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July 20, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Request for comment on the proposed rule to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act; File No. S7-21-11

Dear Ms. Murphy:

We submit this letter in response to the request of the U.S. Securities and Exchange Commission (the "Commission") in Release No. 33-9211[1] (the "Release") for comment on its proposals regarding the disqualification of securities offerings involving felons and other "bad actors" (the "Proposed Rule" or the "Rule") from reliance on the safe harbor from registration provided by Rule 506 ("Rule 506") of Regulation D[2] under the Securities Act of 1933, as amended[3] (the "Securities Act"). The Proposed Rule is designed to implement provisions of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act[4] (the "Dodd-Frank Act").

We appreciate the opportunity to comment on the Release. Seward & Kissel LLP has a substantial number of clients, many of which are private funds and managers of private funds that rely on Rule 506, that would be affected by the adoption of the Proposed Rule. We respectfully submit the following comments and request that the Commission consider them before adopting the Proposed Rule. The views we express in this letter, however, are our own and do not necessarily reflect those of our clients.

I. The Rule should provide "grandfathering" for events that occur prior to the effective date

The Commission has proposed not to "exempt, grandfather or otherwise make

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[1] Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, Release No. 33-9211 (May 25, 2011).
[2] 17 CFR 230.506.
[3] Securities Act of 1933, 15 U.S.C. 77a et seq.
[4] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 10 Pub. L. 111–203, 124 Stat. 1376 (2010).

special provisions"[5] for events that occurred before enactment of the Dodd-Frank Act or the effective date of the Proposed Rule (the "Effective Date") but has requested comment on whether such grandfathering or other accommodation should be provided.[6] We strongly believe that it would be grossly unfair to apply the prohibition of the Rule (the "Prohibition") to issuers based on conduct that occurred prior to the Effective Date. In light of the Rule's expansive nature, many issuers would be effectively put out of business, forced to replace key personnel or forced to take other significant measures to ensure compliance with the Rule. Issuers should be given the opportunity to implement adequate procedures to ensure compliance with the Rule *going forward* but should not be required to take into account past events.

We recommend a compliance framework similar to what was provided for in Rule 206(4)-5 under the Investment Advisers Act of 1940, addressing political contributions by investment advisers[7] (the "Pay to Play Rule"), whereby the Rule would provide a separate compliance date and the Prohibition would not be triggered by events that occurred prior to such date.[8] Additionally, as was provided under the Pay to Play Rule[9], the Rule should include a transition period that provides issuers with a significant amount of time to design and implement adequate compliance procedures. If the Rule is adopted as proposed, immediately upon the Effective Date, issuers would be required to take inventory of all events that have the potential to disqualify them from reliance on Rule 506 (each, a "Disqualifying Event"), many of which may have occurred several years prior to the Effective Date. Given the expansive nature of the Proposed Rule, this would present a significant burden for most issuers and would likely result in disqualification for many issuers that have been conducting Rule 506 offerings without incident for years. We are identifying two specific circumstances in which the Rule's retroactive application to the conduct of covered persons would be especially unwarranted:

- As the Commission notes in the Release, the Rule does not take into account covered persons who entered into settlement agreements prior to enactment of the Dodd-Frank Act and therefore could not have known that such settlement would later constitute a Disqualifying Event under the Rule.[10] Issuers should not be penalized for entering into such arrangements, or any other arrangements that would constitute a Disqualifying Event, given that they had no notice that doing so would disqualify them from reliance on Rule 506.

- The Proposed Rule would also apply to any person that "has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers

[5] Release, at 31,530.
[6] Release, at 31,531.
[7] 17 CFR 275.206(4)-5.
[8] Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. IA-3043, at 41051 (July 1, 2010).
[9] Id.
[10] Release, at 31,530.

> in connection with a sale of securities"[11] ("Solicitors"). In the context of private funds, a standard contract with a Solicitor contains a continuing obligation to pay the Solicitor in relation to past and future investments by any client introduced by the Solicitor. These compensation arrangements typically survive termination of the contract between a Solicitor and an issuer and/or its sponsor. Furthermore, for private fund issuers that conduct ongoing offerings, the issuer and/or its sponsor typically has an obligation to compensate the Solicitor for each sale to an investor that was originally introduced by the Solicitor. Thus, the Proposed Rule has, what we believe to be, the unintended consequence of penalizing issuers that utilized Solicitors that were or later became subject to a Disqualifying Event in connection with sales of securities *prior* to the Effective Date. More specifically, any investors previously introduced by such a Solicitor would not be able to make any new investments without triggering the Prohibition for the issuer. We believe that this treatment is contrary to the Rule's stated intent which is for the Prohibition to apply only to sales made *after* the Effective Date.[12]

If the Commission determines not to provide for grandfathering of conduct that occurred prior to the Effective Date, then we recommend that the Commission provide guidance that, in the private fund context, payments made by an issuer to a Solicitor after termination of their contract would not affect the issuer's eligibility to rely on Rule 506. A private fund issuer should be permitted to terminate its contract with a Solicitor (which would mean there could be no further sales directly attributable to the Solicitor's post-termination efforts) and upon such termination, not be subject to the Prohibition as a result of a Solicitor's conduct, regardless of whether there is a post-termination compensation obligation.

II. The Proposed Rule should not go beyond the scope of Rule 262, the disqualification provisions of Regulation A under the Securities Act, and Section 926 of the Dodd-Frank Act

Under Section 926 of the Dodd-Frank Act ("Section 926") Congress directed the Commission to adopt rules that are substantially similar to Rule 262, the disqualification provisions of Regulation A under the Securities Act ("Rule 262"), and that also cover the triggering events specified in Section 926. In an effort to simplify the framework and presentation of the Rule, the Commission proposes to create one category of "covered persons" to which all of the provisions of the Rule would apply. The Commission notes that a consequence of this approach is that several provisions would be broader under the Proposed Rule than under Rule 262.[13]

While we applaud the efforts of the Commission in seeking to create a more

[11] 17 CFR 230.506(c)(1).
[12] Release, at 31,531.
[13] Release, at 31,527-28.

streamlined regulatory framework, we are concerned that the streamlined Rule broadens the Rule beyond what Congress intended. Section 926 was enacted "to better protect investors while facilitating capital formation."[14] We believe that an overly broad application of the principles underlying the Rule would impede capital formation without serving the stated goal of investor protection, as it would unjustifiably disqualify many issuers from reliance on Rule 506. As a consequence, many issuers that would have otherwise relied upon Regulation D would be forced to rely upon the statutory private offering exemption of Section 4(2) of the Securities Act. Such offerings would effectively be operating outside the scope of public disclosure since the Commission and the public would not have access to any of the information that would have otherwise been provided on Form D.

In order to minimize the burden that the Proposed Rule could impose on the ability of small businesses to raise capital, we urge the Commission not to broaden the Rule beyond what is currently provided in Section 926 and Rule 262. Conduct by certain covered persons that is not currently prohibited by Rule 262 and is not explicitly referenced in Section 926 should not disqualify an issuer from reliance on Rule 506. If the Commission wishes to address disciplinary matters that are outside the scope of the Congressional mandate, we recommend doing so through the imposition of additional disclosure obligations in an issuer's Form D. This approach would allow investors to make the ultimate choice regarding whether to invest with a particular issuer in light of certain disciplinary matters.

III. The Proposed Rule is unduly burdensome as it would apply to beneficial owners and executive officers

The list of persons to whom the Proposed Rule would apply includes beneficial owners of 10% or more of any class of an issuer's equity securities.[15] We recommend that the Commission remove 10% beneficial owners from the list of covered persons under the Proposed Rule, or, in the alternative, increase the percentage ownership threshold from 10% to a percentage that reflects a majority interest. Many issuers that claim the Rule 506 exemption are private investment funds in which the investors (i.e., the beneficial owners) are, by design, passive investors. We don't believe that there is a rationale for disqualifying an issuer that is a pooled investment vehicle from reliance on Rule 506 based on the conduct of a 10% passive equity owner. A beneficial owner should have at least some element of control over an entity in order for his acts alone to disqualify the entity from reliance on Rule 506. If the Rule is adopted as proposed, many private fund issuers may be disqualified based on the presence of unrelated passive investors who happen to have high ownership percentages, but who have no actual control over the issuer.

Additionally, the Commission has requested comment on whether it should replace the Rule's reference to "officers" with "executive officers".[16] We believe that this revision is necessary to prevent the scope of the Rule from becoming overly broad. For example,

[14] 156 Cong. Rec. S3813 (May 17, 2010) (statement of Sen. Dodd).
[15] 17 CFR 230.506(c)(1).
[16] Release, at 31,522.

as the Release notes, given that the Rule would cover *any* officers of the Solicitor, there could be a vast number of individuals employed by a Solicitor capable of triggering the Prohibition, many of whom "would not have any involvement with any particular offering, but all of whom would be covered persons for purposes of disqualification."[17] We believe that narrowing the definition of "covered person", as considered in the Release,[18] is of critical importance in order to ensure that issuers will not be disqualified by the conduct of bad actors with no practical connection to the issuer.

IV. The Commission should implement an expedited process for issuers to submit and receive a response regarding requests for waivers

The Rule provides that the Prohibition would not apply "upon a showing of good cause…if the Commission determines that it is not necessary under the circumstances that an exemption be denied."[19] The Release notes that "waivers would have to be issued by a direct order of the Commission itself."[20] Even if the scope of the Rule is narrowed considerably, it is likely that the Commission will still receive a significant number of requests for waivers. As such, we anticipate that it could take the Commission a substantial amount of time to respond to such requests. To help reduce response time, we recommend that waiver requests not rely on a direct order of the Commission but instead be delegated to a division or office that has the appropriate resources to handle them on an expedited basis. We further recommend that the Commission consider that, to the extent an issuer makes such a request, it should be permitted to rely on the exemption while the request is pending.

V. The Commission should clarify what constitutes the exercise of "reasonable care"

The Proposed Rule provides that the Prohibition would not apply "if the issuer establishes that it did not know, and in the exercise of reasonable care could not have known, that a disqualification existed."[21] An instruction to the Rule provides that an issuer would not be able to establish "reasonable care" unless it has conducted a factual inquiry.[22] We are concerned that this approach creates a great deal of uncertainty as to what steps an issuer must take to satisfy this inquiry standard. We urge the Commission to provide guidance regarding how an issuer could establish that it has met this "reasonable care" standard. For example, Rule 502(d)[23] under the Securities Act provides specific criteria for what constitutes reasonable care in the context of an issuer's determination that purchasers are not underwriters within the meaning of section 2(11) of the Securities Act.

We believe that an issuer should be able to satisfy the burden of inquiry through

[17] Release, at 31,521.
[18] Id.
[19] 17 CFR 230.506(c)(2)(i).
[20] Release, at 31,529.
[21] 17 CFR 230.506(c)(2)(ii).
[22] Id.
[23] 17 CFR 230.502(d).

reasonable reliance on written representations, provided there is no reason to believe that the representations are false. Under an alternate approach, as was taken in the Pay to Play rule, an issuer could satisfy the burden by showing that it has adopted and implemented policies and procedures reasonably designed to prevent violations of the Rule.[24] We urge the Commission to consider these approaches and provide guidance on this issue.

VI. Issuers should be afforded a reasonable period of time to take remedial action after the occurrence or discovery of a Disqualifying Event

Under the Proposed Rule, an issuer would immediately become ineligible to rely on Rule 506 upon the occurrence of a Disqualifying Event. This approach would impose a significant burden on an issuer, such as a private fund, whose business relies on making continuous exempt offerings. To minimize this burden, we recommend that the Rule provide for a reasonable period of time[25] (a "Grace Period") after the occurrence of a Disqualifying Event during which an issuer would be permitted to continue to rely on the Rule 506 exemption while remedial action is considered and taken. We further recommend that the Grace Period also apply where an issuer reasonably relies on a covered person's representation that it is not subject to a Disqualifying Event, and the issuer subsequently discovers that such representation was inaccurate. In these circumstances the Grace Period would commence upon the occurrence or discovery, respectively, of the Disqualifying Event.

We appreciate the opportunity to comment on the Proposed Rule. If you have any questions regarding this letter, please contact the undersigned at the telephone numbers indicated below.

Very truly yours,

/s/ Patricia A. Poglinco
Patricia A. Poglinco
212.574.1247

and

/s/ Robert Van Grover
Robert Van Grover
212.574.1205

[24] 17 CFR 275.206(4)-5(e)(2)(i).
[25] The Commission included a similar provision in Rule 202(a)(11)(G)-1 of the Investment Advisers Act of 1940, regarding the meaning of "family client" in the context of "family offices". The rule provides that "a person that is not a family client who becomes a family client as a result of the death of a family member or key employee, shall be deemed to be a family client for one year following the completion of the transfer of legal title." Family Offices, 76 Fed. Reg. 37,994 (June 29, 2011) (to be codified at 17 CFR 275.202(a)(11)(G)-1(b)(1)).