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Via E-mail Delivery

Elizabeth M. Murphy
Secretary
U.S. Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549

**RE: Release No. 33-9211, File No. S7-21-11
Disqualification of Felons and Other
"Bad Actors" from Rule 506 Offerings (the "Release")**

Dear Ms. Murphy:

Thank you for the opportunity to comment on the above-referenced Release which proposes rules to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("New Rules"). The comments contained herein are my own and do not reflect the views of this firm, any member or employee of this firm or any clients of this firm. For ease of reference, my comments will track the request for comment numbers under the relevant headings in the Release.

Covered Persons

#1-2 Although I believe the legislative directive in Section 926(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") that the SEC adopt disqualification rules substantially similar to SEC Rule 262 ("Rule 262") provides the SEC with some flexibility, it makes regulatory sense that the SEC maintain the essential framework of Rule 262 in the New Rules. By keeping the essential framework of Rule 262 in the New Rules, the SEC, the regulated community and securities bar can look to prior interpretations of Rule 262 when in need of guidance on application of the New Rules. Therefore, I would urge the SEC generally to retain the scope of covered persons in the New Rules as currently exist in Rule 262.

#3 Managing members of limited liability companies should be treated the same as general partners of limited partnerships. This generally is the prevailing view of existing Rule 262 by both SEC staff and the practicing bar. Making this explicit in the New Rules merely would be codifying current practice. However, this raises the issue of whether membership interests in limited liability companies should be included in the definition of "equity security" in Rule 405, particularly if the SEC intends the terms used in the New Rules to have the meanings provided in Rule 405.

#4 Unless the SEC is prepared to change the thresholds in both Rule 262 and the New Rules with respect to the beneficial owners of 10% or more of a class of its equity securities, then the threshold of 10% should be adopted in the New Rules.

#5 It would appear appropriate to include definitions within the New Rules only to the extent that such definitions would differ from those in Rule 405. If they do not differ, then no separate definitional section would be necessary.

#6 As a matter of equity, the SEC should adopt a provision in the New Rules which mirrors the exception in Rule 262(a)(5) for events relating to certain affiliates that occurred before the affiliation arose.

#7-8 The SEC should clarify (both in the New Rules and in an amendment to Rule 262) that officers mean executive officers as defined in Rule 501(f) or Rule 405 (the definitions are the same) which focuses on the responsibility and authority the person with respect to the issuer versus an administrative or ministerial role.

#9 Expanding the class of covered persons to include investment advisers and the directors, officers, general partners and managing members would appear to breach the legislative directive of "substantially similar" as these persons currently are not covered in Rule 262. If, in future, the SEC believes it is desirable for investor protection to expand the class of covered persons, it can initiate future rulemaking to revise Rule 262 and the New Rules or seek appropriate statutory authorization to expand the class of covered persons.

Disqualifying Events

Criminal Convictions

In the context of criminal convictions, Section 926 of Dodd-Frank presents a conundrum of interpretation. Section 926(1) directs the SEC to adopt rules "substantially similar" to Rule 262. Presumably, this directive would include Rule 262(a)(3) and (b)(1) which address criminal convictions. On the other hand, Section 926(2)(B) creates a separate disqualification under Section 926 but basically is a restatement of Rule 262 but without any look-back period. The question for the SEC is how to reconcile these two Congressional directives which seem opposite.

I suggest that the SEC should rely upon the statutory construction axiom that the specific should govern over the general.[1] Although Congress, in Section 926(2)(B) expressed a more general application of criminal convictions to create a disqualification (ie no look-back period), it enacted, in the same section, a directive for the SEC to adopt rules creating a disqualification for Rule 506 offerings "substantially similar" to Rule 262. One must presume Congress knew that Rule 262 contained a five-year and ten-year look-back with respect to criminal convictions. Therefore, the specificity of Congress mandating adoption of rules "substantially similar" to

[1] *eg,* 1 Pa.C.S.A. §1933.

Rule 262 should govern over the general language of Section 926(2)(B), particularly as the operative language in that section is identical to that in Rule 262(a)(3) and (b)(1).

#10 The only ten-year look-back provision in Section 926 relates to certain final orders of designated agencies involving specified conduct and not criminal convictions. Therefore, for the reasons set forth in Comment #9, it would be inappropriate and not in keeping with the "substantially similar" directive to impose a uniform ten-year look-back period for criminal convictions.

#11 For the reasons set forth in Comments #9 and 10 above, there should be no basis for a criminal conviction to become a permanent disqualification.

#12 The concept of a shorter look-back period or an exception from disqualification for entities which have undergone a change of control since the occurrence of a disqualifying event appeals to a sense of equity. However, if may be extremely difficult to determine what the shorter look-back period should be and what criteria would justify an exception. Given that the SEC has proposed adopting a waiver provision similar to that contained in Rule 262, it would seem that the better course would be to consider a waiver of a disqualification under the New Rules based upon a subsequent change of control.

#13 The NASAA Letter raises an interesting interpretive issue. If Section 926(2)(B) were interpreted to include a conviction for (1) any felony and (2) any misdemeanor in connection with the purchase or sale of any security or involving the making of a false filing with the SEC, many of the criminal offenses identified in the NASAA Letter indeed could be classified as felonies under relevant law and therefore would be covered by the disqualification in Section 926(2)(B).

If the term "felony or misdemeanor" in Section 926(2)(B) was interpreted as being limited to those occurring "in connection with the purchase or sale of a security or involving the making of any false filing with the Commission," then the concerns raised in the letter referenced in the Release from the North American Securities Administrators Association ("NASAA") could become more germane although a conviction of fraud or deceit in connection with the purchase or sale of a security still would be sufficient to establish a disqualification.

The problem with expanding criminal convictions significantly beyond those related to "the purchase or sale of a security" is that classification of crimes as felonies or misdemeanors primarily is a function of state law and state laws vary significantly as to what conduct is classified as a crime and the gravity which such conduct is viewed. Furthermore, the NASAA letter appears to stray beyond the statutory directive to adopt rules "substantially similar" to Rule 262.

On the other hand, the suggestion to include false filings with banking, futures and insurance regulators appears meritorious as it is similar to the "false filing" provision relating to the SEC in Section 926(2)(B). Regrettably, the statutory language does not provide such flexibility. Just as Congress was able to identify various regulators whose certain final orders may be the basis of a disqualification under Section 926(2)(A)(ii), Congress had the capacity to expand to similar regulators the false filing threshold under Section 926(2)(B). Congress, for whatever reason, chose not do to so and the SEC should acknowledge such legal limitation, albeit perhaps unintentional.

#14 I do not read the language of Section 926(2)(B) as being restricted to convictions occurring in state and federal courts in the U.S. If the SEC were so disposed, if could interpret the language to include convictions in foreign courts which conduct, if it occurred in the U.S. would be a crime under federal law. It is suggested that state law should not be used as the variances may be too great and how would it be decided which state law would apply.

It should be noted that Section 15(b)(4)(B) of the 1934 Act and Section 203(e)(2) and (3) of the Investment Advisers Act of 1940 ("Advisers Act") permit the SEC to censure, limit the activities of, or suspend or revoke the registration of a broker, dealer or investment adviser based upon a conviction by a foreign court of competent jurisdiction substantially equivalent to a the crimes enumerated therein.

Whereas the SEC may have thought it prudent to seek statutory authorization to rely on foreign criminal convictions in context of instituting an administrative proceeding affecting registration as a broker, dealer or investment adviser, such due process concerns should not be present when the SEC is acting in a discretionary capacity such as adopting or interpreting availability of exemptions from the registration requirement of Section 5 of the Securities Act of 1933 ("1933 Act").

If, in the context of disqualification provisions relating to availability of exemptions from securities registration under the 1933 Act, the SEC historically has considered only convictions in state and federal courts in the U.S., it is reasonable that it would not be desirable, at least in this rulemaking, to depart from this past practice.

Court Injunctions and Restraining Orders

With regard to look-back periods under the New Rules, I think the intent of the directive of "substantially similar" means that the terms of the New Rules, including applicable look-back periods, should mirror as much as possible the existing provisions of Rule 262. It is agreed that the New Rules must be tweaked in terms of application, for instance, to underwriters since, as the SEC has observed, the capital raising process represented by Rule 506 offerings is different than Regulation A offerings. The term "substantially similar" recognizes this difference and permits the SEC to make such deviations from Rule 262 as it thinks appropriate under the circumstances.

#15 Based on the foregoing comment, the SEC should adopt the look-back period for injunctions and restraining orders as proposed which reflects the existing provisions in Rule 262.

#16 No. The gravamen of a court injunction or restraining order is that an independent tribunal has determined on the evidence submitted that the public needs to be protected by issuance of a court order enjoining such person from continuing to engage in certain conduct, acts or practices, the violation of which would subject the person to civil contempt. The judicial requirements of a finding of immediate and irreparable harm in the case of preliminary injunctions only underscores the necessity that all injunctions or restraining orders should be encompassed by the New Rules.

Furthermore, if a court determined to enjoin a person from violating Section 5 of the 1933 Act because he engaged in a series of unregistered (but not fraudulent) offerings, I see no public policy reason why such violative behavior should not be the basis of a disqualification just because it did not involve fraudulent, deceptive or manipulative conduct.

#17 For the reasons stated in the preamble to this subsection, I urge the SEC to adopt the New Rules as proposed in this respect.

#18 These are two distinct concepts. Section 926(1) of Dodd Frank directed the SEC to adopt rules substantially similar to Rule 262 to which this subsection relates. Section 926(2), in essence, adopts the language contained in Section 15(b)(4)(H) of the Securities Exchange Act of 1934 ("1934 Act") which was enacted by the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").[2]

This request for comment appears to suggest marrying these two differing concepts when such is not required. Congress, by enacting Sections 926(1) and (2), sought to take two established disqualification provisions and concepts currently existing in the federal securities laws and apply them to Rule 506 offerings. The directive was to take the actors in a Rule 506 offering and analyze them first under the disqualification provisions substantially similar to Rule 262; second under the terms of the disqualification provisions adopted from the 1934 Act; and third under the criminal law. Any attempt to "marry" these concepts into some type of uniform system of disqualifications would do violence to Congressional intent as well as become an interpretive nightmare for SEC staff and securities practitioners alike.

#19 As in Comment #14, I do not view the language in current Rule 262(a)(4) as necessarily being restricted to state and federal courts in the U.S. The only requirement is that it be a court of competent jurisdiction. However, since the SEC has admitted that it historically has interpreted criminal convictions in Rule 262(a)(3) and (b)(1) as only those occurring in state and federal courts in the U.S., it would seem that, for uniformity and internal consistency with respect to disqualifications under the federal securities laws, the SEC should take a similar view with respect to injunctions and restraining orders under Rule 262(a)(4).

Final Orders of Certain Regulators

I would recommend that the SEC, either in the New Rules or by an interpretation incorporated in the adoption release for the New Rules, address the issue of "bars" as used in Section 926(2) of Dodd-Frank. As previously indicated, the genesis of Section 15(b)(4)(H) of

[2] The genesis of this language was Senate Bill 1189 introduced by Senators Collins, Cleland and Gregg on June 9, 1999 entitled the "Microcap Fraud Prevention Act of 1999." S. 1189 was never enacted.

the 1934 Act and Section 203(e)(9) of the Advisers Act upon which Section 926(2) is based was Senate Bill 1189 of 1999 introduced by Senator Collins (R-ME) entitled the "Microcap Fraud Prevention Act of 1999." This provision represented an effort by SEC staff and NASAA representatives to address the issue of fraud in the micro-cap markets, particularly that committed by registered broker-dealers and their associated persons.[3]

Until enactment of Sarbanes-Oxley, no enforcement action taken by a state securities regulator was recognized as a disqualification under Section 3(a)(39) of the 1934 Act. For instance, an associated person of a broker-dealer who became subject to a state securities commission enforcement order barring him from association with a registered broker-dealer in that state had no effect beyond that particular state. To eject such "bad actors" from the securities business nationwide, the SEC or FINRA would have to undertake an investigation and institute a proceeding which largely duplicated what had been done by the state securities regulator which issued the order.

In addition, a 1994 U.S. General Accounting Office ("GAO") report criticized the fact that a person subject to a sanction in the securities business freely could move without hindrance into the insurance, banking or insurance business.[4] In a follow-up report in 1998, the GAO observed that these regulatory loopholes had yet to be closed.[5]

Acknowledging the findings in the GAO Reports and under the auspices of the U.S. Senate Permanent Subcommittee on Investigations which was conducting an investigation concerning fraud in the microcap markets, SEC staff and NASAA representatives collaborated upon drafting criteria as to which the SEC would be comfortable in relying upon certain enforcement orders of state securities commissions as a basis for, in effect, a nationwide disqualification by adding such orders to the list of events that would trigger Section 3(a)(39) of the 1934 Act.

As a then member of the NASAA Federal Legislation Committee and as a staff member in a jurisdiction which had enacted specific statutory bar language,[6] I had the privilege of working with Richard Walker, then Director of the SEC Division of Enforcement and his staff on defining conduct so demonstratively violative of the securities laws that principles of investor protection required that such person acquire a disqualification under Section 3(a)(39) of the 1934 Act. Due to the vagaries of various state laws and varying enforcement efforts and levels of enforcement-related resources, we wanted to ensure that a Section 3(a)(39) disqualification would be based upon a finding of specific serious conduct.

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[3] eg, A.R.Baron & Co., Inc., SEC Administrative Proceeding 3-9167, Release No. 34-37831 (October 17, 1991); Stratton Oakmont, Inc. , *SEC v. Stratton Oakmont, Inc.*, Civil Action No. 94-2681, JHG, D.D.C., SEC Litigation Release No. 14426 (announcing issuance of a permanent injunction); and Hibbard Brown & Co., Inc., *SEC v. F.N. Wolf & Co., Inc. et al.*, SDNY 93 Civ 0379, LLS, SEC Litigation Release No. 14764 (announcing issuance of a permanent injunction).

[4] Securities Markets: Actions Needed to Better Protect Investors Against Unscrupulous Brokers (Letter Report, September 14, 1994, GAO/GGD-94-208).

[5] Responses to GAO and SEC Recommendations Related to Microcap Stock Fraud (September 30, 1998, GAO-GGD-98-204).

[6] Section 512 of the Pennsylvania Securities Act of 1972, 70 P.S. §1-512 (added Nov. 24, 1998, P.L. 829, No. 109).

Therefore, the recommendation was that persons who were (1) barred from association with an entity regulated by a state securities commission or (2) the subject of a final order of a state securities commission based upon a violation of any laws or regulations that prohibit fraudulent, manipulative or deceptive conduct automatically would acquire a Section 3(a)(39) disqualification.[7] In recognition of the GAO reports, this concept was expanded by the SEC and Congress to include final orders issued by state banking and insurance regulators as well as federal banking regulatory agencies. In a summary of these legislative proposals, including the foregoing, SEC staff noted these changes with approval stating that they believed such provisions would enhance the SEC's ability to effectively protect the public from the harms of fraud in the microcap market.[8]

SEC staff and NASAA representatives deliberately used the term "bar" to indicate that the person was prohibited by regulatory order from association with a regulated entity or engaging in a specific business subject to regulation by a state securities commission. This is a distinct concept from the term "suspend" or "revoke" as used in federal and state securities laws which apply only to regulatory actions which may be taken with respect to the license of a currently registered person.[9] In the context of state securities laws, the term "bar" was used to convey the meaning that the offender had committed such egregious conduct that he or she was barred from becoming a registered person, associating with a registered person or engaging in the business of securities which would include representing an issuer or acting as an officer, director, partner or promoter of an issuer offering and selling securities in the state even under a self-executing exemption.[10]

The distinction in state securities law between a "suspension" of effectiveness of a license and a "bar" was carried over into the Uniform Securities Act (2002). Section 412(b) of the Uniform Securities Act (2002) authorizes imposition of a revocation, suspension, condition or limitation on a license whereas Section 412(c) separately authorizes imposition of a bar for certain conduct.[11]

Sanctions available to FINRA for imposition against its members or associated persons include a censure, a fine, suspension for a definite period, expulsions, bar, a temporary cease and

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[7] My recollection is that it was the intent of the parties that this provision would be applied prospectively upon enactment as equitable principles should not permit it to be applied to a person who, when the event occurred, had no knowledge that this provision would have been adopted.
[8] "Microcap Legislative Proposals," SEC Office of Legislative Affairs (April 1999).
[9] Section 412(b) of the Uniform Securities Act (2002) and Section 204(a) of the Uniform Securities Act (1956).
[10] *Accord* 70 P.S. §1-512(a)(1).
[11] An issue with respect to adoption of the Section 15(b)(4)(H) language was whether the state issuing the bar possessed the statutory authority to do so since many state securities laws were based on the Uniform Securities Act (1956) which did not include specific "bar" language. Sarbanes-Oxley had been adopted immediately before the Uniform Securities Act (2002) was approved by the National Conference of Commissioners on Uniform State Laws and Section 412(c) of the Uniform Securities Act (2002) gave certainty to those states which would adopt it that any bar issued pursuant thereto would meet the criteria established in Section 15(b)(4)(H) of the 1934 Act. Conduct which does not form a basis for a bar is insolvency (Section 412(d)(7)) and orders imposed by foreign courts or actions of foreign regulators, stock exchanges or self-regulatory organizations (Section 412(d)(11)).

desist order, or other fitting sanction.[12] FINRA Rule 8310(a)(5) states that FINRA may suspend or bar a member or person associated with a member from association with all members. It appears that FINRA accepts the distinction in use of the term "suspend" and "bar."

The 1934 Act is somewhat similar. Section 15(b)(4) confers authority on the SEC to suspend, limit the activities of, censure or revoke a registration of any broker or dealer and Section 15(b)(4)(F) recognizes the ability of the SEC to issue an order barring or suspending the right of a person to be associated with a broker or dealer.

There also is a distinction to be drawn between "revocation" and "bar." A regulator may revoke a registration but the act of revocation generally does not act to prohibit the person from making application in future, even if deemed to be an effort in futility. On the other hand, absent a matter of grace extended by the sovereign, a bar precludes such consideration for the duration of the bar.

With respect to persons who are not registered persons, Section 21(d)(2) of the 1934 Act permits the courts to "prohibit, conditionally or unconditionally, and permanently, or for such period of time as it shall determine, any person who violated Section 10(b) of the 1934 Act from acting as an officer or director of a company subject to Section 12 or 15(d) of the 1934 Act. Under Section 21(d)(6) of the 1934 Act, a court may prohibit a person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such time as the court shall determine. SEC staff has referred to these actions as "bars"[13]

Although the foregoing "bars" are in the context of federal and state securities laws and FINRA rules, Section 926(2)(A)(i) is broader and includes state and federal banking regulators and state insurance commissions, all of whom may use nomenclature different from the SEC and state securities regulators. For instance, the Office of the Comptroller of the Currency, which regulates national banks, may take administrative action to issue a "prohibition" order for the "removal" of an officer or director where it finds that such person has violated any law, rule or regulation or outstanding agency order or agreement or condition imposed in writing or has engaged in unsafe or unsound banking practices or breached a fiduciary duty.[14] However, the federal banking agencies, when seeking to take action against an accountant from providing services to a regulated financial institution, use the term "debarment" rather than "prohibition."[15]

#20 Under federal and state securities laws, the term "bar" has been used alongside existing concepts of "suspension" and "revocation." Given the great import that a disqualification under Section 926(A)(i) may have and that different designated agencies may use different nomenclature for the same action, I strongly urge the SEC to provide interpretive guidance on the use of the term "bar" in Section 926(2)(A)(i). In this regard, I urge the SEC to adopt two interpretive principles. The first is that the designated agency must have statutory authorization

[12] FINRA Rule 8310(a)(1)-(7).
[13] *Supra* note 8.
[14] *See "The Director's Book* (October 2010) at http://www.occ.gov/publications/publications-by-type/other-publications-reports/director.pdf
[15] 12 CFR 19.243 (OCC) and 12 CFR 308.62 (FDIC).

to issue a bar described in Section 926(2)(A)(i)[16] or be able to point to current judicial authority interpreting the current relevant statute as permitting the designated agency to issue such a bar. The second is that, for purposes of Section 926(2)(A)(i), it is the effect of the order issued by the designated agency which is paramount rather than the nomenclature used.

For instance, a "bar from association with an entity" regulated by a designated agency requires a separation of affiliation with the regulated entity.[17] An order which has the effect of suspending a license of an individual is not a "bar" for purposes of Section 926(2)(A)(i) even though a designated agency may use the term "bar" since, during the suspension (in the context of the securities industry), the individual remains associated with the broker-dealer, and, upon termination of the suspension, automatically and without further regulatory approval resumes effecting transactions in securities on behalf of the broker-dealer. Furthermore, an order of revocation is not a "bar" under this section since it does not preclude re-application with the regulator for the same or different license which may be granted by the regulator.

The statutory language is clear that a bar under Section 926(2)(A)(i)(II) and (III) must be a bar from engaging in the business of securities, insurance, banking, or savings association or credit union activities. Orders of a designated agency which bars a person from only certain activities within the ambit of the types of businesses described in Section 926(2)(A)(i)(I) and (II) should be viewed as insufficient on its face to create a disqualification under Section 926(2)(A)(i). The "bar" must be absolute.

#21 I would agree that, in appropriate circumstances, a cut-off for permanent bars for a person to act in a capacity for which he or she was not barred would be appropriate. For instance, if a person was barred from association with a broker-dealer and, after a substantial period of time, subsequently wanted to participate in a Rule 506 offering as a director, officer, promoter or more than 10% (but perhaps less than 50%) beneficial owner of a class of equity security of an issuer, he or she should be able to do so.

The relevant time period should relate to the seriousness of the conduct which created the bar. For instance, a permanent injunction for violating Section 10(b) of the 1934 Act and Rule 10(b)-5 thereunder should warrant more scrutiny than an SEC or FINRA order which did not find that the person engaged in fraudulent or deceptive conduct. Therefore, I suggest a ten-year cut-off in the first instance and a five-year cut-off in the second instance.

I am unsure what SEC staff is trying to say in the parenthetical of this request for comment concerning "unqualified" bars and those which have a proviso for re-application after a period of time. Under Section 926, the existence of a proviso for re-application seems irrelevant. It is whether a person is "barred" for purposes of Section 926(2)(A)(i) that is relevant, not whether the person may at some future time apply for a license. If a bar is for a specific duration, does not that imply that there is no prohibition on applying for any license upon expiration of the bar? Furthermore, Congress could not have intended that a person could evade the effects of

[16] *See* Section 412(b) of the Uniform Securities Act (2002).

[17] Although federal or state securities regulatory may use the term "bar," the federal banking regulators mostly likely would use the term "prohibited from association with a financial institution."

Section 926 merely by including a proviso in an order permitting re-application. Certainly, there should be no difference under Section 926 between an order barring someone for five years from associating with a broker-dealer versus an order barring a person for five years from associating with a broker-dealer with a proviso that, upon expiration of the bar, the person may re-apply for a specific license.

Final Orders

#22 I think it prudent for the SEC to define "final order" for purposes of the disqualification provisions of Section 926(2)(A)(ii).

#22 - #24 If the SEC determines it prudent to define the term "final order" for purposes of Section 926(2)(A)(ii), the question posed is whether it should use the FINRA definition or the definition in Section 604 of the Uniform Securities Act (2002).

If the SEC currently uses the FINRA definition of "final order" for purposes of Section 15(b)(4)(H) of the 1934 Act, it would appear that uniformity of language and purpose dictates that the interpretation of "final order" should be the same for Section 926(2)(A)(ii). Otherwise, the SEC will be inviting future litigation on the premise that the term "final order" means something different in the context of Section 15(b)(4)(H) of the 1934 Act and Section 926(2)(A)(ii) albeit the relevant statutory language is identical (save for the look-back period added by Dodd-Frank).

In context of Section 926(2)(A)(ii), I do not view the proposed definition of "final order" as being irreconcilable with the Uniform Securities Act (2002) definition. Section 926 applies to an exemption from registration available under the federal securities law and therefore, the SEC, as the administering agency of the federal securities laws, is the competent authority to determine, for purposes of federal law, what constitutes a final order of the designated agencies. In contrast, Section 604 of the Uniform Securities Act (2002) sets forth what constitutes a final order under a state's securities statute and applicable state administrative procedure laws.

Whether the SEC will accept a final order as defined in Section 604 of the Uniform Securities Act (2002) for purposes of Section 926(2)(A)(ii) is a decision solely within the province of the SEC. As previously stated, I think it more important for the SEC, in administering the federal securities laws, to use a uniform definition of final order for purposes of Section 15(b)(4)(H) of the 1934 Act and Section 926(2)(A)(ii) which reflect substantially identical language.

The definition proposed in the Release would require that the order had been issued pursuant to applicable statutory authority and procedures. The question posed by SEC staff is whether it should require that, to be considered a final order, there must be written findings of fact and conclusions of law. Although it would be hoped that most applicable statutes authorizing issuance of final orders by a designated agency would include a requirement for written findings of fact and conclusions of law, given the myriad of designated agencies and associated laws encompassed by Section 926(2)(A)(ii) which could include instances where a designated agency may issue a final order without written findings of fact or conclusions of law,[18] I would suggest that the SEC not adopt such requirement. If the designated agency follows applicable statutory authority and procedures to issue a final order pursuant to such statute and procedures, that should suffice under the definition of "final order" as proposed in the Release. I would urge the SEC to adopt the definition of "final order" as proposed.

#25 No. If the SEC is to adopt a definition of "final order" for purposes of application of Section 926(2)(A)(ii), whether such order would be a "final order" under state law is somewhat irrelevant as the SEC is making a determination whether an order is a "final order" for purposes of Section 926(2)(A)(ii), something which is entirely within the SEC's administrative remit. In this manner, the SEC can avoid becoming an interpreter of a myriad of laws as indicated by Comment #24.

#26 - 27 Final appealable orders of a designated agency should come within the definition of "final order." This is consistent with discussions between SEC staff and NASAA representatives in devising the language which became Section 15(b)(4)(H) of the 1934 Act.[19]

Whether a final order is appealable to a tribunal for review is dependent upon the underlying statue authorizing the designated agency to issue the final order. For instance, most consent orders issued in connection with acceptance by the designated agency of an offer of settlement by the respondent require the respondent to waive any appeal rights he or she may have and the consent order becomes a final order of the agency which is not eligible for an appeal. Furthermore, whether a final order is appealed timely is an election to be made by the respondent.

A more pertinent question is whether a final order of a designated agency, the effect of which has been stayed by a court of competent jurisdiction, remains a final order for purposes of Section 926(2)(A)(ii). On the one hand, one could argue that the final judgment of a designated agency should be honored for purposes of disqualification because it has heard all the evidence and made a decision based upon its expertise as to the industry it regulates. On the other hand, if an independent tribunal, after receipt of a timely appeal and after hearing evidence presented by the designated agency and the respondent, determines to stay the effectiveness of the final order pending a hearing on the appeal, does not equity demand that the respondent should not suffer any adverse consequences until he or she has had due process in accordance with applicable law?

Concern has been expressed that the appeals process could take years and investor protection could be compromised in the interim if the disqualification provision is not applied until all appeals have been exhausted. Under these circumstances, it is my view that due process

[18] Section 604 of the Uniform Securities Act (2002) provides for issuance of summary cease and desist orders which only requires a statement of reasons for the order (not written findings of fact or conclusions of law) and failure to request a hearing or timely request a hearing results in the summary cease and desist order becomes a final order as to that person by operation of law. *Accord* Section 607(a) of the Pennsylvania Securities Act of 1972, 70 P.S. §1-607(a).

[19] Contemporaneous notes of G. Philip Rutledge taken during meetings with staff of the SEC Division of Enforcement (May 1999).

must trump any speculative concerns about compromising investor protection. Due process is a constitutional right and, if the person subject to the final order, complies with applicable law to seek judicial review and asks a court of competent jurisdiction to stay effectiveness of the final order pending judicial review which is granted, he or she should not suffer any adverse effect of such stayed order until a judgment is rendered in the appeal.

I think investor protection is sufficiently safeguarded in that (1) the designated agency will have the opportunity to argue against a stay of the final order before an independent judicial tribunal and that independent tribunal will make a determination based upon the evidence provided by the designated agency and respondent and (2) the anti-fraud provisions of federal and state securities laws would require disclosure of such proceedings in a contemporaneous securities offering in which such respondent was associated.

Therefore, I would suggest that the SEC adopt an interpretation that a final order of a designated agency, the effectiveness of which is subject to a current stay by a court of competent jurisdiction, shall not be deemed a final order for purposes of Section 926(2)(A)(ii). This position appears to be consistent with the effectiveness of sanctions issued by FINRA in the matters relating to Alvin Waino Gebhart, Jr. and Donna Traina Gebhart, In 2005, FINRA's National Adjudicatory Council issued a sanction of a bar against Mr. Gebhart and a one year suspension against Ms. Gebhart. The Gebharts took an appeal, in succession, to the SEC, the U.S. Court of Appeals for Ninth Circuit and the U.S. Supreme Court. Only upon denial of the writ of certiorari by the U.S. Supreme Court in 2010 did FINRA advise that the suspension against Ms. Gebhart became effective.[20]

Another argument to adopt this position is that counsel, in seeking a stay from the appellate tribunal, also most likely would seek a simultaneous stay of any disqualification which might arise under Section 926 and, if the stay was granted to the effectiveness of the agency's order, it is highly likely that the court might stay application of any disqualification which might arise under Section 926.

#28 No. First, the SEC, as the agency responsible for administration of the federal securities laws, should be the only interpreter of those laws, including application of Section 926(2)(A)(ii). Second, agencies regulating similar industries under similar laws may differ as to interpretation of such laws. Under Section 926(2)(A)(ii), there needs to be uniformity across the board as to treatment of "final orders" and only the SEC can provide that uniformity.

[20] http://brokercheck.finra.org/Support/ReportViewer.aspx?SearchGroup=Individual&FirmKey=-1&BrokerKey=1005905&IndvlBCCtgry=1&IndvlIACtgry=1; and http://brokercheck.finra.org/Support/ReportViewer.aspx?SearchGroup=Individual&FirmKey=-1&BrokerKey=2708528&IndvlBCCtgry=1&IndvlIACtgry=1. The start date for the bar against Mr. Gebhart is set forth in FINRA records as May 24, 2005 which is the date of the decision of the National Adjudicatory Council from an appeal of a February 9, 2004 Hearing Panel decision. However, the resolution date of the FINRA action is February 17, 2010. The monetary sanction imposed by FINRA was not paid until March 8, 2011. The suspension imposed against Ms. Gebhart did not become effective until June 7, 2010 after all appeals were exhausted. It is unknown to the author whether either federal court had issued a stay of the FINRA sanctions pending a ruling on the Gebharts' petition for review.

Where consultation with the issuing agency of the final order may be appropriate is when a respondent petitions the SEC for a waiver of a disqualification. In that process, the issuing designated agency may provide valuable insights in assisting the SEC to make a determination on the waiver request.

If the SEC were to consult with the issuing designated agency, what happens if the SEC disagrees with the interpretation? This may result in strained regulatory relations in that the designated agency may query why it was asked in the first place if the SEC subsequently disagrees with the designated agency's view. Also, what happens if like agencies administering a uniform state statute governing the same industry provide the SEC with different interpretations of the same statutory language?

Fraudulent, Manipulative or Deceptive Conduct

#29 Except for the look-back period, this is the same language which appears in Section 15(b)(4)(H) of the 1934 Act. To date, the SEC has not issued rules interpreting the terms "fraudulent, manipulative or deceptive conduct" in context of that statutory provision, which incorporates final orders of the designated agencies based upon violations of any laws or regulations that prohibit fraudulent, manipulative or deceptive conduct. I suggest that, as part of the New Rules, these terms in Section 926(2)(A)(ii) not be defined so they co-exist equally and comfortably with their almost identical twins in Section 15(b)(4)(H) of the 1934 Act.

It is my recollection that SEC staff and NASAA representatives sought to convey in this language that the final order had to contain a finding that the respondent engaged in conduct which violated statutory prohibitions against fraud, deceit and manipulation, such as Section 10(b) and SEC Rule 10(b)-5 of the 1934 Act and Section 501 of the Uniform Securities Act (2002).[21] Final orders relating to other conduct would not suffice under this rubric. However, such other conduct could be the basis of a bar which would have the same disqualifying effect under Section 926(2)(A)(i).[22]

#30 Common law offenses should not be included. The stem of the language in question is that there must be a final order issued by a designated agency that is based upon a law under which that designated agency is competent to adjudicate. The adjudicators of common law are the various courts of competent jurisdiction, not the designated agencies. Scienter, although required for a violation of Section 10(b) and SEC Rule 10(b)-5,[23] is not universally required for a violation of the anti-fraud provisions of state securities laws.[24] Therefore, requiring scienter in

[21] Official Comment No. 5 to Section 501 of the Uniform Securities Act (2002) states, "Because Section 501, like Rule 10b-5, reaches market manipulation, see 8 Louis Loss & Joel Seligman, Securities Regulation Ch.10.D (3d ed. 1991), this Act does not include the RUSA market manipulation Section 502, which had no counterpart in the 1956 Act."

[22] See Section 412(b) of the Uniform Securities Act (2002) which sets forth conduct which is not necessarily fraudulent, deceptive or manipulative but could form the basis for imposition of a bar.

[23] *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

[24] *See Manns v. Skolnik*, 666 NE 2nd 1236 (Ind. Court of Appeals 1996); Section 102(w) of the Pennsylvania Securities Act of 1972, 70 P.S. §1-102(w).

all instances would not fulfill the intent of the statutory language. In addition, the standard for issuing prohibition orders (similar to bars) by the federal banking regulators is unsafe or unsound banking practices or breach of fiduciary duty. Scienter plays no role in such determinations so a decision to require scienter would act to exclude application of Section 926(2)(A)(ii) to such orders which would be contrary to Congressional intent and a plain reading of the statutory language.

#31 No. First, the SEC, as the agency responsible for administration of the federal securities laws, should be the only interpreter of those laws, including the application of Section 926(2)(A). Second, agencies regulating similar industries under similar laws may differ as to interpretation of such laws. Under Section 926(2)(A), there needs to be uniformity across the board as to treatment of "final orders" and only the SEC can provide that uniformity.

Where consultation with the issuing agency of the final order may be appropriate is when a respondent petitions the SEC for a waiver of a disqualification. In that process, the issuing designated agency may be provide valuable insights in assisting the SEC to make a determination on the waiver request.

If the SEC were to consult with the issuing designated agency, what happens if the SEC disagrees with the interpretation? This may result in strained regulatory relations in that the designated agency may query why it was asked in the first place if the SEC subsequently disagrees with the designated agency's view. Also, what happens if like agencies administering a uniform state statute governing the same industry provide the SEC with different interpretations of the same statutory language?

#32 See Comment #31.

Orders of Other Regulators

#33 - 39 I dispute the predicate in the Release that consideration should be given to including SEC cease and desist orders and orders of the Commodity Futures Trading Commission ("CFTC") for purposes of Section 926(2)(A) because "the SEC did not have authority to bring cease-and-desist proceedings when Rule 262 was adopted originally and the rule has not been amended to take account of that authority."

The language upon which Section 926(2)(A) is predicated was enacted as Section 15(b)(4)(H) of the 1934 Act as amended by Sarbanes Oxley in 2002. If the SEC had wanted to include its cease-and-desist orders and CFTC orders within the disqualification scheme in that section which was replicated substantially in Section 926 of Dodd-Frank, it could have done so at that time. It did not. Even when this language was considered originally in context of Senate Bill 1159 in 1999, the SEC Office of Legislative Affairs, in its summary of relevant provisions, did not suggest that the disqualification language under consideration include SEC cease-and-desist orders or CFTC orders.

There is no indication in the Release that the SEC, at any time during the legislative consideration of Dodd-Frank, suggested to Congress that its cease-and-desist orders and CFTC orders be incorporated in Section 926 of Dodd-Frank and/or amended into Section 15(b)(4)(H) of the 1934 Act.

If Congress had so desired, it could have added the CFTC to the litany of designated agencies in Section 926 but it chose not to so. Similarly, Congress could have included SEC cease-and-desist orders as a basis for a disqualification and it declined to do so. Lastly, Congress' directive to the SEC was to adopt rules substantially similar to Rule 262. As none of the foregoing appear in current Rule 262, any attempt to include them in the New Rules would be *ultra vires* and most likely the subject of future litigation.

By declining, at this time, to include SEC cease-and-desist orders and CFTC orders in the New Rules, the SEC can avoid addressing the issues raised in its Request for Comment #34-39. If the SEC believes that inclusion of its cease-and-desist orders and CFTC orders is desirable for investor protection, it can initiate future rulemaking to revise Rule 262 and the New Rules or seek appropriate statutory authorization to include these orders.

Commission Disciplinary Orders

#41 - 43 I agree with the SEC's proposal not to change the substance of current Rule 262(b)(3) (except as to the Section 15B(a) reference as explained in the Release) and would encourage the SEC to codify the interpretive positions of the staff of the SEC Division of Corporation Finance. Anytime the SEC is able to codify its interpretive positions is a positive development for securities practitioners and is to encouraged.

#44 To suggest imposing a disqualification for a longer period than a limiting order or financial industry bar would remain in effect seems to infer second guessing on the part of the SEC as to the appropriateness of the sanction imposed by the relevant designated agency. It also would be inconsistent with the treatment by the SEC of its own orders under Rule 262(b)(3). The SEC should not adopt this suggestion nor the suggested look-back period.

#45 As indicated in the Release, the SEC should codify its current interpretive position that imposition of civil monetary penalties is not a basis for disqualification. I also would urge that non-payment of civil monetary penalties should not form a basis for disqualification. All of the bases for disqualification are premised upon a non-monetary sanction. To introduce a concept of disqualification by non-payment of a monetary penalty is inconsistent with this premise and should be avoided. There may exist a myriad of legitimate reasons why civil monetary penalties may not be paid and, if there are no legitimate reasons, the agency imposing the civil monetary penalties has all the provisions of the authorizing statute at its disposal to enforce collection as well as legal remedies provided by the civil courts.

#46 For the reasons stated in the Release, it appears appropriate for the SEC to eliminate Section 15(B)(a) in the current rule.

Suspension or Expulsion from SRO Membership or Association with an SRO Member

#47 Mindful of the Congressional directive to adopt rules substantially similar to Rule 262, I do not think, at this time, the SEC could or should include a suspension or expulsion from membership or participation in a commodities exchange or commodities self-regulatory organization or from any other organization (including foreign securities exchanges) as these organizations are not specified in current Rule 262(b)(3). However, I think investor protection would be served if the SEC would initiate future rulemaking to revise Rule 262 and the New Rules or seek appropriate statutory authority to include both foreign and domestic commodities exchanges, commodities self-regulatory organizations and foreign stock exchanges.

#48 See Comment #47.

#49 See Comment #47

Stop Orders and Orders Suspending the Regulation A Exemption

#50 Heeding the Congressional directive of adopting rules "substantially similar" to Rule 262, the SEC should adopt a five-year look-back period as currently set forth in Rule 262(a)(1) and (2).

#51 - 52 Mindful of the Congressional directive to adopt rules substantially similar to Rule 262, I do not think, at this time, the SEC could or should include comparable actions by commodities regulators or other regulators, including foreign securities regulators. However, I think investor protection would be served if the SEC would initiate future rulemaking to revise Rule 262 and the New Rules or seek appropriate statutory authorization to include actions by commodities regulators and foreign securities regulators.

U.S. Postal Service False Representation Orders

#53 Although it may be more appropriate for the New Rules to use a ten-year look-back period for orders described in Rule 262(a)(5) and (b)(5) to align such orders with somewhat similar final orders relating to fraudulent, manipulative or deceptive conduct in Section 926(2)(A)(ii), the SEC is constrained by the statutory language of Dodd-Frank. In this instance, SEC was given legislative permission to adopt rules substantially similar to Rule 262(a)(5) and (b)(5) but, in my view, the statutory language prohibits the SEC from adopting a ten-year look-back period. First, the SEC has not stated a conclusion as to whether a U.S. Postal Service Order issued under 39 U.S.C. 3005 is in the nature of a final order rather than, for instance, a cease-and-desist order. Second, Congress elected not to include the U.S. Postal Service as a designated agency in Section 926(2)(A) of Dodd-Frank and the SEC cannot unilaterally include an agency.

Reasonable Care Exception

#54 - 58 I strongly agree that the New Rules will have a significant impact on small business capital formation. Our firm represents a number of small businesses and generally, it is local registered representatives of small, independent broker-dealers which serve as a vital link between small businesses who need capital and those with capital to invest and this is done almost exclusively by non-public offerings under Rule 506 mainly to accredited investors[25] which would be subject to the New Rules. This link is becoming severely strained by recent regulatory attitudes of FINRA toward private placements and most likely will be all but destroyed if the SEC permits FINRA to adopt its muted proposal to amend Rule 5122, but that is grist for another comment letter.

Therefore, the SEC should be rightfully concerned about the extremely adverse effect on small business capital formation if a small business issuer unknowingly involves a disqualified person in a Rule 505 or 506 offering. It is unreasonable for the SEC to expect that a small business person would be able to read and comprehend the dense legal language constituting the New Rules. No doubt, well versed and experienced securities lawyers will argue over the interpretation and extent of the New Rules for years to come. How can the SEC expect small business persons who are focused on growing their business to have any appreciation for what they may view as nit-picking government regulation?

Inadvertent involvement of a disqualified person in a private placement by a small business issuer would have the effect of the issuer having sold unregistered securities for which it may be civilly liable for rescission for which it most likely would have insufficient funds to effect. In context of a Rule 506 offering, loss of the exemption would nullify the preemptive effects of Section 18(b) of the 1933 Act[26] and expose the issuer and its control persons to civil liability and regulatory action (including monetary penalties) in each state in which the securities were offered and sold. Most small business persons will be wary of undertaking a private placement if they were held liable for including in the offering, unbeknownst to them, a person subject to a disqualification.

On the other hand, the SEC should be concerned about those who knowingly involve disqualified persons in private placements. In light of the foregoing, the SEC properly has proposed to adopt a reasonable care standard. However, I disagree with the proposal to adopt the factual inquiry "Instruction" to this reasonable care standard set forth in NASAA's Model Accredited Investor Exemption ("MAIE")[27] and instead urge that the appropriate standard is the one adopted by NASAA in its Uniform Limited Offering Exemption ("ULOE") and endorsed by NASAA in the Uniform Securities Act (2002). Neither include a "factual inquiry" component.

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[25] As that term is defined in Rule 501 of SEC Regulation D and Section 412(a) of Dodd-Frank.
[26] As amended by the National Securities Markets Improvement Act of 1996 ("NSMIA").
[27] Adopted by NASAA on April 27, 1997. Due to current restrictions on general solicitation in the federal securities laws, the MAIE generally may be used only in conjunction with certain offerings exempt from registration under the 1933 Act under Rule 504 of Regulation D, Regulation A and Section 3(a)(11) of the 1933 Act.

First, most small business persons have no idea what factual inquiry means and the SEC has given no guidance as to what constitutes an acquittal of a factual inquiry obligation. Small business issuers crave "bright line" guidance and, by adding "factual inquiry" on top of "exercise of reasonable care," it is compounding, in the eyes of a small business person, one unknown on top of another. Most could cope with understanding that they have to take reasonable steps to determine if a person participating in an offering has a disqualification but they will be at a loss to identify what more they must do to satisfy the "factual inquiry" test. Retaining this requirement only will result in more transactional costs in the form of legal fees imposed on small business issuers as they seek legal counsel (if they can afford it) to assist them in navigating through the thicket of regulation and protect them from regulatory and civil liability.

Second, NASAA adopted ULOE on September 23, 1983 as a corollary to Rules 505 and 506 of SEC Regulation D which contained and still contains a disqualification provision as well as a reasonable care exception. That exception reads, "It is defense to a violation of this subsection if an issuer sustains the burden of proof to establish that he or she did not know and in the exercise of reasonable care could not have known that a disqualification under this subsection existed." [28]

Third, the Uniform Securities Act (2002) was a project undertaken by the National Conference of Commissioners on Uniform State Laws that involved the participation of the American Bar Association, NASAA, the Investment Company Institute, the then-Securities Industry Association and other interested parties. NASAA endorsed the Uniform Securities Act (2002).[29] Since this endorsement occurred subsequent to adoption of the MAIE, it can be inferred that the provisions in the Uniform Securities Act (2002) represents NASAA's most current regulatory thinking on the reasonable care exception.

The Uniform Securities Act (2002) provides a reasonable care exception in the context of issuers,[30] broker-dealers,[31] investment advisers[32] and control persons.[33] In all cases, the language of the exception is that the person did not know, and in the exercise of reasonable care, could not have known (of the order in the case of an issuer or of an existing suspension, revocation or bar in the case of a person seeking employment or association with a broker-dealer or investment adviser). There is no requirement for a factual inquiry as in the MAIE.

In light of this chronology, the factual inquiry component found in the MAIE must be viewed as an anomaly occurring between NASAA's adoption of ULOE and its endorsement of the Uniform Securities Act (2002) and should not be construed as reflecting the current view of NASAA. Since NASAA endorsed the Uniform Securities Act (2002) *in toto* and subsequent to the MAIE, one must assume that it had no problem with dispensing with a factual inquiry

[28] Section 1.B. of the ULOE. The application of ULOE to Rule 506 offerings was preempted by Section 18(b) of the 1933 Act as amended by the National Securities Markets Improvement Act of 1996.
[29] http://www.nasaa.org/NASAA_Newsroom/News_Release_Archive/1572.cfm
[30] Section 204(b) of the Uniform Securities Act (2002).
[31] Section 401(c) of the Uniform Securities Act (2002).
[32] Section 403(c) of the Uniform Securities Act (2002).
[33] Section 412(h) of the Uniform Securities Act (2002).

requirement. To adopt one now would make the New Rules non-uniform with ULOE and the Uniform Securities Act (2002).

Therefore, the principles of uniformity and not placing an unreasonable burden on small business issuers argues for adoption of a reasonable care exception as set forth in proposed Rule 506(c)(2)(ii) without the "factual inquiry" component described in the Release as "Instruction to paragraph (c)(2)(ii)."

Waivers

#59 - 62 I believe that the SEC is compelled by the Congressional directive to adopt rules substantially similar to Rule 262 to provide for waivers of disqualification as currently set forth in the preamble to Rule 262. To my knowledge, SEC staff has not published any compliance and disclosure interpretations concerning the circumstances that likely would give rise to the grant or denial of a waiver. As the SEC has admitted, Section 926 will act to expand significantly the universe of disqualified persons. Therefore, it may be reasonable to expect that SEC staff may experience a significant increase in the number of waiver requests submitted. Under the expanded disqualification provisions of Section 926, SEC staff may view waiver requests from various categories of disqualified persons differently and may want to apply different standards to different categories.

This is to say that it would be exceedingly helpful to securities law practitioners if SEC staff could provide some guidance as to waivers so that counsel could relate the same to affected clients and advise them as to whether, under their particular circumstances, requesting a waiver would be a viable option. This may act to save SEC staff from having to deal with a large increase in waiver requests because as it now stands, a client may have no reason not to file a waiver request.

Although it would be unreasonable to expect SEC staff to address every element which may be a factor in making a waiver determination, it could publish a compliance and disclosure interpretation simultaneously with the adopting release for the New Rules giving some general guidance, such as (1) minimum of amount of time which must pass from the disqualifying event before the SEC might even consider a favorable response, (2) the types of conduct which would give rise to a significant likelihood that no waiver would be granted or (3) the likelihood of granting a waiver for an entity which has undergone a change of control since the disqualifying event (see Comment #12).

I would urge the SEC to adopt, as part of the New Rules, an automatic waiver provision which state securities regulators successfully have maintained in ULOE for almost 30 years[34] and in the MAIE for almost 15 years.[35] These waiver provisions automatically become effective if (1) the party subject to the disqualification is licensed or registered to conduct securities-related business in the state in which the order, judgment or decree creating the disqualification

[34] *Supra* note 26.
[35] http://www.nasaa.org/content/Files/Model_Accredited_Investor_Exemption.pdf. Section D(2) provides specific waivers of the disqualification provisions.

was entered or (2) the state securities administrator or the court or regulatory authority that entered the order, judgment or decree waives the disqualification.

To simplify an automatic waiver but not to the prejudice of applying for, and granting of, discretionary waivers, I would suggest that the SEC adopt, as Rule 506(c)(2)(iii), the following automatic waiver language:

(iii) If the person subject to a disqualification enumerated in paragraph (c)(1) currently is licensed or registered to conduct a business which is subject to regulation by the commission, authority, agency or officer which issued the order creating the disqualification.

This automatic waiver concept is premised on the fact that, if the agency which issued the order creating the disqualification is satisfied that the disqualified person should continue to hold a license to conduct a business regulated by that agency, then other regulatory agencies should defer to that agency's determination.

Adoption of this automatic waiver provision also would answer, in part, the SEC's query as to whether, before granting a waiver request, it should consult or seek the concurrence of the agency which issued the final order. Under this provision, continued licensure by the agency which issued the final order implies its concurrence in a waiver and, in the case of state securities regulators, assurance that they already have accepted the principle of certain automatic waivers.

Transition Issues

At the outset, all must understand that transition rules, of necessity, will be arbitrary and, in many cases, the question simply is where to draw the line.

Disqualifying events that pre-date the rule

#63 - 65 The SEC has proposed taking past disqualifying events into account under the New Rules. As the SEC has admitted, Section 926 greatly increases the universe of disqualified persons.

At the meeting where the SEC approved publication of the Release, Commissioner Paredes spoke eloquently about a potentially large number of persons who voluntarily entered into settlements with the SEC and other regulators without the knowledge that doing so would restrict in future their ability to engage in certain activity.[36] His view is that, under applicable federal case law, the absence of an explicit temporal reach enacted by Congress in Section 926 establishes a presumption against retroactivity. SEC staff countered that enactment of Section 926 implicitly mandates immediate application of retroactive events upon effectiveness of the rules (which, of course, were to have been effective per legislative mandate by July 21, 2011). So, perhaps mandates are really in the eye of the beholder.

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[36] http://www.sec.gov/news/speech/2011/spch052511tap-item1.htm. *See also supra,* note 7.

More charitably, SEC staff may be concerned that a significant delay in the application of the disqualification provisions would adversely affect investor protection but, on the other hand, these protections have been absent from Rule 506 offerings since 1983. Upon enactment of NSMIA and the preemption of ULOE with respect to Rule 506 offerings, state securities commissions brought to the attention of the SEC the resulting lack of federal and state disqualification provisions applicable to Rule 506 offerings and asked the SEC to consider imposing such disqualification but the SEC showed no such interest and merely said that it would make referrals of any abuses to its Division of Enforcement.[37] So, why now the rush?

To put Commissioner Paredes' concerns in perspective, previously a "bar" only created a statutory disqualification under Section 3(a)(39) of the 1934 Act. So, a person readily may have accepted a "bar" in a settlement with a regulator because he had no future intention of re-entering the brokerage business and therefore, the Section 3(a)(39) statutory disqualification would have been of no concern. However, at the time he may have accepted the "bar," he may have had no idea that such acceptance now would have the effect of disqualifying him from participating in a Rule 506 offering, even as a minority shareholder.

It appears that Commissioner Paredes is saying that enactment of the Rule 506 disqualifications is such a major game changer that it can be presumed that many persons who voluntarily entered into settlements which at the time had only the effect of a limited disqualification, if any, would not have done so had they anticipated enactment of the scope and magnitude of Section 926 of Dodd-Frank. It should be noted that the language in Section 926 of Dodd-Frank underwent significant and sweeping changes during the legislative debate to the point where no one really knew what the final language would entail until right before final Congressional passage.

It is acknowledged that the vast majority of administrative proceedings are concluded by accepting offers of settlement from respondents which result in consent orders. These consent orders are issued without submission of evidence before a tribunal and contain limited, albeit negotiated, findings of facts and conclusions of law. Often, respondents elect to settle regulatory matters because they do not have the financial resources to fund long-term litigation and want to move on with their business life. They generally are at a disadvantage in context of the resources at the disposal of the state which can be devoted to pursuing a particular matter or person.

As a compromise, I would urge the SEC to grandfather all pre-existing disqualifying events which arose as a result of settlements and consent orders and would support the SEC's conditioning of this the grandfathering on disclosure of the basis for the disqualification. I think

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[37] *See* Letter dated March 3, 1998 to Arthur Levitt, Chairman, U.S. Securities & Exchange Commission from Robert M. Lam, A. Richard Gerber and John A. Maher, respectively Chairman and Commissioners of the Pennsylvania Securities Commission. Letter dated May 18, 1998 to Brian Lane, Director, Division of Corporation Finance, U.S. Securities & Exchange Commissioner from John A. Maher, Commissioner, Pennsylvania Securities Commission. Letter dated April 16, 1998 to Robert M. Lam, Chairman, Pennsylvania Securities Commission from Arthur Levitt, Chairman, U.S. Securities & Exchange Commission. Letter dated June 10, 1998 to John A. Maher, Commissioner, Pennsylvania Securities Commission from William E. Morley, Senior Associate Director, Division of Corporation Finance, U.S. Securities & Exchange Commission.

this appropriately balances the legal issues raised by Commissioner Parades with the investor protection issues implicit in enactment of Section 926. Although certain conduct will be grandfathered from the disqualification effects of Section 926, the SEC will have assurances that the investing public will be provided with appropriate disclosure describing such conduct upon which to make an informed investment decision.

On the other hand, where a respondent has had his full day in court, and after a hearing on the record with written findings of fact and conclusions of law, becomes subject to an order resulting in a disqualification, there should be no grandfathering of the disqualifying event.

It is the general consensus of the securities bar that Section 926 does not become operative until the SEC has issued final rules as required by that section. Therefore, the grandfathering of disqualifying events arising from settlements should date from the effective date of the New Rules since that is when Section 926 becomes operative.

#66 It would seem that equity would demand that, if necessary, the SEC should extend any waivers to Rule 506(c) which previously were granted by the SEC under Rule 262, Rule 505 or Regulation E.

Effect of Ongoing Offerings

#67 - 68 The timing of Rule 506 offerings generally is propelled by business considerations, not timing of regulatory actions. Therefore, issuers do not plan offerings around when the New Rules may become effective. Therefore, I propose the SEC adopt the following:

- The New Rules would not apply to sales in an ongoing offering where the issuer had filed Form D with the SEC prior to the effectiveness of the New Rules where "no" was checked on Item 8 of Form D. If, prior to effectiveness of the New Rules, an amendment was filed to change the response to "yes" for Item 8, then the rule immediately set forth below would apply.

- The New Rules would not apply to an ongoing offering where the issuer had filed Form D with the SEC prior to the effectiveness of the New Rules where "yes" was checked in Item 8 of Form D until the date on which the annual updating amendment was required to be filed with the SEC. The disqualification requirements would apply only to sales made on or after the date the next annual amendment was required to be filed with the SEC.

- If an issuer made sales in an offering prior to the effective date of the New Rules but was not required to file and did not file Form D with the SEC on or after the effective date of the New Rules, the New Rules would apply only to sales made in the ongoing offering on or after the effective date of the New Rules.

Timing of Implementation

#69 This is highly dependent upon the terms of the New Rules. For instance, if the SEC would adopt the (1) suggested automatic waiver provision, (2) grandfathering with respect to disqualifications arising from settlements with appropriate disclosure, and (3) suggested effect on ongoing offerings, then I think a shorter implementation period of 60 days would be sufficient. If the SEC decides not to adopt any of these suggestions but particularly the effect on ongoing offerings, a significantly longer implementation period (ie, 120 days) may be required for counsel to comprehend the scope of the New Rules, determine how the New Rules apply to each of counsel's clients and communicate the impact, if any, on their clients' business, current securities offerings and any planned capital raising initiatives.

I appreciate the opportunity to provide comments on a very detailed and thoughtful Release.

Very truly yours,

G. Philip Rutledge
Partner