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February 15, 2005

VIA E-MAIL

Jonathan G. Katz
Secretary
Securities and Exchange Commission
430 Fifth Street, NW
Washington DC 20549-0609

RE: Comments on Amendments to Regulation M: Anti –manipulation Rules Concerning Security Offerings. - File Number S7-41-04

Dear Mr. Katz,

As former investment bankers who were directly involved in hands-on positions of leadership and accountability in the management of over 1500 new issues of securities during 60 + years of collective experience, we share a deep love and respect for and an avid interest in the practice of investment banking and the so-called new issue process.

We have maintained an active role in the industry as co-editors for the Securities Industry Association *Capital Markets Handbook* ("*Handbook*"), published by Aspen Publishers. We designed the *Handbook*, now in its *6th Edition*, to be a handy reference for capital markets/syndicate/investment banking practitioners as well as a useful tool for compliance, regulatory and legal participants in the issuance of new securities. Because it is relevant to the issues on which we wish to comment, we also note that we are co-authors of "Big Bucks for Big Business" a brief history of underwriting syndicates appearing in *Financial History* – The Magazine of the Museum of American Financial History - Issue 76, Summer 2002.

We have followed closely the developments leading up to the U.S. Securities and Exchange Commission's (the "SEC" or the "Commission") proposal to amend Regulation M, including: 1) NASD Proposed rule 2712 in August 2002; 2) the so called "Global Settlement" in April 2003; 3) the publication of the *NYSE/NASD IPO Advisory Committee Report* in May 2003; and 4) amendments to NASD Proposed Rule 2712 in November 2003 and again in August 2004.

We are increasingly alarmed at what we consider to be proposals that either will not work or will be detrimental to the orderly functioning of the primary capital markets included in the *NYSE/NASD IPO Advisory Committee Report and Recommendations.*

We feel strongly that the complete absence of members with experience in executing large numbers of capital markets transactions on the NYSE/NASD IPO Advisory Committee calls into question many of its recommendations and raises suspicion of an undisclosed "agenda" (we are left to wonder whether the effort was a thinly disguised attempt to divert the SEC's attention from SRO oversight failures). Additionally, we are disturbed by the underlined portion of the following remark made in the introduction of the SEC's open meeting held and web cast on October 13, 2004: "…the price of an offering and the aftermarket trading price should be determined by investor demand and should be free from the manipulative influence from <u>those that brought the issue to market and who stand to profit most from the transaction</u>".

The real beneficiaries of an IPO transaction are the issuer, its founding entrepreneur(s), early stage angel and venture investors, and the issuer's current management. In our collective experiences, the economic benefit to these parties is almost always significantly greater than the 7% (or smaller) gross spread that underwriters stand to earn on most IPOs.

The point we wish to make here is that the investment banker/underwriter is a middleman bringing together an issuer, in need of capital and liquidity, and investors seeking a return on their capital. The issuer wants to sell as small a piece of itself at as high a price as is possible, and the investors want the most attractive terms possible from a variety of alternatives – "*sell dearly and buy cheaply*" -- thus the parties are natural adversaries and both will lie, dissemble, exaggerate, threaten and otherwise seek to persuade the underwriters to give their respective point of view the greatest weight. Not infrequently, these two parties to a transaction try to persuade underwriters to bend the rules that govern the investment banks' conduct in their favor.

Managing such conflicts is the very essence of investment banking. History long validates the role of the middleman/agent in this context. Those charged with revising rules, or writing new ones that govern the conduct of underwritten public offerings would do well to take into serious consideration the nature of these conflicts and the economic calculus at stake in underwritten offerings. We believe that a deep understanding of these factors is necessary for, and should be at the core of, enlightened regulatory behavior.

That said, we are compelled to speak out on several of the proposed amendments to Regulation M, among which are:

- "Require syndicate covering bids, indicating that the underwriter is buying shares to cover his short position, to be publicly disclosed to the market for the security in distribution, similar to what is required by the market for stabilizing bids."

We feel such an amendment is unwise and unnecessary for the following reasons:

1. This proposal addresses a non-existent problem. We have reviewed the NYSE/NASD IPO Advisory Committee Report and Recommendations and find no mention of syndicate covering bids as contributing to artificial inflation of aftermarket prices. This discovery is in keeping with our own personal experiences in lead managing underwritten offerings.

   This proposal assumes that syndicate short covering transactions compete with investors in the aftermarket for IPOs and, as such, should be disclosed to the market as is required for stabilization activities. As you know, there are two types of over-allotment techniques: the so called "green shoe" over-allotment that grants underwriters an option to purchase up to 15% of the deal size in additional shares from the issuer for a specified period of time - typically 30 days - at the public offering price and the so-called "naked short" that underwriters can cover only in the secondary market. The Agreement Among Underwriters (AAU) typically limits the net long or short position of the underwriting account at the close of the day to 15% - 20% of the total underwriting commitment.

   As a practical matter, deal economics come into play here: the selling concession, typically 60% of the gross spread and paid on the sale of each share, adds to the "short cost" and thus turns repurchases at the offering price or higher into money losing transactions for the underwriting account.[1] While short covering resulting from a "naked short" is the only activity that would force the lead underwriter into the market in competition with investors, its value as a tool to assist in the distribution far outweighs any detriment to secondary market investors.

   The very first day of trading in any IPO finds the market for the new shares at its most inefficient state. Each succeeding day begins to strengthen the foundation for true secondary market liquidity in the shares. In most short covering activities there is an absence of investors, the market for the newly issued securities threatens to or is trading below the offering price and the underwriter is, by default, the market. In our experience underwriters rarely employ "naked shorts" in corporate IPOs. This technique does play a useful function in the distribution of closed end funds and can be essential in follow-on distributions where a market already exists.

   Existing shareholders frequently regard follow-on and secondary offerings as liquidity events, often signaling their intention to sell into the offering to take advantage of the investor interest in the issue resulting from underwriters' marketing activities and from their knowledge/presumption that the underwriters will have both the ability and the will to support the offering price. In the rare case when a lead manager employs a "naked short" in an IPO, the size of the short is almost always relatively small because of the potentially enormous economic risk to the underwriters, and its use reflects a strong lack of confidence in the quality of the indications of interest in the "book".

[1] See attached Syndicate Economics for examples of short covering under different circumstances

2. The proposal defeats the purpose of the overallotment technique and introduces new distortions into aftermarket trading. The SEC has long recognized that the purpose of overallotment is to facilitate "an orderly distribution of the offered security by creating buying power, which can be used for the purpose of supporting market price".[2] Both the preliminary and the final prospectuses must disclose the potential employment of an over-allotment, both the "green shoe" variety and the "naked short" variety, in great detail. Rule 104 already requires that "Any person effecting a syndicate covering transaction or imposing a penalty bid shall provide prior notice to the self-regulatory organization with direct authority over the principal market in the United States for the security for which the syndicate covering transaction is effected or penalty bid imposed."

In SEC Division of Market Regulation Staff Legal Bulletin No. 9: *Frequently Asked Questions About Regulation M*, staff opined that underwriters only need to give notice of the presence of a penalty bid when they actually assess it. Further, staff suggests that, if the lead manager gives notice because its AAU contains a penalty bid provision, but in the end does not impose a penalty bid, the lead manager should file an amended notice to reflect that no penalties were assessed.

We mention these points only to suggest that current rules mirror long standing practices, and we feel that such rules and practices are adequate to the task of informing the market about covering bids and penalty bids on which we will comment further. The appearance of a disclosed syndicate bid (as proposed in the amendments to Regulation M) in a rising market will signal that the underwriters are short "naked", leading traders to try to "squeeze" the short and thereby force the secondary market price higher. Disclosing a syndicate covering bid in a falling market would signal that the deal is in trouble and invites investors and short sellers to pile on and thereby drive the price lower. Inherent in this specific proposal to amend Regulation M is, in our opinion, a dangerous lack of appreciation by regulators and academics of the tender nature and lack of depth (*i.e.*, liquidity) in the immediate aftermarket for newly issued securities.

Further to this last statement, specific to IPOs and because there is no reservoir of daily buy and sell orders unrelated to these offerings, there is no "buffer" to help absorb selling from initial purchasers who had no fundamental investment interest in the new issue anyway. This artificiality of the market in an IPO in the early days of its trading life cries out for committed buyers/investors.

3. Underwriters can easily subvert this proposal to require public disclosure of syndicate covering bids by executing such transactions after hours and/or

[2] SEC Release No. 34-3506 (November 16, 1943) the Director of the SEC Trading and Exchange Division opined "In considering the question you have raised, we may start with the premise that a syndicate overallotment is customarily made for the purpose of facilitating an orderly distribution of the offered securities by creating buying power which can be used for the purpose of supporting market price."

offshore. In this event, such activity can indeed become an instrument of manipulation.

- "Prohibit the use of penalty bids."

To prohibit the use of penalty bids, or more precisely the penalty clause in the AAU, would, in our opinion, be detrimental to the orderly functioning of the capital markets for the following reasons:

1. It would eliminate a practice that has evolved over a long period of time and withstood the scrutiny of the courts[3] as a means of maintaining discipline among the various underwriters and selected dealers in an underwriting syndicate, and, in our opinion, is an essential tool for use in the conduct of a fixed price underwriting. In a practical sense its primary value is intimidation. When money is on the table, underwriters and investors will fight over it. The threat to take some of it away is a useful tool in dealing with a very human quality- greed.

2. To boost the quality of their distribution, some firms have routinely imposed penalties on their own sales force (independent of any penalty imposed by the lead manager). Such firms have then used this internal policy as the basis for seeking increased participations in underwriting syndicates to the benefit of their sales force and their investor customers. In our opinion this course of action is strictly a business decision, a means of differentiating one firm from others. Investors have many choices with regard to the broker/dealer with which they elect to do business. Such policy will attract some customers and repel others. It is also important to remember that imposition of a penalty bid does not affect the investor at all – only the careless or unprofessional retail broker/institutional sales person.

3. The NYSE/NASD IPO Advisory Committee has expressed a desire to prohibit the inequitable imposition of "flipping" penalties. All too often, underwriters and selected dealers penalize the flipping activities of retail customers while the lead manager ignores the flipping activities of institutional customers. This inequitable disparity has long been the subject of debate among investment banks; every firm professes the goal of equality but enforcement practices are not consistent with professions.

   We believe that the SEC would serve all parties better by simply mandating that, should a lead manager elect to impose a penalty bid, its imposition

[3] In U.S. v. Morgan et al., Judge Harold Medina in his Oct. 14, 1953 opinion reviewed some 1300 AAUs spanning a period of thirty years. He concluded that the withholding commission (*i.e.*, penalty) clause was in common use in the period following World War I, that Morgan Stanley subsequently eliminated the clause and then restored it. He concluded that this technique and other syndicate practices were "nothing more or less than a gradual natural and normal growth or evolution by which an ancient form has been adapted to the needs of those engaged in raising capital". 118F.Supp. 621(S.D.N.Y. 1953). We highly recommend reading this decision to learn about and to put into context the evolution of syndicate practices.

must apply to all aspects of the distribution. The NASD could monitor compliance with this ruling through spot inspections of the lead manager's internal deal accounting for offerings where a penalty bid has been imposed. It will be easy for firms to include the appropriate language in their respective Agreements Among Underwriters.

- "Adopt a new rule under Regulation M that would expressly prohibit certain IPO abuses that occurred in the late 1990's and in other "hot issue" periods, including "tying" an allocation of shares on an agreement by the customer to buy shares in another less desirable (*i.e.*, "cold") offering or to pay excessive trading commissions on unrelated securities transactions."

In our experience these allocation practices first emerged as a suggestion to sales representatives by their investor customers in an effort to secure larger allocations in sought after IPO, *viz* "You scratch my back and I'll scratch yours." After several of these investor propositions the sales representative or others in the same office would begin to solicit such inducements. The financial press gave extensive publicity to some of these practices, especially "spinning" as far back as 1997. In our opinion "spinning" was a clear violation of the spirit of the NASD's "Free Riding and Withholding Interpretation". Appropriate Regulatory response at the time would have nipped these practices in the bud. It is all very well to pass new rules but enforcement of existing rules would be a more effective and efficient regulatory tool.

As lifelong capital markets practioners we know that the capital markets professional sits at the fulcrum on which all of the competing forces surrounding deal making pivot- the center of the trading floor. To resist the pressures and temptations to go along with the crowd, not to do what everyone else is doing (and therefore risk being ostracized as not part of the team), and to ignore irregularities of behavior that cross over the line, demand character.

Alan Greenspan observed, "Rules cannot substitute for character".[4] Character creates reputation and trust; trust builds confidence; and trust and confidence are vital to the conduct of the securities business. Character in this context has to be buttressed by a through knowledge and understanding of securities law and market regulations, and their origins, coupled with a familiarity of the customs, lore, and traditions of the deal-making business.

While we believe that the investment banking business has an ample supply of people of character, there must be a much greater emphasis placed on the education of investment banking and capital markets professionals in the laws, rules, lore and customs of their craft. Such an effort will surely yield greater benefits than the wholesale implementation of additional rules.

[4] Remarks at 2004 Financial Markets conference of the Federal Reserve Board of Atlanta at Sea Island, GA, April 16, 2004, www.federalreserve.gov/boarddocs/speeches

Respectfully submitted,

John C. Burch, Jr.

Bruce S. Foerster

SYNDICATE ECONOMICS - 7,000,000 Share IPO offered @$15.00 per share

Public Off. Price	Gross Spread %	Gross Spread $	Components of Gross Spread:	Selling Concession %	Selling Concession $	Management Fee %	Management Fee $	Underwriting Fee %	Underwriting Fee $
$ 15.00	7%	$ 1.05		60%	$ 0.63	20%	$ 0.21	20%	$ 0.21

Example 1

Shares Offered:					
Firm Commit.	7,000,000	$ 7,350,000.00	$ 4,410,000.00	$ 1,470,000.00	$ 1,470,000.00
Green Shoe	1,050,000	$ 1,102,500.00	$ 661,500.00	$ 220,500.00	$ 220,500.00
Naked Short	1,050,000	N/A	$ 661,500.00	N/A	N/A
Total	9,100,000	$ 7,350,000.00	$ 5,733,000.00	$ 1,470,000.00	$ 1,470,000.00

Assume Market opens + 15% and trades to up 20% -Avg. cost to cover "naked" short up 17.5% - "Green Shoe" Option exercized in full

Shares Offered:					
Firm Commit.	7,000,000	$ 7,350,000.00	$ 4,410,000.00	$ 1,470,000.00	$ 1,470,000.00
Green Shoe	1,050,000	$ 1,102,500.00	$ 661,500.00	$ 220,500.00	$ 220,500.00
Naket short	covered	covered	$ 661,500.00	N/A	N/A
Total	8,050,000	$ 8,452,500.00	$ 5,733,000.00	$ 1,690,500.00	$ 1,690,500.00

Loss on Naked short	Per Share	Naked Short $
Offering Price	$ 15.00	
less selling Concession	$ 0.63	
Net proceeds to Syndicate	$ 14.37	$ 15,088,500.00
Less:Avg. Cost to cover (+12.5%	$ 17.625	$ 18,506,250.00
Loss on Naked short	$ (3.26)	$ (3,417,750.00)

	Less Syndicate Expenses:
Advertising	$ 45,000.00
Business Travel	$ 50,962.57
Roadshow	$ 97,510.30
Closing Expenses	$ 9,175.79
Co-Mangers Expense	$ 62,207.30
Computer/ Data Process	$ 55,364.11
Day Loan Interest	$ 4,781.00
Legal	$ 315,000.00
Postage & Communicat.	$ 9,207.70
Printing	$ 16,905.70
Misc.	$ 5,040.03
Syndicate Exp.	$ 671,154.50
Loss(Gain) on Oversale	$ 3,417,750.00
Total Syn. Exp.	$ 4,760,059.00
U/W Profit(Loss)	**$ (3,069,559.00)**
per share	$ (0.3813)

Assume Market opens flat and trades down -Avg. cost to cover "naked" &"green shoe" shorts is $14.68 - Penalty bid is in effect.
Example 2

Shares Offered:					
Firm Commit.	7,000,000	$ 7,350,000.00	$ 4,410,000.00	$ 1,470,000.00	$ 1,470,000.00
Green Shoe	covered	covered	N/A	N/A	N/A
Naket short	covered	covered	$ -	N/A	N/A
Total	7,000,000	$ 7,350,000.00	$ 4,410,000.00	$ 1,470,000.00	$ 1,470,000.00

Loss on Naked & G'shoe short	Per Share	Naked & G'shoe Short $
Offering Price	$ 15.00	
less selling Concession	$ 0.63	
Net proceeds to Syndicate	$ 14.37	$ 30,177,000.00
Less: Average Cost to cover	$ 14.680	$ 30,828,000.00
Loss on Short Covering	$ (0.31)	$ (651,000.00)

Syndicate Expenses:	
Advertising	$ 45,000.00
Business Travel	$ 50,962.57
Roadshow	$ 97,510.30
Closing Expenses	$ 7,799.42
Co-Mangers Expense	$ 62,207.30
Computer/ Data Process	$ 55,364.11
Day Loan Interest	$ 4,063.85
Legal	$ 310,500.00
Postage & Communicat.	$ 9,207.70
Printing	$ 16,905.70
Misc.	$ 5,040.03
Syndicate Exp.	$ 664,560.98
Loss on Short Covering	$ 651,000.00
Total Syn. Exp.	$ 1,315,560.98
U/W profit	$ 154,439.02
Penalty Recovery*	$ 926,100.00
Net U/W Profit	**$ 1,080,539.02**
per share	$ 0.1544

*assume 70% recovery of green shoe & naked short

Economics for members of the Underwriting Syndicate

Assume 1 Lead Book-running Mansger , 2 Co Managers , 3 major bracket underwriters & 4 sub Major bracket underwriters

Example 1

Underwriters Brackets	U/W Commitment Shs.w/ Green Shc	Pot	Retention	**Selling Concession***	**Management Fee****	**Underwriting Fee*****	Total
Lead Mgr.	2,300,000	5,806,500	240,000	$ 3,809,295.00	$ 1,267,875.00	$ 1,360,016.86	$ 6,437,186.86
				$ -			
Co Mgr 1	2,012,500	1,139,500	200,000	$ 843,885.00	$ 211,312.50	$ 1,190,014.75	$ 2,245,212.25
Co Mgr 2	2,012,500	1,161,100	200,000	$ 857,493.00	$ 211,312.50	$ 1,190,014.75	$ 2,258,820.25
Maj. 1	345,000	33,000	35,000	$ 42,840.00		$ 204,002.53	$ 246,842.53
Maj. 2	345,000	26,000	35,000	$ 38,430.00		$ 204,002.53	$ 242,432.53
Maj. 3	345,000	34,900	35,000	$ 44,037.00		$ 204,002.53	$ 248,039.53
Sub Maj. 1	172,500	11,000	15,000	$ 16,380.00		$ 102,001.26	$ 118,381.26
Sub Maj. 2	172,500	28,000	15,000	$ 27,090.00		$ 102,001.26	$ 129,091.26
Sub Maj. 3	172,500	33,000	15,000	$ 30,240.00		$ 102,001.26	$ 132,241.26
Sub Maj.4	172,500	22,000	15,000	$ 23,310.00		$ 102,001.26	$ 125,311.26
Total	8,050,000	8,295,000	805,000	$ 5,733,000.00	$ 1,690,500.00	$ 4,760,059.00	$ 12,183,559.00
				$ 5,733,000.00			

* Selling economics 10% retention bal. inst. pot (pot economics-lead 60%, co's 10% each, 20% jumpball)

**Management fee (negotiated among mgrs.) Lead mgr 75% Comanager 12.5% ea.

***Underwriting Fee less prorata share of expenses

Example 2

Underwriters	U/W w/o"shoe"	Pot	Retention	**Selling Concession***	**Managetment Fee****	**Underwriting Fee*****	Total
Lead Mgr.	2,000,000	5,806,500	240,000	$ 3,809,295.00	$ 1,102,500.00	$ 111,274.57	$ 5,023,069.57
Co Mgr 1	1,750,000	1,139,500	200,000	$ 843,885.00	$ 211,312.50	$ 97,365.25	$ 1,152,562.75
Co Mgr 2	1,750,000	1,161,100	200,000	$ 857,493.00	$ 211,312.50	$ 97,365.25	$ 1,166,170.75
Maj. 1	300,000	33,000	35,000	$ 42,840.00		$ 16,691.18	$ 59,531.18
Maj. 2	300,000	26,000	35,000	$ 38,430.00		$ 16,691.18	$ 55,121.18
Maj. 3	300,000	34,900	35,000	$ 44,037.00		$ 16,691.18	$ 60,728.18
Sub Maj. 1	150,000	11,000	15,000	$ 16,380.00		$ 8,345.59	$ 24,725.59
Sub Maj. 2	150,000	28,000	15,000	$ 27,090.00		$ 8,345.59	$ 35,435.59
Sub Maj. 3	150,000	33,000	15,000	$ 30,240.00		$ 8,345.59	$ 38,585.59
Sub Maj.4	150,000	22,000	15,000	$ 23,310.00		$ 8,345.59	$ 31,655.59
Total	7,000,000	8,295,000	805,000	$ 5,733,000.00	$ 1,525,125.00	$ 389,460.98	$ 7,647,585.98