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July 14, 2011

BY ELECTRONIC DELIVERY

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, Securities Act Rel. No. 9211 (SEC File. No. S7-21-11)

Dear Ms. Murphy:

On behalf of the firms identified below, we are pleased to provide comments concerning the Securities and Exchange Commission's recent proposal to establish a new disqualification provision applicable to private placements conducted pursuant to Rule 506 of Regulation D.[1] The Proposing Release addresses a requirement set forth in Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[2]

Each of the firms identified below regularly represents clients in connection with regulatory, civil, and criminal enforcement investigations and related litigation involving potential violations of state and federal securities laws. We regularly negotiate settlements that resolve allegations of wrongdoing and advise a broad range of clients on the potential collateral consequences that can flow from enforcement actions brought by state and federal authorities. Our comments are provided in a representative capacity.

INTRODUCTION AND SUMMARY

The domestic capital markets function best when the laws and rules that govern them are fairly enforced. Companies and individuals violating the law must confront the consequences of their actions, which often include severe penalties and sanctions that can substantially restrict their activities. These consequences serve important objectives of punishment and deterrence under the federal securities laws. As counsel to a host of market participants we regularly work with our clients to structure effective compliance programs. These programs are designed to prevent violations, to identify and confront misconduct when it occurs, and to enable firms to address allegations of potential violations of the law responsibly as they arise.

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1 Securities Act Rel. No. 9211 (June 1, 2011), 76 Fed. Reg. 31518 (the "Proposing Release").

2 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or "Dodd-Frank"), Pub. L. No. 111-203, 124 Stat. 1376 (2010).

We recognize that there are a variety of state and federal disqualification and ineligibility provisions that also serve important remedial and gate-keeping objectives. Some of these provisions limit the availability of exemptions from securities registration for those subject to certain types of orders and sanctions. For example, the registration exemptions set forth in Regulation A, Rule 505 of Regulation D, and Regulation E contain substantially similar disqualification provisions in their current forms. These provisions are also each accompanied by relief and waiver procedures in recognition of the fact that the public interest may not be served if, under the circumstances, the disqualification would be unnecessary or operate in an unduly severe manner.

In most cases, the potential consequence of these "bad actor" provisions on the future activities of individuals and companies facing a prospective enforcement action has a critical impact on how the settlement process is considered, negotiated, and structured. The finality and certainty achieved by a negotiated settlement is of particular importance to both the regulators and the settling parties whose ongoing business operations require predictability. As a result, regulators and settling parties spend considerable time evaluating the key material terms, including the potential consequences of such settlement, any ameliorating waiver applications that may be needed, and the likelihood that relief will be forthcoming under the relevant circumstances.

Although we recognize the purpose for the Commission's Proposing Release and the congressional mandate that it reflects, we have several serious concerns about the Proposing Release as currently structured. We are primarily concerned that the retroactive application of the proposed disqualification would unfairly upset previously negotiated civil and administrative settlements and risk unwarranted disruption to private capital formation unless a more tailored approach is adopted. We also believe that certain other aspects of the proposed rule require clarification.

Our comments are summarized as follows:

- ***Retroactive Application of the Proposed Rule 506 Disqualification Is Not Required By Dodd-Frank.*** Neither the Dodd-Frank Act nor its legislative history supports the retroactive application of the proposed Rule 506 disqualification. Indeed, the one-year period prescribed by Congress for the rulemaking signals that the contrary was intended. In light of federal cases and administrative decisions rejecting the retroactive application of similar disqualification provisions (including one adopted by a companion provision of the Dodd-Frank Act), the Commission should reconsider its preliminary position, which would almost surely result in costly and unnecessary litigation and obvious unfairness to those who have settled enforcement actions in the past. We urge the Commission, instead, to evaluate alternative interpretations of its statutory authority to apply the rule prospectively or use its explicit authority under Rule 262 (as incorporated by the statute and by proposed Rule 506) to grant waivers to reach the same result.

- ***The Commission Has Previously Construed Disqualification Provisions Prospectively and Should Continue To Do So Here.*** Retroactive application of the proposed Rule 506 disqualification would reflect a marked departure from how similar disqualification provisions have been administered by the Commission. Neither of the two most recent "bad actor" disqualifications was applied retroactively for all prior events. One of them, a statutory disqualification from the safe harbor for forward-looking statements set forth in the Private Securities Litigation Reform Act of 1995, involved comparable statutory language and a three-year look-back provision. The other, an ineligibility provision adopted in connection with amendments to Securities Act Rule 405 in 2005, was accompanied by a provision excluding prior settlements from the look-back provision in light of concerns about the unfairness of retroactive application.

- ***If the Commission Believes that It Should Apply the Rule 506 Disqualification Retroactively, the Commission Should Limit the Scope of the Retroactive Application and Grandfather Prior Settlements, Extend the Terms of Previously-Granted Waivers under Rules 262 and 505, and Take Other Steps To Avoid Unfairness.*** Retroactive application of the Rule 506 disqualification would have the effect of adding a new material term to existing settlements and decrees, in many cases years after their finalization and issuance. Many of these settlements involved the issuance of Commission orders waiving then-applicable disqualifications and other coordinated actions with state, federal, and self-regulatory staff. The need to revisit settlements and seek relief from a disqualification not then existing undercuts the finality of settlements and should be avoided. To mitigate this unfairness, the Commission should (1) adopt a "grandfather" provision excluding civil or administrative settlements occurring prior to the effective date of proposed Rule 506; (2) extend the terms of previously granted waivers issued under the current versions of Regulation A, Rule 505 of Regulation D, or Regulation E to cover the proposed Rule 506 disqualification; and (3) specify that, for a transitional period approximating the customary duration of a Rule 506 offering, the proposed Rule 506 disqualification will not apply to offerings already underway, including continuous offerings of unregistered investment funds.

- ***The Commission Should Continue To Entertain Waiver Applications Mindful of the Remedial Purpose Intended by the Disqualification.*** The Commission should continue to consider applications for relief from the disqualification provisions of proposed Rule 506 using criteria that reflect the remedial nature of the disqualification. The existing course of practice under current Rule 262 of Regulation A, Rule 505 of Regulation D, and Rule 602(e) of Regulation E has worked well and achieves the Commission's objectives of protecting investors and promoting capital formation. We similarly urge the Commission to avoid using regulatory disqualifications as cumulative penalties for misconduct more properly addressed in connection with the underlying enforcement or disciplinary action.

- ***Other Aspects of the Proposing Release Require Clarification.*** The Commission should make clear that the disciplinary events set forth in proposed Rule 506(c)(1)(iii)(B) are limited to those violations that involve violations of scienter-based laws or regulations; adopt amendments clarifying that any waiver applicable to a state order otherwise triggering a disqualification under proposed Rule 506(c)(1)(iii)(B) obviates the need for separate relief from the Commission; narrow the definition of "covered persons" as it applies to officers and 10% beneficial owners; and refrain from expanding the list of triggering events beyond the mandate set forth in Dodd-Frank, absent some showing that the existing disqualifications under Securities Act Rules 262, 505, and 602 are somehow inadequate to protect investors.

DISCUSSION

I. THE DISQUALIFICATION PROVISIONS OF THE PROPOSED RULE SHOULD NOT APPLY RETROACTIVELY.

A. Neither the Statute Nor the Legislative History Compels Retroactive Application of the Disqualification Provisions.

The application of the proposed Rule 506 disqualification to events pre-dating the provision's adoption would be impermissibly retroactive under the Supreme Court's decision in *Landgraf v. USI Film Products*.[3]

Absent a clear statutory provision or statement of congressional intent, retroactive application of newly adopted laws and regulations is strongly disfavored under American jurisprudence.[4] The relevant standard for determining whether a new rule should be given retroactive application is set forth in *Landgraf*:

> [The] first task is to determine whether Congress has expressly prescribed the statute's proper reach. If Congress has done so, of course, there is no need to resort to judicial default rules. When, however, the statute contains no such express command, the court must determine whether the new statute would have retroactive effect, i.e., whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed. If the statute would operate retroactively, our traditional presumption

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[3] Landgraf v. USI Film Products, 511 U.S. 244 (1994).

[4] Id. at 265 ("[T]he presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to confirm their conduct accordingly; settled expectations should not be lightly disrupted.") (citations omitted).

> teaches that it does not govern absent clear congressional intent favoring such a result.[5]

In its Proposing Release the Commission stated its preliminary view that the use of the past tense in the look-back provisions *requires* retroactive application of the disqualification provision and further noted that, in remarks introducing the legislation, Senator Dodd similarly used the past tense when referring to the operation of the look-back provision.[6]

We believe that neither the statute nor the legislative history supports this view with respect to the retroactive application of the proposed Rule 506 disqualification. First, unlike many federal statutes, there is no provision whatsoever addressing its retroactive application. For obvious reasons, the language used to describe the underlying triggering events for the disqualification is necessarily temporal (e.g., "has been convicted"; "is subject") in light of the intended operation of the look-back provision. This is no more unusual or remarkable than a "three strikes" provision specifying how prior convictions are to be treated or, for that matter, countless other provisions in the federal securities laws which describe a variety of historical data or criteria relevant to a host of specialized rules (Average Daily Trading Volume calculations, accredited investor annual income provisions, WKSI issuance statistics, etc.). None of these language references in the rules has ever been construed to require – or even permit – retroactive application of the normative standards themselves. Second, the single statement by Senator Dodd upon introduction of the legislation seems only to highlight the absence of clear congressional guidance on Section 926's retroactive application. *Landgraf* requires a clear statement of congressional intent.

Moreover, federal courts have found that a statute that delays its effective date in fact suggests a congressional intent to *avoid* retroactive application.[7] Rather than immediately establishing a statutory disqualification, or directing that the Commission do so, Section 926 instead specified that the Commission should issue a rule *within one year* of the Dodd-Frank Act's enactment.[8] Surely this aspect of the statute is more telling about congressional intent concerning retroactive application of the disqualification than one statement by a Senator in the Congressional Record.

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[5] Id.; Proposing Release, 76 Fed. Reg. at 31530 n.92 & accompanying text.

[6] 156 Cong. Rec. S3813 (May 17, 2010) (statement of Sen. Dodd) ("New Section 926 would disqualify felons and other 'bad actors' who have violated Federal and State securities laws from continuing to take advantage of the rule 506 private placement process. This will reduce the danger of fraud in private placements.").

[7] See Koch v. SEC, 177 F.3d 784, 786 (9th Cir. 1999) ("Congress delayed the effective date on the amended version [of the statute] by six months to permit courts and attorneys to prepare for the change in the law. Thus, at the very least, the amended version cannot be applied before the effective date . . . . " (quoting Kaiser Aluminum & Chem. Corp. v. Bonjorno, 494 U.S. 827, 839 (1990))).

[8] 15 U.S.C. §77d note.

The Proposing Release's suggestion that Section 926 compels the retroactive application of the proposed Rule 506 disqualification is all the more curious in light of the court cases and administrative decisions – discussed by Commissioner Paredes in his statement at the open meeting when comments were solicited on the Proposing Release– that have rejected the retroactive application of several similar disqualification and sanction provisions.[9] These and other authorities call into question not only the wisdom but the permissibility of any Commission determination to retroactively apply the proposed Rule 506 disqualification. Such an action will certainly invite disruptive, burdensome, and costly litigation by those whose activities would be retroactively and adversely affected by such an interpretation. We urge the Commission to avoid this unnecessary result – which is not compelled by the Dodd-Frank Act – and to evaluate alternative interpretations of its statutory authority to apply the rule prospectively or to use its explicit authority under Rule 262 (as incorporated by the statute and by proposed Rule 506) to grant a universal waiver for all events occurring prior to the effective date of proposed Rule 506 to reach the same result.

B. Similar Disqualification Provisions Have Not Been Applied Retroactively.

Retroactive application of the proposed Rule 506 disqualification would reflect a marked departure from how similar disqualification provisions have been historically administered by the Commission. In connection with the two most recently adopted disqualification provisions, the Commission and its staff recognized that important policy considerations and fairness weighed against retroactive application of the newly-adopted disqualifications, especially as to negotiated settlements.

The safe harbor for forward-looking statements established by the Private Securities Reform Act of 1995 (the "PSLRA")[10] and the securities offering reform provisions of Rule 405 applicable to well known seasoned issuer ("WKSI")[11] status and eligibility to use free writing prospectuses each contain disqualifications that are triggered by specified disciplinary events and sanctions. At the time of their adoption, the three-year look-back provisions of these disqualifications were not construed by the Commission or its staff to apply to all prior events predating their effective dates. Indeed, in the definition of "ineligible issuer", the Commission adopted a specific provision exempting decrees and orders agreed to in settlements entered into prior to Rule 405's effective date expressly to address concerns about the potential unfairness of applying the disqualification provisions of Securities Act Rule 405 retroactively.

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9 Koch, 177 F.3d at 789 (holding that the SEC's attempt to apply the penny stock bar authority under Exchange Act § 15(b)(6) retroactively was impermissible); Sacks v. SEC, 635 F. 3d 1121, 1125-27 (9th Cir. 2011) (holding that the SEC may not apply a new FINRA disqualification rule against a party based on events occurring prior to the promulgation of the new rule); John W. Lawton, SEC Rel. No. ID-419, 2011 WL 1621014, at *4 (Apr. 29, 2011) (finding that the retroactive application of the associational bars added by Section 925 of the Dodd-Frank Act was impermissibly retroactive).

10 See Securities Act § 27A(b); Exchange Act § 21E(b).

11 See Securities Act Rule 405.

Much like Section 926, the relevant sections of the PSLRA and the accompanying legislative history were silent as to the retroactive application of the disqualification to disciplinary events occurring prior to its passage. It is our understanding, however, that the Commission staff did not require (and therefore did not need even to entertain) relief applications for triggering events prior to 1999 – the first year in which the three-year look-back period would have applied to events occurring after its adoption.[12]

Likewise, the definition of "ineligible issuer" under Securities Act Rule 405 includes a three-year look-back period. Addressing concerns from a number of commenters about retroactive application of the disqualification provisions to negotiated settlements, the Commission amended its initial proposal to exempt settlements occurring prior to December 2005, the effective date of the rule.[13] The Commission staff later extended this grandfathering by interpretation to include agreements-in-principle reached with the staff of the Division of Enforcement prior to the effective date of the rule, even though those agreements were subject to Commission approval and finalization that regularly took several months after its effective date.[14]

The same considerations apply to the Proposing Release. The statutory mandate directed the Commission to adopt a rule – modeled on current Rule 262 – that endeavors to keep bad actors out of Rule 506 offerings while preserving the current waiver procedures that permit the Commission to determine whether the disqualifications in any given situation would be in the public interest. Giving prospective application to the proposed disqualification is fully consistent with both the power currently exercised by the Commission pursuant to Rule 262 (and, hence, Section 926) and with its sensible approach to the implementation of similar disqualifications in the PSLRA and in Rule 405. We see no reason to adopt a more inflexible approach here.

C. Retroactive Application Would Be Unfair and Inject Uncertainty Into the Private Placement Market.

The retroactive application of the proposed Rule 506 disqualification would unfairly inject uncertainty into the private placement market by upsetting the settled expectations of those market participants and issuers who previously resolved enforcement actions on the understanding that their ability to engage in Rule 506 offerings would be unimpaired. Additionally, it would be highly disruptive to an issuer or firm that hired an individual prior to the issuance of the Proposing Release, only later to learn that a subsequently-adopted rule

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[12] See In the Matter of Certain Market Making Activities on Nasdaq, Securities Act Rel. No. 7624, 1999 WL 6694 (Jan. 11, 1999).

[13] Securities Offering Reform, Securities Act Rel. No. 8591, 2005 WL 1692642, at *41-42 (July 19, 2005).

[14] See, e.g., MetLife, Inc, SEC No-Action Letter, 2006 WL 659489 (Feb. 21, 2006); Lincoln National Corporation, SEC No-Action Letter, 2006 WL 2787059 (Aug. 31, 2006); Waddell & Reed, Inc., SEC No-Action Letter, 2006 WL 3820079 (Oct. 31, 2006); Hartford Financial Services Group, Inc., SEC No-Action Letter, 2006 WL 3423219 (Nov. 8, 2006); MBIA Inc., SEC No-Action Letter, 2007 WL 801948 (Jan. 29, 2007).

resulted in the loss of the issuer or firm's ability to rely on Rule 506 because of that person's disciplinary history.

Many, if not most, of the country's leading national and regional investment banks – on whom corporate and investment fund private issuers rely for ongoing and contemplated Rule 506 private placements – have been parties to one or more enforcement actions that may trigger a disqualification under proposed Rule 506. Some of these actions occurred over a decade ago and involve the types of orders (like permanent injunctions) that would not be subject to any limitations on the look-back period under the proposed Rule 506 disqualification. In connection with these enforcement actions, a substantial portion of these market participants sought and received relief from a variety of disqualifications – including, but not limited to, the disqualification currently applicable to Rule 505 of Regulation D – and reasonably understood that they could continue to perform services in furtherance of their small issuer and investment fund clients' capital raising activities with certainty.

Retroactively applying the look-back provisions of the proposed Rule 506 disqualification would unduly restrict and burden this capital formation activity. No settling party prior to the enactment of Section 926 in July 2010 had any opportunity to consider how its passage would bear on the ramifications of a contemplated settlement. No settling party prior to the issuance of the proposed rule in May 2011 had any indication that the disqualification would apply retroactively. In addition, no settling party prior to the effective date of the rule will have had any opportunity to seek relief under Rule 506. Imposing that level of uncertainty on market participants with such a critical role in the primary market for capital formation should give the Commission pause. Such action would risk damage to the investors and the issuers who would ultimately bear the costs of abandoned issuances, the transition expenses associated with the movement to different placement agents/underwriters, and the delay and opportunity costs related to the consideration of any needed relief, however successful such efforts might ultimately be.

II. IF RETROACTIVELY APPLIED, THE COMMISSION SHOULD NARROW THE SCOPE OF RETROACTIVE APPLICATION AND EXEMPT NEGOTIATED SETTLEMENTS, EXTEND THE SCOPE OF PREVIOUSLY GRANTED WAIVERS ISSUED UNDER THE CURRENT REGULATION D, AND LIMIT DISRUPTION TO ONGOING OFFERINGS.

Should the Commission determine to apply the proposed Rule 506 disqualification retroactively to enforcement actions occurring prior to the enactment of the Dodd-Frank Act or the effectiveness of the proposed rule, we recommend the adoption of one or more of the following mechanisms to minimize unfairness and to avoid undue burdens on capital formation. First, the look-back provisions of the disqualification should not apply to firms that have previously entered into civil or administrative settlements that would otherwise trigger a Rule 506 disqualification. Second, previously granted relief waivers issued under the current versions of Regulation A, Rule 505 of Regulation D, or Regulation E should be extended to cover the disqualifications under the proposed rule. Finally, the proposed Rule 506 disqualification should not apply to offerings already underway, including continuous offerings of unregistered investment funds, as such disqualification would unduly burden and disrupt the course of ongoing private capital raising. Adopting these mitigating measures would, at least, partially alleviate many of the fairness concerns implicated by retroactive application of the proposed Rule 506 disqualification.

A. The Finality of Negotiated Settlements Should Not Be Undercut By Retroactively Applying the Look-Back Provisions of the Disqualification.

As noted above, the Commission has previously "grandfathered" negotiated settlements from the ineligible issuer provisions of Rule 405, and it should do the same here, if a determination is made to apply the proposed Rule 506 disqualification retroactively.

Negotiated settlements are an important aspect of the enforcement process in both federal and state law enforcement, including, in particular, the enforcement programs administered by the Commission, the Department of Justice, various state securities administrators and attorneys general, and state and federal banking regulators.[15] Companies regularly attempt to settle enforcement proceedings in an effort to end or avoid costly and disruptive litigation and the uncertainties associated therewith and, quite frequently, to spend resources enhancing internal controls and compliance rather than fighting with regulators. These settlements generally involve a compromise of claims and defenses, with the settling party agreeing to the entry of sanctions in response to allegations or administrative findings of misconduct, typically on a neither-admit-nor-deny basis. Settling firms assess the impact on their future activities that would result from particular charges or sanctions and often seek waivers from those disqualifications that may, in light of the alleged violations, disproportionately and unfairly impede their ongoing operations or access to the capital markets. The finality and certainty achieved by a negotiated settlement is of particular importance to both the regulators and the settling parties whose ongoing business operations require some predictability. These settlements also benefit investors, as they conserve corporate assets and avoid unnecessary expense.

Regulatory settlements are typically the subject of considerable negotiation between the relevant governmental authority and the firm. These negotiations concern not only the key terms and conditions of the charging instrument, order, contemplated sanctions, and ancillary relief, but also the collateral consequences of the contemplated sanctions to the ongoing activities of the settling firm or individual. Settling parties and their counsel spend considerable time evaluating the legal implications as well as the pros and cons of contemplated settlements, regularly working with the government authority to achieve settlements that balance the sanctions and the collateral consequences against the costs and risks of continuing to contest the alleged violations.

Consistent with their duties to shareholders, before authorizing a proposed settlement, senior management and boards of directors regularly insist on briefings about the potential

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[15] For example, in fiscal year 2010, the Commission entered into negotiated settlements with 694 defendants. NERA, SEC Settlement Trends: 2H10 Update (Dec. 7, 2010), at http://www.securities litigationtrends.com/PUB_Settlements_Update_H2_1210.pdf.

consequences of such settlements, any ameliorating waiver applications that may be needed, and the likelihood that relief will be forthcoming under the relevant circumstances. Settling companies and their senior management seek assurances that, consistent with both customary practice and fairness, appropriate relief applications will be considered by the Commission or its staff in connection with the settlement itself. The assumption is that the key determination as to whether a given collateral consequence or disqualification is in the public interest, or whether instead the situation is appropriate for some relief, will be made at a time when the staff involved in the enforcement action are most familiar with the underlying facts and equities. Indeed, each of the firms submitting this letter has been involved as counsel in negotiations where the issue of a potential disqualification or collateral consequence has had a critical impact on the settlement process or whether a settlement was indeed possible. Yet, as proposed, the retroactive application of the Rule 506 disqualification would have the effect of adding a new material term to existing settlements and decrees years after their finalization and issuance. This is all the more troubling in the context of multi-jurisdictional settlements in which every effort was made to coordinate with state, federal, and self-regulatory staff.

The relatively recent series of settled Commission actions involving auction rate securities illustrates the unfairness of retroactive application of the proposed Rule 506 disqualification. In a number of settlements in 2008 and 2009, the Commission, FINRA, and state attorneys general for several states brought coordinated actions against a number of firms. Not only did these settling firms submit relief applications to the Commission to address then-applicable disqualifications, they also worked with state securities administrators and attorneys general to negotiate language to be included in follow-on state actions that would avoid subsequent disqualifications arising from the same operative set of facts. With the consent of the SEC and self-regulatory organization ("SRO") staff, the settlements ultimately consummated with these attorneys general and state securities administrators included statements specifying that the orders did not indicate that the defendants or any of their affiliates or current or former employees should be subject to any disqualifications contained in the federal or state securities laws or SRO rules and waived any disqualifications from relying upon registration exemptions or safe harbor provisions.[16] These settlements made sense and arrived at a reasoned balance

[16] See, e.g., In the Matter of Wachovia Securities, LLC, et al, Docket No. S-20665A-09-0071, Dec. No. 70896, at ¶16 (Ariz. Corp. Comm.) (Mar. 24, 2009) ("This Order is not intended to indicate that Wachovia or any of its affiliates or current or former employees shall be subject to any disqualifications contained in the federal securities law, the rules and regulations thereunder, the rules and regulations of self regulatory organizations or various states' securities laws including any disqualifications from relying upon the registration exemptions or safe harbor provisions. In addition, this Order is not intended to form the basis for any such disqualification."), at http://images.edocket.azcc.gov/docketpdf/0000094907.pdf; In the Matter of Banc of America Securities LLC, et al, Docket No. S-20668A-09-0181, Dec. No. 71071, at ¶8 (Ariz. Corp. Comm.) (May 21, 2009) (waiving disqualification under state law, and stating that the order was not intended to trigger disqualification under the federal securities laws or SRO rules), at http://images.edocket.azcc.gov/docketpdf/ 0000098309.pdf; In the Matter of Morgan Stanley & Co. Incorporated, Consent Order, at ¶26 (Cal. Dep't of Corps.) (Nov. 18, 2009) (same), at http://www.corp.ca.gov/ENF/pdf/m/morganstanley_findings2.pdf; In the Matter of Deutsche Bank Securities Inc., Case No. AP-10-04, at ¶13 (Mo. Sec. of State.) (Jan. 14, 2010) (same), at http://www.sos.mo.gov/securities/orders/AP-10-04.asp; In the Matter of Goldman, Sachs & Co., Case No.

between the alleged violations and the sanction, as weighed against the purpose and disproportion of an absolute and blind application of the disqualification provisions in the rules. The proposed rule would render these negotiated terms meaningless and require numerous relief applications to be prepared simply to preserve the status quo.

In connection with its 2004 proposal to amend to Securities Act Rule 405, the Commission sought and received numerous comment letters urging the prospective application of the ineligible issuer provision for many of the same reasons we advance today.[17] The Commission ultimately adopted rule amendments that negated the look-back provisions of the ineligible issuer definition for negotiated settlements entered into prior to the effective date of the amendments.[18] Moreover, the Commission staff subsequently deemed agreements-in-principle reached prior to the effective date of the rule to be qualifying "settlements" in light of the importance of avoiding unfair treatment of those negotiating with the staff in good faith.[19] We believe the policy objectives behind the Rule 405 exemption for negotiated settlements — and the flexible approach taken by the staff in construing its application — are even more apt in the context of the proposed Rule 506 disqualification given the current and heavy reliance on the rule as currently drafted, the steps taken by settling firms and individuals to preserve their ability to rely on similar registration exemptions, and the inability to seek relief at the time settlements were negotiated.

B. Previously Granted Waivers Addressing the Current Regulation D Should Extend To Any New Disqualification under the Proposed Rule Arising Out of the Same Event.

Section 926 instructed the Commission to model the Rule 506 disqualification provision on Securities Act Rule 262, which governs waivers of the existing disqualification under Rule 505 of Regulation D. As noted in the Proposing Release, the Rule 505 waiver provision is identical to Rule 262 and incorporates it by reference,[20] making the same standard applicable for waivers of disqualifications arising under either rule.[21] Proposed Rule 506(c) would similarly

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AP-10-021, at ¶45 (Mo. Sec. of State.) (July 20, 2010) (same), at http://www.sos.mo.gov/securities/orders/AP-10-21.asp.

[17] Securities Offering Reform, Securities Act Release No. 8501, 69 Fed. Reg. 67392, 67413 (Nov. 17, 2004); Securities Offering Reform, Securities Act Release No. 8591, 70 Fed. Reg. 44722, at 44747 n.234 & accompanying text (Aug. 3, 2005) ("Securities Offering Reform Adopting Release").

[18] Securities Offering Reform Adopting Release, at 44747.

[19] See, e.g., MetLife, Inc, SEC No-Action Letter, 2006 WL 659489 (Feb. 21, 2006); Lincoln National Corporation, SEC No-Action Letter, 2006 WL 2787059 (Aug. 31, 2006); Waddell & Reed, Inc., SEC No-Action Letter, 2006 WL 3820079 (Oct. 31, 2006); Hartford Financial Services Group, Inc., SEC No-Action Letter, 2006 WL 3423219 (Nov. 8, 2006); MBIA Inc., SEC No-Action Letter, 2007 WL 801948 (Jan. 29, 2007).

[20] Proposing Release, 76 Fed. Reg. at 31520.

[21] Proposing Release, 76 Fed. Reg. at 31529 & n.89. Rule 262 and Rule 505(b)(iii) each require "a showing of good cause" and a finding that the disqualification "is not necessary under the circumstances."

incorporate the same standard for the issuance of waivers. Having previously concluded that good cause was shown and that a substantially similar disqualification was not "necessary under the circumstances," the Commission should not now require a separate relief application on the same set of facts. Accordingly, the Commission should make prior grants of relief under the disqualification provisions of Rules 262 and 505 effective as to events triggering the disqualification provisions of proposed Rule 506.

Extending the scope of relief previously granted under Rules 262 and Rule 505 would also avoid the unnecessary administrative burdens associated with processing duplicative relief applications. Counsel for parties that previously sought and received waivers for prior enforcement actions would need to identify prior actions potentially triggering the proposed disqualification provision, refamiliarize themselves with the underlying facts of the matter, prepare new relief applications (presumably modeled on the earlier submissions), and submit these applications to the staff of the Division of Corporation Finance for consideration by the Commission. The volume of relief requests would likely be substantial — since 2003 over 80 waivers have been granted. The Proposing Release provides no delegated authority to the staff to grant these waivers and any retroactive application of the proposed Rule 506 disqualification will add a considerable burden to the Commission's applications docket without any meaningful justification. Extending the terms of previously granted relief would not only be fair and consistent with the statute but would alleviate this burden.

The Commission should also make available some form of expedited application process for those who have previously settled Commission proceedings but had refrained from seeking relief under Rules 262, 505, or 602 because, at the time of such settlements, that relief was unnecessary or inapplicable to their activities. Firms and their counsel often make the practical determination not to seek relief that is unnecessary in light of their current or contemplated business activities. The registration exemptions set forth in Rules 262, 505, and 602 were and are uncommonly used and many settling firms and their counsel relied instead on the availability of Rule 506 and its preemption of state law disqualifications.

C. Ongoing Offerings Should Be Allowed To Continue For a Specified Transitional Period.

As discussed in the Proposing Release, Rule 506 is the most widely used exemption from registration for limited and private offerings under Regulation D.[22] For the twelve months ended September 30, 2010, the Commission received over 16,000 initial filings for offerings claiming the exemption under Rule 506 of Regulation D.[23] Many firms rely on the Rule 506 exemption to raise capital, including investment funds and small businesses across the country. If the Commission applies the disqualification to require an immediate cessation of ongoing sales in the midst of a current offering, there would be a substantial risk that capital raising would be disrupted for many of these firms while relief applications were prepared and considered. And,

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22 Proposing Release, 76 Fed. Reg. at 31519.

23 Proposing Release, 76 Fed. Reg. at 31519 n.8 & accompanying text.

in the event relief was ultimately not granted, there would be further delay for those seeking to access the capital markets under this rule while alternative approaches (such as switching placement agents or severing ties with individuals subject to the proposed disqualification) are evaluated.

Ideally, the Commission should determine that an exemption for all offerings ongoing at the time of the rule is appropriate and consistent with the statute. At a minimum, we urge the adoption of a transitional period that takes into account the typical, average, or median length of a Rule 506 offering to avoid, among other things, investor and issuer injury from the potential for failed or disrupted offerings.

III. THE COMMISSION SHOULD CONTINUE TO CONSIDER DISQUALIFICATION WAIVERS USING A STANDARD THAT REFLECTS THE REMEDIAL NATURE OF THE DISQUALIFICATION.

The standard governing the Commission's consideration of relief applications from the disqualification provisions of Rule 262, Rule 505, and proposed Rule 506 is identical. Pursuant to that standard, the Commission must find that the applicant has made "a showing of good cause" and that the disqualification "is not necessary under the circumstances." Historically, the Division of Corporation Finance has supported relief in circumstances in which the misconduct at issue did not relate to a private placement conducted pursuant to Regulation A or Regulation D, and the applicant was able to make certain customary representations concerning the manner in which the enforcement action was resolved, the remedial measures taken to prevent recurrence, and the absence of any objection to the issuance of relief from the Division of Enforcement staff overseeing the enforcement action.

The Commission should continue to consider applications for relief from the disabling provisions of proposed Rule 506 using criteria that reflect the remedial nature of the disqualification. Because the universe of conduct and alleged violations that can trigger operation of the disqualification potentially is so broad relative to the public interest implications and the need for such disqualification in a given case, we encourage the Commission to continue its historical practice of engaging in careful and nuanced assessment of relief applications the Commission.[24] We similarly urge the Commission to avoid using regulatory disqualifications as cumulative penalties for misconduct more properly addressed in connection with the underlying enforcement or disciplinary action. Each of the disqualification or ineligibility provisions in the federal securities laws was designed to serve a remedial purpose. Unless a disqualification would achieve its remedial objective it should be waived. Disqualifications should not serve as an additional penalty or trap for the unwary.

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[24] We believe that the Division of Corporation Finance's recent Statement on Well-Known Seasoned Issuer Waivers reflects just such a framework in the context of Rule 405, focusing on the alleged misconduct, the remedial actions taken by the issuer, and the impact and potential undue hardship if a waiver request is denied. See U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Statement on Well-Known Seasoned Issuer Waivers (2011), at http://ww.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp.htm.

IV. OTHER ASPECTS OF THE PROPOSED RULE REQUIRE CLARIFICATION.

A. Disqualifying Orders Based on "Fraudulent, Manipulative, or Deceptive Conduct" Under Proposed Rule 506(c)(1)(iii)(B) Should Require Violation of a Scienter-Based Law or Regulation.

Proposed Rule 506(c)(1)(iii)(B) provides that final orders of a state securities commission, a state banking authority, a state insurance commission, a federal banking agency, or the National Credit Union Administration trigger a disqualification if they are "based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct." We are concerned that, without further clarification, this provision will present interpretive difficulties under the varying formulations used in state and federal laws to address prohibited conduct. We also believe that "technical" violations of state securities codes that do not by their terms require any intentional misconduct or scienter should not result in disqualification under proposed Rule 506(c)(1)(iii)(B).

Unlike the practice observed in Commission orders and consent decrees, the many state and federal authorities listed in proposed Rule 506(c)(1)(iii) often issue orders that cite generally to broad statutory enforcement authority permitting a disciplinary action without specifying which subpart or provision is implicated. Although the allegations or findings accompanying the order regularly provide detailed information about the nature of the misconduct, the cited authority for the action (or the sanction) is often ambiguous. Some state codes contain, within the same section, antifraud provisions and provisions addressing far less culpable misconduct. Since 2002, interpretive challenges have been encountered in connection with applying the statutory disqualification arising under Exchange Act Section 3(a)(39)(F) for state actions meeting a similar definition set forth in Exchange Act Section 15(b)(4)(H).

The Commission should make clear that the disciplinary events set forth in proposed Rule 506(c)(1)(iii)(B) are limited to those violations that involve violations of scienter-based laws or regulations or are otherwise plainly identified as implicating a prohibition against "fraudulent, manipulative, or deceptive conduct" as those terms are commonly understood. A scienter-based limitation on this provision would ensure that the disqualification is correctly applied.

B. State Orders Waiving Disqualification Should Not Require Separate Relief from the Commission.

State orders, such as those issued in the auction rate securities settlements described above, regularly waive any applicable state disqualifications and recite the absence of any intention to cause any disqualifications under other law or regulation, including the federal securities laws. Orders issued by state securities regulators reflecting a considered determination to waive disqualifications from limited offerings exemptions ought to be afforded deference by the Commission.

Both the Model Accredited Investor Exemption and the Uniform Limited Offering Exemption exclude from the operation of their disqualification provisions parties that (1) remain licensed or registered to conduct securities related business in the state where the order creating the disqualification occurred or (2) are the subject of a waiver of the disqualification entered by the state securities administrator, the court, or the regulatory authority that entered the order giving rise to the disqualification.[25] We urge the Commission to adopt amendments to the proposed rule to clarify that any express or implied waiver applicable to a state order otherwise triggering a disqualification under proposed Rule 506(c)(1)(iii)(B) obviates the need for separate relief from the Commission.

C. The Proposed Disqualification Should Not Be Applied Beyond the Proposed Rule or Otherwise Expanded.

The Proposing Release asks for comment on whether the triggering events for disqualification required by the Dodd-Frank Act for Rule 506 should be extended to the other exemptions under Regulation A, Regulation D, and Regulation E or otherwise expanded beyond the scope of the current proposal. In the absence of any statutory provision requiring such an extension, and in light of the similar absence of any showing that the current rules have operated in a manner that has led to abuses under those exemptions, the Commission should refrain from expanding the scope of the disqualifications applicable to them. Indeed, given Section 926's directive to model the disqualification on current Rule 262 and its enumeration of only two additional categories of disqualifying events, the SEC's statutory authority to expand this list is highly uncertain and would be inconsistent with traditional canons of statutory construction.[26] This is particularly true to the extent that the Proposing Release questions whether to expand the proposed Rule 506 disqualification beyond the current scope of Rule 262 and Section 926 to certain foreign orders and convictions, which would raise a host of interpretive and fairness issues in light of differing judicial systems.

Nor do we believe that the Commission should reverse its longstanding interpretation of Securities Act Rule 262 — by rule or otherwise — and treat SEC and CFTC administrative cease-and-desist orders as an appropriate basis for disqualification.[27] Such a departure would not be "substantially similar" to the current Rule 262 and would in fact add a large class of regular and routine disciplinary proceedings to the disqualification, something at odds with the statute's

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[25] Model Accredited Investor Exemption §D(2)(a)&(b); Uniform Limited Offering Exemption §1(B)(6)&(7).

[26] See, e.g., Cipollone v. Liggett Group, Inc., 505 U.S. 504, 517 (1992) (stating that the principle *expressio unius est exclusio alterius* supports construing a statute's specific enumeration of a category as a limitation on scope).

[27] As set forth in the Proposing Release, the SEC and the staff have historically interpreted Rule 262 "to require disqualification only for as long as some act is prohibited or required to be performed pursuant to the order," and therefore have not treated censures or orders to pay civil money penalties as disqualifying. Proposing Release, 76 Fed. Reg. at 31527 & nn.69-70. Indeed, on this very basis, many dozens of settling parties have refrained from seeking relief from the disqualifications otherwise arising under current Rules 262, 505, and 602.

instruction. Administrative cease-and-desist orders regularly address violations of the federal securities laws that do not require any showing or finding of intentional misconduct.[28] Having the mere fact of such an order disqualify an organization from particular types of capital formation activity seems unnecessarily punitive, especially in light of the other administrative remedies that address serious misconduct (e.g., registration suspension or revocation) and which themselves are recognized bases for disqualification under current Rule 262.

D. The Definition of "Covered Persons" Should be Narrowed.

The Proposing Release requests comment on whether the definition of "covered person" that applies to existing Rule 262 is appropriate in the context of Rule 506. Given the broader applicability of Regulation D and the many types of entities and financial intermediaries that would be affected by the proposed rule, the Commission should narrow the definition of "covered person" as it applies to officers and 10% beneficial owners.

The term "officer" as defined in Rule 405 is overly broad given the scope of Regulation D offerings and accordingly should be revised to refer to "executive officers." As the Commission notes, the definition of "officer" includes "a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization."[29] Large financial institutions who often serve as solicitors typically have hundreds or thousands of employees with titles such as these, most of whom do not have the authority to create policy on behalf of the organization and do not play an executive role.[30] Coupled with the requirement that issuers must make a factual inquiry into each covered person in order to rely on the reasonable care exception from the proposed rule,[31] the broad definition of "officer" would impose significant and undue costs on issuers. Instead, the Commission should revise the definition to refer to "executive officers" as defined in Rule 405, which includes only those officers who perform policy-making functions on behalf of the issuer. By limiting coverage to "executive officers," the disqualification would be more appropriately tailored to the disciplinary history of those individuals who in a real sense lead an organization.

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[28] For example, the books and records provisions of the federal securities laws are strictly enforced and even certain "antifraud" provisions require only a showing of negligence. See, e.g., Advisers Act §§206(2), 206(4).

[29] Proposing Release, 76 Fed. Reg. at 31521.

[30] See, e.g., C.R.A. Realty v. Crotty, 878 F.2d 562, 567 (2d Cir. 1989) ("We hold that it is the duties of an employee . . . rather than his corporate title which determine whether he is an officer . . . ."); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston, 566 F.2d 1119, 1122 (9th Cir. 1978) ("The title 'Vice President' does no more than raise an inference that the person who holds the title has the executive duties and the opportunities for confidential information that the title implies. . . . The record in this case convincingly demonstrates that Livingston was simply a securities salesman who had none of the powers of an executive officer of Merrill Lynch.").

[31] Proposed Rule 230.506(c)(2)(ii).

The Commission also requests comment on the proposed coverage of beneficial owners of 10% or more of any class of the issuer's equity securities. This standard should instead be based on actual control, as defined in Rule 405, which looks to the power to direct or cause the direction of the management and policies of the issuer. Oftentimes issuers who rely on Rule 506 have passive investors who own over 10% of the issuer's equity securities but have limited, or no, control over the issuer's management and policies. For example, issuers formed as limited partnerships or limited liability companies, such as private investment funds, may have one or more 10% shareholders who are purely passive investors, and have no ability to direct or control the fund's actions or policies.[32] With a 10% shareholder standard, such issuers would risk triggering bad actor disqualification based on the actions of passive investors unaffiliated with the management and operations of the issuer itself. Such issuers, whose securities are frequently continuously offered, would also be required to make a factual inquiry in order to rely on the reasonable care exception, which would impose an unnecessary ongoing expense on the issuer. In order to avoid this undue burden, the Commission should revise the standard to include only those shareholders who exercise actual control over the issuer.

E. The Rules for the Disqualification of Entities Should Recognize Changes in Control.

The Proposing Release asks whether there should be different treatment for entities that have undergone a change of control since the occurrence of a disqualifying event.[33] Consistent with our belief that these disqualification provisions ought to be construed to achieve their remedial purpose of screening out bad actors and not punitively, we urge the Commission to minimize any operation of the proposed rule that would disqualify an entity for years, or permanently, when those responsible for the violations giving rise to the disqualification no longer control the company. Changes in control and management regularly occur in connection with efforts to resolve regulatory and other governmental investigations. Indeed, pertinent guidance calls for this type of change in corporate governance to be considered in connection

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[32] As the Commission recognizes, a significant percentage of issuers in Rule 506 offerings are private investment funds. See Proposing Release, 76 Fed Reg. at 31521 n.29.

[33] Proposing Release, 76 Fed. Reg. at 31522-23.

with charging decisions and penalty assessments.[34] The same principles should apply here and we accordingly support Proposed Rule 506(c)(3) and interpretations consistent with its objective.

[34] See, e.g., U.S. Sec. & Exch. Comm'n, Statement of the Securities and Exchange Commission Concerning Financial Penalties, Press Release No. 2006-4 (Jan. 4, 2006) (stating that the Commission considers "[w]hether the corporation has replaced those persons responsible for the violation" when determining whether to assess a monetary penalty); Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Rel. No. 44969 (Oct. 23, 2001) (considering that the company dismissed culpable management and employees in determining not to bring an enforcement action against the company); see also U.S. Sec. & Exch. Comm'n, Answers to Frequently Asked Investor Questions Regarding the Bear Stearns Companies, Inc., Press Release No. 2008-46 (Mar. 18, 2008) ("[C]onsistent with prior statements and guidance by the SEC, the staff would favorably take into account the circumstances of the JPMorgan acquisition of Bear Stearns when considering whether to recommend an enforcement action against JPMorgan arising out of statements made by Bear Stearns in the 60 days before the public announcement of the merger.").

CONCLUSION

We appreciate the opportunity to comment on the Proposing Release. We are available to discuss these comments with the Commission or its staff should it be helpful to consideration of the Proposing Release.

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