Los Angeles County Bar Association
Los Angeles, California

October 2, 1981

Mr. George A. Fitzsimmons, Secretary
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Re: File No. 57-891 - Release No. 33-6339: Proposed Revision of Certain Exemptions from the Registration Provisions of the Securities Act of 1933 for Transactions Involving Limited Offers and Sales

Dear Mr. Fitzsimmons:

We appreciate the opportunity to comment on Release No. 33-6339. In general, we strongly support the thrust of proposed Regulation D, and believe that the proposed rules, if adopted, will tend to encourage capital formation by providing much needed uniformity and by reducing excessive cost burdens on issuers in connection with limited offerings. We believe, however, that the following aspects of the proposed rules deserve further consideration prior to their adoption.

<u>Definition of "Accredited Investor"</u>

We support the incorporation of the "accredited investor" concept into proposed Regulation D and the addition of new categories of accredited investors. One of the principal benefits of the accredited investor concept is the elimination of subjective judgments by the issuer relating to the suitability of investors. However, Subsections (5), (6) and (7) of proposed Rule 501(a), which create new categories of accredited investors, pose problems both of interpretation and of the extent of investigation which must be undertaken by an issuer.

Proposed Rule 501(a)(5) defines an accredited investor as any purchaser of $100,000 or more of securities of the issuer for a combination of several types of consideration, including certain installment obligations secured by an unconditional bank letter of credit, dischargeable within two years of the first issuance of the securities. Since the proposed rule and the rule it is designed to replace (Rule 146(g)(2)(i)(d)) share the same purpose, i.e., to assure adequate bargaining power for purchasers executing installment obligations, the time limitations for discharge of the obligations should be equivalent under both

provisions. In a recent no-action letter, the Staff concluded that purchasers of partnership interests who tendered a combination of cash and full-recourse promissory notes payable within five years would be purchasers "for cash" within the meaning of Rule 146(g)(2)(i)(d) and, therefore, excludable from the thirty-five purchaser limitation of Rule 146. (Continental-American Drilling Program 1981-1, Ltd., avail. 8/24/81.) We recommend that the time period in Rule 501(a)(5) be made consistent with this no-action position.

Proposed Rule 501(a)(6) which defines an accredited investor as any natural person whose individual net worth exceeds $750,000, raises questions as to the manner of calculating an individual's net worth (e.g., cost or market value of assets?), and as to the issuer's responsibility to verify such net worth. It is suggested that this definition be revised to define "net worth" as the individual's reasonable- estimate of the total fair market value of such person's assets less such individual's total liabilities. Moreover, to clarify the issuer's duty of verification, the definition should expressly permit the issuer to rely upon a written representation from the individual as to such person's net worth unless the issuer has reason to believe that such written representation is materially inaccurate.

Proposed Rule 501(a)(7) poses a similar question as to the issuer's duty to determine whether an investor's adjusted gross income exceeds $100,000. Most individuals are reluctant to give copies of personal tax returns to issuers. Accordingly, it is suggested that the issuer be expressly permitted to rely upon the written representation of the proposed investor as to satisfaction of this requirement.

Disclosure Requirements

We feel that the provisions of proposed Rule 502(b)(2), requiring issuers not subject to the Securities Exchange Act reporting requirements to furnish Regulation A information for offerings up to $1,500,000 and Form S-18 information for offerings from $1,500,001 to $5,000,000 are too onerous, costly, and time consuming, and that a less burdensome disclosure standard would not be inconsistent with the concept of investor protection. It is difficult, however, to formulate a standard of disclosure less extensive than the Regulation A, S-18 requirements, which disclosure would adequately protect investors. One possible approach for offerings up to $5,000,000 is to require non reporting issuers to furnish investors with (i) information of the same kind as that required to be included in an annual report to shareholders prepared in accordance with Rules 14a-3 and 14c-3 (except that the proposed financial statement disclosure requirements presently contained in proposed Rule 502(b)(2)(A) would remain unchanged); and (ii) a brief description of the securities being offered and the use of proceeds from the offering. Although it could be argued that mere annual report type information is insufficient, the data required by Regulation A and S-18

are extensive and small businesses necessarily will experience great expense and inconvenience compiling such a thorough and complete disclosure document. Moreover, an issuer can never be certain that it has complied with the informational requirements of these forms.

The 60% Provision

We agree strongly with the theory behind the novel 60% provision contained in proposed Rule 502(b)(1). However, subparagraph (B) of proposed Rule 502(b)(2)(v), which affords the non-accredited investor an opportunity to obtain specific disclosure information, even if the 60% test is met, fails to accomplish the major objectives of the 60% provision, i.e., reduction of the costs and disclosure burdens of the offering. We feel that the issuer should only have to inform non-accredited investors, in those instances where 60% or more of the offering is purchased by specified accredited investors, of their opportunity to obtain, upon written request, the same information as provided to accredited investors. This modification would reduce the costs associated with the preparation and delivery of a disclosure document and simultaneously assure that if the 60% test is satisfied, accredited and non-accredited investors would be permitted equal access to identical information.

We also recommend that proposed Rule 502(b)(1)(ii), governing the timing of disclosure be clarified. The proposed rule requires information to be furnished to all purchasers "during the course of the offering and prior to sale," but also states that such information need not be furnished to non-accredited investors if, inter alia, 60% or more of the total offering "is purchased" by certain accredited investors. A practical question arises as to whether an issuer can with any certainty elect not to furnish specific disclosure information to non-accredited investors during the course of the offering and prior to sale on the basis of the 60% provision, if such an issuer must await actual purchase of the securities offered to determine whether the 60% provision is applicable.

The rule should permit an issuer to elect not to furnish specific disclosure information during the course of the offering and prior to sale so long as either (1) it reasonably believes that institutional accredited investors will purchase 60% or more of the offering, or (2) 60% or more of the offering is so purchased. The proposed rule also should provide that offerings as to which the issuer elects the 60% provision disclosure exemption shall not be deemed effective until such time as 60% or more of the offering is purchased by institutional accredited investors, or if such 60% of the offering is not so purchased, the issuer terminates the offering and provides all nonaccredited purchasers with the required specific disclosure information. Until such time as the-offering is effective all proceeds received pursuant thereto shall be held in escrow, and such monies shall be returned to all purchasers in the event that such an offering terminates without

becoming effective, and to nonaccredited investors who, after receiving the specific disclosure information, decide not to purchase the securities offered.

Notice Requirement

Although we understand the reason for including the notice requirement, we believe that procedural aspects of the notice requirement should place only a nominal burden on the issuer. With this in mind, Form D filings should not be required every six months, but only within 120 days of the end of every fiscal year during which securities are offered in reliance upon a Regulation D exemption. Form D would then conform with Forms 4(6) and 242, upon which proposed Form D was modeled, and which require only year-end information.

Also issuers should not be required to file any notice for a Rule 504 offering of less than $250,000. This de minimis amount is appropriate in order to simplify the burdens of both the issuer and the Commission.

Finally, we would add to Regulation D a provision that inadvertent failure to file the Form D notice would not result in the forfeiture of Regulation D exemptions. We believe that issuers who inadvertently fail to file the notice within the time prescribed in Form D should not be penalized, but should be permitted within 15 days of the time such inadvertent error is discovered, to file the notice and perfect the Regulation D exemption. Thus, only willful failure to file the notice would affect the availability of an exemption.

In conclusion, we feel that proposed Regulation D will have a desirable effect on the capital formation process. The new rules will reduce burdens and costs associated with relatively small offerings and will provide a coherent scheme for the raising of capital by small business, Our comments are intended to highlight a few aspects of the proposed rules the clarification and modification of which would further enhance the efficacy of proposed Regulation D.

The views expressed herein are submitted on behalf of the Executive Committee of the Business and Corporations Law Section of The Los Angeles County Bar Association and are not necessarily the views of The Los Angeles County Bar Association.

Thank you for permitting us to comment on Release No. 33-6339.

Respectfully submitted,

William D. Gould
for the Executive Committee of the

BUSINESS AND CORPORATIONS LAW SECTION OF THE LOS ANGELES COUNTY BAR ASSOCIATION