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

Re: Comments on behalf of Certain Private Fund Managers on "Bad Actor" Proposals
SEC File No. S7-21-11

Ladies and Gentlemen:

On behalf of certain clients that manage private investment funds, we respectfully submit the following comments on the proposal by the Securities and Exchange Commission (the "SEC" or "Commission") to amend (i) Rules 501 and 506 of Regulation D under the Securities Act of 1933, as amended (the "Securities Act"), and (ii) Form D thereunder (the "Bad Actor Rules") [1]. The Bad Actor Rules are intended to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), enacted on July 21, 2010.

We would like to thank the Commission for this opportunity to comment on the proposal. We trust that our comments will aid in formulating a regulatory regime that addresses Congress's concern in enacting Dodd-Frank to protect investors by disqualifying certain individuals from participating in Regulation D offerings without disrupting the business activities of persons who have operated entirely within the law for many years despite previous disciplinary histories.

Section 926 of Dodd-Frank[2] requires the SEC to adopt rules to disqualify certain securities offerings from reliance on the safe harbor in Rule 506 of Regulation D. Congress directed that these rules be "substantially similar" to those in Rule 262 under the Securities Act, which disqualifies certain persons from participating in limited public offerings of up to $5 million made in reliance on Regulation A under the Securities Act. In contrast, Rule 506 of Regulation D permits the private offering of an unlimited dollar value of securities to an unlimited number of "accredited investors" and up to 35 non-accredited investors without registration under the Securities Act.

1 Securities Act Release No. 9211, May 25, 2011 (the "Proposing Release").

2 This section is entitled "Disqualifying Felons and other 'Bad Actors' from Regulation D Offerings."

As indicated in the Proposing Release, Rule 506 is the most widely used of the three Regulation D exemptions. Previously, there have been no disqualification provisions applicable to Rule 506.

We represent managers of private investment funds who rely on Rule 506 to sell interests in their funds, and we support in principle the proposed Bad Actor Rules. However, the SEC has requested comments on a number of issues that go beyond the provisions of Rule 262 and the specific directions of Section 926 of Dodd-Frank. In some cases, certain of our clients employ individuals who could be disqualified from participating in Rule 506 offerings if some of the proposed or suggested provisions are adopted as part of the rule amendments. In certain cases, we believe this would lead to gross unfairness because of the open-ended nature of the sanctions that could cause disqualification, with no countervailing benefit to the public interest.

Disqualifying Events and Covered Persons

Under the proposed Bad Actor Rules, the Rule 506 exemption would not be available to any offering if the issuer or any other "covered person"[3] is subject to certain disqualifying events. Based on the language of Dodd-Frank, the following disqualifying events from Rule 262 (applicable to Regulation A offerings) should be included in the amendment:

- Felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission within the last five years in the case of issuers and the last ten years in the case of other covered persons;

- Injunctions and court orders within the last five years against engaging in or continuing conduct or practices in connection with the purchase or sale of securities, or involving the making of any false filing with the Commission;

- U.S. Postal Service false representation orders within the last five years; and

- Filing or being named as an underwriter in a registration statement that is subject to a stop order proceeding or for which a stop order has been issued in the last five years.

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3 The Commission has proposed that the following persons be considered "covered persons":

- the issuer and any predecessor of the issuer or affiliated issuer;
- any director, officer, general partner or managing member of the issuer;
- any beneficial owner of 10% or more of any class of the issuer's equity securities;
- any promoter connected with the issuer in any capacity at the time of the sale;
- any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering; and
- any director, officer, general partner, or managing member of any such compensated solicitor.

In addition, with respect to covered persons other than the issuer, it is a disqualifying event to be subject to a Commission order:

- revoking or suspending their registration as a broker, dealer, municipal securities dealer, or investment adviser;
- placing limitations on their activities as such;
- barring them from association with any entity; or
- barring them from participating in an offering of penny stock; or
- being suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or national securities association for conduct inconsistent with just and equitable principles of trade.

In addition, Section 926 of Dodd-Frank specifically requires that the following also be disqualifying events under Regulation D:

- Final orders issued by state securities, banking, credit union, and insurance regulators, federal banking regulators, and the National Credit Union Administration that either
  - bar a person from association with an entity regulated by the regulator issuing the order, or from engaging in the business of securities, insurance or banking, or from savings association or credit union activities; or
  - are based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within a ten-year period; and
- Felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission.

Expansion of Categories of "Covered Persons" and "Disqualifying Events"

The Commission is soliciting public comment on a number of potential expansions of the terms "covered persons" and "disqualifying events". We offer our comments on certain of the Commission's questions as set forth below. Numerical references correspond to the numbered requests for comments in the Proposing Release.

(9) Would it be appropriate to expand the coverage of the rule to include investment advisers and their directors, officers, general partners, and managing members? If so, should such an extension apply only for particular types of issuers, such as those that identify themselves as "pooled investment funds" on Form D, or for registered "investment companies," "private funds" and BDCs? Or should it apply for all issuers?

In many private investment fund structures, the relationship between the fund and its investment adviser is purely contractual. Even in situations where the adviser and the fund or its general partner are in the same corporate family or where management and advisory funds are performed by the same entity, the investment advisory function is distinct from other fund administrative functions. While portfolio managers may provide valuable information in meetings with investors, they often are not in fact the drivers of the sales function. The sale of fund interests is generally the responsibility of other personnel or affiliates (in the case of funds that sell their own shares) or of broker-dealers acting under selling or placement agent agreements with the funds.

The investment management function clearly is delineated and fund investment managers are or soon will be subject to regulation under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), which has extensive statutory disqualification requirements set out in Sections 203(e) and (f). We believe it is both counterproductive and burdensome to impose additional, and in some cases more onerous or conflicting, requirements under the Securities Act on entities that are subject to similar regulation under a statutory and regulatory scheme focused on their business. Accordingly, we do not believe investment advisers should be subject to the Regulation D requirements. Advisers or their personnel who are integrally involved in the structure of a fund (e.g., general partners or managing members of funds) will already be subject to such provisions in those capacities and other advisers should not be subject to the rule simply by virtue of being advisers to funds.

(21) Under current interpretations of Rule 262, bars are disqualifying for as long as they have continuing effect, which means that permanent bars (for example, an "unqualified" bar, which does not contain any proviso for re-application after a specific period) is permanently disqualifying. By contrast, most other disqualifying events operate only for a specified period (for example criminal convictions give rise to a disqualification period of five or ten years). Would it be appropriate to provide a cut-off (for example, ten years), for permanent bars?

We believe that it is essential to apply a cut-off period for permanent bars in order to avoid gross unfairness to individuals without a countervailing benefit to the public. It is counter-intuitive that serious criminal acts have time limits, while potentially less serious acts giving rise to permanent bars would not. In this context, we would also request that bars in which the respondent had leave to reapply but chose not to do so be made subject to a cut-off of no more than ten years.

The following situation illustrates the importance of such treatment. Mr. X was a floor trader on a commodities exchange. Almost 20 years ago, the CFTC brought an action against him and a number of other floor traders for antifraud violations. Almost 15 years ago, Mr. X settled the case in order to put the litigation behind him and move on to new business ventures. The sanctions Mr. X agreed to as part of the settlement included a cease and desist order, a fine, a one-year trading suspension and a revocation of his floor broker's license with leave to re-apply after four years. By the time he was eligible to reapply, Mr. X had already started another business as investment manager to private investment funds. He had no further need for his floor broker's license and did not re-apply for such a license despite his ability to do so under the settlement terms. Mr. X has not been involved in any regulatory action since his negotiated settlement.

Mr. X is co-principal of the corporate general partner[4] of certain funds that sell interests only to "qualified purchasers" within the meaning of Section 3(c)(7) of the Investment Company Act of 1940, as amended. His prior sanctions were disclosed in each of the funds' offering documents for ten years. This is consonant with the period for disclosure that would have applied had Mr. X's company been a registered investment adviser making such disclosures on Part 1A of Form ADV.[5]

Moreover, investors who meet with Mr. X's company even now, after the disclosure is no longer in fund documents, become aware of the sanctions via internet search engines or disclosure by the company in response to investor diligence requests. In this manner investors can perform the diligence on Mr. X's sanction that they feel necessary.

Thus, investors have been and are aware of the sanctions and have the opportunity to discuss these issues with Mr. X during the investment process. There would be no additional benefit to them if they were deprived of the opportunity to discuss investment matters with a key portfolio of the fund because of a 15 year old negotiated settlement in a different industry.

34) Should the rules specify that certain types of Commission cease-and-desist orders would always give rise to disqualification? For example, we could treat cease-and-desist orders related to violations of the anti-fraud provisions of our statutes and rules in this way (or perhaps those that require an element of scienter), by analogy to the Section 926 standard of "fraudulent, manipulative or deceptive conduct." Similarly, we could treat cease-and-desist orders related to violations of Section 5 of the Securities Act in this way, on the basis that persons who violate Section 5 should lose the benefit of exemptive relief from Section 5 for some period of time afterward. Should other categories of orders be expressly covered in this way?

We do not think it appropriate that any cease and desist orders previously negotiated as part of a settlement pre-dating these proposed rules be treated as disqualifying events. In our experience, industry participants (both individuals and firms) often agree to cease and desist orders because, as part of a settlement, they acknowledge that it is their obligation to comply with laws and regulations which, if violated in the future, will lead to much more severe repercussions. Thus, agreeing to cease and desist from violating such laws

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4 Technically Mr. X is not within the proposed definition of "covered person" as drafted, which reaches only the general partner of the "issuer", which in this case would be the fund. We recognize that the provision may reach the individuals who, even though they are structurally one level removed, are the persons participating in the Rule 506 offering.

5 . See Item 11 of Part 1A of Form ADV and Instructions on Part 1A prefatory to that item.

and regulations is often not heavily negotiated at all, and is accepted as "routine" in the settlement process, with its primary effect being prophylactic in respect of future violations. Being denied the availability of the Regulation D exemption can hardly be considered a routine or anticipated consequence of agreeing to a cease and desist order.

Even if the Commission were to treat cease and desist orders as disqualifying events, we urge that it be done prospectively only and certainly not apply with respect to past negotiated settlements. We note, however, that the inclusions of any cease and desist orders as disqualifying events, even prospectively, likely will have a chilling effect on regulators' ability to negotiate settlement agreements in the future.

(36) Would it be appropriate to include the CFTC in the list of regulators whose final orders are potentially disqualifying? If so, should the rules specify that certain types of CFTC orders would always give rise to disqualification, or that certain types would never give rise to disqualification? If so, what types of orders should be included or excluded?

The statutory disqualification schemes applicable to investment advisers (Section 203(e) and (f) of the Advisers Act) and broker-dealers (Section 15(b)(4)(H)of the Securities Exchange Act of 1934, as amended) include certain CFTC orders as disqualifying events. Thus, broker-dealers selling securities in Rule 506 offerings currently may be disqualified if they become subject to certain CFTC orders. We acknowledge that it may be appropriate to include the CFTC as a potentially disqualifying agency so that all persons, including persons selling securities in such an offering on the basis of an applicable exemption from broker-dealer registration, will be subject to the same standards.

As in the case of orders of the SEC discussed above under Question 34, we do not think it appropriate that any cease and desist orders of the CFTC be included as disqualifying events. In addition, disqualifications resulting from CFTC orders should not be open-ended or imposed retroactively as a disqualifying event, as discussed in response to Questions 21, 34, 63, and 65. To do otherwise would create significant unfairness to persons who negotiated settlements of CFTC claims in the past without full knowledge of the future consequences under the law.

(59) Is it appropriate for our bad actor disqualification rules to provide for Commission authority to waive disqualification as proposed?

We believe it is essential for the Bad Actor Rules to provide for a streamlined disqualification process to enable individuals to seek to obtain timely waivers. Especially in this time of rapid transition to the provisions of Dodd-Frank, imposition of these disqualification rules without a waiver process could be extremely burdensome to certain established hedge and private equity fund clients, and create unintended and inequitable consequences.

If the Commission were to decide not to impose a ten-year cut-off as discussed above under Question 21, Mr. X (in that example) could be viewed as ineligible to participate in discussions with prospective investors, yet much information about the funds and their investment policies and strategies can only be provided by Mr. X. Absent a ten-year cut-off or a waiver mechanism, he would have no recourse other than to re-apply for a license that he no longer wants or needs. Thus, we believe the waiver process is essential to equitable application of the rules.

(63) Should the Commission provide for grandfathering of pre-existing disqualifying events, or other phase-in procedures for the new disqualification provisions? What would be the effect on issuers, other covered persons and investors of implementing the new bad actor disqualifications without grandfathering, as proposed? Would providing for grandfathering be consistent with the requirements of Section 926 of the Dodd-Frank Act?

We believe that it would be appropriate for the Commission to grandfather pre-existing disqualifying events.[6] Implementing the new bad actor disqualification provisions without such relief could lead to the disqualification of persons who negotiated settlements in good faith to avoid litigation costs and consequences, have run their own investment firms for years without adverse incident, and who would suddenly have to cease contact with investors at the stroke of the Commission's pen. In the case of Mr. X, in question 21 above, this could lead to the eventual decline of the assets of the funds and jeopardize the viability of the firm.

We therefore believe that such grandfathering is not only consistent with the requirements of Section 926 of Dodd-Frank, but further, is necessary to prevent the Bad Actor Rules from having a retroactive effect not clearly intended by Congress, as discussed by Commissioner Paredes in his statement at the Commission's open meeting proposing the rules.[7] We agree with Commissioner Paredes that "fundamental notions of due process" militate against giving the Bad Actor Rules retroactive effect absent an express statutory grant, regardless of the "legitimate and important policy goals" that may be advanced by such retroactivity.

(64) If we provide for grandfathering, should we grandfather disqualifying events that occurred before enactment of the Dodd-Frank Act, before the date of this Release or before adoption or effectiveness of the amendments to Rule 506? What impact would that have on investor protection? Would the impact on investor protection be reduced if we required disclosure of grandfathered events?

We believe that it would be appropriate to grandfather disqualifying events that occurred before the enactment of Dodd-Frank, as it was at that time that industry participants became aware of the requirement that covered persons subject to disqualifying events would not be able to participate in Rule 506 offerings.

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6 We recognize that certain disqualifying events, e.g., criminal convictions for securities fraud, may merit different treatment.

7 Http://www.sec.gov/news/speech/2011/spch052511tap-item1.htm, May 25, 2011.

(65) Alternatively, should we grandfather only certain disqualifying events? For example, we could grandfather orders arising out of negotiated settlements agreed to before enactment of the Dodd-Frank Act, or before the rules were proposed, adopted or became effective, in light of the possibility that the party would not have agreed to the relevant order if it had known that a collateral consequence of the agreement would be disqualification from all Rule 506 offerings. Would providing a different treatment for pre-existing negotiated settlements limit the effectiveness of the bad actor disqualification rules?

Whatever the Commission's determination under Question 64, we believe it is appropriate to grandfather all regulatory orders that were the product of a negotiated settlement in the interests of due process and as a matter of equity. In our experience, collateral consequences are carefully considered as an element of any decision to settle an open enforcement action. If Mr. X (and other individuals of whom we are aware) had known that they might not be able to participate in Rule 506 offerings when the settlement was agreed to, it is almost certain that they would not have agreed to terms that would have precluded that activity. Rather, such individuals might have negotiated a different settlement or even chosen to litigate the allegations against them. This is especially true of Mr. X, who negotiated a settlement after he had already entered the private investment fund business, where success is dependent on the ability to raise capital in Rule 506 offerings.

(67) Is it appropriate for disqualifying events to apply to sales of securities made after the effective date of the new rules in offerings that are underway at the time the new rules become effective, as proposed?

We do not believe it would be appropriate for disqualifying events to apply to sales of securities made after the effective date of the new rules if the offering has commenced prior to the effective date of the rules. As described above, the structure of private investment fund firms often calls for participation in meetings with prospective and existing investors by investment management personnel whose input is critical to the sales effort. To eliminate them from such participation of the funds they manage could have adverse effects on the ability of such funds to raise additional capital and thus on existing investors. While disqualified individuals might be precluded from participation in future offerings, it would be inequitable to existing investors in continuously offered funds to deprive them of the services, input and ability to raise additional capital of the individual managers with whom they have invested.

(68) Is it appropriate for disqualification requirements to apply to each sale of securities, as proposed? Or should we measure disqualifying events only at the time of the commencement of an offering? Conversely, should we disqualify all sales in a continuous offering if a disqualification occurs during the offering, including sales that have already been made?

We believe it is appropriate for disqualification requirements to apply only at the commencement of offerings. As mentioned above, certain individuals of whom we are aware have been selling securities in Rule 506 offerings of existing funds that they manage. To eliminate their participation in such offerings would change the nature and viability of the product and potentially harm the investments of existing investors who invested prior to the effectiveness of the sanctions.

It would be entirely inappropriate to disqualify all sales in a continuous offering if a disqualification occurs during the offering. Even if the Commission were to remove a disqualified individual from future sales efforts, it would be unfair to existing investors, as well as the issuer, to call into question the registration status of the offering under the Securities Act solely as a result of the actions of a single individual who had not been disqualified at the time previous sales were made. Thus, we urge the Commission to apply disqualification only prospectively, after an individual becomes subject to sanction. While the disqualified individual could no longer participate in any ongoing offering, or in any future offerings under Rule 506, neither prior sales nor the status of offerings in progress should be affected.

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Please contact either Fred M. Santo (fred.santo@kattenlaw.com) or Marybeth Sorady (marybeth.sorady@kattenlaw.com) if you wish to discuss our comments.

Sincerely,

Katten Muchin Rosenman LLP

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