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VIA ELECTRONIC SUBMISSION: RULE-COMMENTS@SEC.GOV

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-13-20

Dear Ms. Countryman:

We appreciate the opportunity to submit comments to the Securities and Exchange Commission (the "Commission" or the "SEC") on the proposed exemptive order referenced above. *Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders*, Exchange Act Release No. 90,112, 85 Fed. Reg. 64,542 (Oct. 13, 2020) (the "Proposed Order"). We applaud Chairman Clayton and the Commission's continued efforts to facilitate the flow of capital to small businesses, particularly in the wake of the COVID-19 pandemic.

However, we write to raise our concern that a number of recent SEC enforcement actions that are now being litigated are directly contrary to the Commission's stated goals in the Proposed Order and, in fact, will likely diminish any benefits that small businesses would receive if the Proposed Order were promulgated. We believe that it is important for the Commission to consider the likely diminished benefits from the Proposed Order as a result of these SEC enforcement actions when assessing the potential costs and benefits of the proposed exemption—and to take corrective action by bringing those misguided enforcement actions to an end.

As the Commission notes in its notice of proposed exemptive order, Finders "often play an important and discrete role in bridging the gap between small businesses that need capital and investors who are interested in supporting emerging enterprises." 85 Fed. Reg. at 64,543. Thus, Finders can only be effective in helping secure capital for small businesses to the extent that there are investors to find who are interested in and capable of providing their capital to small businesses.

Today, a critical category of investors who provide substantial capital to small businesses are convertible note lenders. *See* Tom Zanki, *Companies Tap Convertible Debt in Droves Amid Pandemic*, Law360 (May 1, 2020), https://www.law360.com/articles/1269038/companies-tap-convertible-debt-in-droves-amid-pandemic. These convertible note lenders loan funds to small businesses, such as publicly-traded microcap and small cap companies that are unable to access more traditional sources of capital. Typically, as part of these transactions, if the small business does not repay the loan within a certain period of time, the convertible note lender has the right to convert the outstanding loan amount into discounted shares of the publicly-traded small business, which the lender can resell into the public markets in compliance with SEC Rule 144 (17 C.F.R. § 230.144).

As we explained in an article, enclosed herewith as Exhibit A, published earlier this year in the *National Law Journal*, entitled "Aggressive SEC Enforcement Actions Could Limit Small Business Recovery Resources," the SEC Enforcement Division has brought a number of recent litigated enforcement actions targeting these convertible note lenders, alleging that they are acting as unregistered dealers in violation of Section 15 of the Exchange Act, despite the fact that these firms do not directly interact with the investing public or otherwise engage in traditional "dealer" activities. As we discuss in the article, the novel and extraordinarily expansive definition of "dealer" that the Enforcement Division has adopted in these cases is contrary to the plain terms of the Exchange Act, over a century of precedent, and decades of the Commission's own guidance. Moreover, as particularly relevant here, these enforcement actions against convertible note lenders threaten to choke off the flow of capital to the very small businesses that the Commission seeks to assist with the Proposed Order.

The Enforcement Division's actions against convertible note lenders therefore threaten to significantly decrease any benefits that small businesses could hope to receive from the Commission's easing of Finders' registration requirements. After all, decreasing the burdens on Finders does not do small businesses much good if there are many fewer investors left for the Finders to find. The Commission cannot rationally continue its extralegal crackdown on convertible note lenders, while simultaneously claiming that unburdening the Finders who seek those lenders will help facilitate capital growth. *See, e.g.*, *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2126 (2016) ("[A]n '[u]nexplained inconsistency' in agency policy is 'a reason for holding an interpretation to be an arbitrary and capricious change from agency practice.'" (second alteration in original) (quoting *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005))). The Commission can do one or the other—it can continue its misguided effort to drive convertible note lenders out of business, or it can try to expand small business access to capital—but it cannot do both.

The Commission should choose responsible capital formation. That is what the markets and this country's small businesses—and all who rely on them—need during these difficult times. In considering whether to adopt the Proposed Order, the Commission must therefore also abandon its extralegal assault on convertible note lenders.

Sincerely,

/s/ Helgi C. Walker

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Cc: Jay Clayton, Chairman
Caroline A. Crenshaw, Commissioner
Allison Herren Lee, Commissioner
Hester M. Peirce, Commissioner
Elad L. Roisman, Commissioner
Brett Redfearn, Director, Division of Trading and Markets

Exhibit A

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Aggressive SEC Enforcement Actions Could Limit Small Business Recovery Resources

The commission's Enforcement Division has waged an overly aggressive and entirely unnecessary campaign against the very firms that provide capital and liquidity to the small businesses the SEC says it wants to help.

BY **HELGI WALKER, BARRY GOLDSMITH, JONATHAN SEIBALD AND BRIAN RICHMAN**

In recent public statements, the chair and other commissioners of the Securities and Exchange Commission have struck the right chord: they have vowed to leverage every tool in their regulatory tool kit to facilitate the flow of capital to the thousands of small businesses that are struggling to stay afloat in the wake of the COVID-19 pandemic. However, contrary to the SEC's stated priorities, the commission's enforcement division has waged an overly aggressive and entirely unnecessary campaign against participants in the market for convertible debt—the very firms that provide capital and liquidity to the small businesses the SEC says it wants to help. Witness *SEC v. Fierro* in the U.S. District Court for the District of New Jersey, or *SEC v. Keener* and *SEC v. Almagarby* in the U.S. District Court for the Southern District of Florida.

In these litigated enforcement actions, the enforcement division has taken the novel position that various lenders in the shares of convertible debt—firms that do not directly interact with the investing public—are actually "dealers" subject to the full range of registration and other regulatory requirements applicable to public securities businesses. Why? Because some borrowers opt to satisfy their outstanding debt by allowing the lender to convert that debt into discounted shares of stock in the borrower, which the lender under SEC regulations can sell after waiting six months. The enforcement division


SEC headquarters

insists that this well-established activity satisfies the definition of a dealer because the lender is "buying and selling securities" for its "own account."

That is just wrong. The division's theory would not only sweep in thousands of unsuspecting businesses that buy and sell securities; it breaks with the plain terms of the Securities Exchange Act, over a century of precedent and decades of the commission's own guidance. A dealer is a known quantity under our nation's securities laws, and no one—including the SEC—has ever thought that the term referred to any business that just so happened to buy and sell securities, even a lot of securities. Quite the contrary. The term distinguishes a particular, preexisting type of public securities business—a dealer—from another type of preexisting public securities business—a "broker." Such businesses occupy two sides of the same coin. Under the Exchange Act, while a broker effectuates a client's trades as an agent—buying and selling securities for the client—a dealer effectuates a client's trades as a principal—buying and selling securities from or to the client.

Either way, the key is public customers. Many individuals and businesses trade securities—but only a broker or a dealer holds itself out to the investing public as a public securities business. The commission has long recognized as much. In 1992, for instance, in *In re Gordon Wesley Sodorff Jr.*, the commission acknowledged that certain "factors"—such as handling investors' money and securities, rendering investment advice and sending "subscription agreements to investors for their review and signature"—are what "distinguish[ed] the activities of a dealer from those of a private investor or trader." SEC guidance has made the same point for decades—listing similar customer-facing factors in, for example, 1977, 1987, 1993, 1998, 2002, 2003, 2007 and 2008. And the courts have long agreed, as the U.S. District Court for the Northern District of Texas explained in 2016, in *Chapel Investments v. Cherubim Interests*: "To be considered a dealer, a person must be engaged in the securities business, such as soliciting investor clients, handling investor clients' money and securities, rendering investment advice to investors, and sending investors subscription agreements for their review and execution."

This customer focus is not just compelled by the law, but by sound public policy. Dealers, after all, are subject to an expensive, complex regulatory regime designed to protect investors, including standards of professional conduct, financial responsibility requirements, record-keeping requirements and employee-supervisory obligations. Which is all well and good for entities with customers, but entirely nonsensical for businesses without that just happen to buy and sell securities for their own account.

For these reasons, convertible debt lenders are not—and, before the Enforcement Division's misguided enforcement endeavor, have never been—considered dealers. A convertible debt lender, as the name implies, loans money to a small business in exchange for a convertible note. It is not, to quote the Exchange Act, in the "regular business" of "dealing." It does not "buy[ ] and sell[ ]" the same security in the same condition. It does not interact with the investing public. It does not hold investor's securities. It does not quote a two-way market. And it does not offer investment advice—to anyone, ever. In no world, then, is it engaged in the public-facing business of offering dealer services to others.

That should end the matter. The Enforcement Division should never try to change the law (not to mention the commission's long-standing guidance) through regulation by enforcement, outside the proper legislative or rulemaking processes. That is especially true here, where the Enforcement Division's targeting of vital financing providers threatens to take much-needed capital out of the convertible debt markets, squeezing small businesses and introducing a level of regulatory uncertainty that would be inappropriate in the best of times—and we are far from that. If the Enforcement Division really believes that convertible debt lenders are dealers just because their business involves buying and selling securities, who is next? Hedge funds? Investment companies? Day traders?

Consistent with its stated goal of supporting small businesses during the pandemic, and in order to adhere to the long-established meaning of "dealer" under the federal securities laws, the commission should rein in the Enforcement Division's misguided campaign against those who provide much-needed capital to small businesses through the convertible debt market.

Helgi Walker *is a partner at Gibson, Dunn & Crutcher and chair of the firm's administrative law and regulatory practice group. Barry Goldsmith is a partner at the firm and co-chair of the firm's securities enforcement practice group. Jonathan Seibald and Brian Richman are associates at the firm.*