507 and Regulation S offerings, which we believe is appropriate and desirable. Doing so would expand capital-raising alternatives for companies without diminishing investor protection.

Rule 508

We recommend that Rule 508 be amended to add Rule 507 to the list of Regulation D exemptions entitled to the benefit of relief for "innocent and immaterial" mistakes.

Qualified Purchasers

As noted, the Commission proposes to define large accredited investors under Rule 507 as "qualified purchasers" in order to make securities sold under Rule 507 "covered securities" so as to avoid state securities laws interfering with the utility of the Rule 507 exemption to raise capital as contemplated by NSMIA.

We believe that the intention of Congress in enacting NSMIA would best be fulfilled by defining large accredited investors or their equivalent as "qualified purchasers" for all purposes and not just in connection with Rule 507 offerings. If these investors are qualified for purposes of Rule 507, there is no reason that they should not be qualified for other purposes.

---

[17] Stanley Keller and William Hicks, "Unblocking Clogged PIPEs: SEC Focuses on Availability of Rule 415," 21 Insights 2 (May 2007).
[18] See ABA 2007 Letter at pp. 33-34.
[19] See ABA 2007 Letter, at p. 37, regarding elimination of restriction on directed selling efforts under Regulation S.

Thus, for example, we expressed in our comment letter filed September 20, 2007 on the S-3/F-3 proposal our concern that the objective of facilitating capital formation for smaller issuers would not be met if inconsistent state securities registration requirements were permitted to interfere. This concern would be addressed, in part, if large accredited investors or their equivalent were defined as "qualified purchasers" across the board so that an issuer who wanted to avoid state securities registration requirements for an offering on Form S-3 or Form F-3 could choose to limit eligible purchasers to these investors.[20]

Pooled-Investment Vehicles

Consistent with our comments above, we recommend that the Commission eliminate the prohibition against general solicitation in offerings by pooled-investment vehicles. This approach may be implemented by eliminating the prohibition from Rule 506 or, if the Commission instead adopts Rule 507, either by adopting Rule 507 as a safe harbor under section 4(2) or by otherwise designating a Rule 507 offering as not involving a public offering, for example by providing separate relief for pooled-investment vehicles under section 6(c) of the Investment Company Act. While we recognize that section 6(c) does not give the Commission blanket authority to waive compliance with express statutory provisions of the Investment Company Act, an exemption under it would be (i) in the public interest and consistent with the protection of investors and (ii) consistent with retaining the private offering requirement of sections 3(c)(1) and 3(c)(7) of that Act.

Our recommendation is consistent with that made in the Commission's 2003 staff report "Implications of the Growth of Hedge Funds", at least with respect to 3(c)(7) funds. As that Report states:

> We question whether the restrictions on general solicitation for private placement offerings of interests in funds relying on Section 3(c)(7) of the Investment Company Act should be retained. Unlike a Section 3(c)(1) fund, a Section 3(c)(7) fund can be sold to an unlimited number of investors, so long as they are "qualified purchasers." There seems to be little compelling policy justification for prohibiting general solicitation or

---

[20] The concern that state securities registration requirements would undercut the benefits of expanded Form S-3/F-3 availability would be even more fully addressed if "qualified purchaser" were defined to include any purchaser in an offering under Form S-3 or Form F-3; we note that NSMIA and its legislative history identify the type of offering as a relevant criterion in connection with defining "qualified purchaser."

Some members of the Committees have expressed concern that the purposes of expedited offerings under shelf registration on Forms S-3/F-3 are being frustrated in some states by the requirement for filings for each take-down and by delays in the review process when "covered securities" are not involved. They recommend that the Commission consider these issues consistent with the purposes of NSMIA. For example, in connection with addressing the "covered security" status of securities registered on Form S-3 or Form F-3, the Commission might provide that any state notice filing authorized by section 18(c)(2)(A) of the Securities Act may cover all series and classes covered by the shelf registration in a single filing with a single fee prior to the first offer thereunder in the applicable state.

general advertising in private placement offerings of Section 3(c)(7) funds that are sold only to qualified purchasers.[21]

The Committee reaffirms its comments on the Commission's pooled-investment vehicle proposals contained in Release No. 33-8766 and No. IA-2576 set forth in the Committee's comment letter dated March 12, 2007, as supplemented by relevant comments in this letter.

Need for Comprehensive Reevaluation

As we have indicated, we believe that the Commission's proposals, both in the Proposing Release and the other related releases, represent helpful incremental improvements to the existing regulatory system. We have offered suggestions that we believe would enhance these improvements within the framework proposed by the Commission.

Although we can embrace these incremental improvements, we continue to see the need for a more fundamental and comprehensive reevaluation of the regulatory regime applicable to non-registered (primarily private) offerings and to bring the requirements applicable to these offerings into line with modern practices and communications technology. The reasons for this and the recommendations of the Committee are described in the ABA 2007 Letter. As beneficial as the current initiatives are, we urge the Commission to view them as a beginning and not as the end point of what should be a continuing process to modernize regulation of the non-public capital-raising process, both for smaller and larger issuers, in light of the continuing development of technology, market practices and globalization. Specifically, the following subjects, among others, deserve attention:

- Elimination of limitations on the manner of offering, namely general solicitation and general advertising under Regulation D, offers to non-QIBs under Rule 144A and directed selling efforts under Regulation S.

- Rationalizing the classes of investors eligible to invest in different exempt offerings.

- Extending the availability of issuer safe harbor exemptions to resales by control persons and holders of restricted securities.

---

[21] The Report went on to draw a distinction, with which we do not agree, between "accredited investors" and "qualified purchasers" as follows:

> The staff would be reluctant to ease or eliminate the prohibition on general solicitation for hedge funds or other funds that use the accredited investor standard as their minimum investor criteria. We believe that such an arrangement could increase the level of risk of investment interest by less wealthy investors. On the other hand, permitting funds, including hedge funds, that limit their investors to a higher standard (e.g., qualified purchasers) to engage in a general solicitation could facilitate capital formation without raising significant investor protection concerns.

- Recognizing the ability of broker-dealers to act in a principal as well as agency capacity for resales and, with their affiliates, to avoid being treated automatically as underwriters when they resell.

- Expanding guidance for differentiating public and private offerings.

- Establishing workable guidance for determining when nominally separate offerings should be integrated and when they can be distinguished, and standardizing safe harbor periods in view of changed market conditions and information availability.

- Clarifying further application of the integration doctrine to private and public offerings which are proximate in time, and revisiting other staff interpretations which create impediments to capital formation that may not be justified by investor protection needs.

Overall Effect of the Proposals

We compliment the Commission and its staff on the important package of initiatives it has proposed. Taken together, they will significantly improve the opportunities for capital raising by smaller issuers and the efficiency of their capital raising activities without sacrificing investor protection. We have suggested modifications in this and other comment letters that, if made, will accomplish these objectives to an even greater extent, still while preserving investor protection.

Specifically, the Commission's initiatives will improve the ability of companies to raise capital without registration by being able to seek out potential investors in a more effective way and with greater certainty regarding which offering activities are permissible without running afoul of difficult integration doctrines. In addition, reducing the restricted periods under Rule 144 will make exempt offerings more attractive to investors and yield better pricing for issuers as a result of the increased liquidity. Non-public issuers also will benefit from being able to use equity as compensation to a greater extent without triggering Securities Exchange Act registration.

At the same time, the Commission's initiatives will improve the registration process for smaller issuers, making it a more attractive alternative to exempt offerings. This is achieved through extending the benefits of shelf registration to smaller companies and expanding the number of companies eligible for scalable disclosure, including reduced financial statement requirements.

Combined, these improvements in the capital raising process will give smaller companies financing alternatives to such vehicles as PIPEs and equity lines that sometimes have raised regulatory concerns with the Commission.

The modifications we recommend will expand these improvements. By way of example:

- Permitting broader solicitation than the limited advertising proposed will put companies in a better position to locate qualified investors and to tell their story more effectively.

- Addressing the relationship of Rule 507 to other offerings will make use of Rule 507 more workable and will provide clear alternatives for issuers, the absence of which might discourage use of Rule 507.

- Refraining from reintroducing tolling to Rule 144 will increase the attractiveness of private investments and issuers will benefit from the ability of investors to engage in permissible hedging activity.

- The relief for equity compensation arrangements will be more useful if unnecessary restrictions, like those on transferability, are eliminated and more realistic information requirements are established.

- The utility of shelf registration on Forms S-3 and F-3 will be increased if the artificially low cap is eliminated or at least increased to a more useful level.

We believe that adoption of the Commission's proposals with the modifications we suggest would significantly improve the regulatory climate for smaller issuer financings and bring the initiatives closer in line with the recommendations of the Advisory Committee and the Committee without sacrificing the Commission's investor protection mandate.

* * * * *

We appreciate the opportunity to provide these comments to the Commission. Members of the Committees are available to discuss these comments should the Commission or the staff so desire.

Respectfully submitted,

/s/ Keith F. Higgins

____
Keith F. Higgins, Chair
Committee on Federal Regulation of Securities

/s/ Lawrence A. Goldman

____
Lawrence A. Goldman, Chair
Committee on Middle Market and Small Business

/s/ Ellen Lieberman

____
Ellen Lieberman, Chair
Committee on State Regulation of Securities

Drafting Committee

Margaret A. Bancroft	David B.H. Martin
Meredith B. Cross	Martin R. Miller
Catherine T. Dixon	Alan M. Parness
Stanley Keller	Paul N. Roth
Edwin C. Laurenson	Anne Yvonne Walker
Richard M. Leisner	Elizabeth Ayres Whitman
Ellen Lieberman	William J. Williams, Jr.
Mike Liles, Jr.	Thomas W. Yang

cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Annette L. Nazareth
Commissioner Kathleen L. Casey
Mr. John W. White, Director, Division of Corporation Finance
Mr. Gerald J. Laporte, Chief, Office of Small Business Policy, Division of Corporation Finance