Geoffrey T. Chalmers, Esq.
Attorney at Law

33 Broad Street
Suite 1100
Boston, MA 02109

Tel (617) 523-1960
Fax (617) 227-3709
e-mail: chalm@worldnet.att.net

U.S. Securities and Exchange Commission,
100 F Street, NE,
Washington, DC 20549-1090
Att: Ms. Nancy Morris, Secretary

March 9, 2007

Re: File No. S7-25-06
Release No 33-8766, December 27, 2006
Proposed New Rules

Dear Sirs:

Set forth below are my comments on new Rules proposed by the Commission in Release no 33-8766.

As I have practiced and taught securities law for many years and also worked for the Commission I believe I have a perspective that may prove useful.

I believe that the proposals are, as put forth, an egregious case of "overkill" which may well once again "backfire" in the Commission's face, adding further to a general perception amongst securities practitioners that the Commission is seriously inept. I would urge a complete "back to the drawing boards" approach before these proposals are adopted. In the public eye and potentially in the courts (a) they won't work to solve the perceived problem and (b) they will inadvertently injure those they purport to protect.

A. They Won't Work to Solve the Perceived Problem

The proposal is, I believe, intended to address a perceived "threat" to investors in the enormous growth of unregulated private investment pools, primarily "hedge funds." The Commission's lately ill-fated amendment to the Advisor Act Rules was intended to address this perceived "threat" by requiring hedge fund managers to register as investment advisers. Now the Commission proposes again to address the "threat" by "protecting" investors with a net worth over $1 million but less than $2.5 million. This is to be done by withholding the Regulation D "safe harbor" exemption to the issuers who allow these investors into their funds.

Most troubling, the proposal addresses not only the "point of sale" of fund securities but the ongoing operation of the fund. Investors must be periodically checked out *after they have already invested* to see if they have fallen below the magic threshold and thrown out of the fund if they do. Existing non-qualified investors are prohibited from putting in more money.

Technically here, the Commission is clearly on shaky ground. Regulation D is not a regulation controlling how a hedge fund may act or whether it or its manager must register, but is merely a "safe harbor" from the definition of a "public offering" under the 1933 Act. The 1933 Act is not a regulatory statute (like the 1934 Act and the 1940 Acts). It is a disclosure statute. It gives the Commission absolutely zero right to regulate the ongoing operations of any issuer. Any attempt by the Commission to do so via the 1933 Act, if challenged in court, may well result in another "Goldstein" decision.

Not only that, but the proposal is fundamentally ineffective. The 1933 statute regulates only "public offerings." Section 4(2) of the statute is careful to exempt any transaction "not involving a public offering." Many, many court cases exist independently of the "safe harbor" offered in Regulation D and confirm the legal principle enshrined in the Statute that a fund which does not make a "public offering" may issue its securities free from the registration requirements of that Act. Indeed the language of Regulation D itself recognizes that complying with the Regulation is not the only way to avoid having to register. It is truly hard to imagine the SEC topping these court decisions and prosecuting a hedge fund manager for having made a "public offering" by having private meetings of his personally introduced clients and putting them into a hedge fund, however poor and ignorant those clients may be. The obvious response of the industry to this feeble attempt by the SEC to regulate their business via a 1933 Act "safe harbor" rule will be to blow it up (again) in court or the U.S. Congress and otherwise to ignore it.

This would be a sad fate indeed for Regulation D, a Rule that was intended to be a companion piece to the 1996 National Securities Markets Improvement Act, designed in part to provide a uniform capital-raising mechanism which got the states essentially out of the business of regulating private placements. If the Commission's proposed Rule change is adopted, issuers who ignore Regulation D will then use the old Uniform Limited Offering Exemption ("ULOE") adopted by most states. This requires that each private placement be submitted for examination (and fee payments) to each state securities regulator where the offering is to be sold. Unless all the states adopt a uniform $2.5 million threshold (which is highly unlikely) there will be immediate chaos in the private placement markets.

(B) <u>They will Inadvertently Injure Those They Purport to Protect</u>

I am at a loss to understand why the Commission has included all pooled investment vehicles in the proposal, including venture capital funds. The exception for "business development companies" (which doesn't fit must venture funds) seems to have been an afterthought. I just don't understand why, gratuitously, the Commission would risk alienating not only the powerful hedge fund lobby but also the venture capital community. Who is the Commission protecting by this?

The concept of all this is hard to grasp, inasmuch as folks with over $1 million but under $2.5 million must constitute no more than a tiny percentage of the investing public.

I don't believe I have heard a squeak out of the press or anyone else about "fraud and overreaching" in the venture capital business.

Venture funds have been a vital part of the capital raising process for small companies in this country for over 100 years. So here, in a misguided attempt to head off a perceived "threat" from hedge funds and "protect" millionaires, the Commission imposes a severe injury on a legitimate capital raising process. It does this by now withholding the benefits of Regulation D, the very 1990's financing mechanism by which the Commission liberated that industry in the first place and smothering it again in the very welter of state regulation that had so long hampered the growth of small business capital.

<u>Conclusion</u>

For the foregoing reasons, I urge the Commission to withdraw or re-engineer its proposals. Even better, now that the Congressional committees are in hands more friendly to securities reform, why not get the issues of hedge fund regulation resolved in Congress and stay away from ill-advised regulatory reactions and tortured "closet legislation" which hurt, not help, the persons they purport to protect?

Sincerely,

Geoffrey T. Chalmers