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Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Re: File No. S7-891
Proposed Regulation D

Gentlemen:

The comments set forth in this letter .are submitted in response to the Commission's request for comments in Securities Act Release No. 6339 (Aug. 7, 1981), proposing Regulation D, a new regulation governing the offers and sales of certain securities without registration under the Securities Act of 1933 (the "1933 Act").

Before commenting specifically upon the details of the Commission's proposals, we wish to commend the Commission and its staff for undertaking this effort to reexamine and rationalize the current exemptions contained in rules 240, 242 and 146 under the 1933 Act. We believe that the Commission's proposal represents an important step toward the goal of eliminating unnecessary, overlapping and burdensome requirements which impede the capital formation process and unduly escalate costs. Notwithstanding our general agreement with the approach taken in proposed Regulation D, we believe that certain modifications and amplifications to the proposals are essential if the Commission is to achieve its goal of alleviating the burdens imposed on small business consistent with protection of investors.

I.
Statutory Basis

We would suggest that the Commission clarify that it is promulgating the entirety of Regulation D, or, at a minimum, rules 501-503 and 506, as safe-harbor provisions under section 4(2) of the 1933 Act. Although the Release indicates several statutory bases for the proposed Regulation, including the exemptions contemplated by sections 3(b), 4(2) and 19(c)(3)(C) of the 1933 Act, and mentions that issuers may continue to rely on exemptions created by the 1933

Act, it does not specifically state that the Regulation is intended to be a safe-harbor for transactions effected pursuant to section 4(2) of the 1933 Act. Among other considerations, we are concerned that alternative statutory bases for Regulation D would raise serious questions as to the effect of judicial precedent under the existing exemptions in actions brought under Regulation D.

We also agree with the observations and are persuaded by the arguments contained in Carl Schneider's letter dated September 10, 1981, to Edward F. Greene, Esquire, that, in connection with adoption of Regulation D, the Commission would do a great service to the bar to interpret section 4(2) so as to clarify that the Regulation D approach, which limits the manner of the offering but not the number of offerees, should be a proper interpretation of statutory law as well. Based upon our research over the years, we agree that proper construction of the statutory exemption would permit an unlimited number of offerees, so long as the manner of the offering and the number of purchasers were both properly limited.

In connection with the Commission's deliberations on adoption of Regulation D pursuant to section 4(2), we wish to draw the Commission's attention to the very substantial problems potentially raised by extension of credit considerations. To be blunt, failure to adopt Regulation D pursuant to section 4(2) would have the unfortunate and immediate effect of bringing to a halt hundreds of millions, if not billions, of dollars of private real estate, research and development and many other kinds of partnership offerings which provide for installment payments. This result would obtain regardless of the economic sense of staggering investor contributions.

As the Commission is aware, section 7(c) of the Securities Exchange Act of 1934 (the "1934 Act") makes it unlawful for any broker or dealer (whether or not registered under the 1934 Act) to extend or maintain credit for the purpose of "purchasing or carrying" securities in contravention of the rules and regulations prescribed by the Board of Governors of the Federal Reserve System (the "Board"). Pertinent rules and regulations are contained in Regulations T.

In 1972, the Board declared, in what we believe is a somewhat questionable interpretation, that sale by a broker or dealer of limited partnership interests in a program required to be registered under the 1933 Act would constitute arranging credit to purchase or carry securities if the program contains a provision that payment for the interests may be made in installments. In 1975, the Board amended Regulation T to exempt from its operation transactions effected in compliance with section 4(2) of the 1933 Act. (12 C.F.R. §220.7 [1981]) Later, that exemption was extended to section 4(6) of the 1933 Act. (CCH Fed. Sec. L. Rep. ¶22,231) As of this date, no corresponding amendment has been adopted with regard to offerings effected pursuant to sections 3(b) or 3(a)(11), and there

has been no definitive interpretation of Regulation T's applicability, to such transactions. Recently proposed liberalizations of Regulation T would not affect the situation.

Without specific amendment by the Board of Regulation T to exempt from its operation transactions effected in compliance with Regulation D, unless the Commission promulgates proposed Regulation D so that transactions coming within its scope would be defined as exempt pursuant to section 4(2), no offerings of limited partnership interests, where payment for the units is to be made in installments, could be effected pursuant to Regulation D without substantial risk of violating section 7(c) of the 1934 Act.

Finally, promulgating Regulation D pursuant to section 4(2) would have the added advantage of achieving instant federal-state coordination with approximately six states whose private placement transaction exemptions currently cover, in one form or another, transactions not involving a public offering or transactions not involving a public offering within the meaning of section 4(2) of the 1933 Act and the rules and regulations promulgated thereunder. As we all know, legislatures of the fifty states are not prone to move with collective lightning speed; adoption of Regulation D pursuant to section 4(2) would therefore have the effect of immediate uniformity with the laws of at least several states.

II.
Definition of "Accredited Investor"

1. The Concept of Self-Certification

The Commission notes in the Release that, among the suggested changes which are not included in the proposed definition of "accredited investor," were suggestions of self-certification by the investor as to the investor's net worth, sophistication and financial experience. We respectfully request that the Commission's reassess its decision not to introduce this concept into Regulation D.

One of the most troubling aspects of current rule 146 concerns the subjective determination of an investor's net worth, sophistication and financial experience, based upon information separate and apart from statements made by the investor. We have found that it is virtually impossible for an issuer to satisfy itself as to these matters without consideration of the investor's affirmation and would hope that the Commission would see fit to remove the restrictions upon reliance on self-certification. Were the concept of self-certification introduced, an issuer

could then reasonably rely upon representation letters from purchasers to make these determinations, thereby yielding less subjectivity and greater certainty to the process of investor qualification.

2. Purchases by Directors and Executive Officers

We are in complete agreement with the Commission that directors and executive officers of the issuer of the securities should be deemed to be "accredited investors." However, since it is intended that Regulation D also be available to partnerships, we would suggest expansion of the definition contained in rule 501(a)(4) to include the following additional persons who occupy similar positions with regard to limited partnerships: (i) the general partner of a limited partnership whose securities are being offered or sold; (ii) any director or executive officer of a corporate general partner of a limited partnership whose securities are being offered or sold; and (iii) partners of a general partnership which itself is a general partner of a limited partnership whose securities are being offered or sold, and, if such general partner is a corporation, any director or executive officer of such corporation.

3. Persons Purchasing $100,000 or more of Securities of the Issuer

(a) Although we understand the Commission's concern with respect to spreading installment obligations over unduly long periods of time, we have a number of concerns with proposed rule 501(a)(5) as currently drafted. First, we would suggest that the uncollateralized sixty day payment provision contained in subsection (ii) be expanded to recognize that the vast number of installment payment sales are made with respect to partnership securities having meaningful tax ramifications and that, in addition to staging installment payments to match the financial needs of the venture, such payments are also timed to enable investors, so long as funds are not currently needed by the venture, to spread their payments among several tax years. Accordingly, we would suggest that the sixty day discharge period be revised so as to permit "discharge of the obligation by April 30 of the year following the year in which the first issuance of the securities occurred."

(b) We believe the two year outside discharge date provided for in subsection (iii) is too short to match up with many different kinds of venture economics. Additionally, we note that this time limitation is even more restrictive than the position the staff has taken in response to no-action requests as recently as August of this year. In that regard, we wish to draw the Commission's attention to the Continental-American Drilling Program 1981-I, Ltd. no-action letter available 8/24/81, in which the staff of the Commission implicitly blessed a five year

installment period. While we recognize that any safe-harbor rule may be more restrictive than its predecessor, we respectfully request that the Commission consider providing a five year permitted discharge period.

(c) We fail to see the connection between coupling the requirement for an unconditional obligation to pay to be discharged within a specified time period with the additional requirement that the obligation be secured by an unconditional letter of credit. To the extent the Commission believes a personal and unconditional obligation to pay over the longer time period must be collateralized, we would suggest the requirement be phrased in terms of "collateral (other than the securities being purchased) which is adequate in relation to the amount of indebtedness." We believe that the letter of credit requirement is unduly restrictive and costly and has no effect upon the unconditional nature of the underlying obligation. Additionally, we object to the concept of building into the federal securities laws an extra two points for the national banking system. Accordingly, we would suggest that the letter of credit requirement be deleted from rule 501(a)(5).

(d) As the Commission is aware, in recent months exchange offers, whereby holders of oil and gas limited partnership interests are offered an opportunity to exchange those interests for stock in a corporate issuer, have proliferated, and there is no reason to believe that the foreseeable future will see any lessening of such offerings. However, we find that current rule 146, as well as proposed Regulation D, defines permissible methods of payment of the $100,000 or $150,000 investment in such a way so as to effectively exclude any private exchange offerings. Accordingly, we would suggest that rule 501(a)(5) be expanded to include a new subsection (v), to cover limited partnership interests which are not registered or required to be registered pursuant to section 12 (g) of the 1934 Act or oil and gas property interests which have been valued by the issuer at not less than $100,000.

4. <u>The $750,000 Net Worth Requirement</u>

We respectfully request the Commission to clarify whether the individual net worth requirement is to be computed inclusive or exclusive of home, home furnishings and automobiles and, in that connection, strongly suggest that the computation be made exclusive of such items.

As an aside and in response to the Commission's request, we have fundamental questions as to whether subparagraphs (6) and (7) have anything whatever to do with the concept of accreditation. Income and net worth inquiries apparently are directed at discerning an investor's ability to bear the economic risk of the transaction, a factor rarely if ever mentioned as a necessary or even relevant

offeree attribute outside of rule 146. We note also that the Commission itself has removed ability to bear the economic risk as a purchaser qualification requirement pursuant to rule 506.

III.
Calculation of Number of Purchasers

We would suggest that proposed section 501(d)(ii) be amended to provide that the collective beneficial interest requirement be 50 percent "or more" of any trust or estate.

We would also point out to the Commission that the introductory cross-references contained in section 501(d) should be to sections 505(£) and 506(b).

IV.
Information Requirements

1. Accredited Investors and Information Delivery

Proposed rule 2(15) encompasses several categories of accredited investors, three of which include individuals who are not closely related to (i.e., who are not directors or executive officers of) the issuer. At the same time, proposed rule 502(b)(l)(i) states that if the issuer sells an issue of securities only to accredited persons, rule 502 does not require that specific information be burnished to purchasers.

Presumably, the rationale contained in a similar provision of rule 242 also serves as the underlying rationale for the provision in Regulation D. That rationale assumes that these persons are able to demand and receive whatever information they deem necessary or appropriate. While we understand that the Commission is not advocating that no information be provided to individual accredited investors, we believe the above rationale to be seriously flawed when applied to partnership offerings. As a practical matter, partnership offerings are negotiated, structured and examined fully only through the actual drafting of offering documents. To infer that various categories of individual investors in a partnership offering (excluding executive officers and directors of the issuer), because they meet minimum suitability and investment requirements, are able to ask for and receive whatever information they may desire is to ignore the practical realities of these offerings and the marketplace in which they are offered and sold.

We would therefore suggest that, although we believe it appropriate to exclude all categories of accredited investors from computation of the permissible number of purchasers, we believe the information delivery requirements contained in rule 501(b)(1)(ii) should also apply to accredited investors as defined by rule 501(a)(5), (6) and (7) and would suggest deleting these categories of accredited investors from rule 502(b)(1)(i). [As a gratuitous drafting comment, we point out to the Commission that the term "accredited investor" is utilized as "accredited persons" in rule 502(b)(1)(i).]

2. <u>The 60% Test</u>

Generally, we are in accord with a proposal like the 60% test contained in section 502(b)(1)(ii). This provision would obviate the necessity for voluntary and specific disclosure where 60% or more of a total offering is purchased by one or more accredited investors, so long as other investors purchase on the same or better terms. We would suggest two modifications, however:

First, we would suggest that, for reasons elaborated upon above, the 60% test be met only by purchases by one or more of the <u>institutional</u> accredited investors and by directors and executive officers of the issuer. We would exclude from the 60% computation the classes of accredited investors described in sections (5), (6) and (7) of proposed rule 501(a).

Second, we would suggest that the provision as adopted contain only a requirement that the issuer, upon written request, elect to provide to other accredited investors and non-accredited investors the same written information provided to the accredited institutions. The ability of a non-accredited investor to obtain, upon written request, "the information required by paragraph (b)(2)" necessarily requires, in all instances where there may be non-accredited investors, that full disclosure documents be prepared and on-hand, in the event a non-accredited investor requests to be provided with them. As drafted, then, the proposal is counter-productive, both from the point of view of issuers seeking relief from disclosure burdens and from the point of view of investors needing protection. If the underlying theory of the 60% test is sound (and we believe it is), provision to non-accredited persons upon written request with the same written information provided to accredited institutions should suffice.

3. <u>Audited Financial Statements</u>

Although we are aware of the Commission's belief that it is inconsistent with the concept of investor protection to permit issuers to offer securities without audited financial statements, we believe it would be unduly burdensome to small

business for the Commission to condition availability of exemptions upon the providing of financial statements certified by an independent certified public accountant. We notice that, even for offerings up to $1,500,000, where audited financial statements frequently cannot be obtained without undue burden or expense, the issuer's balance sheet must be audited as of a date within 120 days of the commencement of the offering. We note also that, for offerings of $1,500,001 to $5,000,000, and for offerings in excess of $5,000,000, there is no provision for omission of audited financial statements where it would be an unreasonable burden and expense for the issuer to obtain them.

Especially with regard to small business financing, we believe these provisions to be unduly burdensome, expensive and restrictive and respectfully request the Commission to reexamine its decision to deny availability of the proposed limited offering exemptive rules to small businesses for whom the obtaining of an audited balance sheet or audited financial statements would be an unreasonable burden and expense.

V.
Limitation on Manner of Offering

The Release states that proposed rule 502(c) would prohibit the issuer and any person acting on its behalf (except as specifically provided in certain offerings pursuant to proposed rule 504) from offering or selling securities by means of any form of "general solicitation" or "general advertising." We are aware that this provision is similar to the provision contained in rule 146(c) and would suggest that the Release adopting Regulation D specifically refer to recent staff interpretations of identical language in the rule 146 context indicating certain forms of solicitation which are not deemed to be "general solicitation or general advertising" prohibited by rule 502(d).

We note that most of the staff interpretations referred to above deal more specifically with the term "general advertising" than with "general solicitation." Absence of relevant case law or staff interpretation of the term "general solicitation," coupled with the Release footnote adverting to offerings made to large numbers of purchasers perhaps involving a violation of the prohibitions against general solicitation and general advertising are very troublesome to us.

As stated earlier, we believe Regulation D, which is similar to the rule 146 approach, limiting the manner of the offering but not the number of offerees, is a proper interpretation of statutory law as well as a workable safe-harbor provision. Certainly, although rule 146 mandates careful control of the offering process, it implicitly permits an unlimited number of offerees; if rule 146 is, as we believe it is, a valid safe-harbor promulgated pursuant to section 4(2), it therefore must

logically follow that section 4(2) itself, imposes no maximum limits on numbers of offerees. Indeed, paragraph (c)(3) of rule 146 expressly provides that written communications to qualified offerees are not deemed to be a form of general solicitation or general advertising. The better view, which we believe is consistent with this provision, is that the number of offerees alone is really nothing more than a indicia of the manner of the offering and that a carefully controlled offering, which is aimed to and in fact does result only in qualified investors purchasing securities, should not be deemed to be "general solicitation or general advertising."

We therefore respectfully urge the Commission to include in rule 502(c) a statement that a carefully-controlled offering effected in compliance with rules 505(c) and 506(b) will not be deemed to have involved general solicitation or general advertising solely by virtue of the number of offerees. We believe that failure to include language clarifying the term "general solicitation," if the referred-to footnote is included in the Release promulgating Regulation D, would subvert the Commission's effort to ease the capital formation burdens on small business and would do a great disservice to the practicing bar, which by necessity would be left to devise arbitrary permissible number of offeree guidelines as a means of rationalizing the actual provisions of Regulation D with the language of the Release.

Additionally, we would draw the Commission's attention to the fact that, because of the restrictions of section 7(c) of the 1934 Act and the rules and regulations of the Board contained in Regulation T discussed previously, registration of large private placements made only to accredited investors, which contain installment payment features, is not a viable alternative to utilization of the safe harbors provided in Regulation D.

VI.
Transaction-Related Compensation

1. Requirements for Broker-Dealer Registration

As drafted, rule 502(e) introduces a not insignificant amount of mischief into the exempt offering area. As we interpret Regulation D, all of the safe-harbor rules contained therein would be unavailable if any commission or similar transaction-related remuneration is paid or given other than to a bank or a broker-dealer who is registered both under section 15(b) of the 1934 Act and pursuant to applicable state regulations.

With regard to registration under the 1934 Act, as we are sure the Commission is aware, requirements for broker-dealer registration with respect to self-

underwritten issues are far from clear. This is true especially with regard to general partners selling units of limited partnership interest in partnerships of which they are general partners and with respect to salaried officers of those general partners who themselves receive no commissions or remuneration in connection with the offering.

In January 1977, by way of proposed rule 3a4-1, the Commission addressed itself to the murky area of the so-called "issuer exemption" and the circumstances under which persons selling certain self-underwritten issues are required by federal law to register as broker-dealers or salesmen under the 1934 Act. Although it was announced that the staff of the Commission was reviewing comments received on the proposal and intended to make its recommendation to the Commission during 1980, the rule has not yet been adopted. (See 1933 Act Release 6117 [Aug. 31, 1979]) Nevertheless, it is our understanding that the staff is utilizing the proposed rule's guideline, without benefit of adoption of the rule, in giving interpretative advice. The net effect remains general confusion as to when persons selling certain self-underwritten issues are even required to be registered as broker-dealers under the 1934 Act.

With regard to state broker-dealer registration requirements, individual state provisions vary widely, although most states do not require that individuals selling securities pursuant to exempt transactions be registered as broker-dealers or agents in their states. This result is obtained through a variety of provisions. Some state statutes define "agent" or "salesman" so as to exclude individuals effecting transactions exempted as non-public or private under those states' blue sky laws. In a few state statutes, there exists a similar exclusion in the definition of "broker" or "dealer." In still other state statutes, the exclusion is found in the subsection dealing with securities licensing requirements and provides that either a dealer, agent or both are excluded from the broker-dealer registration or licensing requirements if they deal solely in exempt transactions, including non-public offerings. Again, there is no consistency, the only common thread being a non-registration requirement in most states for sellers of securities in exempt transactions.

Because of these provisions, by including a provision such as section 502(e), the Commission is in the somewhat anomalous position of forcing voluntary, broker-dealer registration at both the federal and the state levels upon persons who wish to take advantage of the federal limited offering exemptive rules. We would suggest instead that the Commission limit the commission payment prohibitions to brokers and dealers who, if required to be registered as broker-dealers or salesmen at the federal and/or relevant state levels, are so registered.

2. <u>Purchaser Representative and Investment Advisory Remuneration</u>

As we interpret the transaction-related remuneration prohibitions of rule 502(e), no compensation, except to banks or registered broker-dealers, could be paid by any person (whether the issuer or the investor) for the services of his "purchaser representative," investment adviser (whether or not registered or required to be registered under the Investment Advisers Act of 1940); attorney or accountant. We question whether the Commission intended to achieve this undesirable result and respectfully request revision of rule 502(e) to obviate it.

In this regard, we note that, in 1978, the Commission proposed an amendment to rule 146 which would have prohibited persons receiving compensation from an issuer to act as offeree representatives. (See 1933 Act Release 5913 [Mar. 6, 1978]) However, after a storm of protests from the industry and upon reflection by the Commission, that proposal was withdrawn. (See 1933 Act Release 5976 [Sept. 8, 1978]) We would hope that the Commission did not intend, by virtue of this Regulation D prohibition, to accomplish indirectly what it specifically proposed and opted not to adopt by way of amendment to rule 146.

VII.
Calculation of Offering Limits of Rules 504 and 505

We note that rules 504(b) and 505(b) include instructions for computing the aggregate offering price of securities of the issuer permitted pursuant to those rules. Essentially, computations pursuant to rules 504 and 505 must include aggregate gross proceeds from any securities sold during the preceding twelve months pursuant to those rules and Regulation A and securities sold in violation of section 5(a) of the 1933 Act. Specifically, we note that aggregate gross proceeds from any securities sold pursuant to sections 4(2), 3(a)(11), 4(6) or, for that matter, from any registered public offering (provided that at the time of the offering the issuer is a qualified issuer) are not included. If this is the Commission's intent, we respectfully request such clarification in the Release adopting Regulation D.

VIII.
Restriction on Use of Rule 505 by Reporting Companies

We respectfully request the Commission to reassess its proposal to limit the availability of rule 505 to non-reporting companies, believing as we do, that such restriction is not in the interest of facilitating the capital formation process. However, if utilization of rule 505 is to be limited to non-reporting companies, the Commission may wish to delete subsection (a)(5), which provides that an issuer utilizing rule 505 be current in its periodic report filings under the 1934 Act.

IX.
Creation of Rule 506 Exemption

We note that proposed rule 506 as drafted does not by its terms create an exemption as do rules 504 and 505 and respectfully request that the Commission consider amending the proposal to include such language.

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We appreciate the opportunity to express our views regarding proposed Regulation D and we would again like to commend the Commission's efforts in trying to overcome the many problems which we have experienced in working with the existing array of limited offering exemptions. If we may be of any further assistance, please contact us. We would be pleased to elaborate on anything discussed herein should you so decide.

Very truly yours,

JACKSON, WALKER, WINSTEAD, CANTWELL & MILLER

By: Linda A. Wertheimer