RECORD OF PROCEEDINGS

SECURITIES AND EXCHANGE COMMISSION

ADVISORY COMMITTEE
on
SMALLER PUBLIC COMPANIES

First Day of Meeting
October 24, 2005

9:30 a.m.

Securities and Exchange Commission
Multi-Purpose Room L006
100 F Street, N.E.
Washington, D.C.
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PROCEEDINGS

The following Members were present in person:

Patrick C. Barry
  Stephen E. Bochner
  Richard D. Brounstein
  Pastora S.J. Cafferty
  James A. “Drew” Connolly, III
  E. David Coolidge, III
  Alex Davern
  Joseph "Leroy" Dennis
  Janet Dolan
  Richard M. Jaffee
  Mark Jensen
  Richard M. Leisner
  Robert E. Robotti
  Kurt Schacht
  Ted Schlein
  James C. Thyen
  John B. Veihmeyer
  Herbert S. Wander

The following Members were absent:

  C.R. "Rusty" Cloutier
  Deborah D. Lambert
Scott R. Royster

The following Official Observers were present in person:

Daniel L. Goelzer

Jack E. Herstein

The following Official Observer was absent:

George J. Batavick

The following SEC personnel were present in person:

Anthony G. Barone

Alan L. Beller

Chairman Christopher Cox

Mark W. Green

William A. Hines

Gerald J. Laporte

Kevin M. O’Neill

1                     ***************
2             MR. WANDER:  Why don’t we begin our meeting and we'll
2a  call the meeting to order.  This
3   is a meeting of the Securities and Exchange Commission
4   advisory committee on smaller businesses, and as you will
5   notice from our program, it says, "Opening Remarks," but it
6   doesn’t say from whom, so we are fortunate this morning to
7   have Chairman Cox here to start with some introductory and
8   opening remarks. It is our pleasure and Jim and my pleasure to
9   introduce him to all of you.
10             CHAIRMAN COX:  Thank you very much.
First of all, thank you for being here. Thanks for what you are doing -- members, observers, everybody here, and I am getting the front end of what will be two more days on top of the nine months that you have already put in, so I just want you to know how deeply appreciative not only am I as Chairman, but all of the Commissioners and the professional staff of the Securities and Exchange Commission for what you are doing.

This advisory committee was established even before I became Chairman, but I have been a supporter of what you have been doing even before the President nominated me. This is a wonderful purpose and the SEC is very, very much in need of the information and the guidance that you are going to provide, and as Chairman I will be very interested in receiving your work product at the beginning of next year.

So I want to state that at the outset.

Second, since I haven't had a chance personally to meet with many of you, just a little bit about my background that perhaps you didn't know. In addition to serving in Congress and serving as a securities practitioner, I actually started a small business at one point and it was smaller, I hope, than most of yours. I hope you have grown, all of you, a little bit bigger than Context Corporation, which I started out with my dad in the 1980s. It had an interesting business. It translated in real-time Pravda, which was the Soviet Union's major newspaper, if one can call it that, and we distributed this product, which was a complete replica of the Russian original except in English, graphically identical.
in every respect, typefaces matched from cyrillic to roman
and so on, radio and TV listings, editorial cartoons -- as if
the rest of the newspaper were not an editorial -- in 26
countries around the world.

It was a fascinating thing to be involved in
something that was brand new. Nobody had ever tried to and
nobody has since attempted to translate in real-time an
entire newspaper, a daily, and reproduce it this way. It
took a team of 50 full-time translators to do that. But it
was an impressive thing for me to watch this organism, to
watch the way a small business develops.

I had perhaps more realistic, in terms of scale,

experience as a lawyer working with small companies, venture
capital financed companies -- in fact, some venture capital
firms out in California, mezzanine level companies and early
stage public companies.

What I discovered as a result of all of that
animated a lot of what I did in Congress over 17 years. I
came to the firm conviction that small business is the
critical engine of growth in the United States of America,
that small business really does drive innovation. It really
is the genius of our system and albeit a great many enormous
multinational companies have acquired the successes of
smaller businesses along the path of their growth. Without
the small business engine America and indeed the world
wouldn't be what it is.

We are critically dependent as a nation and as a
global economy on small business, and so from the standpoint
of the Securities and Exchange Commission, it's going to be
very, very important for us to keep this alive, to make sure
that we are focused on what is necessary for capital
formation, a key part of the SEC's mission and also one of
the principles that you have adopted here, to make sure that
we are doing everything necessary for investor protection,
because if investors don't have confidence they won't
continue to put their money into small business and the
investor protection is also one of the critical missions of

The entirety of the principles that you have
adopted, beginning with investor protection, is a perfect
fit, I think, with what the Commission has in mind for this
advisory committee and for ultimately what our aim has to be
as regulators. Investor protection, balancing costs and
benefits, we really need your guidance in this area because
we want to make sure that we are spending essentially the
economy's money wisely in achieving the benefits that
Congress intended when they passed Sarbanes-Oxley, for
example.

Maintenance of our culture of entrepreneurship I
think refers directly to what I just remarked upon --
encouraging capital formation, as I mentioned, is what we need to be all about and lastly keeping it simple, perhaps that is the rabbit in the hat of this whole exercise, because it is very easy to be for all the above, but doing it and not missing our stride is going to be much, much more difficult.

Godspeed in this mission. It is very, very important. I want to thank you for what you are doing and I want you to know, since you are all such busy people, I am pretty sure that we picked the right people. As Alan Beller's fond of saying, "If you want a job done right, pick a busy person to do it." We have a grouping of people that fit that description to a T, and I am extremely impressed that notwithstanding how busy you are and how much time you put into this already, you want to have even more meetings perhaps than we could immediately pay for.

I want you to know we are going to finance as many meetings as you need to have because we want to get this job done right. We are behind you to the hilt.

Thank you very much for what you are doing. Good luck. I had a chance to meet with Jim and Herb for the second time this morning. I am very much, as you know, looking forward to receiving your final recommendations early next year, and I hope that we can move on them with alacrity here at the Securities and Exchange Commission. Thanks very much.

MR. WANDER: Thank you.
(Applause.)

CHAIRMAN COX: Thanks.

MR. WANDER: We are also fortunate to have Alan Beller with us this morning, who is also going to provide us with some opening remarks.

MR. BELLER: I'm really not going to attempt to follow up on that. I think Chairman Cox said essentially everything that I would say. I have been speaking with him. I have been speaking with other members of the Commission. They continue to be very, very strong supporters of the idea of this committee, and more importantly, they continue to be very, very strong supporters of the work that this committee is doing. They look forward to seeing the recommendations. Given the work that has been done, I am confident that those recommendations are going to be taken very seriously.

The Chairman has indicated that. I think the Chairman and I are committed to getting those recommendations the prominence they deserve and getting them considered on an expeditious basis. I know some of the things you have been talking about have been around for -- not quite as long as I have, but, you know, 20 years, and they are entitled to serious consideration by the Commission, and that is what you will get and what your recommendations will get.

Beyond that, I know you have a lot of work to do over the next two days, and I am not going to take up any
more of your time. Jim, the meeting and Herb, the meeting
and the floor are yours. I thank you for your work today,
and I wish you Godspeed as you continue it over the next
couple of days and thereafter. Thanks very much for being
here and thanks for doing this.

(Applause.)

MR. WANDER: Good morning, everybody. I hope you
are satisfied with the arrangement, the way we have set up
the tables. We have each of the subcommittees together, and
I think this room is quite appropriate for our meetings today
and tomorrow.

You'll notice on the agenda for today that after

the opening remarks we are going to have a discussion and
evaluation of witness presentations at recent meetings and
written statements received.

I will provide a short introduction to that, but I
am going to alert all of you that we would like to have this
discussion to be quite thorough, quite interactive, and we
are going to call on all of you to give us your views because
we think it is important that the committee members express
themselves and we find out where we are in agreement, and
frankly, if we are not in agreement to note that and to see
if we can bridge some gaps.

When we finish that, we will go into reports from
the subcommittees, and what we have produced for everybody is
a list of items where there appears to be alignment among the
subcommittees, in the individual subcommittees, and -- away
from the mike? Oh, okay. How's that? Usually they say move
closer.

And so we will discuss those, not I hope in any
great depth, and then we will adjourn for the day. The
subcommittees will meet during the rest of today, so that
when we open our meeting tomorrow morning at 9 o'clock, we
will have consideration of subcommittee reports and
recommendations and at least narrow the recommendations so
that at least we can begin fresh to start putting together
our final recommendations in due course, so that we can

present them to the Commission, and then at the end of
tomorrow's session we will really look at next steps and the
timetable and outline how we will prepare our final report
and recommendations.

Jim, did you have any comments that you would like
to make?

Before we go into the discussion of what we have
learned, I would like to mention a couple of things that have
happened that you should be aware of, in case you haven't
seen or heard of them yet.

First is that the COSO report will be published I
think tomorrow. Some of us received an advance copy over the
weekend. It is going to be voted upon, I think, today, if
that is correct, and will be out tomorrow. It is about this
thick (indicating) and all of you will get a copy. Don't do
what I did. I printed it out at home on my home printer,
which took over an hour and a half, so do it in your offices.
But that will be a document that we will want to review,
particularly Janet's subcommittee.

The other thing that I would like actually to mention
to Dave -- your subcommittee. There are two things that have
happened on the analyst front. One is that the SEC has
published some interpretations of the soft dollar rule 28(e),
and it is actually quite a lengthy release. Your committee
may want to look at that, and if appropriate, actually

recommend to the whole committee that we provide comments to
the SEC on that, since that is one of topics that you are
supporting and I think unanimously.

In addition to that, it has been reported, although
I haven't seen the official word, that a group of
regulators in NASDAQ, et cetera, have also supported some
rules that would permit third -- paid for by issuers third
party research, and I can't go much beyond that, other than
what I sent out to everybody, but actually maybe Kurt will
help us later on and discuss that, since I know he is very
familiar with that.

So those are two developments that have
happened just in the last two days or last week.
Now I am going to move on to the topic that I would like to devote some attention to today. We have essentially finished our fact-finding process, and are moving onto considering our recommendations. Our fact-finding has been quite extensive, and Jim and I believe that before moving on we should as a full committee review what we have learned, share our observations with each other, and assess the need, if any, for developing recommendations to be made to the Commission.

When we started on this journey last April we adopted five overarching principles. Let's repeat them, so that they are at the forefront of our thinking, and Chairman Cox mentioned them.

They are: further the Commission's investor protection mandate; seek cost choice benefit inputs; keep it simple; maintain the culture of entrepreneurship; and capital formation should be encouraged.

We should also keep in mind the SEC's mission, which, as you notice from the plaque up in the lobby, is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.

We have learned a lot, and not all we have heard has been consistent. That was, in my view, to be expected. It is our job now to evaluate all this mix of information, assess it, and use it as the foundation for our
recommendations. Each of you committee members were selected because of your knowledge base and experience. Now is the time to utilize your skills to sift through all the information presented to us, and to help form our committee's recommendations.

Let me briefly review what we have learned.

First, we received approximately 110 written submissions in response to our request for public comment. We also received seven written comments regarding our first public meeting. We received approximately 270 on-line responses to our 29 questions and 20 written answers to those questions.

In terms of oral presentations, we had 12 in New York City in June, 8 in Chicago in August. We had 11 presenters in San Francisco in September. In addition, at that meeting we had five presenters from the Small Business Forum and we were fortunate enough to have Larry Rittenberg, the head of COSO, also make a major presentation to us. Finally, a week or so ago we had seven more presenters in New York City.

These written and oral submissions cover the waterfront. We had accounting firms, large and small, investors, big institutions, smaller, small cap investors, buy-out firms, venture capital firms. We had company representatives, CEOs, CFOs, comptrollers.
We had organizations such as the FEI, the Society of Corporate Secretaries and Governance Professionals, the Center for Public Audit Firms. We had many people from the analyst community. We had some attorneys. We had a lot of community bankers. We had the NASDAQ, the AMEX, and the Pink Sheets, and we had some professors.

In addition, I want to particularly acknowledge the work of the SEC staff. We have received a wealth of information from not only Gerry's staff, but also from the Office of Economic Analysis, and from the Office of the Chief Accountant.

We want to thank each of those who has helped us along this way for their splendid contribution to us.

(Applause.)

MR. WANDER: Now it is up to us to bring all this information together and use our experiences and knowledge to form a coherent set of recommendations for the Commission.

So that is my brief introduction this morning. I would, rather than start calling on people to give their views, would anyone like to volunteer to go first?

Well -- Richie?

MR. LEISNER: Well, this is the capital formation subcommittee and I pinch-hit a little bit for Dave Coolidge, who is to my left as he was making his own investigations of
the capital formation in other areas during a couple of our
meetings, and so with Dave's permission I am going to report
briefly on I think what the sense of our committee's findings
are.

You know, we did get direct testimony in San
Francisco from Jerry Niesar, who was one of the founders of
the ABA private placement broker dealer study group, and I
think Jerry did an excellent job of encapsulating the problem
there, which is how do people seeking capital tell the good
guys from the bad guys in a place where lots and lots of
capital is needed and lots and lots of capital is being
raised by people who are not licensed as broker dealers.

The essence of that testimony I think is a request
that leadership be provided to take the next step. There is
a very good scholarly background in the Business Lawyer
article that has been distributed and this is an idea that
has been percolating through the bar and with the assistance
and participation of certain of the regulators for a number
of years, so the next step is for somebody to come forward
and lead a project and because there are multiple agencies
involved and there are lots of difficult challenges
associated with this project, I think our sense is that the
SEC would be the ideal agency to move that forward.

Now that is the only direct testimony that I think
we experienced dealing with capital formation for
smaller public companies and for private companies, but I think everybody who listened to the testimony would agree that you can learn a lot about the capital formation world by listening to what full-blown public companies and smaller public companies have experienced in the post-Sarbanes-Oxley world and from the perspective of capital formation sort of lower down in the totem pole, I think we would agree that you now need to be larger to qualify to go public than would have been the case a decade ago. It is more expensive to get to that threshold. It's more expensive to cross the threshold, and of course we have been hearing lots of testimony and the other subcommittees will talk about the nuts and bolts of life as a public company.

So the conclusion is inescapable, that lots and lots of companies that a decade ago might have been thinking about going public are thinking about something else, but they don't have less of a need for capital.

The other things they are thinking about are private capital or getting sold, and if they are continuing down their plans, maybe more so than a decade ago, something in the capital formation arena that addresses the need for capital growing companies is as important as ever, and we think our proposals, starting with the private placement broker dealer and probably the other largest proposal is
doing something to relax the current prohibitions against
advertising and general solicitation in the private offering
area. Those are sort of the two that I guess would be at the
top of our list.

Unlike some of the other committees I think our in
absorbing all this testimony we kind of turned internally and
I’ll let the subcommittee members disagree, but mostly we had
agreement on the items that we recommended thus far.

Our challenge wasn't setting priorities and also in
limiting the number of proposals we got something that's
sneaking up on looking a little bit like a laundry list but
we didn't have places where we had arguments that somebody
didn't think the ideas were good ones.

MR. WANDER: Okay, any comments on Richie's
comments? Dave?

MR. COOLIDGE: Let me just add to what Richie
talked about. With respect to companies that are
contemplating a public offering, clearly the landscape has
changed, a lot of it due to regulatory requirements that they
are facing -- the expense of complying -- and as a result
there are fewer companies perhaps that have been willing to
go that route, go public.

I think at the same time, though, you can't say it
is strictly a regulatory environmental issue. It is also a
market environmental issue. The markets have changed.
Investors are demanding I think bigger companies, greater public float that is created at the time of an initial public offering and this would be for the larger institutional investors, so even in the absence of the regulatory change you would probably have seen the bar raised for companies that were contemplating a public offering just to meet those minimums that institutional investors require from a liquidity standpoint and a market cap standpoint. So that is sort of what has happened. Companies that are private today do have alternatives to raise capital. We have had testimony to that effect and perhaps, as Richie suggested, our committee is focused on making it a little bit easier to raise capital in the private markets because the public markets are not as available as they once were. I think there is a whole other group of companies that sort of have found that the game has changed on them. They went public at a time when being really small wasn't as big an issue from a regulatory compliance and cost standpoint and also perhaps wasn't as big an issue from an investor standpoint, so there's lots of companies out there, the small public companies, that are being pressured on the cost side because of the regulatory environment and also being pressured on the investor's side because there is a lack of investment research for these companies. There is a lack of interest in a lot of
in institutional investors for these companies and they are feeling orphaned, I mean, and I think there's lots and lots and lots of public companies out there that don't feel that they have the support they need or the interest that they need to continue as a public company, and again it was both the market changing situation and a regulatory changing situation that created a situation where more of these companies felt orphaned.

Investment research is a topic that we discussed. It's been testimony from several people. Clearly research budgets at the Wall Street firms have been cut pretty dramatically. Lots of companies have been dropped. There's many, many companies out there that are public, so, as Richie said, this creates a dilemma and one of the things that we have addressed in our committee is this going private issue. If you are caught as a company in a position where it's not attractive to be public, it's not interesting to be public, one of the options is to go private, and the rules for going private are quite difficult, and the smaller you are again the more expensive it is to jump through all those hoops and accomplish what you may think is good for your company, which is getting out of the public market.

So we want to encourage capital formation. We want to make it attractive to go public and not too burdensome to go public. At the same time, if the public markets are not
the right place for companies, we don't want to make it terribly burdensome to go in reverse, because the rules of the game have changed, so I think that is an area that we are interested in creating some additional relief for smaller public companies.

On the other hand, there is one thing going on. We didn't have a lot of testimony from venture capitalists, but Ted Schlein, who is not here at the moment, is in the venture business. The amount of capital that has been raised in private equity funds has grown very, very, very dramatically, so there is a viable private alternative for many companies. It is not easy to get money from some of these sources, so you have to be a very well-qualified company, but fortunately offsetting this lesser access I think to public capital, there is substantial private capital that's been put together to provide investment capital for companies that need it and want it.

So it is a curious situation I find that we are dealing with, which is lots and lots and lots and lots of smaller public companies and they don't really know if it's a great place to be because of the cost of the regulatory environment and the potential, you know, orphanage or lack of interest on the part of the investment community, and again on the research side we have talked about that and you noted at the beginning that there's some movement at the SEC and
with other regulators that are going to encourage the
continuation of research, facilitate the flow of dollars to
pay for that research for those companies that want it to stay
public. That
is a very critical thing that they need to have in order to
get their story out and be an attractive investment for lots
of investors.
So I think we have kind of focused on the right
issues, but we are dealing with a market and a regulatory
environment that is different than it was five and ten years
ago and it's -- you know, I don't think we can turn the clock
back and say it's going to be just like it was ten years ago
and practically anybody could go public -- and did.
But I think many of the recommendations that we are
contemplating making do try and make it easier for those
smaller public companies to either stay in the market, get
research coverage, lessen the burden, or if they want to opt
out, make it a little easier for them to opt out.
So anyway, those are my general remarks.

MR. WANDER: Thanks, Dave. I just would add one
other thing to this analyst coverage. The SEC, as you know,
has adopted some rules recently for larger public companies,
particularly in the securities offering area, and it's very
clear that the existence of analyst coverage, the "eyeballs,"
as Alan Beller called it, is a real plus in the regulator's
eye because it means somebody else is looking at the company
so that the enforcement division isn't as active in that
area, so it is another reason for that.

Drew? I saw you move the microphone.

MR. CONNOLLY: That was your first clue.

Well, thank you, and I most assuredly want to echo
Dave Coolidge's and predecessor to that Richie Leisner's
remarks because they do sum up, almost leaving nothing for me
to add, but there are several interesting footnotes to our
activities that hopefully we can take some credit for
already.

I am looking at an NASD notice to members that came
out in September where they are soliciting from their members
and presumably the public as well commentary on enhanced

short interest reporting. As you can recall from our last
hearing, that was a big issue for me. It doesn't
specifically address the bulletin board of the Pink Sheets
but obviously we're early days.

It seems to me at least at the micro-cap tier of
the marketplace and the individual investor portion of the
marketplace there is an untoward focus on whether or not
short selling has been either naked or covered short selling
has been in somehow a manipulative market practice. I think
that one of the hallmarks of this committee, when we finally
tender our report, should be that we have examined this issue
so as to give confidence on a go forward basis.

The other part that I would like to comment about Mr. Coolidge's presentation is the whole focus of research, both brokerage firm, investment banking firm sponsored research on the buy side, and then quite frankly the resurrection of issuer paid research as a model to attract qualified -- whether they be CFAs, whether they be members of the National Institute of Investor Relations, whether they be other standards credentialed organizations. Companies are going to be given an opportunity to tell their story and expose their company, warts and all, to the investor public, and I think that clearly in the internet age and the immediate ability to do research, do a wider and broader audience, that is a very, very good thing.

Then finally, just in terms of the issue of going private and how we make that simpler, or propose to make that simpler, one of the things I hope we focus on, and this really was part of the testimony I gave last year, on the House Financial Services Committee, is the focus on investors who were already in.

One of the concerns I guess on a proactive, going forward basis is the investor protection side of things, one part of that investor protection has to be protecting the folks who are already invested, as opposed to preventing folks from bad choices going forward, so I hope we focus
there as well, and once again second the prior comments from
the capital formation committee.

MR. WANDER: Dave?

MR. COOLIDGE: I just remembered there is one item
I didn't mention that I think I want to keep everybody
informed, and it has to do with the trading markets, the
NASDAQ and I think one of our main focuses has been the
over-the-counter bulletin board market and the fact that the
NASDAQ in effect transferred that over to the NASD and, you
know, we did have some testimony that was very concerned
about whether that was going to be a successful transition
and going forward the bulletin board market was going to be a
well maintained and viable market.

Our committee has the same concern, not that we
have any reason to believe it won't be maintained as a viable
market, but just that the focus, the emphasis, the energy,
the dollars to support it were quite focused on making sure
that that occurs, that it doesn't become -- you know, not
only do our companies that are traded there become orphans
but the market itself becomes an orphan.

Somebody with a real desire to make that a good
place for a lot of these smaller public companies to trade
and the resources and the energy to make sure that it is
maintained as a good market -- I mean promoting a market like
that or maybe promoting is not the right word, but keep it as
a market that investors like to deal in and have confidence in is very, very important to these smaller public companies. If that market were to deteriorate, it would not be good news for capital formation. It would not be good news for these companies, and so, you know, that is really in the NASD and the NASDAQ's control at this point in time, but whatever this committee can do to make sure that the pressure is on or the heat is on to make that a very viable market and put the necessary resources into it to continue it is another focused topic of our committee.

MR. SCHACHT: Can I ask one question of this group? I don't care who answers it, but just on this notion of lesser access to capital or is the access the same, there is just a higher cost related to the integrity of the numbers?

What comes to mind is the testimony we heard in San Francisco from one of the underwriter folks, and I forget who it was, but mentioning that in their view people are still going public, the ones that want to go public are going public. They are making that decision to do so, so there is not really a lesser access to public capital.

MR. COOLIDGE: Well, I guess the way I describe it is that it is up to the owners to decide whether they want the company public or not and what you without question see in today's markets is private equity sponsors being the
owners, the decisionmakers on that go-forward to a public
market, and they are doing it because they feel it is in
their best economic interest to do that.

Ted is not here, but he mentioned, you know, one of
his portfolio companies, they did the work, they figured that
this was a viable public offering candidate and they went to
the management and said, "Come on, this is what we want to
do," and the management said, "We don't want to go public. I
mean it's just going to create a whole series of issues for
us -- time distractions, expenses to the bottom line, et
cetera, et cetera, et cetera."

And in this particular case Ted's firm had control
of the situation and they said, "You are going public," you
know, and so that was the end of the story, but some of

these, say, family-owned companies or management-controlled
companies, the willingness or the interest in being public
has definitely declined because of the regulatory hurdles and
so the capital is out there. I think that's probably what
the testimony said, for those companies that do meet the
minimum standards, and as I said in my earlier remarks, the
standards have clearly gone up.

There's just not the same level of interest in the
really small public company, and I don't know how you want to
define it, but the way that we define it at our firm is
minimum $50 million to do an IPO, minimum $150 million market
cap to go public. I mean that is where we draw the line.

Now others may draw the line lower. Other bigger firms probably draw the line higher, but that is what is going on in the marketplace. Underwriters are setting their standards at a level, and that is -- you know, when a company goes in and talks to a very major underwriting firm, you know that those numbers are going to be higher. When he talks to our firm, which specializes in small to mid-size companies, you know, that is what we consider the minimum.

Now there are others that will do smaller deals, but I would say that the intermediaries, the underwriting community, has clearly raised the bar so the access is not as ready as it was historically for smaller companies, for smaller deals.

So, you know, it can get done, and maybe it gets done in a public mode, but it isn't really a full-blown public offering and you don't get to the NASDAQ daily quotes, et cetera, et cetera, unless you meet a lot of these minimums, and you certainly don't attract the kind of investors that most companies want to have if you don't get to these minimums.

A lot of it has had to do, as I said, with the marketplace. You have seen a good example of a T. Rowe Price that used to have, you know, a few billion under management, and we would sell them $20 million IPOs all day long. Well,
now they have got a hundred billion under management and they are just not going to play at that really small company level. They've got to see bigger companies, bigger deals, so the consolidation on the buy side has created some of this. As I said, it's a marketplace phenomenon as well as a regulatory issue, so, you know, the capital is out there, but clearly the rules I think and the minimums for going public have changed pretty dramatically in the last five to ten years.

MR. JENSEN: Can I follow up? I'm sorry. Go ahead.

PARTICIPANT: I'll yield.

MR. JENSEN: Well, I think that is an interesting point. I think we ought to drill down on that a little bit, because it seems like the notion of the aggregation of capital into larger and larger funds is a marketplace dynamic that is undeniable, and I think as a result of that it has caused IPO candidates to actually have to raise a lot of capital because it takes as much time to invest $5 million as it does to take to invest $50 million. So the question is is it -- what is really the driving force? Is it the capital aggregation that is going on in the centers of that capital, or is it the burden of being a public company and cost, the regulatory cost, of being a public company, because that about -- it's not the same
necessarily but it is -- there's a lot of cost you have regardless of what size you are.

MR. COOLIDGE: I think there are both dynamics going on at the same time. In my opinion, it raised the bar.

MR. WANDER: Anybody else have any comments?

MR. BOCHNER: I guess this is a little bit between the 404 subcommittee and the capital formation subcommittee, but talking about public offerings, I think we would hopefully all agree that 404 seems to be the biggest cost area that people have addressed concerns about in our testimony or written responses, and so I'm wondering about the Capital Formation Subcommittee's thoughts about the impact of 404, in particular, on the IPO process and whether the existing -- or maybe I ought to broaden it to all of governance reform.

You know, we've got this huge new set of rules in the governance disclosure, internal controls and other areas, that apply to companies going public, although we do have some phase-in periods. We have phase-in periods for board independence. We have some phase-in for 404.

And I'm wondering whether we have evaluated enough the -- whether those timelines, that relief is appropriate for a company going public, particularly in the 404 context. In other words, is that creating a chilling effect, that huge cost?
And I think that's sort of a classic investor protection versus cost kind of an issue. Because, on the one hand, you'd like to have the best internal controls possible for a company going public. On the other hand, we've got to get companies public. We need to encourage capital formation. And as we've seen, until we solve this issue for smaller public companies, it's just such a large cost, a large component for a small company trying to get public and raise money.

MR. CONNOLLY: I'm going to take a first crack at that, Dave, if I may?

David is obviously still a major bulge bracket investment banking firm. I come out of.

MR. COOLIDGE: I wish.

MR. CONNOLLY: I got your annual report. Certainly bigger capital than I used to play with.

But I have a background on the street as well, most recently late '90s, with a smaller New York member firm, and our efforts in those days, pre-SOX, to go through the due diligence presentation material and pull together what we legally needed and what we, from the standpoint of our attorneys, needed to be a sponsoring underwriter was significant then. I can only imagine that it has gotten substantially stronger.

And, clearly, I don't think I'd want to be in
Goldman Sachs' shoes right now with having taken Refco public a couple of months ago.

My sense of it is that the information gathered and the costs attendant to pulling that capital together, almost by definition, at the smaller end is going to require bridge financing just obviously to get to the IPO.

My hope is -- and there's certainly an interesting statistic -- there's something like 5163 NASD member firms.

I'm going to be looking for a number of those who will specifically state that they will reach out for a lower minimum than Blair.

Because, you know, quite frankly, the costs and the time investment are not -- if not exactly -- they are similar. So there needs to be an economic rationale for the lower tier. But, clearly, those front end expenses are a real detriment.

MR. COOLIDGE: Steve, managements are fearful. So there's just -- that's not a monetary or a financial issue. It's just, gee, do I want to be signing, you know, all those financial statements, you know, exposing myself financially and, you know, to potential lawsuits and criminal whatever.

So that's just a psychological barrier you've got to get over.

I'd say that the costs of 404 are factored into
what is it going to cost for us to do this? That's going to
deduct from my net income. My valuation is going to be a
multiple of that net income out two years or one year.
That's how these deals get put together. You look at the
forward numbers. You put a multiplier.

So if that number is lower, and you multiply it,
you know, and it doesn't get to the kind of minimum market
cap, well, yeah, okay, that can be a show-stopper, say,
that's too expensive. It's going to hit our net income too
hard. We can't go public until it's a less material item.

MR. BOCHNER: Well, yeah. I think there's an
additional issue which I had in mind, which is, you know, not
all public offerings succeed, and I suppose the smaller the
company, the less likely success. Markets can change,
companies can change.

So there's a certain capital commitment that a
small company makes, and it's, you know, in the order of
several million dollars of lawyer fees, accounting fees,
internal control consulting help. And so part of what I was
thinking about was your issue, that calculus of being public.

But the other part of my issue was that up front
cost and that risk you take with the up front cost. For
example, if we said you ought to be fully 404 compliant on
day one when you're public, because that's important to
investors, you know, that's a large amount of capital and it
takes a lot of maturity for a company to do that.

On the other hand, maybe we split the baby, and we say, you know, the underwriters will hopefully do due diligence on this issue. They'll look at the controls and the accounting staff and so on. And we think to encourage capital formation, let's not make the owners take that up front business risk right away, but let them phase into it over a period of time.

So that was really more the debate that was going through my mind.

MR. COOLIDGE: I think the way underwriters have dealt with that in general is, you may get a representation for the company that they will be, you know, compliant with 404 when they are required to be, after going public.

And at least I'm not aware of one where they said we don't want to go forward until you are 404 compliant, and spend all the money now before we even file the registration statement. It's been more of a forward-looking commitment on the part of companies.

And then they've got to do the numbers to figure out how much it's going to cost and whether that's going to really impact the valuation or not.

MR. CONNOLLY: Steve, there's one other issue here at the lower tier. I don't believe -- I haven't heard for
years of any such thing as a firm commitment underwriting.

So the underwriters are all doing best efforts underwritings, which in effect means if they can't find customers to place the offering, that offering will fail.

It's no longer an issue of a firm, an underwriting firm committing their own capital. They may on some of the larger deals, but certainly the small deals are, you know, subject to market demand immediately.

MR. JAFFEE: This is a wonderfully interesting discussion for me, and I started out thinking retrospectively because Dave and I worked on my public offering a long time ago, and certainly at the size my company was at the time we went public, we would never consider, and never could go public in the environment that we're in.

But I was really -- besides telling old stories, I was thinking about -- one of the areas I think we haven't focused on enough is looking forward rather than looking backward.

And what I mean by that is that this committee is probably unique and probably won't be reconvened or a committee like it for a long time in the future. So maybe it would be worth thinking about what's the world going to look like 5, 10, 15 years from now in terms of these kinds of issues.

And I don't see regulation being reduced, in
general. And I think that's another issue that I'm focused
on, because our company is an extractive industry. We mine
clay out of the ground, and so we have a large number of
environmental regulations which maybe other companies do or
don't have.

So I see the landscape as increasing regulation,
increasing cost and burden of regulation. And so this piece,
this 404, or Sarbanes-Oxley, is just one more nail in the
coffin of a small company that's attempting to do the right
thing, as we understand the right thing to be done.

The other thing that I don't see getting any
better -- maybe I'm too pessimistic, because we've certainly
talked about it -- is tort reform. We got a legal system
that seems to be continuously -- whether or not the -- you
know, the settlements get knocked off at appeal or not, but
there's -- out there there's constant threat of having your

business taken away because of the legal system.

And a number of us here from Chicago are involved
in the medical area, and we're the poster child for medical
malpractice settlements. We just had one from the county
hospital for $35 million. One individual in the hospital
that Dave and Pastora and I are associated spent $60 million a
year just to take care of the trial lawyers and the
malpractice issue.

So, again, I'm looking at it in a broader context.
I don't think it's going to get any easier. I think that this regulation is very burdensome, and whether or not we can come up with specific examples of how it inhibits capital formation in any one individual case is not the whole thing.

The other thing that bothers me, and we have had -- we have one -- I believe an attorney who took a company public on the London market, and I forget what you call that market --

MR. WANDER: AIM.

MR. JAFFEE: AIM, yeah. You know, if you think about it -- I haven't even read his book yet, but Friedman's got this book out about the world is flat, and I heard him being interviewed by Russert on TV the other day. And I got a bunch of grandchildren, and he was making the point that they're going to have to compete with kids from Shanghai and Bombay and various places. And I'm sure that's probably true.

If you think about it going forward on a competitive basis with other areas of the world where capital may be available or where markets for trading securities may be available, I think that's an area that we shouldn't lose sight of.

I mean, if I wasn't public, and I knew all that I know now when I was thinking of going public, I'd sure pick up the phone and call the guy from this London market.
Because I'd say to myself, why do I want to expose myself to a legal system and to this 404 stuff -- and I come from a point of view which I don't believe 404 is really protecting the investor to any significant extent, so I look at it mainly just as a bunch of sunk non-useful costs.

And so if I were going public today, and I were talking to you as I did 35 years ago, I would say, hey, Coolidge, can we take this thing on the London market rather than worrying about NASDAQ or the NYSE and so forth.

I don't know whether that's -- because we're in this category -- like Dave describes, I mean, we're happy, we're public, we got a market, we got investors, and paying a dividend. Everybody is -- nobody's too unhappy. But if I could throw a switch and get private, I'd do it. But I can't. It's just too tough.

So -- I don't know if that helps, but it seemed to me -- and the subject here was to evaluate the testimony. It seemed to me that those people who are really in the trenches, dealing with the problem -- and I would characterize those people as being the CFOs that we heard, particularly in Chicago. They were crying out for help. There's a lost of cost, and they're having great trouble.

If I put it at the other end of the spectrum, the regulator who we heard in San Francisco, oh, it's easy, and every CFO can fill out the form in a day and solve the
10 problem in a week, and the costs that we're hearing about are
11 really over-exaggerated, and they're all going to go down in
12 a year or two, it's real easy.
13
14     I think that the truth is closer to the
15     practitioners of the CFOs that we heard from, that this
16     regulation is really quite burdensome.
17
18     So I don't know if that's helpful. It's more
19     general than --
20
21     MR. WANDER: No, we'd like to hear everybody's
22     views. I'm going to call on Steve and then -- is there
23     somebody over here? Or you, Mark.
24
25     MR. BOCHNER: I'll be quick here, since I kind of
26     led down this alleyway to begin with. I guess I'd like to
27     request, since we're -- the 404 work is still ongoing, that
28     perhaps the capital formation subcommittee, and maybe the 404
29     sort of put a little note in areas to consider.
30
31     Once we figure out what the right balance is in
32     terms of the implementation of 404 with respect to smaller
33     public companies, we ask ourselves as a group, did we get it
34     right for the companies going IPO for the first time?
35
36     So come back to this issue once we figure out where
37     our 404 decisions land.
38
39     MR. WANDER: Mark?
40
41     MR. JENSEN: Yeah, I just wanted to go back. First
42     of all, I agree with what was said. But what I wanted to do
is take it back to some of the testimony we heard, and not
give my own point of view, but, rather, what I heard other
people say.

And, interestingly, I bring up the community banks
again because we heard a lot from those guys. But there was
a reoccurring theme there that that I think we may have missed.
And the theme that I heard was the burden of regulation on
top of regulation. It was, nothing ever got taken away, more
just got added.

And you kind of get to the point after you heard
that for a while, it's like, well, maybe what we've got is a
system that is becoming so top heavy and so complex --
because there was also a reoccurring theme from Irwin
Federman, who blasted 404, if you recall -- or Sarbanes-Oxley
generally, and got an ovation for doing it. But I think he
had the same theme, which was -- and he talked about

competitiveness, and he's an old semiconductor guy, and he
talked about how the United States was losing its
semiconductor business in the '80s being beat by the Japanese
because they knew how to build quality into a product, and
they didn't inspect it in. They didn't have inspectors
running around, they just built quality into it, and then
didn't have to look at it at the end.

And he was using that and analogizing that to a
regulatory system, what companies should be able to -- or
should bake this into what they do, build quality into what they do, and not have to regulate it or inspect it in later.

And I think -- as a committee, I think those are some things that I took away from it. I did hear -- we did ask Bill Hambrecht -- back on your question -- if you remember, I asked him about underwriter liability, and, you know, 404 or lack of 404 certifications in registration statements, whether that gave him any problem, and he said no, and that because he had his own 33 Act liability, he had to do his own due diligence.

So now we're going to see -- because in the case of Refco there were two material weaknesses identified by the auditor. They were put into the prospectus. So you got two material internal control weaknesses identified in the prospectus, and underwriters took them public anyway, some quality underwriters, and people invested, seemingly not caring about it at the time.

And so, as an auditor, I look at it and I go, well, is disclosure enough? And no amount of regulation solves those kinds of things. The only thing that solves those kinds of things are what Irwin Federman said, which is having things baked in and built into companies that enable them to control themselves.

MR. WANDER: I'm not sure, but I think there were
significant deficiencies.

MR. JENSEN: Well, okay. Well, I stand corrected.

MR. WANDER: But I've been too busy on committee work. I haven't had a chance to go read the Refco prospectus - Janet?

MS. DOLAN: Well, I was just going to suggest a format here since maybe it would be better. Why don't I give my comments on behalf -- as the chair of the 404, and then maybe invite the rest of our subcommittee to make their comments? And we'll have perhaps a little more cohesive, and then maybe move it on to the next committee.

MR. ROBOTTI: I'm sorry. I really feel as if I've got -- one more thing that has to be disclosed on that.

MR. WANDER: Go ahead, Bob.

MR. ROBOTTI: I'm sorry. A lot of what we talked about, I want to kind of echo from the point of view -- of course, I'm an after-market participant, not a pre-market participant. So I'm not interested in necessarily as much the capital raising function, and there are alternatives to the public market.

But, you know, I think there is too much regulation. I think 404 really has to be reevaluated for the small companies, because if you change the rules to make it easier for them to exit the marketplace, and you increase their cost of regulation and the amount of regulation over
time, you're going to increase the pool of companies that no
longer see the public market as a place in which it makes
sense for them to be.

And if you're going to ease them leaving the
markets -- and one of the reasons they're going to ease the
market is because of the cost of regulation. And I think,
you know, therefore, that's why you really have a tradeoff
here.

The cost of the regulation -- and I think
specifically 404 is one of them -- is too burdensome, and
you're going to encourage more companies that then go away.
And from a company point of view, I am sympathetic to the
company, but I also have to think about -- you know, the
number one rule we all have here is investor protection.

And there's a huge number of investors. Those
investors are not institutional because the institutions
don't invest in this market. It is a bifurcated market.
Like the small cap, microcap market is very different.

We have the institutions who become larger. Even
the small cap investors become larger and larger, therefore,
less willing to commit capital to this market. So because of
that, you've created a huge amount of companies, with a huge
number of investors that potentially we're taking away
investor protections for.

The alternative is, you have to reduce the cost of
it. You have to reduce the cost of it. Otherwise, I think we lose one of the objectives that we have, kind of core and fundamental.

So it's a repeated concept. We've got too much cost, probably. How do we do something? But it's from a different point of view. It's the after-market point of view, as opposed to pre-marked point of view, capital raising point of view.

Sorry, excuse me, Janet.

MR. WANDER: Before we move on to you, Janet, I just thought we haven't heard from this side of the room, Leroy's group, and I'm sort of trying to get just general views. You don't have to speak only about your own area, but I think it's worthwhile so that everybody knows what everybody else's thought process has been, and where we may have agreement or disagreement.

So any comments on a general nature?

MR. DENNIS: I wrote down some things as I was listening to everybody, and what I heard from the testimony -- and I'll just rattle some of these off, the testimony and also some of the things that we received in written comments.

We clearly heard from our -- I'm on the accounting standards committee that -- two separate sets of standards is
appropriate for the market.

We heard a lot of discussions about relationship between auditors and their clients, although I would tell you we heard a lot more of it early in the process and a lot less later in the process so at least from my standpoint tends to make me think that maybe the guidance from the PCAOB is working. We heard a lot about the ability of smaller public accounting firms to audit smaller firms, and I think we heard some of the testimony in San Francisco that that is a way to potentially broaden your competition and potentially reduce cost, although, you know, the fact is that 404, as currently written, is probably not going to -- we're never going to go back to the 1990s as to what things cost.

We heard some comments on COSO, and, really, the surprise to me was that how -- as I thought about it, how involved COSO really is in setting standards now, given that most companies in the United States use their framework to set controls, and that they really are a fairly informal organization in how it's funded and the processes they go through, although doing some very important work.

Heard a lot of companies about delisting, going dark, and I think we all agree that's probably not the best thing for the market when there's no information being presented to people.

And then probably -- I think Jim said it best, when
we had the tastes great, less filling comments on 404. It seems like you're either on one side of a camp or the other, and not much in the middle.

I do believe it's real important that for the smallest companies, that we be very aggressive in what we recommend on 404, keeping in mind the investor mandate protections that we have in place.

But I would tell you the other thing I heard a lot of was that a lot of thing in Sarbanes are working very well. Tone at the top, the board involvement, the audit committee involvement, all that stuff working very well at some cost, but certainly a lesser cost than the 404 transactional side of testing.

And then the last thing I wrote down was, you know, that -- I think Larry testified to the number of errors in restatements in the smaller public companies, and that the SEC spends a lot of time in that area with smaller companies, although the dollars are obviously not the size of an Enron or a Worldcom or something like that, but that there are a lot of numbers involved in the number of restatements and the number of errors that are uncovered in smaller public companies.

And those are -- as I reflected back, those are some of the things that I remember from the testimony that stood out. I guess I'd ask John or Patrick for any other
MR. VEIHMEYER: I would just add. I think one of the things that surprised us from an accounting subcommittee standpoint in terms of the testimony is, we heard less about big GAAP, little GAAP than I think any of us anticipated when we began this endeavor.

There really didn't seem to be a strong view about needing a little GAAP for little companies or smaller public companies. We didn't hear any of that to speak of.

And the more we talked about the concepts that I think led us into that big GAAP, little GAAP initial agenda item, I think the more it becomes clear that the issues that I think lead people to think we need a little GAAP for smaller public companies are just as true for large companies as they are for small companies in terms of problems with standards as they're currently written and the complexity and everything else, that that's a problem being experienced by the largest companies as well as the small companies.

I think you'll see that reflected in some of the recommendations that we have. So I think that was surprising from the testimony standpoint for us.

And then I think -- you know, Herb, back on your comments,

I think, you know, if there's one thing that the testimony proved it's where you stand depends on where you sit, I
guess.

And there wasn't a lot of consensus, but I agree with you that what we really need to do is not rely too heavily, I think, on any one individual or any one set of testimony, because everyone comes to the table biased by their perspective and where they sit in the capital market system.

And what we really have to do is, I think, resist the temptation to rally around maybe the most persuasive, or the loudest of the folks providing testimony, and really be reflective and balance everything that we've heard and everything we bring to the table in terms of our respective backgrounds as we move forward with recommendations.

MR. DENNIS: Patrick, given you're the only one in the real world, in our group, anyway, do you want to say anything?

MR. BARRY: Yeah, I mean, for me, a lot of the testimony was still sort of geared towards the larger companies than the companies my size. I really represent the smaller, microcap size company.

The thing that struck me the most was sort of the testimony in New York. There was sort of a back and forth, and they were talking about, you know, not really investment in smaller cap funds. They were really talking about investing in companies you know and using the information,
and they were basically talking about Enrons. And if you look at the information, you know, one, you shouldn’t have invested based upon what was there, or if you didn't know it, you shouldn't invest in it. Someone would get lost with, you know, putting the onus on the shareholder to understand what they're invested in.

I mean, I deal with a lot of companies probably that Bob deals with, and the investors are largely very unsophisticated, and I think we do a good job presenting the financial information, the Q's and the K's, et cetera, and they're not looking at them.

Where does sort of our burden as a practitioner end and where do you say, hey, we've got to run a business, and push the burden back on the investor to say, you've got to do your due diligence, and you've got to start using the information.

And it's sort of -- I feel like something's lost, where I think some of the things that Dave was talking about, the economies are going to take care of themselves.

You know, there's -- I'm in the after-market for public capital, and three years ago I might have talked to David's firm because we were doing $30 million, you know, secondaries, and people were interested in doing that. And now I'm in the PIPE market, and there's not necessarily
anything wrong with the market. It's sort of -- you know, the big guys don't want to touch it for their own economic reasons. So there is access to capital for me. It's just in a different format.

And I think we're sort of -- you know, everybody's sort of looking at how do you protect against the Enrons? I don't think you ever protect against that. I think, you know, you have to do enough to give an informed investor information and assume they're informed on the other side.

I'm not sure that any of the testimony really focused on the burden that the investor has to do their due diligence.

That's sort of what strikes me as -- you know, I deal with these guys every day, and they're just -- they're not sophisticated, they're not informed, and I just don't know where my burden stops and theirs starts.

MR. WANDER: That's an interesting comment.

Pastora?

MS. CAFFERTY: Let me say that my experience is very different from most of the people in the room. I know a lot more about mid-cap and large cap companies than I do about smaller public companies.

But nothing I have heard here or in testimony is something that I haven't heard from large cap and mid-cap companies. And that is, that no one likes the costs and
everyone's a little bit nervous about new regulations.

But reflecting on testimony and on the data, I think the issue that's very persuasive is the disproportionate cost of 404 to the smaller companies.

This is very persuasive. Whatever we do, not well, yes, whatever we do is going to be done in a political climate, and I think the fact that the same relief that is wished for by smaller public companies is being wished for by large and mid-cap companies.

I think the strongest argument here is the disproportionate costs, and the disproportionate costs is very persuasive.

Going beyond that, I have heard nothing or read nothing in the testimony except occasionally or in discussions that really would persuade me that anything but the 404 cost is really seen as onerous.

There's a lot of positive testimony that was given on the impact of Sarbanes-Oxley, and I would argue that the change in tone in the top and the change in tone in the board room is the greatest impact of Sarbanes-Oxley, that the culture has changed, and in my view and my experience, it is nothing but a change for the better.

To do that in a way -- and I think your points about baking it in are excellent -- to do that in a way that basically builds the controls better into the process, rather
than make it an attestation of those controls, which is an
added burden, may make a great deal of sense.

I do not think that looking forward, as Dick Jaffee
suggested, takes us away from regulation. If anything, you
know, we look at Refco in the last couple of weeks, the fact
that a very reputable firm took them public -- and, indeed, I
would not like to be in their shoes. But, on the other hand,
where were the investors who were investing in this, and what
did they read?

We will not be able to come up with any regulation,
I think, that guards against fraud. That is impossible. The
Enrons will go on. That's not the job, I think, of the
regulators. The job of the regulators obviously is to catch
it and then enforce it and put the right people necessarily
fined or punished.

But hopefully what we can do -- and I think
Sarbanes-Oxley does that -- is set a tone which makes the
likelihood of fraud lesser, simply by -- and I think baking
in is a point, but it's also the penalties of the
regulations.

I think for this committee to be most effective,
given the testimony, given the data that the SEC staff has
pulled together for us, is to focus on financial costs, and
particularly -- and any other cost that's disproportionate.
I think when we look at this proportionality, I think we can
be very persuasive.

I think if we go beyond that, just complaining that this is a highly litigious environment with a great deal of regulation, again, listening very careful to Dick Jaffee, that's not the world going forward. Part of it is the complexity of the world.

And I must say, the European markets are increasingly regulated. They're different regulations, but in a way the London market, in particular, has had much more tone at the top regulations for the last 15 years. We're very behind the European markets. So globalization, if anything, argues for greater, not less, clarity of regulations.

MR. WANDER: Okay, thank you. Is there anyone who hasn't spoken that would like to? Otherwise, I'm going to go back to the agenda. Yeah, Jim?

MR. THYEN: I'd like to make some comments on proportionality just to give some context, and respecting that viewpoint is determined by where you sit.

It's the cost choice that is forced or driven upon a small public company that is causing the greatest amount of pain because it changes the cost structure, the internal cost structure of the company, and it changes it rather abruptly.

In my world, in the electronics side, we are in a global value chain. We have customers all around the world,
customer value chain. We also have a global supply chain.
Our supply stretches around the world.

On the furniture side, we're primarily domestic on
the customer side, although I don't know that any customer is
truly domestic anymore, and we are global on the supply side.

Now, material costs, when you look at the cost
structure of a company -- and I'm coming to burden and the
burden of regulation in general and how the way this was
implemented really disproportionately changed the whole cost
structure.

The world is getting flatter, and the Internet, the
communication, it's moving a lot quicker, a lot faster. To
serve a customer globally you have to have pretty accurate
inventories, pretty accurate record-keeping, or it will break
down and you won't even serve that customer.

So it is important that we bake it in in a
preventive, up front way.

Material costs generally are moving the world
prices. They're generally the same price wherever you are in
the world. Logistics, it's the cost of moving of time and
distance, moving to and from.

And so that brings you to burden. And burden, if
you want to define it as perhaps the cost of one hour, labor
and overhead, including cost of capital, to convert your
materials to a package of value that your customer
appreciates and is willing to pay for.

When I look at information from The Economist magazine, when I hear us talk, one of the things that I didn't hear said in terms of the disproportionate costs of this burden -- and, Dick, I think you started -- you hit upon it. In Western Europe the cost of one hour of burden, labor, overhead, whether it's social cost, whether it's government regulations, whether it's market regulations, is about -- in U.S. dollars, it's about $110 to $120 in Western Europe per hour.

So if you had made this pencil in Western Europe, your material would be about the same. Now, you would pay more in logistics, depending on where you're going to ship it to, who you're going to sell it to, and where you're buying your components, time and distance. But if you assembled and manufactured it, $110 to $120 in Western Europe.

In the United States, $50 to $60 per hour, fully loaded burden of one manufacturing hour. In Eastern Europe -- Poland, Romania, Czechoslovakia, the Slovakian countries -- $20 to $25, one hour burden to make this same pencil. In Mexico, $20 to $25, some range there. In Asia --

Thailand, China, Vietnam, Malaysia -- $10 to $12.

Now, when you're a manufacturing company trying to compete, the disproportionate cost, the amount that is added to the burden, is a big deal, especially if you're smaller,
because if you're a smaller public company, we compete on skill, not on scale. So we don't really have the leverage in procuring material to change that cost structure to offset that burden that comes from the cost of a manufacturing -- one fully loaded manufacturing hour.

If we are going to remain competitive in the global market, I don't know that it's a choice of getting rid of regulation, because all of us support the need to restore confidence of the investor in the marketplace.

I don't know any of us that disagree with the need -- we all support the need for good internal controls. But it must be done in a way that the overhead burden, the one hour of burden -- and it's not the labor, it's not the employee. Because when you start comparing productivity, in the United States we have a 2000, 2100 man-year -- or hour-year. Europe, sometimes 1300, 1400 hours a year.

It really is the rest of that cost structure -- and I believe as we go through our debate here, one of our big challenges is -- certainly, if we can keep regulation from being added to move us into European cost structures of $110, $120, that's going to be good news.

But we really have to find a way, given the regulations we've got, how we get that cost structure down, because that skill set from Asia, from Mexico, is world class. And that is our competition. And the more we move our
cost of burden above that $50 to $60 per hour, the less
competitive we become in the world.

I would just like to share that with you so you
kind of calibrate it as we go through the two days.

MR. WANDER: Dick, and then Janet.

MR. JAFFEE: Jim, I thought that was brilliant, frankly, I think, because I think you put numbers on what I
was conceptually attempting to communicate, that in real
cents, we are putting ourselves in a position of becoming
less competitive on the world market.

And I would like to also follow up on a couple
points that Pastora made. To me, most of Sarbanes-Oxley has
been positive and has been implemented, and I'm glad we have
it, and I don't have a problem with it at all. It really --
for me -- and I don't have the issues about, you know, that
Drew understands or that Dave does in the markets because I'm
not involved in that.

But for me, the whole thing revolves around 404.
And it's not just only what is 404 costing me, and the
accounting fees are up, it is really the issue, is 404
accomplishing what we would all say would be a good outcome?

And it seems to me very questionable that the
answer is yes. Because it seems to me that the way it's been
implemented, the way it's been focused on -- and maybe the
PCAOB briefing is going to help it to some degree -- but up to
what I've heard to this point, it has been so much at the transactional level, so much a focus in energy and cost, on documentation, which is, again, if you analogize to quality control, the wrong way to go. That's all about the check and checking the checkers rather than starting at the tone at the top and really understanding what the outcomes are supposed to be.

So I'm having trouble with 404 because of two things. I think it's making us less competitive, it's raising the burden cost, as Jim said. I don't see it having the desired outcome that it was supposed to have.

And in terms of the political environment, the one thing that I found that was -- I'm sure you're all aware -- but there was a piece in The Wall Street Journal co-authored by Bob Dole and Tom Daschle on this subject, which I thought was amazing, that -- first of all, that they wrote something together, and, secondly, that they picked this subject together.

So there may be a political environment where a recommendation that would be bold in 404 might be received better than we think it might be.

MR. WANDER: Janet?

MS. DOLAN: I just want to make a couple comments that perhaps haven't been mentioned so far, although it does build a lot on what Dick just said.
If the real question to us is how do we evaluate the testimony we've heard, and what haven't we heard, and do we need any more. I presume that's what we're trying to get at.

MR. WANDER: Sure.

MS. DOLAN: I have three areas. But one is, I think we appreciate very much having a sort of ad hoc hearing a couple weeks ago from investors.

That helped a lot, because at the end of the day, what we're really trying to find out, and this is building on what Dick said, which is we heard a lot of testimony about the cost. The real question is, does it make a difference?

I would say one of the things we heard from the testimony is there's no alignment among investors as to whether this really makes a difference. I thought that was the most startling conclusion to come out of the New York testimony two weeks ago.

We had a number of investors, as somebody has already said, many of them don't invest in micro-caps, that's one category, but many of them said, "It hasn't changed my behavior. It's nice to have, but I do my own research. My job is to go in and meet with the leadership of the company. I form my judgment about the caliber of the company based on the people who run it."

I found that quite disturbing that, you know, we
have an opportunity to bring investors in to say, "I would invest only in companies that do get a 404 certification and I wouldn't in others," and we didn't get any indication of that, and when pressed, we asked investors, "Do you invest in companies outside the United States who don't have this burden," and they said, "Yes, we feel the need to diversify and do you ask a higher premium."

They couldn't answer that in terms of, "How do you actually calculate the value of this?"

So in terms of what we have heard and what we haven't got in front of us to work with, we do not have a monolithic view from investors that, for all the expense that went into this, that it really is making a difference.

The second is, I think we've heard nothing, and perhaps we couldn't expect to, but we have heard nothing on what happened here. Is this really what was intended? We've certainly gotten innuendoes, but we certainly know from outside documents that the expectation was that this was going to cost a company $90,000 a year.

I think when you roll out this kind of huge regulatory burden as fast as we did, we owe it to both the regulated and the investment public to do some sort of reflection on if we knew then what we knew now, would we do it this way, and if we wouldn't, how would we calibrate it? And I think calibration is the word we heard.
So we didn't hear any testimony on that, but I think all of us are taking that as our charge.

The last point is, and I think it was touched on over in Leroy's table there, but we can sort of laugh and chuckle a little bit about this sort of combination of regulatory and legal liability, but that is the 800-pound gorilla in the middle of the room here, and we can't ignore it.

I would compare it, I would compare the process to when we were naming our first child before he was born. Every name I came up with, my husband would say, "Oh, no, you know what nickname they're going to put on that. They'll call him da da da da."

And I said, "What, did you do this when you were a child?"

It's the same process here. Every time we come up with any kind of reform, we go right down the road of, "Oh, but what kind of legal exposure will this expose somebody to?" We right away run all the scenarios on what kind of possible malpractice or some other exposure is somebody going to be exposed to, and therefore, we can't have that reform.

So it is a big thread here, and we've had very little testimony on it, so in terms of the testimony, those would be the three areas that I would say we didn't get
uniformity from investors, and we certainly didn't get an overwhelming burden of evidence from investors that this really does make a difference, this changes their behavior, this drives their investment decisions, it really makes U.S. capital markets much more attractive than other markets they could invest in.

We didn't hear anything on is this really what the regulatory climate was expected to be, or did we somehow get off-track and how do we get it back; and we didn't hear enough on what is this regulatory and legal liability exposure that is so threatening that kind of stands in the way of sort of stepping back from the precipice and sort of right-sizing this to fit what the market can bear?

MR. WANDER: Leroy?

MR. DENNIS: I just want to echo Janet's comments, because I think in everything we talked about in our group, it does come back to legal liability, and the question from the auditor's standpoint is, "Well, if I'm going to be held responsible for something regardless, then I'm going to do it."

I think what I take from all that is if we are going to recommend less regulation or less steps or however we want to call our recommendations, there's a corresponding expectation of the courts and the legal system that there's less being done, so we can't, if we walk out of this with
less regulation under 404 for micro-cap companies, we can't also go to the courts and expect the same level that we have today in liability for all the participants -- the company management, the auditors, the underwriters, everybody.

MR. WANDER: And the lawyers.

MR. DENNIS: And the lawyers. I was going to exclude them, but --

(Laughter.)

MR. DENNIS: -- but we can't have the same expectation of them if we require less regulation on the other side.

MR. WANDER: I think that actually was -- Janet's point and your follow-up is something that I don't think we have discussed.

I think the big public policy issue is, we tend to think of our court system as being a safety valve -- higher quality, people have a chance to have these class action lawsuits.

But, you know, in the end, is it right? I mean, they're blaming all that on why we don't have vaccine, for example, and so we're without vaccine.

In any event, that's my little editorial on that.

Rich?

MR. BROUNSTEIN: Hi. Rick Brounstein.

Again, I'm going to speak just basically from my
role on the 404 Committee. And I don't disagree with
anything Janet said, I agree with it all.

A couple points I have that kind of jumped out at
me, and not all-inclusive.

Everyone seemed to be, you know, whether they were
for on the yes 404, on the no 404 side, they all seemed to
have what I'll call the spirit of 404.

Everyone, you know, if they were down in the
trenches, it was too expensive, but everyone sort of, you
know, from a 30,000-foot level, said it builds investor
confidence.

I think the people down in the trenches understand
the cost of it more, and it struck me as amusing that, you
know, one of our speakers, who admitted to being an author of
SOX, you know, talked about it in terms of, you know, well,
the CFO ought to be able to do his work in a day and they
ought to be able to audit it in a week.

Well, I think we know that that's not the case, but
if you could do that, it would come back to if everyone was
spending 90 or 91 thousand dollars, I think was the number
that the SEC predicted, we wouldn't be having this
discussion.

So in many ways, I saw a lot of convergence, maybe
not a lot of understanding about what's involved, but a lot
of convergence about, you know, 404. The theory behind this
was that it improves investor confidence, and that's a good goal.

Secondly, virtually nobody presenting was willing or did invest in the smallest of these companies that this committee has defined as the micro-caps, and I heard some shock when we talked about the proportionality that's come out a little bit today, that, "Well, it can't possibly cost that much, or if it does, something is very wrong."

But, quite indeed, when you take a look at the markets for what is half of the companies in our environment, if you are a fund manager, they're probably too small for you to invest in, and we tried to get small-cap fund managers, and I think I recall one person in the entire group of 44 presenters that said they actually have any investments in what we call a micro-cap.

My last point is everybody, on the other hand, admitted that good corporate governance, you know, is a major deterrent of fraud, and my take-away there is, as we take a look at what we're going to do, we have to make sure that the requirement for good corporate governance is something that's important to all the companies that we're considering.

MR. WANDER: Kurt?

MR. SCHACHT: I'm just glad we have a committee hearing today, because I think we have some discussion to do about what we heard the investors' viewpoint was at some of
these hearings, because I actually came away thinking that we gleaned at least a couple things from investors.

That is that, by and large, the professional institutional investors that we talked to felt that internal controls were important, and I think by and large, all investors feel that internal controls are important, it's just a question of what the level, what's the proper level of independent outside verification we need to have as part of that process.

I think everybody that's been a part of this discussion can stipulate to the fact that the costs are high and disproportionate. I think we knew that coming in. I don't think we learned anything new in that regard.

But I think it's important to understand investors do care about this.

You know, whether they're actually asking about it, whether they -- I think one of the comments was that there's a lot of information that's out there and available for investors, and what's their responsibility?

Well, I would certainly agree that investors have a responsibility to be competent to understand what they're investing in, but to suggest, if the suggestion is that investors aren't paying attention to this and that that somehow mitigates the responsibility of the issuer to provide clear and concise and consistent information, I would argue
with that.
So we get down to this question about what is the
level of proper independent external review of the internal
control structure, and the question we're going to be
struggling with, is it none for some public companies, or is
it a matter of a more cost-conscious, a more focused and
direct implementation of 404.

Thanks.

MR. WANDER: A couple people haven't made comments.
Before we take a short break and then go into our
committee presentations, Alex, did you have something you'd
like to share with us?

MR. DAVERN: Yeah. Just in the vein of everybody
being heard, I guess, I appreciate the opportunity to be
heard.

Alex Davern.

I'd first off like to say I think we got very good
testimony overall. I think we heard obviously from
companies, auditors, regulators, investors, COSO, so I think
we got a lot of good input.

I like what Kurt said, that we all came, most
people came here with the perception that there was a large,
disproportionate cost for smaller companies, and I think we
all had that confirmed for ourselves.

I'd echo Janet's comment that the biggest cause of
that problem I personally believe is the whole legal
liability system we operate under, and that really is the
800-pound gorilla she said. I would echo that completely.
I do believe very strongly, personally, that what's
happened has and continues to do significant damage to small
public companies in America, and I do personally passionately
believe that it's very bad for the country and that we have a
great opportunity to try to find a way to do what's right.
I take my guidance on what I think is right going
back to what I think was originally intended.
We've heard reference today to SEC's role and the
expectation it would cost $90,000, and I go back to what Rick
said about the testimony we heard from Lynn Turner, that it
should take a week to execute this requirement of 404, and I
think it probably should, and that was, I believe, what was
probably intended.
Unfortunately, what happened I believe is certainly
not cost-effective, not productive, not what was intended, I
think, by the SEC, and therefore I assume not what was
intended by Congress, and I think it's our job to try to find
a way to right-size that.
My conclusion I've also formed from listening to
all this testimony is that tweaking around the edges of the
procedures and process of executing 404 will not achieve the
goal of right-sizing. I just don't believe that will work.
As Janet said, we've gone down multiple paths, and we always end up it creates too much liability for somebody. So I'd also echo what Leroy said. As long as auditors have the responsibility, they're going to protect themselves, as they should. It's a rational, economic decision for them to make.

I personally believe the only way we will effectively right-size this is we've got to specifically eliminate some of those responsibilities for certain classes of companies, to make any substantive forward progress on it; and I believe from the testimony we've heard that investors in general will support that, and as long as the emphasis on management is clear, that they continue to have a requirement to have strong internal controls, they continue to certify against those controls.

And I think all the other provisions of SOX, absent 404, I believe are very, very effective in helping promote what the investor wants, which is a management team who is focused on running the business as honestly and presenting those results as honestly as possible. So I believe we need to look at fundamental change and we need to be bold, and that tweaking won't make any difference.

Thank you.

MR. WANDER: Would either of our two observers like
to make a couple comments?

Jack or Dan?

Dan?

MR. GOELZER: Dan Goelzer.

Yeah. Of course, my attention has been primarily to the comments about 404, as I guess is true of many of the other people in the room.

I thought I heard six things.

First, surely from the perspective of the preparers, particularly the CFOs, the point was very clearly made that the cost of 404 compliance, documenting controls, testing controls for purposes of an assessment, was disproportionately high relative to the resources available to the company, that unlike the situation with much larger companies, you could be talking about a significant proportion of the company's revenues, for example, that had to be devoted to this activity, and at the same time, they felt that the benefits were not significant, for, people suggested a variety of reasons, but primarily because, in a smaller enterprise, the CFO, for example, is much closer to the day-to-day operation of the controls than in other companies.

With respect to the second, with respect to the perspective of the investors, I guess I would largely agree with what Janet and Kurt said.
I think what I took away was that investors generally, institutional and perhaps individual to the extent they think about it, do have an expectation that public companies have effective controls in place.

That doesn't quite answer the question about what they need to see and how they would act on it in terms of external verifications of that, like management assessments or auditor attestations, but I thought that there was a fundamental expectation that companies will have effective controls, as has been required, well, since 1977, at least, long before the Sarbanes-Oxley Act was passed.

The third thing I was kind of struck by was that I thought the managements felt that there was a surprising lack of guidance available to them about how a smaller company ought to structure its controls and how it ought to assess their effectiveness if they're going to have to do that.

Obviously, as we've heard at great length, there are pages and pages and pages of stuff available from the PCAOB about how the auditor ought to do the attestation process, but that guidance, which is really just aimed at the auditor part of the process, has sort of I guess bled over into what management has to do because there isn't much practical guidance available to management.

There is obviously the COSO framework and we know that COSO is going to be coming out with something soon that
at least has the purpose of trying to help smaller companies understand how to apply the framework to smaller companies, but I thought that suggested that however people come out on 404, that there was a need to be filled in terms of guidance for smaller company managements on structuring controls.

The fourth thing that seemed to be a pretty common theme was that what's been referred to by the shorthand of "tone at the top" is the most important single factor in terms of the integrity of the company's financial reporting -- the integrity of management, the quality of the people on the board of directors, particularly the outsiders, and other kinds of corporate governance measures that are in place.

Fifth, and others have certainly made this point, I thought there was a pretty general agreement that at some company level the costs of an auditor attestation are not worth the benefits.

What I had difficulty hearing was how that line should be drawn, and we're in a situation now where companies down to approximately 75 million in market cap, accelerated filers, are already in the system.

There's been some suggestion based on the companies' definitions that everybody above 700 or 750 million ought to be taken out of the system again.

At least from what I heard, it's all just opinion. Nobody was really able to point to much tangible guidance as
to how that line ought to be drawn if a new line is going to
be drawn in that area.

Finally, the sixth thing, the final thing I thought
I heard was that while people I think pretty uniformly
acknowledge that the SEC and the PCAOB had done a good job of
trying to redirect the process to a risk-oriented approach in
the May 16th statements that were put out that the PCAOB had
a lot more to do in terms of making sure that auditors really
brought that to bear in the course of their work and felt, I
guess, to put it directly, that the risks of an adverse
inspection report from the PCAOB were equally on the side of
doing the work inefficiently versus not doing enough work.

Thank you.

MR. WANDER: Jack, did you have any comments?

MR. HERSTEIN: This whole process, being from a
small state, this whole process has been a shock to my
system, starting with the definition of a small company,
which from a state regulator, I very seldom see cross my
desk.

But the observations of all the advisors and the
other observer has been excellent.

Definitely, cost seemed to be one of the major

problems. Capital Formation, the committee I'm on, is also
trying to do our best to help with this process.

I believe what Richie said in San Francisco, the
finders should be number one or two on the list, that that
would definitely help the small companies achieve the goal of
raising capital formation.

Tweaking the trading markets, some of the trading
market rules would be helpful.

Also, I noticed that what the commissioner said,
just in my final closing remarks, the commissioner said is
that -- chairman, excuse me -- that, you know, keep it simple
and always remember investor protection.

From a state standpoint, for a lot of the states,
it's, for talking about fraud, it's easier to stop the frauds
before the investors lose their money.

MR. WANDER: Thanks.

We're going to take a short break, it's 20 after
11:00, to 11:30. Then we'll come back to our agenda, and
Leroy, you'll be the first that we'll call on.

(A brief recess was taken.)

MR. WANDER: We're missing a few people.

I know Alex went to get coffee, because I asked him
for some.

(Laughter.)

MR. WANDER: Kevin. Where's Kevin? We've lost
him. Mark and Alex and Richie. Richie is probably on the
phone.

Let me just talk about what we're going to be doing
the next two days.

We're now going to have reports of the subcommittees, and these are really reports telling us where you're at, where you're in alignment, where you're not in alignment, and we'll go through all four subcommittees.

Then we're going to adjourn for the day.

Kevin, I've already asked him, Gerry, to tell us where to go eat, and then we will return for subcommittee meetings the rest of the afternoon, so that you can really work in depth now that we've finished our fact-finding.

By the way, if anybody needs more information, don't hesitate to ask us. We'll see if we can find it or accumulate it.

Then my next question is, we would like to begin tomorrow morning in full committee where we would have the subcommittees come back and, in effect, give us their latest thinking after their afternoon meetings, and recommendations.

I just wonder whether you all need the rest of the afternoon and maybe you'd want an hour tomorrow morning and then we'd begin at 10:00, or whether we should begin with a full committee deliberation at 9:00.

Dave?

MR. COOLIDGE: Do we have all afternoon for the subcommittees?

MR. WANDER: Yes. Yes.
MR. COOLIDGE: I think we'll need tomorrow morning.

MR. WANDER: You would. Okay, that's fine. No, that's fine.

I think we made this two days so that we don't get rushed through something, because we really becoming the important part of it.

Steve, I guess we're going to have an hour tomorrow morning, so we will begin tomorrow morning at 10 o'clock. Hopefully, we will be through by 3 o'clock, and I say that because Don Nicholaison's farewell reception is in the same room we're meeting in.

(Laughter.)

MR. WANDER: Okay. Yes, Steve.

MR. BOCHNER: For the subcommittee meetings, will we, should we meet here at 9:00 and then somebody will divide us up? What's the --

MR. WANDER: I think you could -- Gerry, do you know the room numbers?

MR. LAPORTE: Yeah. When Kevin gets back, he'll tell you this afternoon.

We've got some rooms reserved in the building, and he'll assign you a room this afternoon. I think it'll be the same room tomorrow morning.

MR. WANDER: It's on the third floor. That's all I
But Kevin I think is looking for a power point projector. Oh, here comes the coffee. Now we can begin. See, you didn't realize what you were signing on for.

MR. DAVERN: I've got an opportunity for a small business.

(Laughter.)

MR. WANDER: Okay.

MR. CONNOLLY: Can I just --

MR. WANDER: Oh, sure, Drew.

MR. CONNOLLY: This is Drew Connolly.

I have asked Deal Flow Media, who is the publisher of something called the PIPEs Report as well as the Small Cap Report, for their copyright permission to distribute parts of the September PIPEs Report to this committee, and they were kind enough and gracious enough to give it. I've distributed two sets here, one of which talks about there's a story about Regulation SHO and how it has not in fact impacted the marketplaces perhaps the way it was intended to, the back of which quotes rather directly from our friend the president of the Pink Sheets Club, Cromwell Coulson, talking about what I think appears to be happening, which is
additional enhanced short entrance reporting.

So all of that is background information.

But the real guts of this issue which comes out monthly, both in specificity and in aggregate, is what is the activity in the marketplace having to do with PIPEs, and as I think we’ve talked about before without any specific information, PIPEs or private investments in public equity, have become the de facto IPOs for micro-cap and small cap companies, not by themselves, but largely Pink Sheets, Bulletin Board, and other securities, in the absence of being able to attract investment banking support, there's an entire industry now both of bankers and the attorneys that service these things, that are doing PIPEs.

I guess one of the pages here will outline both the firms that are issuing and the firms that are underwriting, if you will, a PIPE transaction.

The one negative, and I think for my friends and colleagues on this committee who don't have the market timing or the market specific access background, the one concern that continues to resonate is that, in large measure, most of or many of these PIPE investors will make a PIPE investment and often require relatively short-term liquidity such that it's almost required that a micro-cap company go out and do a lot of promotion, create some enthusiasm and some additional market side buying, so that that PIPE investor can sell into
the buying, and therein that has created, I suspect, a fair
amount of enforcement issues and folks should kind of be
aware of that.

So anyway, there's the data. Hopefully, it's
helpful.

MR. WANDER: Does anybody not know what a PIPE is?
If you don't, somebody here will tell you, or ask us. Ask
us, if you -- ask one of the lawyers. I suspect we can tell
you.

Leroy?

MR. DENNIS: I was just going to say I thought a
PIPE was something you used to pump out Louisiana, but --
Herb, are we going to debate each one of these as we go
through this?

MR. WANDER: No.

I really think that we'd like to really have you
tell us where you're at and where you have some disagreement,
and not necessarily debate, but rather, you know, any
comments before, so that you can consider them this afternoon
and then come back tomorrow morning and --

MR. DENNIS: Okay.

MR. WANDER: -- and give us some real
recommendations, and then we'll all slug it out.

MR. DENNIS: I guess I would ask, as people have
comments, you don't have to wait 'til the end to give me
these.

We've had several discussions over the past few weeks and months, and I would say as we come together as a group there tends to be little other issues that come up, and I'll include those as we go through here.

Some of the things that we have a lot of alignment on is, like we've said before, big GAAP/little GAAP does not work and that we will not be recommending anything in that area, that GAAP is GAAP and there should be one set of standards for all the companies in the United States.

We do agree, though, that the implementation dates for new standards, especially more complicated standards, should be extended for micro-cap companies.

Our recommendations really center around the fact that they don't have the resources of the larger companies and that if we allow another year for them to adopt new accounting standards, that gives time for the bigger companies to sort them out and you kind of get some flavor in the market for how the standards are being implemented.

We did have some debate around SAB 74.

MR. WANDER: Dick, can I interrupt?

I just want to emphasize, I think that's a very good recommendation for the reason that the FASB standards don't go through a beta test, and they spring to life all of a sudden, and no one has ever done a scenario planning of
what the problems will be with them.

And so it's very useful if the larger companies, for example, work through those bugs or kinks, and we just saw one with the option pricing, where the FASB said, "Well, it's the day you have an agreement with your option holder as to how you start pricing these," and they hadn't realized the technical problems that that was going to cause, and so that was, fortunately, that was changed before adopted.

So I think this is an excellent recommendation for that additional --

MR. DENNIS: Yeah.

And our thought is that, if you can just sort those out, let the market sort those out and deal with the FASB on a Q&A basis before the smaller companies have to go through the cost to implement those, that that's a good thing.

Now, we also would say to the FASB, there may be some standards that are fairly simple that we should just do, and so it ought to be up to their judgment as they're implementing those.

And traditionally, the FASB has required implementation by public companies on a quicker basis than private companies, and we would just suggest that the micro-companies probably be aligned with the private companies as opposed to being aligning with the public companies as
it comes to implementation.

One of the areas we're still having some discussion on, although I think John and I got closer to this today and with some input from the SEC, is whether or not SAB 74 needs revision.

For those of you who don't know, SAB 74 requires a company to disclose what the effect is going to be on its financial statements of pending but yet unadopted financial accounting standards, and that requires them to disclose what they know about.

I think we're now pretty much in alignment that that standard is fine as written and probably doesn't need to be revised.

Moving on, the second recommendation centers around the areas of independence with auditors.

We found that specifically, companies that do have some overseas operations, but even companies in the United States, there could be some pretty severe consequences for a company should its auditor have either an insignificant or an inadvertent violation of the independence rules.

The poster child example might be, you know, somebody in Sri Lanka doing some bookkeeping for a registrant that's affiliated with the accounting firm, and technically the accounting firm is not independent.

The consequences of that could be that that
company's prior filings are invalid and certainly would have
to be -- potentially have to change auditors.

We think the SEC, for the most part, has been
pretty, I don't want to say lenient, but understanding of
when those situations exist; but having more of a de minimis
rule inside the regulations that would allow the Audit
Committee, in conjunction with the auditor, to make those
decisions might be appropriate.

The next item has to do with accounting standards.

And certainly we all want to move towards a
principles based standard -- oh, by the way, you guys, please
chime in as I say something that you don't necessarily agree
with -- that principles based is the way to go.

We see a lot of problems with that with, and we've
outlined that in a paper as we're pulling our recommendations
together, but there are, you know, there is -- part of this
is the legal liability issue that Janet mentioned, and when
you have -- when you're faced with that environment, people
want rules, they want bright lines, and those are not what
you get with principles based accounting.

And they also -- I think it requires efforts on all
parts to do the right thing, regardless of what the rules
say.

The example I also use is the 123-R calculation or
The first thing that happened after that got issued was the market figured out that if they accelerate some options, that they will never have to take a compensation charge.

That's not, in my mind, in agreement with the principles of that standard, and if we are going to continue to have those kind of things, I don't think we'll ever get to a principles based standard.

However, having said that, we do think that we are going to make a recommendation to the FASB that they consider the ease of implementation and simplicity just as important as theoretical correctness when they're evaluating a new standard.

I'm less concerned about whether a lease is capitalized or not, as long as I know that everybody is treating it the same way, and because it goes to comparability of the financial statements, and when I'm an investor, in my mind, anyway, I seem to -- I would be more concerned about comparability than I would about theoretical correctness.

The next thing we talked about had to do with, also with accounting standards, and we noted that even when GAAP -- you know, there's a lot of pronouncements in GAAP and a lot of interpretations, but we still have emerging transactions that there may not be on point guidance relating
to that.

And so is there some sort of protocol for accounting and terming the accounting for that that the auditor along with the registrant can use that would protect them if they follow that process correctly?

Now, I'm not saying they get to the wrong answer and just because they follow the process that would absolve them of any liability. That's clearly not the case.

But if there is an emerging issue where there isn't clear guidance, if they follow a correct process, do some appropriate disclosure and disclose the alternatives and why they considered what they considered to be the right accounting, is there a way we can protect them from being second-guessed down the road?

The next item has to do with promotion of competition among audit firms for smaller public companies. You know, I think we heard a lot of testimony about some other non-Big Four firms that are qualified to do public company audits, especially of the smaller companies. Certainly, the Big Four are very qualified in that area.

If there's a way that the SEC can promote that competition and promote the ability of those firms by including them on committees like this, including them on other -- more involvement in the profession and the
accounting for those entities might get more promotion of
those entities and allow them to be perceived as a viable
alternative to the Big Four.

Along Dan's lines with the PCAOB guidance.

We think that that guidance is working between the auditor
and his clients.

I've interviewed all of the Big Four and a lot of
the other middle tier firms, and it does seem to be having an
impact. I think we'll know after we go through this busy
season, and our recommendation is going to be that the PCAOB
monitor that through their next inspection season.

If it's not working as they determine, then we
recommend further guidance, but at this point, we believe
that it is going to work as hoped.

I talked earlier about COSO, and we are going to
recommend that the SEC study the structure of COSO and
whether or not it needs to be more formalized with funding
and a more formalized standard-setting process, because it
does seem to be issuing standards, especially in light of
very little guidance on the structures of internal controls
that is available out to companies.

Lastly, the things we are aligned with is we'd like
to have some more enhanced technical assistance for smaller
public companies.

There's a lot of these companies out there, and if
they had a place that was more actively funded, either
independent of the SEC or with the SEC that they could call.

You have usually smaller auditors doing a lot of
these smaller companies, and if they had a place they could
call where they could get some advice and some help, that
would be a good thing.

Some of the things that we have not reached
alignment on, and probably more controversial:

We had some recent discussions on the cost to
change auditors and how do we make that less costly, to
promote competition.

As we thought through that, and I've thought
through it, I don't see us being able to change the education
process required for a new auditor. They're obviously going
to come in, they're going to spend a lot of time and effort
getting to know the company, getting to know the systems. I
don't see that being reduced to any large extent.

The question does come in as to whether or not we
could reduce the involvement of the predecessor auditor in
10-Ks, 10-Qs, and those kinds of things.

I think it also goes to if we're going to reduce
the involvement of those auditors in that process, they would
also have to -- we have to reduce the liability associated
with that, because they're not going to continue to want to

be associated with a statement that they're held responsible
But they would have, for example, if I had a 2004 report out there, and the predecessor, or the successor auditor came in and issued 2005, I still have my 2004 report. I just got to make sure that what -- right now I make sure what's said in the 2005 10-K is consistent with that. Can that be someone else's responsibility, rather than the predecessor auditor?

MR. WANDER: Isn't there also the possibility of, at least for some or all smaller companies, lessening the number of years you have to go back?

MR. DENNIS: Well, right now we're at two, anyway. I think I'd be hard pressed to say you shouldn't issue some kind of comparative financial statements --

MR. WANDER: So you go to two?

MR. DENNIS: -- but you could put that onus on the investor to say, "We're going to issue single-year statements, and you got to go back and pull up the prior 10-K," would be an option, too.

I think it's something we're still debating on what the answer would be, but the premise is, can we reduce that prior auditor involvement so as to reduce the cost to change?

MR. BROUNSTEIN: Can I add one more on this?

MR. WANDER: Sure.

MR. BROUNSTEIN: On the same subject.
So there indeed is a lesser role for the SB clients today --

MR. DENNIS: Yes.

MR. BROUNSTEIN: And I don't know if you've addressed it, but to sort of follow up on that, it would seem to me that as we've now, as a committee, gone ahead and looked at micro-cap and smaller definitions, that you ought to look at those definitions and see if that kind of -- if some of the SB rules should apply to that level standard, because it makes -- you know, and you can issue a two-year balance sheet without three years of income statement, and it allows you, from a predecessor auditor point of view, one less year, and that can be significant.

MR. DENNIS: I think that's something Steve's group is looking at as the regulations of SB; is that correct, Steve?

MR. BOCHNER: Yes.

MR. BROUNSTEIN: Because it seems to tie into this predecessor auditor relationship.

MR. DENNIS: We can look at whether or not, in conjunction with Steve, whether or not the requirements for filers under our smaller definition should be two years versus three, and that's certainly a point we can take a look at.

One that Steve asked me to take a look at, that we
haven't really talked about much yet in our committee, is materiality in financial statements.

We've seen a large increase in the number of restatements has happened. My sense is that there is more of a quarterly analysis for materiality as opposed to an annual analysis in the past.

What the right answer is, I don't know. Is there a different way to deal with immaterial errors in financial statements that are possibly material to quarters?

I am planning to meet with some of the staff of the SEC later on this afternoon and get their views on that, but that's something we've just really sorted out here or just really got put on our list of items to look at in the last two weeks, so we'll be sorting through that and --

MR. DAVERN: Can I comment on that?

MR. DENNIS: Yes.

MR. DAVERN: It's Alex Davern.

I'd like to encourage you guys to take a hard look at that question, because I think that is an area that does cause a lot of problems, and that some form of reevaluation of what are slicing these things up into ever smaller slices makes sense.

MR. DENNIS: Yeah, my sense is --

MR. DAVERN: I think it really should be examined, its practical impact, because there is a de minimis stage we
reach that I think we can have a lot of wasted effort around
if we don't have some form of review of that.

Thank you.

MR. DENNIS: Yeah, and, you know, I think there are
several things contributing to the number of restatements.
One is 404, and the increased auditor involvement in a lot of
areas is uncovering more issues.

I think when you change auditors, there's probably
a bigger risk that other issues are uncovered.

You know, I think we're on a quarterly materiality
level now, which effectively reduces everything by a quarter,
and I think you run into situations where, an immaterial
effect on each quarter is uncovered. It's probably
immaterial on an annual financial statement, but when you go
to correct it, because you have an accumulation of several
quarters, possibly it becomes material in any one quarter.

Is there a better way to deal with that than
restating the past eight quarters? And that's, I think, the
question on the table that we need to sort out.

The last one I would say is -- and we got to be
careful how we explain this.

This really is a thought, and we do not have
alignment on this in our committee. In fact, I would say I'm
in the minority on this, but because I'm the chair, I keep

putting it on the agenda.
MR. VEIHMeyer: Since there's only three of us, and you're in the minority, that kind of nails down who feels what way on this issue.

(Laughter.)

MR. DENNIS: But I got some statistics on the number of registered CPA firms in the United States, and I might not say these correctly, but there's something like 900 registered firms in the U.S. of which 200 or 300 don't audit a public entity and another 400 audit somewhere between one and five.

In our firm, whenever a person comes in and wants to do an SEC account, we will say, "You don't do any right now, we don't think we should allow you to do that on your own, but if you make a commitment to get involved in the industry and get some education and we'll monitor you along the way, then we'll allow them to go forward.

And I'm wondering whether there is something that would be appropriate for the PCAOB to have with firms that audit a smaller number of companies that maybe don't have the right experience that would require them to make a bigger commitment to the SEC business, and I think that ultimately would help in competition, because if I had a smaller number of registered CPA firms out there that did more public entities, I think it possibly could help in the competition.

It certainly would assist in the amount of
regulatory burden that the PCAOB is saddled with, and the
amount of people that they have to hire to accomplish their
task at hand.

I think this also will sort itself out over a
period of years. It's just a question of how long that will
take.

I don't know exactly how the recommendation would
get formulated or even if there's a recommendation there, but
it's something I believe would be correct. I have a lot of
people to convince.

MR. COOLIDGE: Only two.
MR. DENNIS: Pardon?
MR. COOLIDGE: Only two.
MR. DENNIS: Only two here.
(Laughter.)

MR. DENNIS: But, you know, it's just something
that seems to make some common sense to me, and I want to
emphasize I'm not trying to decrease the number of -- if a
firm wants to be in the business, that's fine.

I think they would be required, if they only do one
account, they probably need to have some kind of plan with
the PCAOB that says, "Here's some additional education I'm
going to do."

I mean, the SEC and the AICPA put on a great

training here in December every year, and it's very, very
good.

They ought to have some kind of commitment to increase the number of public companies they do -- something that gets them more involved in the industry. Because as I've learned over my career, whether it be in industry or whether it be in SEC or banking, you can't do one, because if you do one, you don't do it very well. So that's one of the things we're exploring. The other thing I would -- that I heard today, Herb, that's not on our committee agenda, but I think it needs to be somewhere, is the issue that Janet brought up on tort reform. And we've not talked about it in our group, but it seems like something that we need to deal with somewhere in our group. And with that, I would open it up for questions or comments.

Yes.

MR. JAFFEE: Leroy, Dick. Did you at all think about how the accounting standards are formulated, I mean, what the deliberative process is and who they reach out to and how much input they get from users and that sort of thing? Because there's one being formulated now on prepaid mining costs and reserve calculations, which I haven't read
and thought about except my people tell me it doesn't make any
-- they don't think it makes sense in the real world.
And I just wondered whether you stepped back from
that and talked about that.

MR. DENNIS: We didn't go through a lot of the
process that they go through in evaluating that.

Our big thing that when we looked at the standards
was simplicity and ease of implementation.

It just seems like we get so theoretical in the
standards, and then we try to make sure that -- and this is
not faulting the FASB. I think they got a very difficult
job.

But everyone has an exception, and if you're going
to have uniformity and ease, you can't have 15 different
exceptions, and so it has to -- there needs to be less of
those kind of things going on.

But we did not go through the actual process that
they go through to draft a statement or anything like that.

MR. WANDER: Janet?

MS. DOLAN: Leroy, I have a question about -- this
is Janet Dolan. I have question about your principle based
recommendation.

One question is, what action would it take to do
that? What do you -- I mean, what would it actually take to

make that happen?
But then my second question is more of a context, which is, we certainly hear that outside the United States, especially in the U.K., with the Turnbull approach to corporate governance, it is more principle based. It's less, you know, prescriptive and it's more principle based, and it leaves it -- puts it more in the hands of the board and the audit committee to manage risks. And so my question is, did the accounting standards used to be more principle based but we got into a more sort of regulatory, litigious environment and so they become more prescriptive, or have we just had no history in the United States accounting environment of principle based? I mean, would you be recommending something really different, or would you say we've kind of gotten way too prescriptive, let's kind of move back to the center and become what we used to be?

MR. DENNIS: I'll, John, maybe ask for your comments on this, also, but I think it’s going to be very difficult for us to ever get to an effective principles base, because -- and I think the litigation is one of those things, because you have more and more ability to be second guessed in a principles based environment, and you've got to have people that do the right thing right out of the chute, so we can't have designing accounting transactions or designing transactions for accounting purposes as opposed to designing
transactions for business purposes.

We've seen that evolve over the last 15 years or so, where those things have come into play, you know, the number and complicated nature of the financial transactions that are going on.

I think it's going to make it very, very difficult to get to a principles based type environment, and my guess is that -- and this is just Leroy Dennis's prediction, so that's worth what it's worth -- that the Europeans will eventually get to a more rules based environment than they are right now, because what will happen is the same thing that happened in our environment over the last 20, 30 years, is that somebody abused the system, just like 404, someone abused the system, and so we fix the system by requiring everybody to do 404.

And someone will abuse the system over there, and then a rule will be established on how you account for a certain transaction, and then the next rule will be established.

I think that's where we've gotten to over the years, is every time someone abuses the system, regulations respond by creating a rule for everybody.

I think we've yet to figure out a way to identify the bad people up front and just prohibit them from ever being involved in a public company. If we could ever figure
that out, then I think we can go to a principles based standard and be fine.

John?

MR. VEIHMeyer: Yeah.

You know, I think it has gotten more -- you know, to your question about did this evolve, yeah, I think it did evolve over the last 20 to 30 years.

If you just look at the volume of the accounting literature today versus 25 years ago, I think that's an indication of how we have evolved.

You know, the prediction of where we can go, I agree with Leroy. It's not going to be easy. I do think, as we look to convergence to a global and international financial reporting system, there are going to have to be compromises on both sides of the pond, and I expect we will have to make some compromises that would move us to a more objectives based or principles based kind of model.

And we've got some specific thoughts, you know. We've kind of hit it at 30,000 feet. I think we've got some specific recommendations that, even if you don't wholesale throw out what we've got, which I think is very unlikely, I think there are some recommendations that, you know, we're going to put forward around if the standard setter, for example, envisions that there is a bright line test embodied in a particular standard being adopted, make that very clear
in the standard, because there are a lot of standards that I
think, initially issued, appeared to provide grey area for
judgment, practitioners and auditors make reasonable
judgments around implementation of that, and then are second
guessed and find out that someone else looking at it after
the fact believes that was a bright line test and not an area
of reasonable judgment based on your facts and circumstances.

So I think without just making a recommendation
that standards ought to be more objectives based, I think we
can try and make some specific recommendations that would
move us close to that, but I think it's going to be a huge
challenge. It won't happen overnight, and I think this is
our view of some prodding and yet another voice, you know, in
this direction that might be helpful.

MR. DENNIS: Alex?

MR. DAVERN: Yeah.

Just as you bring up the issue, Leroy, of
international accounting standards and the whole notion that
we will come together and have one set of international
standards, I'd just like to raise -- I guess being the one
European in the crowd, perhaps I can do this without fear of
too much recrimination.

I personally have a lot of concern with the notion
that the U.S. would, I won't say blindly, I don't want to

overstate it, but I think we need to be very careful with the
idea that a body of people who are unelected and unappointed by anybody in the U.K. or based in the U.K. become the de facto regulators and standard setters for the U.S. capital markets. I think that's a notion that scares me a little bit.

And I know it's way beyond the purview of our group here, but I think having a national standards body that has preeminence should remain the intent, and I think that would be much better for the U.S. capital markets than delegating that to a committee of unappointed people based in the U.K.

MR. DENNIS: I've heard nobody say that we should delegate accounting standards to anybody outside of the FASB, and I'd be -- I wholeheartedly agree with you.

I do believe that, to the extent we can get those two groups thinking together -- which they are doing. You know, when new statements are issued, they usually float one to the other, and so they are trying to converge together, but -- and hopefully, great minds think alike, so that you don't have somebody on an opposite side of the pond, so to speak, coming up with a completely different answer.

I think the key to all that is the politics out to stay out of the accounting standards process. We saw that attempted to be done here in the United States, and whether or not you agree with the stock option accounting or not, the

prospect for having a political agenda in setting accounting
standards would be a really, in my mind, would be a really scary process.

MR. CONNOLLY: Spoken like a true Irishman.

MR. DAVERN: And I agree with that, and I would also say that the process is already highly politicized in Europe already, especially relative to regulations around banks, et cetera, and this is one that's already very politicized within the EU.

So I just, I urge a little bit of caution. I support your remarks. And I think everybody would agree the preeminence of FASB should continue.

MR. JENSEN: I just had -- I just had a couple of ideas.

First of all, there's a lot of people who would say our accounting system is principles based, but most of the rules that we have today are just how you interpret those principles in certain industries.

So you might get a little bit of argument about that.

But I do think the body of literature has become unbelievably complicated for anybody, including auditors and accountants, companies, everybody to understand.

So I was curious whether you've taken a position on this project I think the AICPA has been looking at in terms of reorganizing all the literature so that it's more
comprehensible and somewhat understandable.

That was one.

And two, I wondered if you had thought at all about is there a recommendation that would encourage the SEC, through -- because that's who our recommendations are going to go to -- to encourage the SEC to encourage the FASB to have better representation from smaller companies along these lines that, you know, maybe the theory would be that they could help keep some of the stuff a little simpler, because they tend to think, you know, a little more rationally than somebody that's dealing with, you know, complex derivatives.

MR. DENNIS: To your second point, we have not talked about whether or not to have representation from smaller businesses on the FASB. That's something that we can put down and discuss. That's a good point.

Certainly we would support, or I would support any kind of effort to make the standards easier to read.

You know, I think part of it comes to trying to get all of these exceptions handled somewhere inside the standards, and so you take a document where maybe the principles piece of it is five pages long, and when you tack on all the possible different exceptions that someone is trying to get into there, it becomes a 150-page document, you know, and unreadable.

One of our recommendations that John alluded to in
our more formal discussions have been whether we can exclude
those type of interpretations and put them in just that, in
some kind of other document where, you know, if you're a real
estate company or a mining company, you can go to that piece
of it for an interpretation of a standard as opposed to
everyone having to read and understand those, relates to all
the different exceptions that are out there.

So if we could, in the actual standards themselves,
be more principles based with the interpretations, maybe
dealing with the one off type situations or the industry
situations, it would hopefully make it a little bit easier to
understand.

MR. JENSEN: Have you thought at all about asking
the SEC to make it easier for small companies to consult with
them directly --

MR. DENNIS: Well, that is one of our
recommendations, is that they have some -- you know, they've
got a help desk right now, I believe, but some more funding
into that that would provide an ability for smaller companies
to call.

I think you question whether or not that needs to
be outside of the SEC, because whether a small company would
want to call the SEC and bare their soul, so to speak --

MR. JENSEN: Well, I think also, if you're going to

-- and your interest in smaller accounting firms, having
smaller accounting firms have access to some help at the SEC would be helpful, as well.

MR. DENNIS: Right.

MR. JENSEN: They may or may not want it, but I mean, I think having it available to them --

MR. DENNIS: I think having some kind of help desk that could assist with those issues for smaller companies -- you know, and I think a lot of them are basic questions, and hopefully try to ward off some comments that are made later on in the process of whether it's an annual 10-K review or review of an S-1 or something like that would -- that's just heading it off before it becomes an issue.

MR. WANDER: Rick?

MR. BROUNSTEIN: Let me just kind of follow on with what Mark was saying.

I really think, you know, we've talked all about 404 and the proportionality. You know, I sit at a micro-cap company, and if you took that out, the next most unproportional thing is all these new accounting standards, whether -- you know, I'll pick on 123-R.

But all of a sudden, I'm out there, you know, having to hire people to do independent valuations of stock options or warrants that are happening in financing, and all these, you know, non-cash things, and I've got to update them every quarter, and we're spending -- you know, I guess I'm --
you know, my thought is, if you peeled away 404 from a
cost/benefit basis, the complexity that is hitting the
accounting standards and the cost that is hitting smaller
companies is probably the next biggest thing that is starting
to get more and more out of line for, you know, I guess, you
know, to play off what Mark was saying, if FASB had more
smaller companies involved in the decision process, maybe it
wouldn't -- maybe you'd get some more balanced, you know,
assessments of what's going on.

But there are a lot of things that we're being
asked to do that I don't think anyone who looks at my
financial statements, you know, cares about, but it's
costing, you know, significant dollars compared to our
revenues.

MR. DENNIS: I agree completely, and I think in my
mind it goes -- and I think the smaller company
representation on the FASB is a good idea to think about.

But, you know, I think it goes to there's no doubt
in my mind that 123-R or 133 or pick any of the standards
that we all like to pick on, they're theoretically correct.
They're difficult to implement. And any time you get into
fair value accounting, it's a very difficult concept to
implement.

Is there a way to make sure that we get 80 percent

of the theoretical correctness there and 85 percent of the
simplicity and comparability in? Because the simpler a
standard is to implement, the easier it is for companies to
get done, the less costly it is for companies to get done,
and the more comparability you're going to have between
companies.

I really don't care whether you have $2.47 per
share of net income. What I really care about is how you
compare to your competition and which one -- in my mind, that
makes the decision of which company I'm going to invest in.

MR. BROWNSTEIN: So is that on the agenda?

MR. DENNIS: Yes.

MR. BROWNSTEIN: Okay.

MR. WANDER: Could I just suggest, since we're being
web cast,

that you state your name before you --

MR. BARRY: This is Pat Barry.

I'd just say, as a way of process, when we began
looking at this, remember one of the first things on our
agenda was should there be a big GAAP/little GAAP, so we sort
of headed down the path of, you know, do we look at
individual FASBs and ask the FASB to go back and revisit
them.

And pretty quickly, from the testimony and the
questionnaires and things we were hearing is, you know, GAAP
is GAAP. We can't really segment the big guys from the
little guys, and that's where you sort of have to draw the line.

And then when talking to the FASB, they basically said, "Look, take a prospective approach. Our docket is, you know, so long for the next five years. Don't bother going back and having revisionist history. Let's try to make this prospective."

So I think our guides are sort of geared to how do we, you know, get them as they move forward and put in new pronouncements to look prospectively versus going back and looking at, you know, should we have 123-R, should it be different for smaller companies, big companies, et cetera. We said, let's look forward on this.

MR. WANDER: All right.

Steve, why don't we move on to the Governance and Disclosure Subcommittee?

MR. BOCHNER: Great. Steve Bochner.

Well, I think I'd like to start with talking about some of the things that we think are working well in Governance and Disclosure, based on our discussion, the answers to our questions, the testimony.

And we think that there's a lot that's going right in this area, the CEO-CFO certifications, and in particular, the processes that have been put in place to support those I think are serving corporate America and the investing public
The whistleblower protections we think are important. The Audit Committee reforms and responsibilities and charter amendments. Board independence, I think is very important. And more frequent SEC review of periodic reports, I think.

And I think we all think all those things have had a positive impact, although I will get to couple of suggestions, or at least one suggestion in the independence area in a moment that one of our members has suggested, and that's an area still under consideration.

But I think that we looked at a lot of areas of current disclosure.

Are the 8-Ks being burdensome, the four business days? Is there something magic about quarterly reports? Board independence.

And what really came back, I think, to all of us, and perhaps a big part of this is just that 404 so dominates the landscape, but we did not get a lot of concerns raised out there in these other areas.

So I would say that the corporate governance changes and the disclosure rules seem to be working pretty well, and putting aside 404 and perhaps some of the auditor relationship issues, not to be a cause of consternation at least among those who have responded for the most part to our
questions and those who have given us testimony, with some exception.

So where are we aligned?

Our first recommendation, which was no further acceleration of periodic reports for smaller public companies beyond 75/40, was voted on by the Commission to propose this for comment on September 21, so we're pleased to see that moving forward.

Secondly, in the S-B area, we've got Regulation S-B applicable to a very small -- the smallest companies, 25 million in market cap and lower, and we think that having two sets of almost parallel regulation -- there's a lot of overlap between those two -- causes complexity with the rules, it causes a bit of a stigma.

And so we've suggested, and I think we've got some signs of support for this, that, and certainly our subcommittee has supported this, that why don't we just have one set of rules with a new SK item which provides whatever accommodations the committee proposes and the SEC agrees to with respect to small businesses.

And we're recommending that threshold get raised to our micro-cap company size, at 100 million in market cap, so the two years financials versus three years accommodation afforded SB filers today, we would propose making that accommodation available to micro-cap companies, it's time to
raise that threshold, and then perhaps taking a look at other accommodations for micro-cap companies that could be similarly put into this new SK item or items such as whatever the 404 Committee comes up with, and we're recommending that as possibly a context in which to make this recommendation.

Another one. I describe this as modest, because I wouldn't say that we received a huge outcry here, either.

But the SEC, as Herb noted, did approve a securities reform release, did issue a securities reform release, and that's final now, and they did move forward with this access equals delivery concept, noting that 70 percent of Americans have Internet access and so saying that the final prospectus doesn't need to be physically delivered.

And so our subcommittee supports that, and suggests that the SEC continue to look at other ways to bring similar efficiencies to smaller public companies, such as the electronic delivery of proxy statements and annual reports, so that as Internet usage increases, do smaller companies who bear these costs disproportionately really need to print paper copies and disseminate them and proxy statements.

That would have to be paired with appropriate protections for investors still wishing to receive paper copies. That might require more time and certainly require access by those investors who need paper copies to get those at no additional cost.
I think a similar suggestion is, again assuming that Internet accessibility is growing and pretty widespread, particularly among the investing public, to consider extending S-3 availability and forward incorporation by reference privileges to smaller public companies.

These smaller companies again disproportionately bear the costs of having to do an S-1 and repeat information that's already on file in 34 Act reports, so once we assume that those reports are available, then these accommodations and efficiencies ought to be made available to smaller public companies.

So we support that.

I'd say one of the areas that we did hear a lot of concern was -- and I think this was highlighted by comments from the smaller banks, and we heard this loud and clear, and I'm sorry Rusty Cloutier, one of our committee members from the banking community, couldn't be here, but it was sort of an outcry with respect to the overlap in regulation.

Duplicate governmental filings, such as financial statements, having multiple regulators filing -- you know, the filing burdens associated with those overlapping requirements were very burdensome, we heard, and so we've made a couple of recommendations in those areas, and those are fairly general, but that the SEC consider synchronizing filings with other governmental agencies, perhaps extending
incorporation by reference privileges to other filings when
they're already on file with a primary regulator, for
example.

We looked at the loan prohibition under
Sarbanes-Oxley. There's only a limited amount that can be
done there, since it's in the statute, and the subcommittee
strongly supports that prohibition.

We noted that there is a lot of confusion about
what is a loan out there, particularly in the -- and even in
the legal community.

And so we urge some clarification of the following
areas: cashless exercise of stock options, indemnity
advances, and relocation accommodations.

I think there's a different of opinion out there,
and at least some confusion as to whether those types of
transactions constitute prohibited loans.

And finally, we did hear from a couple of
responders about the costs associated with EDGAR, and so we
have a recommendation, we have alignment on a recommendation
that seeks to reduce costs associated with SEC filings which
again are higher proportionately for smaller public
companies, and to explore new technologies for filing SEC
documents perhaps in more widely available formats.

Areas still under consideration that we hope to get
some resolution on over the next day or two:
We decided to put on the list this beneficial record holder issue under Section 12(g). That is the 500 shareholder limit and the idea that street name was really not in existence, not recognized when the statute was enacted, and whether we should look at a beneficial holder test.

I think we need a lot more data on that, and I might ask the SEC for some help there in figuring out, if we were to make a move to what would be a more widely common standard such as beneficial holders, sort of where those cutoffs might be appropriate and what kind of transition rules might be appropriate.

There was, and this came from the ABA, but we also have under consideration the idea of excluding holders of unexercised stock options that are issued in compensatory transactions from the determination of holders of record for purposes of Section 12(g) under the theory that those option holders have not made an economic decision to invest yet and so therefore shouldn't be counted for purposes of figuring out whether 34 Act registration should occur.

We're going to kick over the materiality issue to the Accounting Subcommittee here, and I guess I would just add that, and I know some of my lawyer friends on the committee think I'm crazy to wade into this materiality swamp continually, but I think it is a little broken out there,
because now that SAB-99 throws us back into this reasonable investor test, which is basically case law -- you know, go talk to your lawyer about whether a reasonable investor would consider this important -- when you have a penny a share difference making a swing in your stock price, you're going to get very, very conservative calls on that.

If the street is expecting $1.55 and you come in at $1.54, and that impacts stock price, you're going to have a lawyer being conservative tell you, well, that reasonable investors consider a penny a share a difference.

And so that's the kind of problem we've got, is that these small changes result in very conservative calls there, and as a result, we've seen restatements where investors are saying, "Well, why did you restate? That seems immaterial."

MR. COOLIDGE: I would say those are not reasonable investors.

MR. DENNIS: I guess I would also ask the question, Steve, you know, if the market does react to a penny a share, then that sounds like it's material, then.

MR. BOCHNER: Well, it is material as we apply that standard today.

I guess the question is, should you -- should any errors that could conceivably move stock price trigger a restatement when it's, you know, happened, you know, three
quarters, two years ago. I think that's the question. But I mean, it's under -- it's an area under consideration, and I think we're kicking it over to you to resolve, Leroy, so good luck with that.

MR. WANDER: Guess what the answer is?

Any --

MR. BOCHNER: Well, one more, and Dick may want to comment on this, but I think there's a split on the committee on this.

I think some of us think the independence rules are working well, and I have to admit, as being on the NASDAQ Listing Council while these definitions were enacted, I may have the parent problem of thinking, you know, your children are beautiful.

But I think Dick at least views the independence standards as confusing and thinks we might want to think about more of a uniform safe harbor.

So those are the areas under consideration.

MR. WANDER: Any questions for Steve, comments?

Rick?

MR. BROUNSTEIN: Yeah. It's Rick Brounstein.

One comment, and then maybe one question on the last point, that maybe it's a decision of which the committee needs to look at it.

But the first comment is, I really support, putting
on my hat as a small business user, the idea of the S-3 rules, the incorporation by reference.

It is a huge burden. Not only are you, when you're filing these documents, they become much longer, that's probably the least of the problem, because it's pretty easy just to go take what was in other documents and cut and paste them in.

But you go stale, and so if you've got outstanding registration statements, you have a very short period between the time you finish your audit a following year and you have to refile a brand new registration statement. If they happen to be looked at for any reason by the SEC, then you're going to trigger all kinds of violations in your agreements, you're going to have -- your investors will not be able to trade on those, and there's all kinds of penalties associated.

So it seems to be something that is very burdensome for smaller companies, and being in the middle and watching it happen, you know, I guess that just has my vote.

The other piece, and maybe it relates a little bit to the independence rules, but when we talk about corporate governance and how good it is, and how we've been looking in 404 at what to do with the smallest, the micro-caps, one of the things that is clear to me is that the corporate governance standards that apply to companies trading on the
exchanges do not apply to what is today most of all the
micro-caps, and that's if you're trading on the Bulletin
Board or the Pink Sheets, you don't have those same kind of
rules.

And I don't know that, you know, the rules are --
you know, should be equal, but clearly, one of the things
that we've been looking at is, if you're going to lessen the
cost burden on the smallest of the companies, and everyone
talks about tone at the top, just to use it, you know, what is
-- you know, what makes sense from corporate governance
standards, and I think we should decide whether it's, you
know, our committee or your committee, but I think somebody
should tackle, you know, is there reasonable corporate
governance standards for the smallest of the companies.

MR. BOCHNER: Yeah, you've got to -- you know,
traditionally, the SEC and the federal government really was
not in the corporate governance business. You know, that was
something left to the states, Delaware corporate law, as it's
evolved principally, and the listing standards of the stock
exchanges.

So, you know, and there's a question as to whether
everybody should continue to stay in their lane, I think in
the words of Justice Strine.

So I guess I am a little reluctant, but would be
interested in hearing from others, I am reluctant to expand
or recommend an expansion of the role of the SEC and the federal government in the area of corporate governance beyond what we've got today, but others may have different views.

MR. WANDER: Well, but maybe the compromise or the solution is you don't have to change, but if you want to take advantage of anything that you would do under 404, you have to voluntarily somehow commit to the governance standards.

Because I don't think you're going to get a reduction in 404 for the small companies without that, so it's a problem we have to solve and you might want to put it on your agenda, Steve.

MR. BROUNSTEIN: And let me just add to that.

So I think if you follow that to the next conclusion, I think then it takes a fair look as to what makes sense from a corporate governance standard.

I've seen early drafts of COSO, and we'll see what the final one is, but there when the COSO small business report talks about some aspects of corporate governance, and it isn't necessarily that you need a fully independent audit committee, that you need, you know, a majority of independent directors, but there's some reasonableness that makes sense.

I think it was the -- I don't know if it was the ABA presentation, but I think it was one of our speakers that, maybe from Wilson, that talked about the ABA paper, and that was one of our submissions, and made some -- you know,
talked about the idea that in smaller companies they are --
you know, the people that sit on their board are oftentimes,
their consultants are a lot more involved than maybe what we
define as independent and not independent for the purpose of
the smaller company needs a look -- so I guess there's a -- you
know, I agree with Herb that if we want to give on one side, we need
to take away, and especially since everyone goes, you know,
if you got the right tone at the top, you've solved a lot of
the problem, you know, to simply hand off and force the
smallest companies into what today the exchanges require, you
know, may be too burdensome.

And so I'm thinking it's fair to look at that.

MR. WANDER: I hope all of you are strong enough to
carry the COSO report. You need a gorilla to carry it.

Any other comments for Steve?

Yes, Leroy.

MR. DENNIS: Steve, I just had one question on the
ability to exclude unexercised options and the purposes of
12(g).

Are you thinking all option holders or just the top
management or management option holders?

It seems to me like you'd have a different answer
if you had a company that gave options to everybody versus
maybe one that targets them towards certain management or
certain holders.
MR. BOCHNER: We were -- I think we were thinking about options issued in compensatory transaction.

There's an exemption that looks at sort of the compensatory intent on the books today, so we sort of aligned our views on this with that exemption and said, if they're options and the intent is compensatory when they're issued, why have that be part of the count?

You know, I think you might need that if we can resolve this beneficial record holder thing in a more palatable manner, but I think we're struggling.

It's hard to have something that everybody has relied on for some period of time and then to sort of stick a new stake in the ground and say, you know, all of a sudden we're going to require a whole 'nother large category of companies to go public.

So it's a tricky issue, but, you know, it's been raised and there's a perception out there that what we have today isn't fair because it can be gamed simply by aggregating beneficial holders and street name and calling him a record holder, calling one record holder.

MR. WANDER: There's actually, I guess, a couple of petitions to the SEC to change the rule, which the Commission has been sitting on for some time.

Right, Gerry?

MR. LAPORTE: The first petition was filed a while
ago. I don't agree that the Commission has necessarily been
sitting on them.

(Laughter.)

MR. WANDER: That's all right. It wasn't one of my
priority issues.

Any other comments? We'll move right along to --

MR. CONNOLLY: I have one quick one.

MR. WANDER: Yes.

MR. CONNOLLY: And this is Drew Connolly.

Coming from the specific baseline of capital
formation, which is finding investors, and we've spoken, I
think, on several levels about -- hopefully, the end result
of our work product not only makes more effective, efficient
public company interactions with the government and their
investors, but I can't help but think that this committee can
take some steps to encourage or in some way promote financial
literacy among investors.

We are in the internet age. We are in a highly
sophisticated financial era. And whether or not we're
encouraging this at a college level or tying, somehow,
into -- the Treasury Department has a link on their website,
for example, and it talks about financial literacy. And it
is a linkage of all the federal agencies and the work -- it's
far more complex and cumbersome than necessary.

But I'd like to point out that there are some major
companies that have interests in this area that are taking it very seriously. Charles Schwab, for example, embraced the Boys & Girls Clubs and committed X numbers of people and dollars to bringing some level of financial literacy. Now, I don't think they're teaching little kids about stocks and bonds, per se, but they're bringing that along. Merrill Lynch is committed to the Girl Scouts in certain jurisdictions.

So, I don't know how to address this specifically, but if we don't increase the pool of investors, and I mean individual investors who are prepared to assume some of the risk in these little companies, I think we're likely going to shrink the market cap of many more going forward.

MR. WANDER: Okay. Dave, would you like to take center stage, please?

MR. COOLIDGE: Sure. Are we going to have lunch, Mr. Chairman?

MR. WANDER: No, we're going to -- well, we can -- it's 20 till 1:00. We have two more subcommittees to do. Would you -- I'm interested in your views. Would you like to break for an hour and then come back for the next two or would you like to move ahead?

MR. COOLIDGE: (Nodding.)

(Laughter.)

MR. COOLIDGE: Okay. Capital Formation Subcommittee; we've mentioned a few of these in our previous remarks, but let me just go over the list.

Item 1, end prohibition against general solicitation and advertising for transactions with certain purchasers. The idea here is potentially to make private offerings a little more robust, be it a new class of private offering transactions limited to purchasers who do not require the protections afforded by the securities registration process.

This is tricky, because it has to do with definition of your investor base in making sure that you're only soliciting or advertising to those highly sophisticated investors. And it doesn't leak over into less sophisticated investors, which the Commission, I think, generally wants to protect from these kinds of promotional activities in the private placement arena, but it's a subject worthy of some more discussion, I think.

Secondly, going to the intermediaries that do function in the private placement market, I thought, and this would really be an action on the NASD's part, to qualify finders, M&A advisors, and other institutional private placement practitioners in a streamlined way. There is an ABA task force proposal out there on this subject, which we are
thinking of supporting.

Then there's a number of other private placement exemption adjustments that we are thinking about recommending. Again, the relaxation of the solicitation in advertising rules, Rule 152 safe harbor issue, shortening periods that -- in between offerings so that there's a safe harbor after a much shorter period of time from the conclusion of one offering to the initiation of another, et cetera.

I mentioned earlier item 4 in our list, Going Private. I mentioned that before, perhaps looking at the issue of making it easier for small companies to go private; Bob's comments, you know, about -- is this good for the investors. I guess my reaction to that is -- you know, it really depends on the price.

You know, it's good for investors if the price is good. It's bad for investors if the price is not good. But the process and the expense of that process really doesn't have much to do with the price and I don't know whether there's a way of getting to the right price with a more streamlined process, but that's really the gut issue.

And making it easier, at least in my mind, is making it less costly, making it a more efficient thing to execute. It doesn't really speak to the price issue as to whether it's a fair price or not.
Trading Markets; we talked about this, trying to maintain robust trading markets for smaller companies and especially the bulletin board market.

Another issue is information on public companies that broker/dealers need to have in order to trade and make a trading market, Rule 15c2-11. This is information that is not now publicly available, but it is in -- as I understand it, in the broker's possession and also in the SEC's possession -- or the NASD's possession, excuse me.

And the question is whether that should all be made public. It seems like a fairly easy thing to do and if -- you know, full disclosure is the mantra of the SEC and the NASD, why don't they fully disclose what they have with respect to information on these companies.

Potentially making S-3 available for bulletin board companies is another idea and there's a few other items that we're discussing. We're also looking at the PIPE. Drew brought up and distributed this PIPE report.

We're looking at the PIPE process to make sure that that process, because it has become a very significant capital-raising tool for smaller public companies; make sure that there aren't things that we can't do to improve that process and make it a more viable option for smaller public companies without creating problems from an investor protection standpoint.
Research; we've already commented on that. You opened the meeting talking about those two items. I noticed those myself and it looks like the SEC is definitely concerned about the diminution of research in the marketplace and doing things to stem that tide or maybe reverse it.

Let's see. We had an item on Regulation S-B, Steve, that we fully hand off to you. It sounds like you've got the same thoughts that we have in terms of kind of getting rid of S-B, just making it a correction of S-K.

And I guess that's it. We have Rule 701 issues that we're discussing about stock options and whether they're voting securities type -- it's the same issue that you had talked about, Steve. Maybe you and I can talk briefly about what our deliberations were, but that's it.

MR. WANDER: Thanks, Dave. Any other questions or comments?

(No response.)

MR. WANDER: We move -- save the best for the last. Janet Dolan?

MS. DOLAN: And maybe even the shortest. Always -- being the only thing standing between us and lunch encourages simplicity and speed.

So, I would refer everybody to our areas of agreement and areas still under consideration and I will say that I'm going to somewhat merge them by simply painting a
picture for you of where we are and I think from comments
earlier this morning, you can see some of the dynamics that
are going on.

And that is, I think it's very clear that everyone
following -- as Kurt indicates, everyone believes that good
internal controls are important and important to the
integrity of the financial statement. And we are all in
agreement that the 302 Certification and the role of
management in continuing to certify for the integrity of the
controls is a great addition and we all support it.

The area that we are most -- we are struggling with
or that we have the greatest dichotomy within the committee
in which we will work to resolve today, or as quickly as we
can, is all around what's the role of the auditor; what
auditor role should there be for small companies.

And we are ranging from -- as we indicated, I
think, from our very first meeting, the very easiest and more
straightforward is to simply exempt all small companies. A
more complex way of approaching it, which may add greater
investor confidence, however, is, is there something less
than the full auditor testing and attestation; is there a
still a role for the auditor, but something short of the full
auditor testing and attestation.

For instance, we are looking at the possibility
that as you move from the micros, which we, in all
likelihood, are likely to exempt, up through to the larger, as you move up closer to that $700 million market cap, can we have stages of involvement so that we -- closer and closer to the full 404 auditor involvement by the time a company reaches that level, so that you don't have all or nothing can you have kind of a graduated approach.

And that would mean, as you get larger, can we add an auditor role such as -- as part of the audit of the financial statement, the auditors would also opine on the design and implementation.

In other words, sort of assuring that there is a good internal control system in place. They don't have to test it and attest to its operation themselves, but they would opine on the fact that there's a good design and implementation in place, understanding, of course, that the CEO and CFO themselves would be doing the attesting.

And from our conversation this morning, you can imagine some of the tradeoffs we're looking at, which is, if the auditor has to have any role at all, does that do anything to reduce either their exposure or the cost. Both of those are major factors that we're looking at.

And we also are looking at -- while we have -- the size committee did make two cuts of small companies and that may fit for every other committee, but might we look at more gradation when it comes to 404, just as we said, which is,
you might move from the micro up through a couple of layers. And in each layer, you would have more auditor involvement. And the tradeoff there is, we think that anything less than either full exemption or living with the current standards that we have may be that it would require new rulemaking by either the PCAOB or the SEC. And there is a level of debate within our committee as to, is that something you want to engage in. I mean, do we want to look for some new rulemaking which might be around this lesser involvement of the auditor, knowing that the tradeoff there is, you now have a brand-new rule that you may or may not know what it's going to look like when it comes out and you'll have a new level of learning curve, a new learning curve that everybody's got to go through, even though many of the accelerated reporting companies have at least already been through one round of the 404.

So, while our list of areas under consideration where we do not have alignment is short, it is very substantive. It goes right to the heart of the matter of, do we have any -- do we recommend any auditor involvement at all and if so, can we recommend something less than what it currently is and if we do, what would that take and how would it help relieve the cost burden impact that we've certainly all this morning agreed is the number-one concern.

So, those are the areas that we're considering. I
also put on a couple of areas that we did discuss. I would
call them parking lot issues at this point. They’re off to
the side.

We had pretty much discussed and sort of decided
that there wasn't enough committee -- subcommittee
endorsement for having, basically, say, a full 404 but maybe
every three years or every five years, with the idea being
that if you went -- if you were a small company and you went
through your first 404 and you got your certification, then
you wouldn't have to go through it for a few more years. If
you didn't, obviously, you might have to go through it again.

And we had debate around, again, would investors
accept that; wouldn't there be, sort of, the full expectation
of accountability for the audit firms, even if they didn't do
it. So, that was kind of side -- put on the side. I will
say the investors that testified in New York two weeks ago --
there were several of them that said that would be fine, that
they would endorse or certainly support something like that.

We have looked at whether this should be a
shareholder decision; that's for the investors, ultimately
let the shareholders decide. Again, I would say that's a
parking lot issue at this point until we really get the
substance of our bigger issues resolved.

And then there has been some discussion about if
accelerated filers fall within our definition of small but
they've already gone through the process and gotten their certification already, are they going to be within -- are we going to provide an exemption or a reduced burden on them or is the idea that they've already gone through that and they aren't going to get the benefit of this.

These are kind of side issues that we've been debating, but put on the side for now.

MR. WANDER: Steve?

MR. BOCHNER: Janet, have you -- and thanks for doing this. You guys clearly have the toughest job here and we all know that.

Have you thought about, to the extent -- you know, it sounds like there's a lot of agreement that the 404 costs are way higher than anybody expected, causing a lot of problems.

Have you thought about -- to the extent we decide there is -- there should be some exempt status, whether it's micro cap companies or smaller public companies, have you thought about the idea of enhanced disclosure to make up for the absence of an auditor attestation, for example, if we decided, "Look, we just can't get the cost thing right, too expensive, hurting smaller public companies, so what we're going to suggest is much more robust disclosure," maybe significant deficiencies get disclosed, maybe there's a new section on internal controls where management really has to
go through what is the control structure.

So, the idea is use full and fair disclosure and beef that up as an alternative to paring back the requirements which seem so burdensome today.

MS. DOLAN: Yes. That is -- I guess when we say in our -- what we're in agreement with, the importance of the financial statement audit. And it's always a question of, do you start with the floor and build up or do you start with the ceiling and peel away. And maybe you end up at the same place, maybe you don't, but that's exactly what we've been thinking about.

Can we take the financial audit and do more with it if we do, in fact, exempt a 404 audit or can we -- do we start with the 404 audit, but then try to peel away some parts of it. I mean, so it's -- we're looking at both of those.

MR. WANDER: Yes, Mark?

MR. JENSEN: Can I -- I just wanted to add a couple of things that --

MR. WANDER: This is Mark Jensen.

MR. JENSEN: I'm sorry, it's Mark Jensen. I have to tell you, I appreciate all the attention the auditors get in these conversations. In 30 years, I've always felt I wasn't that important, but --

MR. DENNIS: Wouldn't you love to go back to those
days?

(Laughter.)

MR. JENSEN: Yeah, the relative obscurity was good.

A couple of things that I think we're struggling with or at least I struggle with is, first of all, if the audit was free,

if it didn't cost anything for the auditor to do a 404 attestation, there's still a significant cost in the company.

So, you know, I think we have to keep that in mind. I mean, all of the recommendations being laid at the audit, as if somehow, the auditors have driven this cost north, there may be some truth in that, but I think you have to remember if the audit was free, management still has a lot of stuff to do.

And I also worry about another thing that's going on and the lawyers in the room can talk about this better than I, but there -- every state has a standard of due care, even in the private companies, even for private companies, that if you -- you know, so there are lots of laws on the books that aren't necessarily Securities and Exchange laws.

My concern is that the way we are documenting internal controls today, the way they're being tested, the way they're being implemented, this notion of management -- or not notion, but management's assertion under 404 that the internal control environment is proper and working proper, those are best practices today. Those are becoming the
standards of corporate governance in this country and they're going to impact all companies.

And so, I think that to some extent, a little bit about what we're doing here isn't going to really get to the real heart of this matter. I think what does get to the heart of the matter is, as I said earlier today, when Irwin Federman talked about building processes into companies from the ground up.

And that's the piece that -- where I still think we need a strong recommendation. Who is that body? There is no body in the country today who has that as their charge or their responsibility. COSO is a volunteer organization. It's a virtual company. You heard the guy say that. They don't even have -- I don't think they have any employees. I think even he's part time, isn't he?

Gerry, do you know? I think he's part-time.

MR. BROUNSTEIN: He's a law professor, right.

MR. JENSEN: Yeah, he's a law professor. He's part-time.

MR. WANDER: No, he's an accounting professor.

MR. BROUNSTEIN: Accounting, sorry.

MR. JENSEN: And so, somehow or another --

MR. WANDER: You're getting the award for that -- (Laughter.)

MR. JENSEN: So what's happened is, is all of the
internal control stuff has been put back at the accounting firms because they're the only people that had any of that expertise. And we've got to figure out how to get better processes, best practices out there, get better information in people's hands and get the problem corrected that way. That's the only way it's going to get corrected, in my mind, my speech of the morning.

MS. DOLAN: So you can see some of the debate we have.

(Laughter.)

MR. WANDER: Leroy?

MR. DENNIS: Leroy Dennis. Janet, I just have a couple questions. Following up on Steve's comment on disclosure, if we do go down the road of exempting or requiring a lesser standard, is there going to be something that's real apparent to investors, like a ticker symbol or -- you know, something that's right on the 10-K?

Are you -- have you had those kind of discussions as to how we would inform investors there's a difference?

And my other question is, when you talk about possible outcomes for the micro cap companies and you threw out the word, exemption, are you talking about both management's assertion of controls, tying into Mark's comment, or just the auditors' attestation on that?

MS. DOLAN: Generally, we are not talking about
exempting the management certification. We're talking about
the auditor.

MR. DENNIS: I guess I just point out Mark's
comment that --

MS. DOLAN: Oh, for micro caps, I'm sorry.

MR. DENNIS: Yeah, for micro caps.

MS. DOLAN: Yes -- no, we're talking about total
exemption, right.

MR. DENNIS: So, management's assertion and --
okay, for the --

MS. DOLAN: But it is -- I want to say that it's
premature at this point to assume -- when I say that we're
aligned around that, we don't want to yet say that we've got
a framework ready for disclosure, because we're certainly
working on a lot of issues.

So, I just -- the purpose of this is to tell you
the kinds of issues that we're dealing with and -- you know,
where some of the alignment is, but I want to -- I don't want
to suggest that we've taken a position and -- you know, voted
through a particular exemption or not. Nothing has been
voted through yet or anything of the subcommittee. We're
working with the --

MR. DENNIS: I agree and I would emphasize also
that -- you know, for the micro cap companies listening out
there, that any recommendation this committee makes is just a
recommendation and ultimately, it's the commissioners, so they can't go celebrate in the streets just because somebody used the word, exemption, so --

(Laughter.)

MR. WANDER: Yes, Drew?

MR. CONNOLLY: I'm sorry that you took the wind out of my sails there a little bit, Leroy, because we were going to salute the work of the committee in drafting that recommendation.

My concern is twofold, sir. I certainly would object vehemently to a scarlet letter being appended to a company that is a micro cap company. I think that the marketplace will know, by virtue of a company being defined as a micro cap, that if these exemptions are, in fact, applied to a micro cap, that -- you know, the buyer beware if that's the concern.

But I do salute you, Janet, because I think that frankly, when I heard you say that, I didn't really know what to do. But it is also fairly clear to me that -- you know, and Leroy, this is really true, inside every micro cap CEO's heart is a smaller public company CEO waiting to break free.

So, because there is a momentary period in a public company's life where it is a micro cap, I want to assure you that everyone that I've talked to doesn't want to stay a micro cap to the extent that the American dream and their
business model allows them to move forward into a more heavily regulated segment of the public company marketplace.

MS. DOLAN: Well, I would just conclude, on behalf of our subcommittee, two comments and I’m sure Herb and Jim will say the same thing when they close.

The first is, we assume that companies do have an evolutionary aspiration to them and that’s why we’re looking at staging and suggesting stages that companies would go through in their maturity, from a micro up through actually moving out of our definition of small.

That's exactly why we do it. This is not so much about exempting. It's about laying out a road map and helping companies understand what they're going to need as they get bigger and bigger in order to meet the expectations of the marketplace.

But the second is, we just finished taking testimony two weeks ago, so this comment's for everybody, which is, we want to also balance our need to share with the public some status report. And yet, the reservation that we are just now in the stage where we're debating and developing our recommendations.

And so, it's premature for anybody, either around this table or listening, to take anything as a conclusion at this point.

MR. WANDER: That's for sure. Let me make a
comment. We discussed whether shareholders should be able to vote on this. Well, a number of people have said that really isn't -- shareholders shouldn't do that; management should make that decision.

If the ultimate conclusion that we recommend is that for some group of companies, let's say micro cap, they don't have to do a 404 with auditor attestation -- you know, the companies could opt into that. So, don't forget that that is a possibility, that if you think that the -- you would -- your goods, your securities would be more dear in the marketplace, you can obviously opt into that.

And in that regard, I will tell you one very quick story. I was on a program at the Corporate Secretaries Group in Chicago a couple of weeks ago and an investment banker from Milwaukee that does non-profit investment banking, a well-known company, Ziegler & Company, had less than 300 shareholders and decided to deregister. They were very upset when I said, "Go dark, so deregister."

And they actually went through a very lengthy study, hired experts, they actually had Cromwell Coulson come out and visit with them because they're on the Pink Sheets. They decided that they would provide everything but 404 going forward; proxy statements, 10-K type information, everything else.

And they found that their market was not harmed.
In fact, their stock price has gone up because they claim, in any event, that they saved the $800,000 which adds to the bottom line. That's a vignette. It shows you can opt in or opt out. Maybe we ought to think of it on both sides of the coin.

There is one final thing that I should mention, that our friend Joe Grundfest, who is a former SEC Commissioner and joined us for dinner out in San Francisco, has drafted a paper. It isn't published yet, but I did send it to Janet's committee.

I don't know if you got it in time to read it, but very interesting; his suggestion is -- he has two and I'll just give you the first one -- is that -- and this would require a PCAOB amendment -- that we do away with significant deficiencies and that you define material weakness as a reasonable possibility or probable likelihood that a material misstatement will not be prevented or detected, which is a different standard. And he argues in here that that would be good.

He has another standard, which is procedural that you can all read and I'll circulate his article to all of you. So, there are still a number of solutions out there looking for a home.

(Whereupon, at 1:00 p.m., the meeting was adjourned until 10:00 a.m. the next day.)
CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the SEC Advisory Committee on Smaller Public Companies.

Herbert S. Wander
Committee Co-Chair

Date: 11/2/08
Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its meetings of October 14, 2005 and October 25, 2005 and the dates of receipt.

Oct. 25, 2005
Gerald G. Morgan, Jr., Burdett, Morgan, Willamson & Boykin, LLP on behalf of Church Loans and Investments Trust
See also:
* M. Kelly Archer
* Jack R. Vincent
* Steve Rogers
* Bill R. McMorries
* Michael A. Bahn
* Larry G. Brown
* Michael W. Borger
* Alfred J. Smith

Oct. 21, 2005
A. John Knapp, Jr., President and CEO, ICO, Inc.

Oct. 17, 2005
Edmund M. Ruffin, Executive Vice President, Capital Formation Sector and Business Development, Biotechnology Industry Organization
THE KATRINA QUESTION
Hurricane’s Impact on PIPE Issuers Anticipated

by Joe Gose
Hurricane Katrina’s decimation of communities along the Gulf of Mexico has affected recent PIPE issuers, particularly in the energy industry, and her impact will likely spread farther. Thus far, drilling, pipeline, and exploration and production issuers that operate in the area have generally reported minor damage and little business interruption.

But the storm’s wake ultimately could lead to more PIPE financings as energy companies raise capital to repair the havoc wreaked by one of the largest natural calamities in U.S. history. Additionally, environmental remediation companies, home builders, communication firms, commercial contractors and other companies may turn to PIPEs to ramp up for what is sure to become tens of billions of dollars worth of recovery work in Louisiana, Mississippi, and Alabama.

While refinery behemoths such as Valero Energy in all likelihood won’t tap the PIPE market to raise funds for major refinery or platform repairs, the large companies likely will hire smaller engineering, consulting, and construction firms that focus on energy assets. The increased awareness of the country’s flagging refining capacity, which was an issue even before Katrina made landfall, may also spur new refinery construction and spark work for third-party firms.

“There are a lot of public companies that provide services to the energy industry, and they may have the need to staff up to take on these kinds of projects,” says Keith Behrens, managing director of Energy Capital Solutions, which has facilitated four energy placements this year valued at $58 million. “That could be a reason for many of those companies to do a PIPE.”

Continued on page 17

PIPE ISSUERS IN KATRINA DAMAGED STATES

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SHO FAILS TO DELIVER
Reg Has Had Little Effect on Stock Kiting

by Brett Goetschius
Analysis of settlement data recently obtained from the SEC indicates that Regulation SHO has had little effect on reducing the level of extended settlement failures in heavily shorted small cap stocks. The data, obtained exclusively by TPR through Freedom of Information Act requests, show that there has been little change in the amount of “failures-to-deliver” (FTDs) resulting from naked short sales in stocks quoted on the OTC Bulletin Board, American Stock Exchange, and Pink Sheets.

The data includes the total number of shares on a daily basis from April 2004 through July 2005 which have not been delivered to buyers from short sellers of stocks which already have settlement failures exceeding 10,000 shares. Reg SHO incorporates the 10,000 share FTD threshold in its criteria for triggering the mandatory short sale pre-borrowing and

Continued on page 19
ACTIVITY FOR THE PERIOD AUGUST 15 THROUGH SEPTEMBER 15, 2005

During the period August 15 through September 15, deal activity comprising 137 corporate issuers included 106 closed transactions, 22 definitive agreements, 22 announced placements, and two cancellations.

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<th>Status*</th>
<th>C/A Date**</th>
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<th>Ticker</th>
<th>Exchange</th>
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* Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date

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SEPTEMBER 15, 2005
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* Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date.
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### TRANSACTION ACTIVITY

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<td>VERT</td>
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<td>China Mobility Solutions, Inc.</td>
<td>CHMS</td>
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<td>Common Stock</td>
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** Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date

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INDUSTRY RANKINGS FOR 2005 YEAR-TO-DATE

### PIPES ISSUER BY SECURITY TYPE

<table>
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<tr>
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<td><strong>1</strong></td>
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### TOTAL DOLLARS RAISED/SECURED (ISSUER MARKET CAPITALIZATION & SECURITY TYPE)

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<th>$1 b - $4.9 b</th>
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<tr>
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<td>$2,013</td>
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<td><strong>$137</strong></td>
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### PIPE ACTIVITY - BY PRICE TYPE

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#### Variable-Price

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<tr>
<td>Common Stock</td>
<td>901</td>
<td>$2,095.54</td>
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</table>

*Data shown in millions

Unless otherwise noted, PIPES data based on PrivateRaise.com's proprietary EPP Database (TM). EPP Database includes only PIPES that are at least US $1 million and have been executed by public corporations domiciled in the U.S. or by public foreign companies that have a primary listing or a consistent/significant trading presence on any of the U.S. stock exchanges or markets. EPP Database is maintained and updated based on availability and timing of public disclosures (e.g. press releases and SEC filings). Information contained in the EPP Database has been obtained from sources deemed reliable. However, PrivateRaise.com cannot guarantee the accuracy and completeness of this information. The opinions expressed herein do not necessarily reflect those of PrivateRaise LLC. Rankings EXCLUDE Equity Lines and Corporate Investors.

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**INDUSTRY RANKINGS FOR 2005 YEAR-TO-DATE**

### RANKED BY TOTAL DOLLARS INVESTED

<table>
<thead>
<tr>
<th>Rank</th>
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<th>Total $m</th>
<th>Avg. $</th>
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* EXCLUDES transactions where Investment Amount has not yet been disclosed

### RANKED BY # OF INVESTMENTS

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<th>Avg. $</th>
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* EXCLUDES transactions where Investment Amount has not yet been disclosed

### RANKED BY TOTAL DOLLARS PLACED

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THE PIPEs REPORT © 2005 DEALFLOW MEDIA

September 15, 2005
### INDUSTRY RANKINGS FOR 2005 YEAR-TO-DATE

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Trade close-out provisions of the law. Stocks which have FTDs that exceed the threshold level in excess of 0.5% of the issuers' total outstanding shares are placed on a "threshold list" that is distributed daily by each primary U.S. exchange and market center. Those stocks are subject to the mandatory borrow and close-out rules, which are intended to clean up the excessive settlement failures within 13 days of becoming a threshold-listed stock.

Yet, in the first six months after Reg SHO's "mandatory close-out" rule for threshold-listed stocks went into effect, the amount of FTDs in Amex, Bulletin Board and Pink Sheets-quoted stocks that exceed the threshold level has decreased only 17% from the average daily levels of June 2004, when the SEC adopted Reg SHO. Excessive settlement failures decreased only slightly more for the more liquid stocks traded on the New York Stock Exchange and Nasdaq.

And while FTD levels have decreased since SHO’s implementation in January, the amount of decrease pales in comparison to the more than 120% increase in FTDs in Amex, OTCBB, and Pink Sheets stocks that occurred in August 2004, shortly after Reg SHO was adopted but not yet implemented.

The sharp increase in naked shorting immediately after the adoption of the new rules calls into question the wisdom of a decision advocated by the SEC Division of Market Regulation's former head, now commissioner, Annette Nazareth, to delay implementation of Reg SHO and to "grandfather" all failed naked short sale trades executed prior to the January 5 implementation date.

"Failures-to-deliver" are created when equity securities are sold either short or long - and not delivered within the three-day period mandated by the SEC. Long sales rarely result in extended FTDs because in most cases shares are automatically debited from sellers' accounts when they are sold, but short sale rules do not require that the seller have control of the shares he is shorting prior to executing their sale. Short sellers must only attest to their likely availability to be borrowed in time to settle the trade in three days, when delivery of the shares to the buyer must be made. When shares are sold short and, either intentionally or unintentionally, never borrowed and delivered for settlement, a "naked short" is created. When the naked short fails to settle three days later, it is recorded at the clearing agent as a "failure-to-deliver."

Naked short selling, by creating trades that are not backed by the timely transfer of bonafide securities between seller and buyer, injects selling pressure into the market that is not bound by the basic supply-demand forces that normally determine market prices for securities, because the naked short seller is not restricted by the available inventory of shares that can be borrowed for delivery to the buyer at settlement.

Prior to Reg SHO's adoption last year, some PIPE investors employed naked shorting as a means of hedging their investments in illiquid micro cap companies whose stock was otherwise unavailable to be borrowed to support a traditional short position. Several have been accused, by the SEC, NASD, and issuer managements, of using naked shorting to manipulate the pricing of their PIPE investments and increase their returns. The SEC has likened a naked short position to an "undated put option" that gives the investor virtually risk-free leverage.

The daily fails data, provided to the SEC by the National Securities Clearing Corp.
ing Corp. (NSCC), the equities clearing unit of the Depositary Trust and Clearing Corp. (DTCC), includes FTD data for all stock trades processed between large brokerages in the DTCC's Continuous Net Settlement (CNS) system. Trades between buyers and sellers using the same broker are settled inter-

large brokerages in the DTCC's Con-

Trades between buyers and sellers Finally, referred to as "ex-clearing," and

are not included in the CNS data. The
data obtained by TPR is divided into

two sets, one aggregating daily fails of
threshold level stocks listed on the more
liquid NYSE and Nasdaq, and another
set combining fails in the shares of
fully-reporting companies quoted on
the less liquid Amex, Bulletin Board,
and Pink Sheets markets.

In the two months prior to the SEC's
adoption of Reg SHO in June 2004,
excessive delivery failures averaged
570 million shares a day among stocks
quoted on the Amex, Bulletin Board,
or Pink Sheets, and 161 million shares
a day among stocks quoted on the
NYSE or Nasdaq. In the six months
following adoption of Reg SHO, but
prior to it going into effect, the aver-
age level of daily FTDs climbed 17%
among the Amex, Bulletin Board, and
Pink Sheet stocks, and 4% for NYSE
and Nasdaq stocks.

Since Reg SHO went into effect,
average daily fail levels have
decreased 20% for NYSE and
Nasdaq stocks, and 28% for Amex,
Bulletin Board, and Pink Sheets shares. While it appears implementation of the rule had a
substantive initial effect on failure levels, the effect appears to have quickly reached its
limits. Virtually all of the decrease in failure levels occurred in the
first 60 days after SHO's effective
date. Settlement failure rates have not changed signifi-
cantly since March.

While some progress is evident in
reducing the number of extended
failed settlements since Reg SHO
went into effect, it is a far cry from the
expectations of SEC staff and short
sale reform advocates when the rule
was adopted. In a Securities Industry
Association forum on Reg SHO last
November, Larry Bergmann of the
SEC's Division of Market Regulation
told the assembled crowd of clearing
and prime brokerage executives that
the average level of FTDs at the time
of SHO's adoption should be consid-
ered "the high water mark."

"The level of fails should decrease over
the level before [Reg SHO]," Bergmann
said. "The ultimate goal is to reduce the
extended fails we've seen in past years."
Bergman did not respond to calls seek-
ing comment on the FTD data.

Disparity: Liquid v. Illiquid

The two sets of settlement failure data
bring into sharp relief the disparity
in settlement failures of liquid versus
illiquid stocks. On average, there are
3.5 times as many shares in FTD sta-
tus of companies listed on the less liq-
uid OTCBB, Amex, and Pink Sheets
markets than of companies listed on
the NYSE and Nasdaq. This is despite
the huge difference in overall volume
between the two groups of market
centers: the NYSE and Nasdaq trade
about 3.3 billion shares daily, while the
OTCBB, Amex and most active Pink
Sheets average about 1.7 billion shares
day, 95% of which is on the Bulletin
Board.

Such disparity in settlement failures
resulting from naked short trades was
first predicted by Dr. Leslie Boni of the
University of New Mexico in a study
prepared while a visiting financial econ-
omist at the SEC in 2004. The result-
ing research paper, "Strategic Delivery
Failures in U.S. Equity Markets," post-
tulated that most delivery failures were
intentional, the result of investors and
market makers choosing to borrow short
securities that were either too expensive
to borrow or unavailable to borrow at
all. As liquidity was the primary factor
influencing the price and availability
of borrowable shares, illiquid markets
such as the Bulletin Board would expe-
rience the highest level of settlement
failures, Boni suggested.

"Long-lived fails are more likely the
result of strategic fails rather than
inadvertent delivery errors or delays....
Stocks that trade on the Over-the-
Counter Bulletin Board and Pink
Sheets are likely to be among the har-
est hit," wrote Boni. The study,
released as a working paper last
November, has been peer-
reviewed and accepted for
publication by the Journal of
Financial Markets.

The lack of progress in eliminat-
ing naked shorting is bringing pressure on the SEC
to strengthen the enforce-
ment of Reg SHO and per-
haps rewrite it to toughen the
rule's tolerance for extended
settlement failures. The SEC's
Division of Market Regula-
tion has been heavily criti-
cized for intervening to halt NASD initiatives to adopt much stricter anti-naked shorting and mandatory settlement rules that would have required "pre-borrowing" of all Bulletin Board short trades and required mandatory close-out through forced buy-ins of all FTDs within 10 days. The SEC rejected the initiatives, claiming they were superseded by Reg SHO.

A growing chorus of critics among small public company managements, small cap investors, state regulators and former SEC staff is calling on the agency to revisit Reg SHO's more controversial provisions, to step up enforcement (the agency has yet to bring an action against a Reg SHO violator) and to bring more transparency to the micro cap market centers experiencing the brunt of naked shorting activity. Many have pointed to the Reg SHO threshold lists themselves — which routinely list several hundred issuers traded on Nasdaq and the NYSE, yet include fewer than a dozen Bulletin Board issuers on most days — as proof that, for micro caps traded on the less liquid markets, the SEC neither cares to know of nor intends to prosecute violations of Reg SHO.

Cromwell Coulson, CEO of Pink Sheets LLC, has petitioned the SEC to require reporting of short interest in OTC issues, as has been done for years in Nasdaq and NYSE stocks.

"There is a crisis facing the OTC market today in the lack of short sale position reporting and disclosure for OTC issues," Coulson wrote in a recent letter to the agency. "This lack of transparency regarding short selling in the OTC market allows fraudulent acts to go undiscovered and manipulative short sellers to hide.... Small issuers traded on the Pink Sheets and the OTCBB deserve the same transparency and regulatory oversight of short selling as those listed on Exchanges or Nasdaq."

Coulson has asked the SEC to cause the amendment of NASD Rule 3360 and require NASD broker dealers to maintain a record of total "short" positions in all customer and proprietary firm accounts in all publicly traded equity securities as well as report the information to the NASD for public dissemination. "The SEC's action is urgently needed to prevent fraudulent acts, expose market manipulation, promote fair principles of trade and protect investors," he wrote. The agency has made no comment on the proposal.