SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 231 and 241

[Release Nos. 33-6900; 34-29314]

Limited Partnership Reorganizations and Public Offerings of Limited Partnership Interests

AGENCY: Securities and Exchange Commission.

ACTION: Interpretive release.

SUMMARY: The Commission today is announcing the publication of a release setting forth its views concerning existing disclosure requirements applicable to limited partnership roll-up transactions and initial public offerings of limited partnership units and other similar securities. These interpretations are necessary in order to address the concerns that have been expressed recently by investors, Congress and other interested parties. The intended effect of this release is that registrants will provide investors with clear, concise and understandable disclosure of material information about these transactions and offerings.

EFFECTIVE DATE: June 17, 1991.

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SUPPLEMENTARY INFORMATION: Serious concerns have been expressed about the complexity and length of prospectuses, proxy statements and other disclosure documents used in connection with roll-ups of limited partnerships. This interpretive release addresses the application of current requirements to roll-ups and offerings of limited partnership interests and the companion release proposes rule revisions.[1] Together, these releases are intended to improve the overall quality and readability of disclosure documents used in roll-up transactions. This release also sets forth the Commission's views on the application of existing disclosure requirements to initial offerings of limited partnership interests. This release emphasizes the risks of investing in a limited partnership and the restrictions that state partnership laws and limited partnership agreements place on investor rights in an effort to assure that investors are apprised of the risks and limited rights often associated with an investment in a limited partnership. Finally, this release sets forth the Commission's views as to the application of disclosure requirements to registration statements of real estate investment trusts as well as non-real estate limited partnership offerings.

I. Background

Since January 1, 1985, 68 roll-ups involving two or more entities have been registered with the Commission. These roll-ups have involved approximately 1,800 entities, 1.2 million investors and an aggregate exchange value of $7.1 billion.

In a roll-up transaction, a sponsor consolidates two or more public or private limited partnerships or other pass-through investment vehicles into a single entity, or reorganizes a single partnership. In most cases, the roll-up transaction results in a conversion of a limited partner's interest from a finite-life to an infinite-life interest.

While roll-up transactions can be structured in different ways, these transactions typically are accomplished through a merger of the existing entities into a successor entity.[2] Investors in the existing entities receive an interest, usually equity, in the successor entity. The successor generally is either a newly formed corporation or limited partnership. Before a sponsor may proceed with a roll-up/merger, it must receive approval of the transaction from a requisite number of limited partners in each limited partnership, most often the holders of a majority of the outstanding limited partnership interests. Whereas the securities of the existing entities for the most part are thinly traded in the pink sheet secondary markets or not traded at all, the securities of the successor entity often are listed on the New York Stock Exchange, the American Stock Exchange or traded on the National Association of Securities Dealers' ("NASD's") Automated Quotation system.

Roll-ups have created considerable controversy and have generated a variety of criticisms, many of which were highlighted in a series of Congressional hearings on limited partnership roll-ups. Criticisms have focused primarily on issues relating to the fairness of the transactions and the general partners' conflicts of interest, as well as the inadequacy of the disclosure. The fairness of the methods used to value the securities issuable in exchange for investors' limited partnership interests has been questioned. Another area of concern has been the significant discount at which the price of the security received in the roll-up trades in the secondary market.

Serious issues have been raised with respect to general partners' fiduciary duties to the limited partners, including their potential conflicts of interest and lack of independence in structuring and negotiating the terms of a transaction. Critics have questioned the potential overreaching by the general partners inherent in the increased benefits, in terms of compensation, ownership interests and dilution of investors' voting rights, accruing to them in most roll-up transactions. These increased benefits typically include payments for general partnership interests and changes in compensation arrangements.

Additional complaints have been raised with respect to fundamental changes that a roll-up may bring about in the future operations of the successor entity. These changes frequently relate to the entity's borrowing policies, business plan, investment objectives, intended term of existence and voting rights of investors. Limited partners objecting to a roll-up transaction have especially criticized the absence of any legal or equitable alternative to the transaction. The "cram down" effect on objecting partners is perceived as unfair.

Investors may have acquired limited partnership interests for several reasons. A principal reason may have been the expectation of the pass-through of tax benefits,[3] accompanied by the safety of limited liability. When a roll-up is proposed, investors, despite the disclosures in the original offering document, have been surprised to discover how limited their rights are under state laws and the partnership agreements. Many of the state law protections afforded corporate shareholders are not provided to limited partners.

[1] The companion release publishes for comment proposed rules applicable to limited partnership roll-up transactions and is being issued concurrently by the Commission. See Securities Act Release No. 33-6899 (June 17, 1991).

[2] A roll-up may also be effected through an exchange offer. Unlike a merger, an exchange offer will not compel a limited partner to give up his original investment, even if a majority of the other limited partners in the partnership choose to participate in the roll-up. Approximately 11% of the roll-ups have been conducted as exchange offers, less so in more recent years.

[3] Prior to major revisions to the federal tax code beginning in 1984, limited partnerships afforded individual investors the opportunity to invest and to receive substantially the same tax treatment and cash distributions as a direct investment in the asset itself would have provided.

Various changes in the tax code since 1984 have reduced or eliminated the tax shelter and other tax benefits of an investment in a limited partnership. At the same time, industries that have principally relied on the partnership format for raising capital, such as oil and gas and real estate, have suffered substantially. As a result, many limited partnership interests have lost much of their value.

Investors also have complained about the comprehensibility and sufficiency of the disclosure provided in connection with roll-ups. The Commission has undertaken three initiatives to address the perceived problems. First, the Division of Corporation Finance ("Division") has incorporated into its review and comment process a number of disclosure suggestions made by commenters and participants in these transactions.[4]

Second, the Commission is, in this release, setting forth its views of existing disclosure requirements applicable to limited partnership roll-up transactions and initial public offerings of limited partnership units. This release is intended to assist registrants in assuring that investors are provided clear, concise and understandable disclosure about these transactions and offerings.

Third, the Commission is proposing amendments to its rules to enhance the clarity, as well as the substance, of the disclosures provided to investors in connection with roll-ups. The Commission also is reviewing its requirements applicable to partnership offerings to assess the need for any amendments.

The NASD recently has proposed to amend its rules to prohibit member brokers and investment advisers from receiving differential compensation in connection with roll-up transactions.[5] Pending public comment on and Commission approval of the NASD's proposed rule change, prominent disclosure is required of such arrangements, as well as the potential conflicts of interest inherent in this fee structure.[6]

II. Interpretive Guidance

A. Presentation of Information

1. Readability

The primary purpose of the disclosure requirements of the federal securities laws is to provide the investing public with clear, comprehensible and complete information regarding the issuer, security, offering transaction and the risks of the investment. In view of the complexity of roll-up transactions and the risks of a limited partnership investment, meticulous care should be taken to assure that investors are provided with clear, concise and understandable disclosure as required by the rules of the Commission.[7] Legalistic, overly complex presentation and inattention to understandability often make the substance of the disclosure difficult to understand. Further, documents frequently contain vague "boiler plate" explanations that are imprecise and readily subject to differing interpretations. Disclosure of complex matters, such as compensation arrangements and partnership distributions, frequently is copied directly from the partnership and other agreements without any clear and concise explanation of the provisions. Disclosures are often repeated in different sections of the document. Such repetition often increases the sheer size of the prospectus, overwhelming the reader, without enhancing the quality of the information.

While these problems are troublesome in connection with any disclosure document, they are particularly acute in offerings directed primarily towards retail investors. Registrants are advised that where partnership and roll-up transactions are filed and they have not undertaken to present the required information in a clear, comprehensible manner, the staff will advise the registrant that the document cannot be processed until it is so written.

To address these problems, registrants are reminded that information should be presented in clear, concise paragraphs and sentences. To the extent practicable, information should be presented in short explanatory sentences and "bullet" lists.

Consistent with existing requirements, important terms should be defined in a glossary section located in the back of the prospectus. Frequent reliance on defined terms as a primary means of explaining information in the body of the prospectus should be avoided. Rather, defined terms should be used in conjunction with a simple and clearly understandable textual description of their meaning in order for the reader to easily grasp the information being conveyed. For example, when the defined term Net Cash from Operations is used in a prospectus, it should be accompanied by a simple explanation such as "which is defined in the Partnership Agreement to mean generally the partnership's cash flow from operations." This allows the detailed definition to remain in the glossary but provides sufficient information for a reader to more easily understand the disclosure being presented.

Legal and business terminology should be avoided. Registrants should not presume that the investor understands the import of terms such as "best-efforts," "minimum-maximum offering," "dissenters' or appraisal rights." These terms, when used, should be clearly explained.

2. Captions and Headings

Caption and subheading titles should be descriptive of the substance of the disclosure included in the section.[8] For example, the title of the risk factor discussing the limited market for the securities should reflect the lack of liquidity or the inability to resell, rather than simply being titled Liquidity or Secondary Market.

3. Format of Prospectus [9]

There should be a uniform and systematic structure to a prospectus. The headings used in the summary section should correspond to the headings of the various sections in the body of the prospectus. The table of contents should contain these major headings as well as subheadings.

a. *Cover Page.*[10] Prospectus cover pages now contain significant amounts

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[4] In December 1989, one participant, Liquidity Fund, provided to the staff a number of helpful suggestions to provide clearer disclosures about the material effects to investors that will result if the transaction is approved. These suggestions focused on the disclosure of the material differences in the legal rights, obligations and duties of the parties to the roll-up and the impact of the changes in investment objectives on the limited partners.

[5] Securities Exchange Act Release No. 29228 (May 23, 1991), 56 FR 24436 (May 30, 1991). The comment period ends June 14, 1991.

[6] Recommendations by broker-dealers to their customers in connection with securities to be issued in roll-up transactions also have raised concerns involving customer suitability. The receipt of fees tied to the number of "yes" votes obtained may conflict with the duty of broker-dealers, in recommending to customers the purchase, sale, or exchange of securities, to have a reasonable basis to believe that the recommendation is suitable for each customer based on his or her security holdings and financial situation and needs. (See NASD Rules of Fair Practice, Art. III, Section 2, NASD Manual (CCH) ¶2152). Moreover, a broker-dealer's failure specifically to disclose to customers the existence of this conflict may violate the general antifraud provisions of the federal securities laws, particularly where the firm has a preexisting customer relationship with the investors it solicits.

[7] See Rule 421 of Regulation C (17 CFR 230.421). Registrants also are reminded that effectiveness of a registration statement may be denied or a stop order issued when there has not been a bona fide effort to present information in a reasonably clear, concise and readable manner. See Rule 461(b)(1) of Regulation C (17 CFR 230.461(b)(1)); see also, In the Matter of Franchard Corporation, 42 S.E.C. 163 (1964).

[8] See Rule 421(b) of Regulation C (17 CFR 230.421(b)).

[9] See Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

[10] See Item 501(c) of Regulation S-K (17 CFR 229.501(c)), Item 1 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 1 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

of text that result in obscuring the information intended to be highlighted by being placed on the cover page. As a result, it has become difficult to understand at the outset what the offering or transaction is about.[11] The cover page should be in plain English and contain a brief description of the purpose of the offering or the transaction. The most significant adverse effects should be highlighted through the use of a concise list of bullet-type statements. For example, in the case of an offering that presented risks because of a lack of control, substantial fees, leverage, limited voting rights, lack of a secondary market and lack of diversification, the cover page could include a list indicating:

- Total Reliance on General Partner
- Authorization of Substantial Fees to the General Partner and its Affiliates
- Leverage
- Limited Voting Rights of Investors
- Inability to Resell or Dispose of the Units Except at a Substantial Discount From the Per Unit Price
- Lack of Asset Diversification

A practice has developed in limited partnership offerings of setting arbitrary offering amount goals that bear no relationship to the number of securities that ultimately will be sold. Specifically, an offering frequently has a very low minimum goal to break escrow and two significantly higher maximum amounts. This practice may cause confusion in evaluating the current offering and the success of the sponsor's prior offerings. Therefore, the offering terms should refer only to the minimum amount to break escrow and the maximum amount to be offered.

In addition, prospective investors may not fully appreciate the different investment risks that will result from the amount actually raised. Therefore, the offering amount set forth on the top of the cover page should be the minimum amount needed to break escrow. The risk factor disclosure also should be based on the minimum amount. If the minimum amount is met and escrow is broken, the offering amount and other disclosures should be updated to reflect any material changes including investment and business risks that are presented by the offering at that point in time. This will enable an investor to appreciate fully the nature of an investment in the particular partnership at the time that his or her investment decision is made.

b. Table of Contents. A "reasonably detailed table of contents" with specific page references is currently required in all prospectuses.[12] The headings that appear in the table of contents should be consistent and correspond to those used in the body of the prospectus. The table of contents should follow the cover page of the prospectus.

c. Summary.[13] In light of the complex nature of disclosure documents for roll-up transactions and limited partnership offerings, a summary is required.

The summary section should provide investors with a clear, concise and coherent "snapshot" description of the most significant aspects of a roll-up transaction or a partnership offering. However, more often than not, summaries randomly repeat the text of prospectuses. This protracted and confusing structure fails to provide the intended brief overview of the salient aspects of the transaction.

The information that should be included in the summary will vary with each transaction or offering. Issuers should carefully consider and identify the aspects of an offering that are the most significant and determine how best to highlight those points in a clear, concise and understandable manner. The summary for a roll-up transaction generally should include: the name and a description of the entities proposed to be included in the roll-up transaction; a brief description of the roll-up transaction; investor voting rights and the most significant changes in the voting rights, such as the addition of a supermajority provision to remove the general partner; changes in the business plan, the form of ownership interest or management compensation; the general partner's conflicts of interest; the likelihood that the securities received in the roll-up transaction will trade at a substantial discount to the exchange value; the material terms of the roll-up transaction, including the valuation method used to allocate securities in the successor; dissenters' or appraisal rights; investor rights to a limited partner list; any report, opinion or appraisal referred to in the prospectus; the background and reasons for the transaction; risk factors and adverse effects of the roll-up transaction; and, intended benefits of the roll-up transaction. While readers should be cross referenced to the more detailed discussion on the matters covered in the summary, cross references without a short descriptive discussion of the matter should be avoided.

d. Risk Factors.[14] The discussion of investment and business risks associated with the roll-up transaction or limited partnership offering should be short and concise and organized in a careful and logical fashion. Risks of a similar nature should be grouped together so they may be understood in context. For example, risks associated with the business in which the partnership intends to engage should be discussed together. These risks would include, if applicable, risks associated with particular properties, the lack of regulatory approval and the existence of environmental problems. Likewise, investment risks generally should be grouped. These risks would include, if applicable, the lack of liquidity of an investment, limitations on the rights of the limited partners and an enumeration of the rights of the general partner. The risks should be explained clearly, and where one risk is heightened by the nature of the investment, this should be clearly stated. For example, in an initial offering of limited partnership interests where there is not expected to be a liquid secondary market, and where the limited partners may be bound by a vote of a majority of other partners to a substantially changed investment (through merger, the partnership agreement or in other ways), that should be disclosed. In the case of a roll-up that increases the vote necessary to remove the general partner, and thereby substantially changes the business plan of the entity or permits the general partner wide discretion in selecting properties and taking on leverage, clear disclosures should be provided of the enhanced risks introduced by the broader discretion given to the general partner and the reduced ability to remove the general partner.

The risks should appear in order of their materiality to an investor. The most significant risks may warrant bullet disclosure on the cover page of the prospectus. While readers should be cross referenced to the more detailed discussion on the matters determined to be risks, cross references without a short description of the risks should be avoided.

[11] Industry Guide 4 requires specific information to be included on the cover page of a prospectus relating to the offering of interests in oil and gas programs. This release is not meant to change the disclosure requirements as they relate to these offerings. Rather, it is intended to enhance the requirements by providing guidance concerning the presentation of information on the cover page and in the prospectus.

[12] Item 502(g) of Regulation S-K (17 CFR 229.502(g)).

[13] See Item 503(a) of Regulation S-K (17 CFR 229.503(a)) and Item 3 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)).

[14] See Item 503(c) of Regulation S-K (17 CFR 229.503(c)) and Item 7 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 2 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

In a roll-up transaction, the risks posed by the particular transaction generally should be discussed before the risks that are inherent in an investment in a partnership or other generic risks.

e. Income Tax Considerations.[15] The use of a long form tax opinion filed as an exhibit to the registration statement is encouraged. Whether a long form opinion is filed as an exhibit or is included as an appendix, the prospectus should prominently set forth a brief, clear and understandable summary of the material income tax aspects of the roll-up transaction or partnership offering. This section should disclose the material tax aspects upon which counsel is unable to opine. Where counsel is unable to opine on material tax aspects, the prospectus should include a risk factor. If a roll-up transaction is taxable to an investor, risk factor treatment should be afforded.

f. *Prior Performance.*[16] In an initial offering of limited partnership units, the sponsor must provide prior performance information in a narrative and tabular format. The sponsor must present this information in a clear and concise format easily understood by the intended reader. This information must accurately reflect the general partner's ability to offer and manage this program.

In preparing a prospectus, a sponsor should not take line headings from the guide if they are inapplicable or do not accurately reflect the nature of the information. Line entries that are not self-explanatory should be clarified. For example, use of the caption "other" is inappropriate if the entry consists of only a single category of information. When possible, the table should use more descriptive headings (*i.e.*, return of capital). Also, if the line item contains more than one category of information, the presentation should be broken down into various components to the extent material.

B. Quality of Disclosure

The following discussion sets forth the Commission's interpretive views of existing substantive disclosure requirements. The discussion separately presents interpretive views that are applicable to roll-up transactions, interpretive views applicable to both roll-up transactions and limited partnership offerings and interpretive views applicable solely to limited partnerships offerings. These interpretations are intended to result in a clearer presentation of the benefits and detriments of a roll-up transaction or an investment in a particular limited partnership. In each instance, the items may be of such material significance to an investment decision as to warrant summary treatment in the forepart of the prospectus.

1. Roll-Up Transactions

a. *Effects on Different Partnerships.*[17] Roll-up transactions frequently involve combining two or more partnerships that may be affected quite differently by the transaction. Investors in each partnership must be provided information from which to evaluate the potential risks, adverse effects and merits of the roll-up transaction for their particular partnership interests. This disclosure should highlight the materially different effects for their partnership vis-a-vis the other entities involved. Disclosure of different effects should not be "buried" in parenthetical references. For example, it would not be considered adequate to describe a benefit in the following format: "Investors in the partnerships (except Partnership A) should benefit from the ability to sell their interests." When different effects are noted, the name of each partnership that may experience the effect should be included.

b. *Effects of Participation in a Roll-Up by Less Than All Partnerships.*[18] Another feature of roll-up transactions is that, even if one or more partnerships do not consent, the transactions often may be completed with the partnerships that do consent. In a transaction in which numerous partnerships are asked to participate, it is possible that the successor may be formed through many different combinations of partnerships. This creates serious uncertainties about the possible business prospects and financial condition of the successor. In that situation, these uncertainties about the effects of the roll-up transaction should be addressed in the disclosure document.

In addition, if a "fairness opinion" is obtained, the description of the opinion should make clear what partnership combinations it addresses. The description also should disclose whether the opinion addresses whether the transaction is fair to investors in each of the partnerships and, if it does not, why not. If (i) no fairness opinion is obtained, (ii) the fairness opinion does not address all possible combinations, or (iii) the fairness opinion does not reach the fairness of the transaction to the limited partners of each partnership, clear and prominent disclosure of the lack of a fairness opinion on all, or a part, of the transactions in question should be made. Particularly in the case where a fairness opinion on some part of the transaction is obtained, the disclosure should be clear as to those aspects of the transaction, and those partnership interests not covered by the fairness opinion.

c. *Allocation of Interests in the Successor.*[19] A roll-up transaction includes the issuance of interests in the successor to the limited partners and general partner of the partnerships. Accordingly, the method used to allocate the interests is a critical term of the transaction and must be thoroughly explained and illustrated in an understandable manner. This disclosure should include the reasons why this method was selected, what other methods were considered, why they were rejected and a complete description of how assets of the partnerships and the interests of the general partner were valued for purposes of the allocation, including any material assumptions, limitations or qualifications. For example, if the general partner will receive interests in the successor in exchange for previously "subordinated" rights to payments from the partnerships, the method used to determine the value of such rights should be explained. If the method differs among partnerships, the reason and effects of the method used to allocate interests in the successor on the different partnerships also should be highlighted and described.

d. Trading Market. In light of the history of a substantial difference between trading value of the securities issued in roll-up transactions and the exchange value, roll-up transaction disclosure documents should include prominent disclosure of the likelihood that the securities will trade at a price substantially below the value assigned in the transaction. This information should be presented on the cover page and in the risk factors section. The effect on the trading price of the payment of previously subordinated fees or expenses to the general partner should also be discussed. Other factors, such as the successor entity's cash distribution policy, that likely will affect the trading price should be discussed as well.

[15] See Item 4(a)(6) to Form S-4 (17 CFR 239.25), Item 12 and Appendix I to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 14 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

[16] See Item 8 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 13 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

[17] See Item 4 to Form S-4 [17 CFR 239.25].

[18] See Item 4 to Form S-4 [17 CFR 239.25].

[19] *Id.*

e. Reports, Opinions and Appraisals.[20] If a report, opinion or appraisal is referred to in a roll-up proxy statement/prospectus, Form S–4 requires that the information requested by Item 9(b) (1) through (6) of Schedule 13E–3 be provided. Also, the complete, and not summary, report, opinion or appraisal must be filed as an exhibit to the registration statement.

If a negative opinion was rendered by an investment banker or financial advisor concerning the fairness of the roll-up, or an investment banker or financial advisor refused to render a favorable opinion, this must be disclosed. Failure to provide adequate disclosure of this information would constitute a material omission under the anti-fraud provisions of the securities laws.[21]

2. Roll-Up Transactions and Limited Partnership Offerings

a. Application of Guide 5.[22] While Industry Guide 5 ("Guide") by its terms applies only to the "Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships," the requirements contained in the Guide should be considered, as appropriate, in the preparation of registration statements for real estate investment trusts and for all other limited partnership offerings. The Guide addresses disclosure concerns that are applicable to all offerings of limited partnership units, e.g., conflicts of interest, risk factors, compensation and summary of limited partnership agreement.

The requirements contained in the Guide that are relevant to all limited partnership offerings also should be considered, as appropriate, in the preparation of disclosure documents for roll-up transactions. Many of the disclosure concerns, such as conflicts of interest, investment objectives and fiduciary responsibilities, are pertinent to roll-up transactions.

b. Compensation to General Partner and its Affiliates.[23] The description of compensation and fee arrangements in primary offerings by limited partnerships frequently is complicated and obscure. The use of tables as a means of simplifying the disclosure is encouraged. The description of compensation arrangements between the partnership, general partner and its affiliates should give investors a clear understanding of the nature and amount of compensation that may be paid. Commonly, there are categories of compensation to be earned by the general partner. The disclosure document should make clear the distinctions among categories, including the level of potential compensation. The extent to which a general partner may affect the nature of the compensation by undertaking different transactions should be made clear. For example, a general partner might receive a given percentage of operating income (i.e., from rents, etc.) and a different percentage for sales of properties or refinancings. The distinction should be made clear, as well as the potential for the general partner to affect the categories of compensation. Both a narrative and tabular presentation of this information is recommended.

In the narrative presentation, the maximum amount that may be paid in each category of fees or compensation should be prominently disclosed. The tabular numeric presentation of this information should be based on this maximum amount.

Where an issuer states that there are ceilings on certain categories of fees or expenses, the issuer should also state whether the fees or expenses may be recovered by reclassifying them under a different category.

In addition, in a roll-up transaction, the issuer should compare the nature and level of compensation to be paid by the new entity to that paid by the old. To provide for clearer disclosure, registrants should present changes in the structure of fees and other compensation payable to the general partner in a tabular format, and should include specific quantification of such changes, where practicable. Further, the disclosure documents should include textual and numerical disclosure of the fees and other expenses payable to the general partner, affiliates and others solely because of the roll-up transaction.

A pro forma presentation of the compensation and fees proposed to be paid in the new entity should be presented using the historical pro forma financial statements. Where changes in the business plan may result in higher compensation than that shown in the pro forma presentation based on historical activities, the disclosure should address the potential for greater fees than shown in the pro formas and outline the potential differences. Where a compensation ceiling is fixed for a specified time period, the issuer also should set forth a pro forma presentation of the compensation and fees without giving effect to the ceiling.

c. Conflicts of Interest.[24] Many of these transactions or offerings are complicated by the number of affiliated entities involved in the transaction or in the business operations of the entities. Where affiliates of the general partner may participate in the offering or the issuer's business activities, an organizational chart showing the relationship between the general partner and its affiliates in the forepart of the prospectus should facilitate investor understanding of the relationships among such entities.

Registrants should describe concisely the potential conflicts of interest that are present and should identify clearly the transactions and relationships that give rise to such conflicts. The description should address the benefits and detriments that may be realized by the limited partners, the general partner and its affiliates, and any other parties that are subject to a conflict. A description of the procedures used or to be used to minimize the potential conflicts should be provided.

d. Fiduciary Responsibility of the General Partner.[25] Prospectuses are required to identify and explain the nature of the general partner's fiduciary duties to the limited partners. Where the partnership agreement modifies the state-law fiduciary duty standards, the registration statement should compare the state-law fiduciary duty standards with the standards as modified by the partnership agreement. The disclosure also should address the reasons for modifying the duties and the specific benefits and detriments to both the general partner and limited partners from each modification. A tabular presentation of this information should facilitate investor understanding.

A clear description of the limited partners' legal rights and remedies should be provided. Similarly, a clear explanation of defenses available to the general partner, such as the business judgment rule, also should be set forth.

In a roll-up transaction, the issuer also should provide a comparison of the general partner's fiduciary duty standards in the new entity to those in the existing entities. This comparison would describe the fiduciary duty standards in the existing entities, the new entity and, where the new entity is

[20] See Items 4(b) and 21(c) to Form S–4 (17 CFR 239.25).

[21] See 15 U.S.C. 77q(a); 15 U.S.C. 78j(b).

[22] 17 CFR 229.801(e).

[23] See Item 4 to Form S–4 (17 CFR 239.25), Item 4 to Industry Guide 5, Item 801(e) of Regulation S–K (17 CFR 229.801(e)) and Item 10 to Industry Guide 4, Item 801(d) of Regulation S–K (17 CFR 229.801(d)).

[24] See Items 4 and 18(a) to Form S–4 (17 CFR 239.25), Item 5 to Industry Guide 5, Item 801(e) of Regulation S–K (17 CFR 229.801(e)) and Item 12 to Industry Guide 4, Item 801(d) of Regulation S–K (17 CFR 229.801(d)).

[25] See Item 6 to Industry Guide 5, Item 801(e) of Regulation S–K (17 CFR 229.801(e)).

formed under a different jurisdiction, the material differences between the fiduciary duty standards in the old and new jurisdictions.

e. Management.[26] Information about management's business experience is material to an investor's evaluation of an offering and determination of whether to invest in the issuer. While this is true in any offering, it is especially significant when investors must rely largely on the individual expertise and business acumen of the general partner or other adviser to select and operate the properties to be acquired, and realize the stated investment objectives. Where the history of the officers and directors either individually or as a whole is inconsistent with the express or implied assertion that the partnership will benefit from their management, additional disclosure in support of this assertion should be provided. In the discussion of the business experience of officers and directors, where job titles do not indicate clearly the nature of the person's former duties or where job titles may give a misleading impression of the individual's experience, additional disclosure should be provided in order to clarify the nature of the individual's duties.

f. Investment Objectives and Policies.[27] The investment objective of an offering should be clearly and concisely set forth. This discussion must be consistent with other disclosures. For example, where a document describes the possible use of high leverage and an income investment objective, the disclosure would have to address how the business plan relying on high leverage would still permit an income objective.

Further, there must be a reasonable basis to support a stated objective. In this regard, consideration must be given to the effect that conditions or trends in the economy, such as the recent conditions in the real estate industry, may have on the likelihood that a stated investment objective will be realized within the stated anticipated term of the partnership.

Where a general partner may amend the investment objectives of the partnership without the vote of the limited partners, the disclosure document should make clear that, in essence, the investment objectives are those defined by the general partner from time to time. In such cases, lengthy descriptions of a partnership's investment objectives may obscure the fact that the investor is, in essence, buying an interest in an entity with unlimited investment objectives. The document should disclose the general partner's present plans while making clear that these may be totally recast. The document should set forth a description of the factors to be considered by the general partner in making such a change.

Where a partnership agreement permits the partnership to engage in joint ventures, disclosure should be made of those activities that the partnership may engage in through a joint venture that it could not otherwise undertake. For example, where the partnership agreement precludes the purchase of properties under construction, the ability of the partnership to purchase such properties through a joint venture should be disclosed. In such case, the risks and business implications of such activities should be clearly stated.

Recently, several issuers have disclosed in their prospectuses that the general partner, as part of its analysis of prospective property acquisitions, "will retain a national accounting firm to perform certain agreed-upon procedures related to the general partner's financial forecast with respect to each property acquisition" and that "[s]uch procedures will not constitute an examination of the forecast in accordance with standards established by the American Institute of Certified Public Accountants." Disclosure of an independent accountant's involvement with prospective financial statements or forecasts should be limited to circumstances in which the accountant has performed, in accordance with standards issued by the American Institute of Certified Public Accountants, an "examination" of prospective statements that are presented in the prospectus. Disclosure of "agreed-upon procedures" performed or to be performed by an accountant is inappropriate under all circumstances.[28]

In a roll-up transaction, the material effects flowing from the changed investment objectives and policies should be disclosed clearly. For example, most limited partnerships, before a roll-up, are expected to have a finite life, at the end of which they will dissolve and distribute their assets. After a roll-up, the surviving entity will be operated as an ongoing business with no obligation to make distributions or to dissolve. Therefore, while an investor was expecting annual cash distributions and proceeds from the sale of assets and the dissolution of the partnership after a seven to ten year period, the investor will receive dividends when declared by the successor and will be dependent upon the securities markets in order to liquidate his investment.

In addition, most limited partnerships before a roll-up are not publicly traded, so the value of the investment is extremely difficult to determine. After a roll-up, the value of the investment is based on the market for securities of entities operating in a specific industry. This value generally is based on a multiple of operating cash flow and a factor for the market's expectation of the likelihood of the continuation of that cash flow, rather than the appraised value of the underlying assets.

g. Summary of Partnership Agreement.[29] The issuer should identify and discuss the voting and other material rights of the limited partners under the partnership agreement. This discussion should include, but not be limited to, the right to call meetings, vote upon extraordinary transactions such as mergers and consolidations, obtain a copy of the list of partners, receive appraisal or dissenter's rights, inspect partnership books and records, remove and replace the general partner, compel dissolution or liquidation or amend the partnership agreement.

The voting rights of limited partners should be specifically set forth in this section. Such description should include the rights limited partners have to vote on any matter, the vote of limited partners necessary to approve any proposal and the rights of limited partners to submit a proposal to the vote of limited partners.

Any limitations or conditions (including those under state law) that the general partner may place on the exercise of these rights should be explained. If limited partners are not afforded the foregoing rights or if the partnership agreement restricts the rights that limited partners otherwise would have enjoyed under state law, this information should be disclosed. In addition, the issuer should characterize the extent of discretion retained by the

[26] See Item 401 of Regulation S-K (17 CFR 229.401), Item 9 of Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 11 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

[27] See Item 4 to Form S-4 (17 CFR 239.25), Item 10 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.601(e)) and Item 7 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

[28] See AICPA, Guide For Prospective Financial Statements (1986).

[29] See Item 4(a)(4) to Form S-4 (17 CFR 239.25), Item 14 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 15 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

general partner with regard to the operations of the partnership.

In addition to the foregoing, the issuer in a roll-up transaction should clearly compare the rights of the limited partners under the new partnership agreement or governing instruments with the rights of the limited partners under the existing partnership agreements. If limited partners will be affected differently depending on the partnership entity in which they have invested in, a partnership by partnership comparison must be made. If the new entity will be formed in a different jurisdiction, the differences in the rights under the respective state laws should also be described. A similar comparison of the actions that the general partner may take under the new partnership agreement with the actions that the general partner may take under the existing partnership agreements should also be provided.

h. Distributions and Allocations.[30] This section is often too complex for the investor to understand. In order to enhance investor understanding of this section, the narrative text should include shortened definitions of terms that are fully defined in the glossary. This will enable readers to gain a general understanding of the nature of the distributions and allocations without having to refer constantly to the glossary.

It is often unclear whether the distributions represent a return of investors' capital or a return on investors' capital. Whenever cash distributions are discussed on a historical basis, the disclosure should make clear the nature of the distribution. When distributions are discussed on a prospective basis, the disclosure also should make clear, to the extent known, the nature of the distribution.

Limited partnership prospectuses often disclose that limited partners will have a "priority" or "preferred" return on distributions made by the partnership. These descriptive terms should not be used if the right of limited partners to receive their distributions is in any way contingent. More often than not, even though limited partners are purportedly given a "preferred right" to a specified percentage of cash distributions, this right may only be invoked after substantial operating fees and expenses have been paid to the general partner. The disclosure should make clear that, if true, the "priority" or "preferred" distribution follows and does not preclude payments to the general partner. The disclosure should give a sense of the size of such payments to the general partner as well. In the rare circumstance where the right is not contingent and limited partners are guaranteed a priority return, consideration should be given as to whether a separate security exists.[31]

i. Sales Literature.[32] Registrants are reminded of the obligation, in Item 19D of the Guide, to submit all sales literature to the staff of the Commission supplementally prior to its use. This obligation is not extinguished once a registration statement is declared effective. Registrants must continue to submit all sales literature to the staff. Sales literature includes all material used in connection with the sale of the units, whether or not it is prepared by the general partner or its affiliates.

Registrants are also reminded that sales material should present a balanced discussion of both risk and reward and the contents of the literature should be consistent with the prospectus.

3. Limited Partnership Offerings

a. Estimated Use of Proceeds.[33] A principal problem with the presentation of the issuer's estimated use of proceeds in a limited partnership offering is the lack of prominent disclosure concerning the amount that will actually be invested in the business of the partnership. It is often the case in limited partnership offerings that a substantial percentage of the original investment will pay the expenses of the offering and fees to the general partner and its affiliates. The difference between the amounts provided by investors and the amounts expected to be actually invested in assets is of obvious significance to potential investors.

Accordingly, prominent disclosure should be made of the percentage of an investment that will actually be available for investment after the deduction of all front-end fees, commissions, expenses and compensation. This information should be presented in the narrative disclosure before the estimated use of proceeds table. Additionally, it is suggested that the bottom line of the use of proceeds table should reflect this amount. Cover page disclosure of this percentage should also be made in order to place the amount offered in its proper context.

b. Prior Performance.[34] In partnership offerings, the general partner is required to discuss the "track record" or prior performance of other programs sponsored by the general partner. A problem arising with greater frequency is what information is necessary when a general partner was a sponsor of a prior program, but has been removed from that program. Prior performance information should be provided for the period during which that person was the general partner. If the results (*i.e.* final sales of properties) for such a program did not meet expectations or the original investment objectives of the program, a person who was a general partner for any part of the operating period should provide information concerning the adverse developments experienced by that prior program.

The prior performance tabular information should reflect whether prior programs have been able to achieve their stated objectives. Adverse developments contained in the tables should be addressed in detail in the narrative section. The narrative section should be updated whenever the tabular information is updated.

Tabular information should be provided for all programs which have had a closing or have closed within the time period specified by the applicable table. If a program has had a closing and has begun operations, prior performance information should be provided for that program.

With regard to Table III of the Guide, the amount of cash generated from operations should be calculated based on the definition of operating cash flow from the Statement of Cash Flows prepared in accordance with Financial Accounting Standard ("FAS") 95. If the amount in the table differs from the amount that would be reflected in the Statement of Cash Flows, a footnote should be included reconciling the difference. Also with regard to Table III, a footnote should be included that explains how those programs experiencing operating deficiencies are being funded. Typically such deficiencies are built into the program during its first years of operations. However, continuing deficiencies can represent an adverse development that requires additional disclosure. Finally, if a program was designed to provide tax credits to investors, specific line items should be included in both parts of the table that disclose the amount of tax

[30] See Item 9 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d))

[31] A guaranty may be a separate security under section 2(1) of the Securities Act of 1933 ("Securities Act") (15 U.S.C. 77b(1); 15 U.S.C. 77a *et seq.*).

[32] See Item 19 to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)).

[33] See Item 504 of Regulation S-K (17 CFR 229.504), Item 3B to Industry Guide 5, Item 801(e) of Regulation S-K (17 CFR 229.801(e)) and Item 8 to Industry Guide 4, Item 801(d) of Regulation S-K (17 CFR 229.801(d)).

[34] See *supra* note 16.

credits that have been provided to investors.

III. UPDATING OF INFORMATION [35]

Issuers engaged in real estate offerings traditionally have updated prospectuses by means of supplements attached to the basic prospectus. This practice may result in a confusing, disjointed and lengthy disclosure document. In these circumstances, it often is left to the investor to discern not only which information has or has not been modified or superceded, but the substance of the change as well. Material information that ordinarily would appear in the forepart of a prospectus may be spread out in different documents. Moreover, other information in the initial prospectus, such a risk factors or investment objectives, may not be updated in a clear and concise manner. Therefore, just as in the case of non-real estate offering documents, when the document becomes confusing, a post-effective amendment containing a reprinted prospectus will be required. Where a supplement is used, consideration should be given to including an updated summary section as part of the supplement.

IV. MATCHING SERVICES AND CROSSING ARRANGEMENTS

There appears to have been a recent increase in the number of limited partnerships or real estate investment trusts attempting to create an alternative secondary market for their security interests. The most common method used has been a form of matching service, crossing arrangement or some other such liquidity enhancement plan through which a person wishing to sell an equity interest will be matched with someone who is seeking to buy an equity interest. This service often is created to supplement or work in conjunction with a dividend reinvestment plan. Usually, the general partner, advisor or one of their affiliates structures the arrangement and facilitates the matching of potential buyers and sellers. In certain circumstances, services provided by affiliated entities or their associated persons pursuant to a matching service or crossing arrangement could subject such persons to the broker-dealer registration requirement of Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"). [36]

If the general partner, advisor or one of their affiliates is involved in the crossing arrangement, the sale of securities through the arrangement is an offer or sale by the issuer for purposes of section 2(3) [37] and section 5 [38] of the Securities Act. Therefore, the issuer must register under section 5 of that Act a good faith estimate of the number of shares expected to be purchased through the arrangement. The issuer also must undertake to keep the registration statement "evergreen" during the existence of the arrangement. This treatment is similar to that accorded employee stock purchase plans and dividend reinvestment plans for determining whether registration is required under the Securities Act. [39]

List of Subjects in 17 CFR Parts 231 and 241

Reporting and recordkeeping requirements, Securities.

PART 231—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER

PART 241—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

Parts 231 and 241 of title 17, chapter II of the Code of Federal Regulations are amended by adding each of the following Release Nos. and the release date of June 17, 1991, to the list of interpretive releases in each part: 33–6900, 34–29314.

By the Commission.

Dated: June 17, 1991

Margaret H. McFarland,

Deputy Secretary

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[35] See Item 20 to Industry Guide 5, Item 801(e) of Regulation S–K (17 CFR 229.801(e)).

[36] 15 U.S.C. 78o(b); see Rule 3a4–1 under the Exchange Act [17 CFR 240.3a4–1] and Securities Exchange Act Release No. 22172 (June 27, 1985); see also Tri-State Livestock Credit Corporation, letter issued October 18, 1989 and CNB Corporation, letter issued June 9, 1989.

[37] See 15 U.S.C. 77b(3).

[38] See 15 U.S.C. 77e.

[39] See Securities Act Release Nos. 4790 (July 13, 1965), 5515 (August 8, 1974) and 6188 (February 1, 1980); see also Sierra Capital Realty Trust VI Co. and Sierra Capital Realty Trust VII Co., letter issued July 5, 1990.