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July 1, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-21-11

Dear Ms. Murphy:

We are responding to the Commissioner's request for comments in its Release No. 33-9211, File No. S7-21-11, regarding a proposed rule for "Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings," as proposed on June 1, 2011 (the "Proposed Rule Release"). The Proposed Rule would amend Rule 506 of Regulation D by adding thereto a new Rule 506(c) (the "Proposed Rule") and thereby implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The legislative intent of Section 926 of Dodd-Frank is to screen out felons and "bad actors" from Rule 506 offerings.

We have focused our comments on the discussion under II.D. of the Proposed Rule Release, "Reasonable Care Exception." In the Request for Comment, the Commission asks five questions – (54) through (58) – regarding its proposed approach to the use of reasonable care executed with due inquiry as the standard by which compliance with the Proposed Rule will be judged. We respond to the Commission's questions in this letter, informed in large part by the broad experience and best practices of our client, Scherzer International ("Scherzer") of New York, New York and Woodland Hills, California. Scherzer has been performing background investigations in the financial services and related industries for over 18 years both nationally and internationally. We refer you to Scherzer's Web site at www.scherzer.com for further information regarding the firm.

Background and Discussion

In a typical transaction that attempts to comply with Rule 506, there are at least three interested principals: the issuer, the soliciting person (the "Placement Agent") and the investor. The loss of the exemption from registration under Rule 506 will have a material and adverse affect on each of the three. Under the operation of the Proposed Rule, both the investor and issuer will be required to satisfy themselves that each covered person – the issuer and its related persons, as well as the Placement Agent – is not subject to a disqualifying event that would result in the loss of the exemption from registration.

In the absence of an exception or “safe harbor” for actions to be taken by an issuer to avoid the risk of losing the exemption from registration, issuers would be strictly liable for a violation of Section 5. The policy of the Proposed Rule – following from the intent of Section 926 – is to screen out certain individuals. This goal should be realized by encouraging self-policing by issuers and others that permits them to rely on the exemptions from registration without risk of subsequent imposition of administrative or criminal liability. Moreover, the failure of an offering to be exempt from registration could give rise to a right of rescission or other civil remedies on behalf of investors. The combination of these two risks could lead to the substantial retrenchment, if not collapse, of the private placement market in the U.S. This is the market in which not only start-up entrepreneurs, but also substantial operating businesses that privately place both debt and equity securities, private equity funds and hedge funds use to satisfy their capital requirements. Consequently, impairment of this market could have dire effects on the national economy. Therefore, it is imperative that issuers and others be able to transact in this market without additional regulatory risk.

As adopted and as administered, Rule 506 and its companion Regulation D exemptions operate with predictability and a minimum of ambiguity. The over 16,000 Form D filings that the Commission references in the “Background and Summary” section of the Proposed Rule evidences the benefit of a clear, well-drafted rule providing an exemption with significant positive economic effect. The Proposed Rule must be constructed so that full compliance is possible with the same level of predictability. The Proposed Rule presumes that issuers and Placement Agents alike will be able to access reliable and definitive information regarding the existence or not of disqualifying events with respect to covered persons. In theory, an issuer would collect the names of all covered persons in a Rule 506 transaction and then determine whether any of the covered persons has been subject to one of the prescribed disqualifying events during the applicable look-back period. Assuming no problems are found, the transaction is completed with the Rule 506 exemption intact and able to be relied upon.

The contemplated operation of the Proposed Rule should be considered in the context of what is possible for those who seek earnestly to comply with the proposed safe harbor in the real world of investigations today. Accordingly, the “reasonable care” standard and the accompanying requirement of factual inquiry must take into account the best practices and standards employed in the background investigations industry. Background investigations are employed by private businesses for various purposes, including pre-employment checks and regulatory compliance. The practice of using background investigations to verify information regarding officers and directors that is provided in proxy statements and information statements for SEC reporting companies is well-established, as is the use of background investigations for employees of registered investment advisers. The operation of the Proposed Rule would be enhanced and its purposes would be achieved by the use of professionals experienced in the research and analysis of events equivalent to the disqualifying events of the Proposed Rule.

We begin with the obvious and important proposition that there is no national repository of judgments and administrative orders, as acknowledged under II.D. of the Proposed Rule Release.

An important corollary is that the records repositories that do exist do not, in most cases, contain information that uniquely identifies the persons referenced in the records.

If Rule 506(c) is adopted as proposed, then for each Rule 506 offering there are three searches that would represent “due inquiry”:

- a search must be made of all covered persons;
- using the name of each covered person, a search must be made of each of the relevant record repositories listed below; and
- at the state level, the search must be conducted for each state in which each covered person has conducted business or purchased or sold securities.

Under the Proposed Rule, the relevant record repositories (the “Repositories”) are¹:

- Records of convictions, injunctions and restraining orders in the federal and state courts
- Records of certain state and federal regulators, including:
 - State securities commissions
 - Regulators of banks, savings associations and credit unions
 - State insurance commissions
 - Federal banking agencies²
 - National Credit Union Administration
- Records of FINRA and all securities exchanges of all member suspensions or expulsions
- Records of the SEC containing its disciplinary orders and its refusal or stop orders
- Records of the United States Postal Service containing its false representation orders

To further inform the Commission of the best practices followed by background investigation firms in the course of performing background checks, we are submitting together with this letter a document entitled “Dodd-Frank Felon and Bad Actors Disqualifying Event Elements” which provides an overview of the procedures that Scherzer would follow in performing such investigation services. Scherzer believes that its practices adhere to the highest level of proficiency possible. Scherzer also believes that many of its competitors, who vie for the business of the nation’s largest and most exacting financial services clients, follow substantially similar procedures. We urge the Commission to take note of both the exacting detail required by the searches and the practical limitations inherent in these searches.

¹ The records of the CFTC would be added to this list if the final rule includes CFTC violations as disqualifying events.

² We believe that this term should be defined in Rule 501.

The process for searching records of courts of general jurisdiction (both civil and criminal), as well as federal district courts, should be done through the best method applicable to the particular Repository: in person, through databases or by a combination of both to ensure the most accurate and up-to-date results. At a minimum, records should be searched using the name(s) provided to the background investigations firm on a particular document, such as a resume, application or request for investigation. Depending on the client's request, additional names appearing on address trace reports and in other public records may be searched. The search scope varies with the client and the purpose of the investigation, spanning from one jurisdiction of residence and employment to all jurisdictions within the past seven or 10 years. Further searches may entail accessing "national databases." In many instances, and especially if records are located in the "national databases," court documents must be obtained to establish positive identification with the subject and determine record details. For common names, this requires sorting through and reviewing hundreds of records.

The above has even greater application to records that are maintained by federal or state agencies. There are no uniform requirements for record keeping for all federal agencies or across the 50 states. Even within a state, record-keeping procedures vary widely from agency to agency, and there is no assurance that searches by name will retrieve records on an equivalently reliable basis from each of the referenced Repositories.

The policy question then becomes whether, given the importance of Rule 506's exemption from registration to the issuer and Placement Agent, the issuer or Placement Agent should be at risk for not having learned what cannot be known even by those skilled in the investigations process. The best answers, from a regulatory policy perspective, are (i) to expressly permit reliance on searches, analyses and reports from professionals, (ii) to expressly acknowledge that the processes followed by professional investigations firms are within the reasonable care standard and (iii) to provide that inquiry beyond the systemic or external limitations to which professional investigation firms are subject is not required.

Recommendations

Against this background, it is clear that a safe harbor for compliance with the Proposed Rule is essential. It has long been the policy of the SEC to promote compliance with its rules. Without the ability to establish that an issuer has satisfied a clear standard in making its inquiry, issuers and others would lose the exemption and become subject to considerable risk without any intent to do so or without any ability to deflect the risk through compliance.

Both we and Scherzer respectfully request that, in formulating the final rule, the Commission consider and implement the following:

1. Rule 506(c) must contain a "safe harbor" that allows issuers and Placement Agents to take specific actions, analyze the results of those actions and then be able to rely on the availability of the exemption. The "safe harbor" should not only state a general standard of care or duty, but also include specific objective actions that, if followed, are deemed to satisfy the standard of care. In other words, compliance with the "safe harbor" procedures

ensures that an issuer or Placement Agent has satisfied the reasonable care standard and may rely on the Rule 506 exemption, assuming all other requirements of Rule 506 have been met.

2. Rule 506(c) should be clear that the reasonable care standard has been met if due inquiry cannot be made because the agencies whose actions and dispositions are potentially disqualifying events do not maintain publicly-available records that (a) are in searchable form containing data sufficient to positively identify a covered person with a disqualifying event and (b) contain information that is both adequate in scope of coverage and definitive in its details.
3. Rule 506(c) should be clear that the reasonable care standard has been met if a disqualifying event was not found (i) because the disqualifying event was not reported in relevant public records, (ii) because the event preceded, or occurred after, the period of time for which such records are maintained or (iii) because of an error or omission in the records themselves.
4. Because of the complexity of searching the Repositories for the type of information necessary to assess whether felons and other "bad actors" are present, searches may best be performed and analyzed by professional, experienced background investigation firms. Rule 506(c) should be clear that an issuer or Placement Agent will be deemed to have satisfied the reasonable care standard if it uses a reputable³ background investigations firm to conduct the necessary inquiries and then relies on that firm's written report.
5. We believe that the Commission would not permit an issuer or Placement Agent to rely solely on questionnaires or other data submitted by covered persons without efforts by the issuer or Placement Agent to confirm the information so provided. In other circumstances involving Regulation D, the Commission has not permitted self-certification and has required verification for information provided by accredited investors. See IPO Net, SEC No-Action Letter, 1996 WL 431821, at *3 (July 26, 1996). If that is the case, then Rule 506(c) must permit an issuer or Placement Agent to engage the services of a background investigations firm to confirm the responses to the questionnaires and also to rely on the written report of the firm.

At several points within the Proposed Rule Release, the Commission has requested comments to its proposal that disqualifying events based on rulings of non-U.S. courts and non-U.S. agencies be comprehended within the Proposed Rule. We believe that, except in cases in which an issuer or Placement Agent is on notice that a particular covered person may be the subject of a disqualifying event, further inquiry should not be required. The relevant non-U.S. information sources may not be accurate, inclusive, in the English language or available to the public. In comparison to domestic searches, searching foreign record repositories represents an exponential increase in difficulty and uncertainty. Because of the limitations on the ability to conduct

³ We believe that a reputable background investigations firm is a licensed, industry accredited firm that adheres to Federal, state and local laws and regulations with demonstrated expertise in a wide range of background investigations.

Ms. Elizabeth M. Murphy

July 1, 2011

Page 6

investigations that would produce meaningful results, inclusion of foreign disqualifying events would make compliance with the reasonable care standard extraordinarily difficult to assess and consequently could subject those who did not seek to comply with the more difficult process to strict liability on this point.

Both we and Scherzer appreciate the opportunity to provide comments and respond to the Commission's questions and are available for discussion with the Commission of the matters discussed above or other matters related to the Proposed Rule.

Very truly yours,



William A. Newman

WAN:jy

cc: Mr. Larry Scherzer

Element	SEC Scope	Research Procedures
Court of General Jurisdiction (State/County) Criminal Records	In connection with the purchase or sale of a security, making of a false filing with the SEC or arising out of the conduct of certain types of financial intermediaries. The criminal conviction would have to have occurred within 10 years of the proposed sale of securities (or five years, in the case of the issuer and its predecessors and affiliated issuers).	Records would be searched using the method applicable to the particular repository: in person, through databases or a combination of both to ensure the most accurate and up-to-date results, using the name(s) provided and/or listed in address trace reports that are believed to be maiden names or aliases. (The protocol for name searching would be applied to all elements listed herein.) The search scope would be five or 10 years, in all jurisdictions of employment and residence. Court documents would be obtained to establish positive identification with the subject and determine case details.
Federal Criminal Records	In connection with the purchase or sale of a security, making of a false filing with the SEC or arising out of the conduct of certain types of financial intermediaries. The criminal conviction would have to have occurred within 10 years of the proposed sale of securities (or five years, in the case of the issuer and its predecessors and affiliated issuers).	Same as Item 1.
Injunctions & Restraining Orders (State/County)	In connection with the purchase or sale of a security, making of a false filing with the SEC or arising out of the conduct of certain types of financial intermediaries. The injunction or restraining order would have to have occurred within five years of the proposed sale of securities.	Same as Item 1, except for time scope, which would be five years.
Injunctions & Restraining Orders (Federal)	In connection with the purchase or sale of a security, making of a false filing with the SEC or arising out of the conduct of certain types of financial intermediaries. The injunction or restraining order would have to have occurred within five years of the proposed sale of securities.	Same as Item 4.

<p>State Securities Commissions</p>	<p>Final order that bars the issuer from: 1) associating with a regulated entity; 2) engaging in the business of securities, insurance or banking; 3) engaging in savings association or credit union activities, or 4) orders that are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years before the proposed sale of securities.</p>	<p>Information would be obtained through a direct-access database or telephonically, as applicable to the particular state. The time scope would be 10 years.</p>
<p>Regulators of Banks, Savings Associations and Credit Unions</p>	<p>Final order that bars the issuer from: 1) associating with a regulated entity; 2) engaging in the business of securities, insurance or banking; 3) engaging in savings association or credit union activities, or 4) orders that are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years before the proposed sale of securities.</p>	<p>Information would be obtained through a direct-access database. The time scope would be 10 years.</p>
<p>State Insurance Regulators</p>	<p>Final order that bars the issuer from: 1) associating with a regulated entity; 2) engaging in the business of securities, insurance or banking; 3) engaging in savings association or credit union activities, or 4) orders that are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years before the proposed sale of securities.</p>	<p>Same as Item 7.</p>
<p>Federal Banking Agencies</p>	<p>Final order that bars the issuer from: 1) associating with a regulated entity; 2) engaging in the business of securities, insurance or banking; 3) engaging in savings association or credit union activities, or 4) orders that are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years before the proposed sale of securities.</p>	<p>Same as Item 7.</p>

National Credit Union Administration	Final order that bars the issuer from: 1) associating with a regulated entity; 2) engaging in the business of securities, insurance or banking; 3) engaging in savings association or credit union activities, or 4) orders that are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years before the proposed sale of securities.	Same as Item 7.
Securities Exchange Commission (SEC) - Includes Disciplinary Actions & Refusal or Stop Orders	Disciplinary order relating to brokers, dealers, municipal securities dealers, investment companies and investment advisers and their associated persons, which would be disqualifying for as long as the order is in effect. Commission stop order and order suspending the Regulation A exemption issued within five years before the proposed sale of securities.	Same as Item 7, except the time scope would be five years.
U.S. Commodity Futures Trading Commission (CFTC)	Disciplinary order relating to brokers, dealers, municipal securities dealers, investment companies and investment advisers and their associated persons, which would be disqualifying for as long as the order is in effect.	Same as Item 7, except time scope would be as applicable to the particular subject.
Financial Industry Regulatory Authority (FINRA)	Suspension or expulsion from membership in a "self-regulatory organization" or from association with an SRO member, which would be disqualifying for the period of suspension or expulsion.	Same as Item 12.
United States Postal Service False Representation Orders	False representation order issued within five years before the proposed sale of securities.	Same as Item 7.