SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

CHRISTOPHER COX, CHAIRMAN

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE L. NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

59 Documents

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 230, 239 and 249

[RELEASE NOS. 33-8818; 34-55998; INTERNATIONAL SERIES RELEASE NO. 1302; File No. S7-13-07]

RIN 3235-AJ90

ACCEPTANCE FROM FOREIGN PRIVATE ISSUERS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS WITHOUT RECONCILIATION TO U.S. GAAP

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is proposing to accept from foreign private issuers their financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB") without reconciliation to generally accepted accounting principles ("GAAP") as used in the United States. To implement this, we propose amendments to Form 20-F and conforming changes to Regulation S-X to accept financial statements prepared in accordance with the English language version of IFRS as published by the IASB without reconciliation to U.S. GAAP when contained in the filings of foreign private issuers with the Commission.

We also are proposing conforming amendments to other regulations, forms and rules under the Securities Act and the Exchange Act. Current requirements regarding the reconciliation to U.S. GAAP will not change for a foreign private issuer that uses a basis of accounting other than the English language version of IFRS as published by the IASB.

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DATES: Comments should be received on or before [insert date 75 days following publication in the *Federal Register*].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use of the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-13-07 on the subject line; or
- Use the Federal Rulemaking ePortal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-13-07. The file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed/shtml). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Questions about this release should be directed to Michael D. Coco, Special Counsel, Office of International Corporate

Finance, Division of Corporation Finance, at (202) 551-3450, or to Katrina A. Kimpel, Professional Accounting Fellow, Office of the Chief Accountant, at (202) 551-5300, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: The Commission is publishing for comment proposed amendments to Form 20-F[1] under the Securities Exchange Act of 1934 (the "Exchange Act"),[2] Rules 3-10 and 4-01 of Regulation S-X,[3] Forms F-4 and S-4 under the Securities Act,[4] and Rule 701 under the Securities Act.[5]

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[1] 17 CFR 249.220f.

[2] 15 U.S.C. 78a et seq. Form 20-F is the combined registration statement and annual report form for foreign private issuers under the Exchange Act. It also sets forth disclosure requirements for registration statements filed by foreign private issuers under the Securities Act of 1933 (the "Securities Act"). 15 U.S.C. 77a et seq.

The term "foreign private issuer" is defined in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer means any foreign issuer other than a foreign government except an issuer that meets the following conditions: (1) more than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States.

[3] 17 CFR 210.3-10 and 17 CFR 210.4-01. Regulation S-X sets forth the form and content of requirements for financial statements.

[4] 17 CFR 239.34 and 17 CFR 239.13.

[5] 17 CFR 230.701.

b. Financial Statements in Securities Act Registration Statements and Prospectuses and Initial Exchange Act Registration Statements Used More Than Nine Months after the Financial Year End

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I. OVERVIEW AND HISTORY

Foreign private issuers that register securities with the SEC, and that report on a periodic basis thereafter under Section 13(a) or 15(d) of the Exchange Act,[6] are currently required to present audited statements of income, financial position, changes in shareholders' equity and cash flows for each of the past three financial years,[7] prepared on a consistent basis of accounting.[8] All foreign private issuers are currently required to reconcile to U.S. GAAP the financial statements that they file with the Commission if the financial statements are prepared using any basis of accounting other than U.S. GAAP.[9]

The Commission is proposing for comment revisions to Form 20-F and Regulation S-X under which it would accept financial statements of foreign private issuers that are prepared on the basis of the English language version of IFRS as

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[6] 15 U.S.C. 78m(a) or 78o(d). Section 13(a) of the Exchange Act requires every issuer of a security registered pursuant to Section 12 of the Exchange Act [15 U.S.C. 781] to file with the Commission such annual reports and such other reports as the Commission may prescribe. Section 15(d) of the Exchange Act requires each issuer that has filed a registration statement that has become effective pursuant to the Securities Act to file such supplementary and periodic information, documents and reports as may be required pursuant to Section 13 in respect of a security registered pursuant to Section 12, unless the duty to file under Section 15(d) has been suspended for any financial year.

[7] Consistent with Form 20-F, IFRS and general usage outside the United States, we use the term "financial year" to refer to a fiscal year. See Instruction 2 to Item 3 of Form 20-F. Foreign private issuers that are first-time adopters of IFRS published by the IASB are permitted to provide financial statements for the most recent two financial years. See General Instruction G for Form 20-F.

[8] See Item 8.A.2 of Form 20-F. Instructions to this item permit a foreign private issuer to omit a balance sheet for the earliest of the three years if that balance sheet is not required by a foreign jurisdiction.

[9] See Items 17 and 18 of Form 20-F; see also Article 4 of Regulation S-X.

published by the IASB without a reconciliation to U.S. GAAP.[10] The revisions would allow a foreign private issuer to file financial statements prepared in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP. We are not proposing to change existing reconciliation requirements for foreign private issuers that file their financial statements under other sets of accounting standards, or that are not in full compliance with IFRS as published by the IASB.

A. History of the U.S. GAAP Reconciliation Requirement

In a reconciliation, a foreign private issuer that files its financial statements prepared in accordance with a basis of accounting other than U.S. GAAP must identify and quantify the material differences from the requirements of U.S. GAAP and Regulation S-X. The reconciliation to U.S. GAAP may be presented pursuant to either Item 17 or Item 18 of Form 20-F. Under Item 17, an issuer is required to provide a narrative description of differences and a quantitative reconciliation of specific financial statement line items from non-U.S. GAAP to U.S. GAAP, but without all U.S. GAAP and Regulation S-X disclosures. An issuer may use Item 17 when filing its financial statements in an Exchange Act registration statement or annual report filed on Form 20-F, or as part of a Securities Act registration statement for investment grade, non-convertible securities or certain rights offerings. Under Item 18, an issuer is required to provide the reconciling information specified in Item 17 as well as all disclosures required by

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[10] All references in this release to IFRS as published by the IASB refer to the English language version of IFRS. The IASB approves the English language text of any IFRS standard, although the International Accounting Standards Committee Foundation ("IASC Foundation") may issue translations into other languages. See "International Financial Reporting Standards (IFRSs), including International Accounting Standards (IASs) and Interpretations as at 1 January 2005," International Accounting Standards Board Preface to IFRS, at 27.

Regulation S-X and U.S. GAAP. An issuer must comply with Item 18 when filing financial statements in a Securities Act registration statement for offerings of equity, convertible and other securities.

The Commission first addressed discrepancies in financial information provided under a foreign basis of accounting and U.S. GAAP through amendments to Forms 20 and 20-K adopted in 1967.[11] Although a reconciliation to U.S. GAAP was not explicitly required, the amended instructions to Form 20 required that "every issuer registering securities on this form shall file as a part of its registration statement the financial statements, schedules and accountants' certificates which would be required to be filed if the registration statement were filed on Form 10.[12] Any material variation in accounting principles or practices from the form and content of financial statements prescribed in Regulation S-X shall be disclosed and, to the extent practicable, the effect of each such variation given."[13] The financial statement instructions for the annual report on Form 20-K contained a similar requirement.[14]

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[11] See Securities Exchange Act Release Nos. 8067 and 8068 (April 28, 1967). Form 20 was the registration statement under Section 12 of the Securities Act and Form 20-K was the annual report form for foreign private issuers.

[12] Form 10 is the registration statement under Section 12 of the Exchange Act for domestic issuers.

[13] Although the Commission adopted Regulation S-X in 1940 as an instruction booklet to be followed in the preparation of financial statements to be included in filings, application of the Regulation did not extend to foreign private issuers.

[14] Prior to 1967, foreign private issuers were required only to present financial statements consisting of a balance sheet as of the close of the most recent fiscal year and a profit and loss statement for the fiscal year preceding the date of the balance sheet. The financial statements were not required to be certified.

In 1979, the Commission adopted significant amendments to the disclosure requirements applicable to foreign private issuers.[15] These amendments were based on the Commission's belief that "providing more meaningful disclosure to investors in foreign securities not only would promote the protection of investors but may encourage the free flow of capital between nations and tend to reduce any competitive disadvantage with which United States issuers must contend vis-à-vis foreign issuers of securities."[16]

The Commission adopted the current reconciliation requirements in 1982 when adopting new Securities Act registration statements for foreign private issuers as part of its comprehensive efforts to develop an integrated disclosure system.[17] Prior to 1982, offering documents of foreign private issuers contained a full reconciliation, while annual reports required only a narrative description of differences between a foreign basis of accounting and U.S. GAAP.[18]

The Commission's approach has developed in the context of integrated disclosure. In designing the integrated disclosure regime for foreign private issuers, the

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[15] Securities Exchange Act Release No. 34-16371 (November 29, 1979).

[16] Securities Exchange Act Release No. 34-14128 (November 2, 1977).

[17] Securities Act Release No. 33-6437 (November 19, 1982).

[18] Until 1980 the only guidance with respect to accounting principles and financial statements of foreign issuers were form-based requirements and the continued applicability of Accounting Series Release 4, which, since 1935, required only that the accounting principles used by foreign private issuers have authoritative support. In 1980, the Commission amended Regulation S-X adding language to Rule 4-01 to require foreign issuers' financial statements prepared in accordance with a comprehensive basis of accounting other than U.S. GAAP to be reconciled to U.S. GAAP.

Commission endeavored to "design a system that parallels the system for domestic issuers but also takes into account the different circumstances of foreign registrants."[19]

Given the dual considerations of investor protection and even-handedness towards foreign private issuers, the Commission has framed its consideration of the reconciliation requirement as a balancing of two policy concerns: investors' need for the same type of basic information when making an investment decision regardless of whether the issuer is foreign or domestic, and the public interest served by an opportunity to invest in a variety of securities, including foreign securities.[20] Investors' need for the same type of basic information implies that foreign and domestic registrants should be subject to the same disclosure requirements. However, the burden on foreign issuers of meeting the identical disclosure standards as domestic issuers might discourage them from offering their securities on the U.S. market. If foreign issuers chose not to offer their securities in the United States, it would deprive U.S. investors of investment opportunities and potentially compel them to purchase foreign securities on foreign markets, where disclosure may be less than that required in filings with the Commission.[21]

B. The International Accounting Standards Board and IFRS

The IASB is a stand-alone, privately funded accounting standard-setting body established to develop global standards for financial reporting.[22] It is the successor to the

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[19] Securities Act Release No. 33-6360 (November 20, 1981) (the "1981 Proposing Release").

[20] Id.

[21] Id.

[22] For more information on the structure and operation of the IASB, see http://www.iasb.org/Home.htm.

International Accounting Standards Committee ("IASC"), which was created in 1973 to develop International Accounting Standards ("IAS"). Based in London, the IASB assumed accounting standard-setting responsibilities from the IASC in 2001.[23] Since that time, the standards that the IASB develops and approves have been known as IFRS.[24]

The IASB is overseen by the IASC Foundation, a stand-alone organization responsible for, among other things, the activities of the IASB.[25] The 22 trustees of the IASC Foundation appoint IASB members, oversee its activities, and raise necessary

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[23] This was the culmination of a reorganization in 2000 based on the recommendations to the IASC Board contained in a 1999 report by the IASC's Strategic Working Party entitled "Recommendations on Shaping the IASC for the Future." (Full text available at http://www.iasplus.com/restruct/1999swpfinal.pdf). From 1973 until that restructuring, the entity for setting International Accounting Standards had been known as the IASC. The IASC issued 41 standards on major topical areas through December 2000, which are entitled International Accounting Standards. The predecessor standard-setting board was known as the IASC Board.

[24] The IASB continues to recognize the IAS issued by the IASC, as modified or superseded by the IASB. Those IAS now form part of the body of IFRS. See IAS 1, paragraph 11. Standards that are newly developed by the IASB or are extensive revisions of earlier IAS are entitled International Financial Reporting Standards.

In general usage, and in this release, the term IFRS will be used to encompass both IAS and IFRS. The term IFRS is used to refer both to the body of IASB pronouncements generally and to individual standards and interpretations applicable in specific circumstances. For purposes of this release, financial statements "prepared in accordance with IFRS" refer to financial statements that an issuer can unreservedly and explicitly state are in compliance with IFRS as published by the IASB and that are not subject to any qualification relating to the application of IFRS as published by the IASB.

[25] The IASC Foundation is comprised of twenty-two individuals each serving a term of three years subject to one re-appointment. Its staff works directly with the IASB and project resource groups, conducts research, participates in roundtable meetings, analyzes public comments, and prepares recommendations and drafts for consideration by the IASB.

funding for the IASB, the IASC Foundation, the International Financial Reporting Interpretations Committee ("IFRIC"), and the Standards Advisory Council ("SAC").[26]

The IASC Foundation Trustees select members of the IASB to comprise "within that group, the best available combination of technical skills and background experience of relevant international business and market conditions in order to contribute to the development of high-quality, global accounting standards."[27] The fourteen members of the IASB, twelve full-time and two part-time, serve a five-year term subject to one re-appointment. They are required to sever all employment relationships and positions that may give rise to economic incentives which might compromise a member's independent judgment in setting accounting standards. The current IASB members come from nine countries and have a variety of backgrounds. In selecting IASB members, the IASC Foundation Trustees ensure that the IASB is not dominated by any particular constituency. Member selection is not based on geographic representation.

To date, the IASC Foundation has financed IASB operations largely through voluntary contributions from companies, accounting firms, international organizations and central banks. Original commitments were made for the period 2001-2005 and have

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[26] IFRIC interprets IFRS and reviews accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment. The IFRIC is comprised of twelve voting members, appointed by the IASC Foundation Trustees for renewable terms of three years. IFRIC Interpretations are ratified by the IASB prior to becoming effective.

The SAC supports the IASB and provides a forum where the IASB consults individuals and representatives of organizations affected by its work that are committed to the development of high-quality IFRS. The Commission is an observer of the SAC.

[27] IASC Foundation Constitution, Paragraph 20; see http://www.iasb.org/About+Us/About+IASB/About+IASB.htm.

been extended for an additional two years through 2007. In June 2006, the IASC Foundation Trustees agreed on four elements that should govern the establishment of a funding approach that would enable the IASC Foundation to remain a stand-alone, private sector organization with the necessary resources to conduct its work in a timely fashion.[28] The Trustees continue to make progress in obtaining stable funding that satisfies those elements.

The IASB has stated that it is committed to "developing, in the public interest, a single set of high-quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements."[29] In addition, the IASC Foundation has committed to the continued development of IFRS to achieve high-quality solutions through the convergence of national accounting standards.

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[28] The Trustees determined that "characteristics of the new scheme for 2008 would be:

- Broad-based: Fewer than 200 companies and organizations participate in the current financing system. A sustainable long-term financing system must expand the base of support to include major participants in the world's capital markets, including official institutions, in order to ensure diversification of sources.
- Compelling: Any system must carry with it enough pressure to make free riding very difficult. This could be accomplished through a variety of means, including official support from the relevant regulatory authorities and formal approval by the collecting organizations.
- Open-ended: The financial commitments should be open-ended and not contingent on any particular action that would infringe on the independence of the IASC Foundation and the International Accounting Standards Board.
- Country-specific: The funding burden should be shared by the major economies of the world on a proportionate basis, using Gross Domestic Product as the determining factor of measurement. Each country should meet its designated target in a manner consistent with the principles above."

See http://www.iasb.org/About+Us/About+the+Foundation/Future+Funding.htm.

[29] See www.iasb.org/About+Us/About+IASB/About+IASB.htm. See also the IASCF Foundation Constitution.

The use of IFRS is increasingly widespread throughout the world. Almost 100 countries now require or allow the use of IFRS, and many other countries are replacing their national standards with IFRS. The European Union ("EU"), for example, has, under a regulation adopted in 2002, required companies incorporated in one of its Member States and whose securities are listed on an EU regulated market to report their consolidated financial statements using endorsed IFRS beginning with the 2005 financial year.[30] It has been estimated that these requirements affect approximately 7,000 companies in the EU.[31] In addition to issuers in the 27 EU Member States, these IFRS requirements also apply in the three European Economic Area countries of Iceland, Lichtenstein and Norway.[32] Other countries, including Australia and New Zealand, have adopted similar requirements mandating the use of IFRS by public companies.[33] More

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[30] Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, Official Journal L. 243, 11/09/2002 P. 0001-0004 (the "EU Regulation"). EU regulations have the force of law within EU Member States without further implementing legislation at the national level.

[31] Committee of European Securities Regulators ("CESR"), "European Regulation on the Application of IFRS in 2005: Recommendation for Additional Guidance Regarding the Transition to IFRS," (December 2003).

[32] The current EU Member States are: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, Spain, Sweden, and the United Kingdom.

[33] Some countries, such as Australia, have adopted IFRS by incorporating them into their national standards.

countries have plans to adopt IFRS as their national accounting standards in the future, including Canada[34] and Israel.[35]

C. The Financial Accounting Standards Board

The FASB is the independent, private-sector body whose pronouncements establishing and amending accounting principles the Commission has, since 1973, recognized as "authoritative" and "generally accepted" for purposes of the federal securities laws, absent any contrary determination by the Commission.[36] The FASB is overseen by the Financial Accounting Foundation ("FAF"), which is responsible for funding the activities of the FASB and selecting the seven full-time FASB members.[37] The FAF is an independent, non-profit organization that is run by a sixteen-member Board of Trustees. The FASB has oversight of the Emerging Issues Task Force, which is the interpretative entity of U.S. GAAP. The FASB also is supported by the Financial

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[34] See "Implementation Plan for Incorporating International Financial Reporting Standards into Canadian GAAP," available at http://www.acsbcanada.org/client_asset/document/3/2/7/3/5/document_8B452E12-FAF5-7113-C4CB8F89B38BC6F8.pdf?sfgdata=4.

[35] See Israel Accounting Standard No. 29 "Adoption of International Financial Reporting Standards," stipulating that Israeli public companies that prepare their primary financial statements in accordance with Israeli GAAP are obliged to adopt IFRS unreservedly for years starting on January 1, 2008. See also http://www.iasplus.com/country/israel.htm.

[36] See "Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards," Accounting Series Release No. 150 (December 20, 1973) (expressing the Commission's intent to continue to look to the private sector for leadership in establishing and improving accounting principles and standards through the FASB) and "Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter," Release No. 33-8221 (April 25, 2003) (the "2003 Policy Statement"). More information about the FASB is available on their website at www.fasb.org.

[37] See http://www.fasb.org/facts/bd_members.shtml.

Accounting Standards Advisory Council, which is responsible for consulting with the FASB as to technical issues on the FASB's agenda and project priorities.

Consistent with the FASB's objective to increase international comparability and the quality of standards used in the United States, the FASB participates in international accounting standard setter activities. This objective is consistent with the FASB's obligation to its domestic constituents, who benefit from comparability of information across national borders. The FASB pursues this objective in cooperation with the IASB, as discussed in more detail below, and with national accounting standard setters.

The Commission oversees the activities of the FASB as part of its responsibilities under the securities laws. While the Commission consistently has looked to the private sector to set accounting standards, the securities laws provide the Commission with the authority to set accounting standards for public companies and other entities that file financial statements with the Commission.[38] As part of its oversight responsibilities, the Commission provides views regarding the selection of FASB members, and, in certain circumstances, refers issues relating to accounting standards to the FASB or one of its affiliated organizations. The Commission and its staff do not, however, prohibit the FASB from addressing topics of its choosing and do not dictate the outcome of specific FASB projects, so long as the FASB's conclusions are in the interest of investor protection.[39]

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[38] This authority was reaffirmed in the Sarbanes-Oxley Act, Section 108(c) of which states, "Nothing in this Act, including this section...shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws."

[39] See the 2003 Policy Statement.

D. The Commission's Past Consideration of a Single Set of Globally Accepted Accounting Standards and Facilitation of the Use of IFRS by Registrants

The Commission has long advocated reducing disparity between the accounting and disclosure practices of the United States and other countries as a means to facilitate cross-border capital formation while ensuring adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets. The Commission also has encouraged the efforts of standard setters and other market participants to do the same. In a 1981 release proposing revisions to Form 20-F, the Commission expressed its support for the work of the IASC in formulating guidelines and international disclosure standards.[40] As part of a 1988 Policy Statement, the Commission explicitly supported the establishment of mutually acceptable international accounting standards as a critical goal to reduce regulatory impediments that result from disparate national accounting standards without compromising investor protection.[41] Accordingly, it urged "securities regulators and members of the accounting profession throughout the world [to] continue efforts to revise and adjust international accounting standards with the aim of increasing comparability and reducing cost" and reaffirmed its commitment to working with securities regulators around the world to achieve the goal of an efficient international securities market system.[42]

In encouraging the acceptance of mutually agreeable global accounting principles and reducing regulatory burdens while protecting investors, the Commission has

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[40] See the 1981 Proposing Release.

[41] See Release No. 33-6807 (November 14, 1988) (the "1988 Policy Statement").

[42] Id.

recognized that information required by an international accounting standard may be adequate for investors even if that information is not the same as information required under U.S. GAAP. One example of this approach is the 1994 amendment to Form 20-F to accept without reconciliation to U.S. GAAP a cash flow statement prepared in accordance with IAS No. 7, "Cash Flow Statements," which the IASC amended in 1992. In proposing that amendment, the Commission noted that "while there are differences between a cash flow statement prepared in accordance with IAS 7 and one prepared in accordance with U.S. GAAP....the Commission believes statements prepared in accordance with IAS 7 should provide an investor with adequate information regarding cash flows without the need for additional information or modification."[43] In adopting this and other revisions to Item 17 of Form 20-F, the Commission expressed its belief that streamlined reconciliation requirements will facilitate foreign companies' entry into the United States public securities markets in a manner consistent with investor protection.[44]

The Commission more closely examined efforts to develop high-quality, comprehensive global accounting standards in its 1997 report undertaken at the direction

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[43] The Commission proposed these amendments in Release No. 33-7029 (November 3, 1993) and adopted them in Release No. 33-7053 (April 19, 1994) (the "1994 Adopting Release"). Other examples in which the Commission amended its requirements for financial statements of foreign issuers to permit the use of certain IASC standards without reconciliation to U.S. GAAP are described in the SEC Concept Release "International Accounting Standards," Release No. 33-7801 (February 16, 2000) (the "2000 Concept Release").

[44] See the 1994 Adopting Release.

of Congress.[45] In that study, the Commission noted that for issuers wishing to raise capital in more than one country, compliance with differing accounting requirements to be used in the preparation of financial statements increased compliance costs and created inefficiencies. As a step towards addressing these concerns and to increase the access of U.S. investors to foreign investments in the U.S. public capital market, the Commission encouraged the IASC's efforts to develop a core set of accounting standards that could serve as a framework for financial reporting in cross-border offerings, and indicated an intent to remain active in the development of those standards. In that report, the Commission indicated that its evaluation of IASC core standards would involve an assessment of whether they constituted a comprehensive body of transparent, high-quality standards that could be rigorously interpreted and applied.[46]

In February 2000, the Commission issued a Concept Release on International Accounting Standards, seeking public comment on the elements necessary to encourage convergence towards a high quality global financial reporting framework while upholding the quality of financial reporting domestically.[47] In that release, the Commission described high-quality standards as consisting of a "comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation

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[45] Pursuant to Section 509(5) of the National Securities Markets Improvement Act of 1996, "Report on Promoting Global Preeminance of American Securities Markets" (October 1997).

[46] Id.

[47] See Concept Release No. 34-42430 "International Accounting Standards" (February 16, 2000).

decisions."[48] The Commission also expressed the view that high-quality accounting standards "must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied."[49] The release sought comments as to the conditions under which the Commission should accept financial statements of foreign private issuers that are prepared using IFRS, and considered the issue of the U.S. GAAP reconciliation of IFRS financial statements. The Commission has continued to monitor international developments in the subject areas that are discussed in the release.

In 2003, the Commission staff prepared a study on the adoption of a principles-based accounting system, as mandated by Congress in the Sarbanes-Oxley Act.[50] The conclusion of that study was that an optimal approach to accounting standard-setting would be based on a consistently applied conceptual framework and clearly stated objectives rather than solely on either rules or principles, one benefit of which would be the facilitation of greater convergence between U.S. GAAP and international standards. By taking an objectives-based approach to convergence, the study noted, standard setters would be able to arrive at an agreement on a principle more quickly than would be possible for a detailed rule. The staff's report to Congress interpreted convergence as a "process of continuing discovery and opportunity to learn by both U.S. and international

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[48] Id.

[49] Id.

[50] Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System (July 25, 2003).

standard setters," the benefits of which include greater comparability and improved capital formation globally.[51]

In February 2006, Chairman Cox reaffirmed his commitment to the "Roadmap" that was first described by a former Chief Accountant of the Commission in April 2005.[52] The Roadmap sets forth the goal of achieving one set of high-quality, globally accepted accounting standards and suggested several considerations that could affect the achievement of that goal.

The Commission also has taken steps to facilitate the use of IFRS by registrants. When the European Union adopted a regulation in 2002 to require the use of IFRS by all European issuers with publicly traded securities beginning with their 2005 financial year, the Commission adopted an accommodation to allow first-time adopters of IFRS to file two years rather than three years of financial statements in their Commission filings.[53] In so doing, the Commission sought to facilitate the transition to IFRS of the foreign registrants that were using it for the first time. The Commission recognized that this accommodation would reduce costs to foreign issuers and encourage their continued participation in the U.S. public capital market, which would benefit investors by increasing investment possibilities and furthering the efficient allocation of capital. Acknowledging the significant efforts expended by many foreign private issuers in their

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[51] Id.

[52] SEC Press Release No. 2006-17, Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements (Feb. 8, 2006).

[53] Release No. 33-8567 (April 12, 2005).

transition to IFRS, the Commission also extended compliance dates for management's report on internal control over financial reporting.[54]

E. FASB and IASB Efforts to Develop a Work Plan to Achieve High Quality, Compatible Accounting Standards

In October 2002, the FASB and the IASB announced the issuance of a memorandum of understanding, called the Norwalk Agreement, which marked a significant step towards formalizing their commitment to the convergence of U.S. and international accounting standards. The two bodies acknowledged their joint commitment to the development, "as soon as practicable," of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that time, the FASB and the IASB pledged to use their best efforts to make their existing financial reporting standards fully compatible as soon as is practicable and to co-ordinate their future work programs to ensure that once achieved, compatibility is maintained. In a 2006 Memorandum of Understanding, the FASB and the IASB indicated that a common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB and set out a work plan covering the next two years for convergence with specific long- and short-term projects.[55]

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[54] Release No. 33-8545 (March 2, 2005).

[55] "A Roadmap for Convergence between IFRS and U.S. GAAP – 2006-2008," Memorandum of Understanding between the FASB and the IASB, February 27, 2006 (the "2006 Memorandum of Understanding").

II. ACCEPTANCE OF IFRS FINANCIAL STATEMENTS FROM FOREIGN PRIVATE ISSUERS WITHOUT A U.S. GAAP RECONCILIATION AS A STEP TOWARDS A SINGLE SET OF GLOBALLY ACCEPTED ACCOUNTING STANDARDS

The Commission has encouraged movement towards a single set of high-quality globally accepted accounting standards as an important goal both for the protection of investors and the efficiency of capital markets.[56] The work towards acceptance of financial statements from foreign private issuers prepared in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP seeks to foster the continued movement to a single set of high-quality, globally accepted accounting standards. As a long-term objective, the use of a common set of high-quality standards for the preparation of financial statements will help investors to understand investment opportunities more clearly and with greater comparability than if they had to gain familiarity with a multiplicity of national accounting standards.

A. A Robust Process for Convergence

Continued progress towards convergence between U.S. GAAP and IFRS as published by the IASB is one consideration in the elimination of the U.S. GAAP reconciliation. As noted in this release, both the IASB and the FASB have established processes for selecting board members and developing standards to support the development by each board of high-quality accounting standards. Additionally, the FASB and the IASB have established a work plan that seeks the convergence of U.S. GAAP and IFRS. In so doing, both bodies have pledged to use their best efforts to make existing standards fully compatible as soon as practicable, and to coordinate their future

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[56] See the 1988 Policy Statement.

work programs to ensure that compatibility, once achieved, is maintained.[57] This work is expected to continue for many years, and both bodies have expressed a commitment to it. We fully support continued progress on convergence towards the optimal standard, whether that standard may be based on U.S. GAAP, IFRS, or a jointly developed new approach.

As part of this commitment, both the IASB and the FASB are working together on several major projects, and have coordinated agendas so that major projects that one board takes up may also be taken up by the other board.[58] Also, both boards have been working on "short-term convergence," under which convergence will occur quickly in certain areas. This process allows for incremental improvements and the opportunity to eliminate differences without rethinking an issue entirely. If the IASB and the FASB conclude that neither of their models in a particular area is sufficient, they consider a broader standard-setting project.

We do not believe that a particular degree of convergence should be a prerequisite for our acceptance of financial statements prepared under IFRS as published by the IASB without reconciliation. Our proposal to do so is based on, among other considerations, the robustness of a process that lends itself to continued progress of the IASB and the FASB towards convergence over time through, among other things, the joint development of future standards. As noted elsewhere, we recognize that there remain

[57] See the 2006 Memorandum of Understanding.

[58] The joint projects of the FASB and IASB constitute part of the IASB's broader goal to work with national standard setters to develop high quality solutions.

specific accounting subjects and other matters in IFRS that have not been fully addressed. There is a risk that constituents of the two boards may not continue to support convergence if IFRS financial statements are accepted by the Commission without reconciliation to U.S. GAAP. The future work of the IASB and the FASB may result in standards that are significantly different or that are not timely in their development. Nonetheless, we believe that if robust processes for the joint development of high quality standards by the IASB and the FASB are in place, we need not delay considering the acceptance of financial statements that comply with IFRS as published by the IASB without reconciliation to U.S. GAAP.

We will continue to consider the convergence process and the continued progress of the IASB and the FASB in their work plan. We also will consider whether interested parties will continue to have an incentive to support this convergence work should the Commission accept IFRS financial statements from foreign private issuers without reconciliation to U.S. GAAP.

<u>Questions</u>

1. Do investors, issuers and other commenters agree that IFRS are widely used and have been issued through a robust process by a stand-alone standard setter, resulting in high-quality accounting standards?
2. Should convergence between U.S. GAAP and IFRS as published by the IASB be a consideration in our acceptance in foreign private issuer filings of financial statements prepared in accordance with IFRS as published by the IASB without a U.S. GAAP reconciliation? If so, has such convergence been adequate? What are commenters' views on the processes of the IASB and the

FASB for convergence? Are investors and other market participants comfortable with the convergence to date, and the ongoing process for convergence? How will this global process, and, particularly, the work of the IASB and FASB, be impacted, if at all, if we accept financial statements prepared in accordance with IFRS as published by the IASB without a U.S. GAAP reconciliation? Should our amended rules contemplate that the IASB and the FASB may in the future publish substantially different final accounting standards, principles or approaches in certain areas?

B. Consistent and Faithful Application of IFRS

The consistent and faithful application of IFRS as published by the IASB is an important consideration both to accepting financial statements prepared on that basis without a U.S. GAAP reconciliation and to demonstrating that IFRS as published by the IASB represent a single set of high-quality accounting standards, and not a multiplicity of standards under the same name. Over the years, the Commission staff has acquired a broad understanding of the standards comprising IFRS. For over ten years, a limited number of foreign private issuers have included in their filings under the Securities Act and the Exchange Act financial statements prepared in accordance with IAS or IFRS, and over the past year, many more companies have done so. These filings have been subject to the staff's review process, through which the staff has gained experience with the standards.

1. Staff Review of IFRS Financial Statements Filed in 2006

Over the course of 2006, many foreign private issuers filed annual reports on Form 20-F that contained IFRS financial statements following their switch to IFRS for the 2005 financial year. The Commission staff has conducted reviews of those IFRS financial statements as part of its function of reviewing the periodic reports of publicly registered companies, consistent with its normal practice in reviewing filings from U.S. companies and from foreign issuers with financial statements other than those prepared in accordance with IFRS reconciled to U.S. GAAP.[59] These ongoing reviews are an important part of the Commission's effort to gain familiarity with IFRS. In conducting its reviews of IFRS financial statements, the staff made a number of comments regarding the application of IFRS, which have been brought to the attention of issuers through the comment process.[60] Consistent with practice in the staff review program, many issuers indicated that they will address the matters that the staff has raised in future filings, most commonly through improved presentations or enhanced disclosures. The staff has been, and, following the issuance of this Proposing Release, will continue to consider whether issuers address those matters adequately in their Forms 20-F for the 2006 financial year which will help inform the Commission's view as to the quality of the application of IFRS in practice. The staff will continue its regular review function with regard to issuer and auditor practice in applying IFRS. Information obtained from this work will assist in our evaluation of the quality of the application of IFRS in practice.

At present, in filings with the Commission, IFRS (either as published by the IASB or a jurisdictional variation) is used principally by issuers from Europe and Australia.

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[59] Section 408 of the Sarbanes-Oxley Act of 2002 mandates that the Commission shall review disclosures made by reporting companies on a regular and systematic basis.

[60] Staff comment letters are available, 45 days or longer after completion of the staff review, through the SEC website at www.sec.gov. <u>See</u> SEC Press Release dated June 24, 2004.

The number of companies from these areas that are registered under the Exchange Act has decreased over the last several years.[61] Thus, although our staff has reviewed the annual reports of first-time adopters of IFRS, its level of experience is not as great as with U.S. GAAP. In addition, the staff has not undertaken any review of financial statements prepared in accordance with IFRS by foreign companies that are not registered under the Exchange Act. Therefore, the staff's review of IFRS financial statements is limited to a small portion of the total universe of companies that use IFRS.

We recognize the first-year effort undertaken by preparers, auditors, and others in changing the basis of accounting to IFRS. Our staff will continue to identify the areas for improvement to IFRS filers in order to promote increased disclosure and clearer presentation in subsequent financial statements filed with the Commission.

2. <u>Market Participants' Views Regarding IFRS Application in Practice</u>

Market participants from whom the Commission has heard at a March 2007 roundtable held by the Commission staff have indicated their support for the use of IFRS by foreign issuers. Although we have heard from a limited group of representatives from the investor community, those participants, which included representatives of mutual funds, pension funds, rating agencies and other institutional investors, expressed their acceptance of IFRS financial statements for foreign private issuers.[62]

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[61] The number of registered companies from Europe and Australia has declined from over 400 at the end of 2002 to less than 250 at the end of 2006. Not all companies from these jurisdictions switched to IFRS for their filings in 2006. The number of foreign private issuers that filed annual reports on Form 20-F that contained IFRS financial statements during 2006 was less than 200.

[62] Information regarding the Roundtable held on March 6, 2007, including a transcript, is available on the SEC website at http://www.sec.gov/spotlight/ifrsroadmap.htm.

Based on information that we have gathered through the Roundtable and from other commenters, we believe that the auditor community has embraced IFRS as a workable set of standards that can generally be applied across industries and countries. The global auditing profession has been able to audit and report on many thousands of financial statements prepared using either IFRS as published by the IASB or a jurisdictional variation of IFRS.

Some foreign regulators have published reports relating to the implementation of IFRS in their country. For example, the U.K. Financial Reporting Review Panel and the Autorité des Marchés Financiers (the "AMF") of France have both published such reports making observations on IFRS as applied in their jurisdictions.[63]

Although a small number of companies have prepared IFRS financial statements for several years, it was not until the first half of 2006 that a large number of companies published audited annual IFRS financial statements for the first time. Also, as discussed below, audit firms have not been required to opine on IFRS as published by the IASB but have limited their opinions to jurisdictional variations of IFRS, consistent with a company's basis of presentation. In light of this wide-scale use of IFRS being less than two years old, the degree of experience, familiarity and understanding among companies, audit firms, investors, analysts, brokers, regulators, and others is continuing to develop. As experience with IFRS continues to grow, the Commission will monitor for any

[63] For the report of the U.K Financial Reporting Review Panel, see "Preliminary Report: IFRS Implementation" available at http://www.frc.org.uk/images/uploaded/documents/IFRS%20Implementation%20-%20preliminary.pdf. For the report of the AMF, see "Recommendations on accounting information reported in financial statements for 2006," dated December 19, 2006, available at http://www.amf-france.org/documents/general/7565_1.pdf.

possible flaws in the standards and any issues associated with the faithful and consistent application of those standards.

3. **<u>Processes and Infrastructure to Promote Consistent and Faithful Application of IFRS</u>**

As discussed in Part I.B. above, the IASB has stated it is committed to developing a single set of high-quality, understandable and enforceable global accounting standards. In working towards this goal, both the IASB and IFRIC have demonstrated their commitment to resolving significant accounting issues as expediently as possible. However, developing high-quality standards and issuing high-quality interpretations of IFRS may take some time.

A question arises as to what should be done, if anything, in circumstances where neither the IASB nor IFRIC has addressed a particular accounting issue that causes significant difficulties in practice. A securities regulator or its staff, including the Commission, may find it necessary as an interim measure to state a view on such an accounting issue.[64] If it were to do so, the regulator subsequently could consider referring the accounting issue to the IASB or the IFRIC for resolution of the issue for all constituencies. Any view expressed by the regulator may be rescinded upon the IASB or the IFRIC establishing authoritative literature addressing the issue. The Commission and the staff would not expect to issue guidance that is inconsistent with IFRS as published by the IASB, the interpretations provided by IFRIC, or the definitions, recognition criteria and measurement concepts in the IASB's *Framework*.

[64] This is not new, as securities regulators have long been involved in resolving issues related to national accounting standards.

Regulators have put in place infrastructure to identify and address the inconsistent and inaccurate application of IFRS globally. This infrastructure will foster the consistent and faithful application of IFRS around the world. The International Organization of Securities Commissions ("IOSCO"), in which the Commission participates, continues to support the implementation and consistent application of IFRS in the global financial markets. In January 2007, IOSCO's database for cataloguing IFRS interpretations and sharing decisions on application by regulators around the world became operational.[65]

Further, the Commission and the European Commission (the "EC") have agreed that regulators should endeavor to avoid conflicting conclusions regarding the application and enforcement of IFRS. To this end, the Commission and CESR, which the EC has charged with evaluating the implementation of IFRS in the EU, published a work plan in August 2006.[66] That work plan covers information-sharing regarding IFRS implementation in regular meetings of the Commission staff and CESR-Fin, the group within CESR focused on financial reporting. The SEC-CESR work plan also contemplates the confidential exchange of issuer-specific information between CESR members and the Commission, with implementing protocols. In addition, CESR has established among its members a forum and a confidential database for participants to exchange views and share experiences with IFRS.[67]

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[65] See IOSCO's press release regarding its IFRS database at http://www.iosco.org/news/pdf/IOSCONEWS92.pdf.

[66] The press release announcing the SEC-CESR work plan, and the text of the work plan, are available at http://www.sec.gov/news/press/2006/2006-130.htm.

[67] See CESR Press Release 07-163 (April 2007), available at http://www.cesr-eu.org/index.php?page=groups&mac=0&id=13.

Having noted the areas for improvement identified in the Commission staff's review to date of the application of IFRS in filings with the Commission, as well as the potential for other areas requiring standard-setting action, we believe that the approach proposed by the Commission and the information-sharing infrastructure which the international regulatory community is building should contribute to increasing consistency and faithfulness in the application of IFRS across jurisdictions.

Questions

3. Is there sufficient comparability among companies using IFRS as published by the IASB to allow investors and others to use and understand the financial statements of foreign private issuers prepared in accordance with IFRS as published by the IASB without a U.S. GAAP reconciliation?

4. Do you agree that the information-sharing infrastructure being built in which the Commission participates through both multilateral and bilateral platforms will lead to an improved ability to identify and address inconsistent and inaccurate applications of IFRS? Why or why not?

5. What are commenters' views on the faithful application and consistent application of IFRS by foreign companies that are registered under the Exchange Act and those that are not so registered?

6. Should the timing of our acceptance of IFRS as published by the IASB without a U.S. GAAP reconciliation depend upon foreign issuers, audit firms and other constituencies having more experience with preparing IFRS financial statements?

7. Should the timing of any adoption of these proposed rules be affected by the number of foreign companies registered under the Exchange Act that use IFRS?

C. The IASB as Standard Setter

Our consideration of acceptance of financial statements prepared using IFRS as published by the IASB is also premised on the IASB's sustainability, governance and continued operation in a stand-alone manner as a standard setter, which is a factor in the development of a set of high-quality globally accepted accounting standards. As described in more detail in Part I.B., oversight by the IASC Foundation Trustees through the governance reforms that have been implemented, as well as the due process mechanisms established for the consideration and adoption of new IFRSs, contribute to the IASB's role as a standard setter dedicated to developing accounting standards in the public interest. The IASB is free to choose and conduct projects necessary to promote convergence and develop high-quality standards. The IASB solicits views and seeks input from the public throughout the standard-setting process from selecting items for its agenda to developing and publishing an exposure draft and issuing a final standard. The IASB's meetings are open to public observers and summaries of comments received on discussion papers and exposure drafts are made public on the IASB website.[68] This transparent process enables the IASB to obtain relevant views from interested parties, and

[68] See the IASC Foundation Due Process Handbook for the IASB approved by the Trustees March 2006. For additional information, see http://www.iasb.org/NR/rdonlyres/7D97095E-96FD-4F1F-B7F2-366527CB4FA7/0/DueProcessHandbook.pdf.

at the same time to conclude final standards based on its own deliberations, and without undue external pressure.

Since the late 1980s, the Commission staff has participated in the development of IAS and IFRS primarily through IOSCO, taking an active role in the standard-setting process undertaken by the IASC and the IASB. In this regard, the Commission staff has reviewed and contributed to comments on many exposure drafts of standards published by the IASC and the IASB. Additionally, the Commission staff as an IOSCO representative serves as a non-voting observer at IFRIC meetings. The Commission also is an observer of the IASB Standards Advisory Council.[69]

Questions

8. The IASB *Framework* establishes channels for the communication of regulators' and others' views in the IFRS standard-setting and interpretive processes. How should the Commission and its staff further support the IFRS standard-setting and interpretive processes?

9. How should the Commission consider the implication of its role with regard to the IASB, which is different and less direct than our oversight role with the FASB?

D. Summary

Fostering the use of a single set of high-quality, globally accepted accounting principles, would, in our view, serve to protect investors and promote capital formation

[69] See http://www.iasb.org/About+Us/About+SAC/SAC+Members.htm.

by enhancing comparability across companies and increasing access to foreign issuer investment opportunities for investors in the U.S. public capital markets while reducing regulatory burdens and costs for issuers. As noted earlier, the Commission has for over 20 years sought to promote the development of a global, high-quality set of accounting principles. The acceptance of financial statements prepared in accordance with IFRS as published by the IASB without a U.S. GAAP reconciliation will further promote this goal. By such acceptance, the Commission will demonstrate its commitment to both investors and to the global capital markets.

Achieving a single set of globally accepted accounting standards will require the contributions of many parties, including standard setters, regulators, auditors, issuers, and investors themselves. The IASB and the FASB have established procedures for their ongoing joint efforts to achieve convergence. The infrastructure is being developed to lead to the consistent and faithful application of IFRS by issuers. We will continue to evaluate the progress towards convergence, the application of IFRS, and the work of the IASB.

We believe it is an appropriate time to propose and solicit comment on acceptance, in the filings of foreign private issuers, of financial statements prepared in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP.

<u>Questions</u>

10. The Commission has gathered certain information from representatives of issuers, investors, underwriters, exchanges and other market participants at its public roundtable on IFRS. We are interested in receiving information from a broader audience. Is the development of a single set of high-quality globally

accepted standards important to investors? To what degree are investors and other market participants able to understand and use financial statements prepared in accordance with IFRS as published by the IASB without a U.S. GAAP reconciliation? We also encourage commenters to discuss ways in which the Commission may be able to assist investors and other market participants in improving their ability to understand and use financial statements prepared in accordance with IFRS. How familiar are investors with financial statements prepared in accordance with IFRS as published by the IASB? Will the ability of an investor to understand and use financial statements that comply with IFRS as published by the IASB vary with the size and nature of the investor, the value of the investment, the market capitalization of the issuer, the industry to which the issuer in question belongs, the trading volume of its securities, the foreign markets on which those securities are traded and the regulation to which they may be subjected, or any other factors? If so, should any removal of the reconciliation requirement be sensitive to one or more of these matters, and, if so, how?

III. DISCUSSION OF THE PROPOSED AMENDMENTS TO ALLOW THE USE OF IFRS FINANCIAL STATEMENTS WITHOUT RECONCILIATION TO U.S. GAAP

A. Eligibility Requirements

The proposed amendments to allow a foreign private issuer to file financial statements without reconciliation to U.S. GAAP as currently required under Item 17 or 18 of Form 20-F, as appropriate, would apply only to a foreign private issuer that files its financial statements in full compliance with the English language version of IFRS as published by the IASB.[70] The proposed amendments will apply to an eligible issuer regardless of whether it complies with IFRS as published by the IASB voluntarily or in accordance with any requirements of its home country regulator or an exchange on which its securities are listed.

Under the proposals, in order to be eligible to omit the reconciliation, an issuer would be required, in a prominent footnote to its financial statements, to state unreservedly and explicitly that its financial statements are in compliance with IFRS as published by the IASB.[71] In addition, in its report, the independent auditor must opine similarly on whether those financial statements comply with IFRS as published by the IASB.[72]

The proposed amendments would not be available to an issuer that files financial statements that include deviations from IFRS as published by the IASB. A foreign private issuer that does not state unreservedly and explicitly that its financial statements are in compliance with IFRS as published by the IASB, or for which the auditor's report contains any qualification relating to the application of IFRS as published by the IASB, would continue to be required to provide the U.S. GAAP reconciliation under current rules. Similarly, an issuer that files its financial statements using a set of generally accepted accounting principles of another jurisdiction also would continue to reconcile to

[70] These proposed amendments would not encompass use, if finalized, of the IASB's proposed IFRS for Small and Medium-sized Entities.

[71] This statement is consistent with the language requirements of IAS 1 "Presentation of Financial Statements," paragraph 14.

[72] This language could be provided in addition to any representation about compliance with standards required by the home country.

U.S. GAAP as under current rules when preparing its financial statements for inclusion in a registration statement or annual report.[73]

The proposed amendments will not apply to issuers using a jurisdictional or other variation of IFRS. It would be acceptable for an issuer to state compliance with both IFRS as published by the IASB and a jurisdictional variation of IFRS, and an audit firm to opine that financial statements comply with IFRS as published by the IASB and a jurisdictional variation of IFRS, so long as the statement relating to the former was unreserved and explicit.

In their filings with the SEC, the majority of foreign private issuers that have referenced IFRS have stated that their financial statements are in compliance with IFRS as published by the IASB (in addition to stating compliance with a jurisdictional variation of IFRS). In contrast, few audit reports contained an opinion on IFRS as published by the IASB (in addition to opining on a jurisdictional variation of IFRS).

We believe that the benefits of moving towards a single set of globally accepted standards as a long-term objective, including increased transparency and comparability of financial statements, are attainable only if IFRS represents a single set of high-quality accounting standards and not a multiplicity of divergent standards using the same name. Thus, we believe that it is appropriate to condition our acceptance of IFRS without

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[73] An issuer that is eligible to rely on the proposed rules, if adopted, would be permitted to continue to reconcile its IFRS financial statements to U.S. GAAP. An issuer that elects to do so would follow all current requirements with regard to the preparation of that U.S. GAAP reconciliation contained in Item 17 or 18 of Form 20-F, as applicable.

reconciliation on the financial statements being in full compliance with IFRS as published by the IASB.

Our acceptance of a set of financial statements without reconciliation to U.S. GAAP would mark a significant change in our requirements. We are proposing that the amendments apply if an issuer follows the approved English language version of the standards to assist U.S. investors to understand IFRS, to assist in achieving comparability and consistency across jurisdictions, and, as a practical matter, because the Commission's work is conducted in English.

Questions

11. Without a reconciliation, will investors be able to understand and use financial statements prepared using IFRS as published by the IASB in their evaluation of the financial condition and performance of a foreign private issuer? How useful is the reconciliation to U.S. GAAP from IFRS as published by the IASB as a basis of comparison between companies using different bases of accounting? Is there an alternative way to elicit important information without a reconciliation?

12. In addition to reconciling certain specific financial statement line items, issuers presenting an Item 18 reconciliation provide additional information in accordance with U.S. GAAP. What uses do investors and other market participants make of these additional disclosures?

13. Should we put any limitations on the eligibility of a foreign private issuer that uses IFRS as published by the IASB to file financial statements without a U.S. GAAP reconciliation? If so, what type of limitations? For example, should

the option of allowing IFRS financial statements without reconciliation be phased in? If so, what should be the criteria for the phase-in? Should only foreign private issuers that are well-known seasoned issuers, or large accelerated filers, or accelerated filers,[74] and that file IFRS financial statements be permitted to omit the U.S. GAAP reconciliation?

14. At the March 2007 Roundtable on IFRS, some investor representatives commented that IFRS financial statements would be more useful if issuers filed their Form 20-F annual reports earlier than the existing six-month deadline. We are considering shortening the deadline for annual reports on Form 20-F. Should the filing deadline for annual reports on Form 20-F be accelerated to five, four or three months, or another date, after the end of the financial year? Should the deadline for Form 20-F be the same as the deadline for an issuer's annual report in its home market? Should we adopt the same deadlines as for annual reports on Form 10-K? Why or why not? Would the appropriateness of a shorter deadline for a Form 20-F annual report depend on whether U.S. GAAP information is included? If a shorter deadline is appropriate for foreign private issuers that would not provide a U.S. GAAP reconciliation under the proposed amendments, should other foreign private issuers also have a shorter deadline? Should it depend on the public float of the issuer?

[74] The terms "accelerated filer" and "large accelerated filer" are defined in Rule 12b-2 under the Exchange Act [17 CFR 240.12b-2]. "Well-known seasoned issuer" is defined in Rule 405 under the Securities Act [17 CFR 230.405].

15. Although reconciliation to U.S. GAAP of interim periods is not ordinarily required under the Exchange Act, foreign private issuers that conduct continuous offerings on a shelf registration statement under the Securities Act may face black-out periods that prevent them from accessing the U.S. public capital market at various times during the year if their interim financial information is not reconciled. Even if commenters believe we should continue the U.S. GAAP reconciliation requirement for annual reports that include IFRS financial statements, to address this issue should we at least eliminate the need for the U.S. GAAP reconciliation requirement with respect to required interim period financial statements prepared using IFRS as published by the IASB for use in continuous offerings?[75] Should we extend this approach to all required interim financial statements?

16. Is there any reason why an issuer should not be able to unreservedly and explicitly state its compliance with IFRS as published by the IASB? Is there any reason why an audit firm should not be able to unreservedly and explicitly opine that the financial statements comply with IFRS as published by the IASB? What factors may have resulted in issuers and, in particular, auditors refraining from expressing compliance with IFRS as published by the IASB?

17. If the proposed amendments are adopted, should eligible issuers be able to file financial statements prepared using IFRS as published by the IASB without a U.S. GAAP reconciliation for their first filing containing audited annual

[75] See Item 8.A.4 of Form 20-F, which requires interim period financial statements in certain circumstances.

financial statements? If the amendments are adopted, what factors should we consider in deciding when issuers can use them? For example, should we consider factors such as the issuer's public float (either in the United States or world wide), whether the issuer has issued only public debt, or the nature of the filing to which the amendments would be applied? Will investors be prepared to analyze and interpret IFRS financial statements without the reconciliation by 2009? If not, what further steps, including investor education, may be necessary?

B. U.S. GAAP Reconciliation

1. General

The basic requirements for financial statements filed by foreign private issuers are described in Items 17 and 18 of Form 20-F. Under Item 17(c), a foreign private issuer currently has two options: either to prepare its financial statements and schedules according to U.S. GAAP; or, alternatively, to prepare them under the generally accepted accounting principles of another jurisdiction with a reconciliation of specific line items to U.S. GAAP as enumerated under Item 17(c)(2). This reconciliation includes a narrative discussion of reconciling differences,[76] a reconciliation of net income for each year and any interim periods presented,[77] a reconciliation of major balance sheet captions for each year and any interim periods,[78] and a reconciliation of cash flows for each year and any

[76] See Item 17(c)(1) of Form 20-F.

[77] See Item 17(c)(2)(i) of Form 20-F.

[78] See Item 17(c)(2)(ii) of Form 20-F.

interim periods.[79] We are proposing to revise Item 17(c)(2) so that reconciliation will no longer be required from issuers using IFRS as published by the IASB.[80]

As discussed in Section III.D., portions of Regulation S-X that do not relate to the form and content of an issuer's financial statements, including, for example, auditor qualification and report requirements and financial statement requirements for entities other than the issuer, would still continue to apply to foreign private issuers that prepare their financial statements using IFRS as published by the IASB without a U.S. GAAP reconciliation.

Several sub-paragraphs of Item 17(c)(2) relate to reconciling disclosure required of issuers that rely on certain IAS. The partial accommodations contained in these sub-paragraphs were available to issuers using home country GAAP or IFRS. They are rarely relied upon in practice and appear no longer needed by issuers that use IFRS as published by the IASB.[81] We are therefore proposing to eliminate these sub-paragraphs for purposes of all foreign private issuer filings. Specifically, we are proposing to delete Items 17(c)(2)(iv)(B) and (C), which relate to reconciling disclosures to be provided by issuers that rely on IAS 21 "The Effects of Changes in Foreign Exchange Rates." We

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[79] See Item 17(c)(2)(iii) of Form 20-F, containing the exception relating to IAS 7 "Cash Flow Statements."

[80] We are not proposing to amend Item 17(b), which we do not read as imposing U.S. GAAP requirements on financial statements prepared using IFRS as published by the IASB.

[81] As noted above, the IASB has incorporated IAS developed by the IASC into IFRS. In addition, the sub-paragraphs were added at a time when IFRS was undergoing substantial development and it was appropriate to permit compliance with selected international standards. Such partial compliance with IFRS is not consistent with these proposals, which are based on full compliance with IFRS as published by the IASB.

also are proposing to delete Item 17(c)(2)(viii) relating to reconciling disclosures to be provided by issuers using IAS 22 "Business Combinations," with respect to the period of amortization of goodwill and negative goodwill, as IAS 22 has been superseded by IFRS 3 "Business Combinations" and may no longer be used by an issuer preparing financial statements under IFRS. For this reason, we also are proposing to eliminate the related Instruction 6 to Item 17. However, we are retaining the IAS 7 "Cash Flow Statements" accommodation contained in Item 17(c)(2)(iii).

Item 17(c)(2)(vii) relates to disclosures that issuers using proportionate consolidation may omit from their U.S. GAAP reconciliation. We are not proposing any revision to this paragraph, which continues to apply to issuers using home country GAAP (if permitted by that GAAP). An issuer using IFRS as published by the IASB would satisfy the requirements of this paragraph by providing IAS 31 "Interests in Joint Ventures" disclosures.

A U.S. GAAP reconciliation under Item 18 builds on the information content of Item 17. In addition to providing reconciling information for the line items specified in Item 17(c), Item 18(b) requires that an issuer also provide in its financial statements all information required by U.S. GAAP and Regulation S-X.[82] The proposed elimination of the reconciliation requirement for IFRS financial statements also applies in situations in which the issuer currently would be required to prepare a reconciliation under Item 18. Accordingly, we propose revising Item 18(b) to indicate that disclosures required by U.S.

[82] U.S. GAAP and Regulation S-X information need not be provided for a period in which net income has not been reconciled to U.S. GAAP, or for financial statements for an entity or subsidiary covered by Rules 3-05 or 3-09 of Regulation S-X.

GAAP and Regulation S-X would not be required if a registrant files its financial statements using IFRS as published by the IASB.

Questions

18. Do we need to make any other changes to Items 17 or 18 or elsewhere to implement fully the proposed elimination of the reconciliation requirement for issuers using IFRS as published by the IASB?

19. Is any revision necessary to clarify that the provisions relating to issuers that use proportionate consolidation contained in Item 17(c)(2)(vii) would not apply to IFRS financial statements that are not reconciled to U.S. GAAP under the proposed amendments? If so, what changes would be appropriate?

20. Is the IAS 21 accommodation still useful for non-IFRS issuers? Is it clear that an issuer using IFRS would not need to provide disclosure under Item 17(c)(2)(iv)? If not, what changes would be necessary to make it clear?

2. Interim Period Financial Statements

Under the proposal, foreign private issuers that are eligible to omit the U.S. GAAP reconciliation in their audited annual financial statements would likewise be able to omit a reconciliation from their unaudited interim period financial statements. To the extent a foreign private issuer is required to provide interim period financial statements, the financial statements would have to be prepared in accordance with IFRS as published by the IASB.[83]

[83] The discussion in this section relates solely to registration statements and prospectuses under the Securities Act and initial registration statements under the Exchange Act. There are currently no requirements under our rules relating to the form or content requirements of a foreign private issuer's reports on Form 6-K under the Exchange Act. See Form 6-K [17 CFR 249.306].

Questions

21. Would issuers have any difficulty in preparing interim period financial statements that are in accordance with IFRS as published by the IASB?

22. Do foreign private issuers that have changed to IFRS generally prepare interim financial statements that are in accordance with IFRS, and do they make express statements to that effect?

a. Financial Information in Securities Act Registration Statements and Prospectuses and Initial Exchange Act Registration Statements Used Less Than Nine Months After the Financial Year End

In registration statements and prospectuses under the Securities Act and initial registration statements under the Exchange Act, if the document is dated less than nine months after the end of the last audited financial year, foreign private issuers are not required to include interim period financial information. However, if a foreign private issuer has published interim period financial information, Item 8.A.5 of Form 20-F requires these registration statements and prospectuses to include that information.[84] The intent of this requirement is to make information available in U.S. offering documents as current as information that is available elsewhere.

The instructions to Item 8.A.5 require that an issuer providing interim financial information describe any material variations between the accounting principles, practices and methods used and U.S. GAAP, and quantify any material variations that are not already quantified in the financial statements. We are adding an instruction to Item 8.A.5

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[84] Under Item 512(a)(4) of Regulation S-K [17 CFR 22.512(a)(4)], a foreign private issuer that registers securities on a shelf registration statement basis is required to undertake to include any financial statements required by Item 8.A of Form 20-F at the start of any delayed offering or throughout a continuous offering.

of Form 20-F with regard to interim period financial information that is made public by a foreign private issuer to clarify that interim period information does not need to be reconciled to U.S. GAAP when the interim information is prepared in accordance with IFRS as published by the IASB.

b. Financial Statements in Securities Act Registration Statements and Prospectuses and Initial Exchange Act Registration Statements Used More Than Nine Months after the Financial Year End

In registration statements and prospectuses under the Securities Act and initial registration statements under the Exchange Act, if the document is dated more than nine months after the end of the last audited financial year, foreign private issuers must provide consolidated interim period financial statements covering at least the first six months of the financial year and the comparative period for the prior financial year.[85] These unaudited interim period financial statements must be prepared using the same basis of accounting as the audited financial statements contained or incorporated by reference in the document and include or incorporate by reference a reconciliation to U.S. GAAP.[86] The instruction that we are proposing to add to Item 8.A.5 would clarify that an issuer does not need to provide that reconciliation if it prepares its interim financial statements using IFRS as published by the IASB.

Under the proposed rules, although an eligible issuer may provide IFRS financial statements for an interim period without reconciliation, that issuer would continue to be required to comply with Article 10 of Regulation S-X with regard to financial statements

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[85] See Item 8.A.5 of Form 20-F and Item 512(a)(4) of Regulation S-K.

[86] See Items 17(c) and 18 of Form 20-F.

for interim periods, when that information is required under Item 8.A.5 of Form 20-F. There are several differences between IAS 34 "Interim Financial Reporting," which prescribes the minimum content of an interim financial report and the principles for recognition and measurement in financial statements presented for an interim period, and Article 10 of Regulation S-X. First, because IAS 34 permits more condensed balance sheet, income statement and cash flow information detail than does Article 10, financial statements prepared under IAS 34 can be limited to major headings and subtotals. Second, unlike IAS 34, Article 10 contains an explicit statement that interim disclosures must be sufficient to make interim period information presented not misleading. Third, Article 10 requires contingent liability disclosures even if no change has occurred since the year end, whereas IAS 34 requires disclosure of any changes in contingent liabilities since the year end. Fourth, Article 10 requires footnote disclosure of summarized data for equity investees that is not required under IAS 34.

Questions:

23. How significant are the differences between IAS 34 and Article 10? Is the information required by IAS 34 adequate for investors? If not, what would be the best approach to bridge any discrepancy between IAS 34 and Article 10? Should issuers be required to comply with Article 10 if their interim period financial statements comply with IAS 34? Should we consider any revision to existing rules as they apply to an issuer that would not be required to provide a U.S. GAAP reconciliation under the proposed rules?

3. IFRS Treatment of Certain Areas

As noted, IFRS as published by the IASB constitute a comprehensive basis of accounting that may be used by foreign private issuers in the preparation of their financial statements that are contained in Commission filings. There are certain limited areas in which the IASB has yet to develop standards or in which IFRS permits disparate options. These areas are not new, and existed at the time the IASB and the FASB were developing their 2006-2008 work plan.[87] However, based on our staff's review of IFRS filings with the Commission to date, we have a number of observations regarding the application in practice in these areas, in which we also ask for public feedback.

a. Accounting for Insurance Contracts and Extractive Activities

There are two industry areas that have been identified by the IASB as lacking standards: insurance contracts and extractive activities.

IFRS 4 "Insurance Contracts" provides limited guidance on the accounting to be followed by companies that issue insurance contracts or hold reinsurance contracts. Except in some areas, IFRS 4 permits a company to continue to apply its pre-existing home country accounting principles for insurance contracts. Insurance company accounting and practices vary greatly throughout the world in areas such as revenue recognition, claim expense recognition, policy benefit recognition, and policy acquisition costs, resulting in substantial variation in reporting practices.

The IASB has noted that it is in the process of developing a standard for insurance contracts because "there was no IFRS on insurance contracts, and insurance contracts

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[87] See "SEC Welcomes Plans of U.S., International Standard Setters for Convergence of Accounting Systems," SEC Press Release dated February 27, 2007.

were excluded from the scope of existing IFRSs that would have been relevant (e.g., IFRSs on provisions, financial instruments, intangible assets); and accounting practices for insurance contracts were diverse, and also often differed from practices in other sectors."[88]

IFRS 6 "Exploration for and Evaluation of Mineral Resources" provides limited guidance with respect to the accounting for exploration and evaluation activities undertaken by oil and gas and mining companies. Except in certain areas, companies are permitted to look to other sources for guidance. Items not addressed by IFRS 6 include, for example, thresholds for capitalizing or expensing a variety of costs, and the manner in which capitalized costs are subsequently depreciated or amortized.

The IASB adopted IFRS 6 in December 2004 as a first step in light of the need to develop a standard in time for it to be applied by companies that were adopting IFRS in 2005.[89] The IASB acknowledged that its complete consultation in this area could not be completed in that time frame, and that developing a global consensus on a rigorous and comprehensive approach would require extensive consultation.

On both of these projects, the IASB continues to make progress towards developing standards under IFRS. Nonetheless, we do not believe that the lack of comprehensive standards in IFRS in these areas alone should delay our consideration of fully accepting IFRS as published by the IASB without a U.S. GAAP reconciliation.

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[88] Excerpt from the IASB website at http://www.iasb.org/Current+Projects/IASB+Projects/Insurance+Contracts/Insurance+Contracts.htm.

[89] See IASB Press Release dated December 9, 2004.

b. Accounting Treatment for Common Control Mergers, Recapitalization Transactions, Reorganizations, Acquisitions of Minority Shares Not Resulting in a Change of Control, and Similar Transactions

There are certain areas, for example, accounting treatment for common control mergers, recapitalizations, reorganizations, acquisitions of minority interests, and similar transactions, for which IFRS does not have a specific standard or interpretation. When a standard or interpretation of IFRS does not address a matter, IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors," provides guidance, including looking to the most recent pronouncements of other standard-setting bodies. With a lack of specific guidance, companies can look to various (and differing) recognition, measurement and presentation practices, including their home country accounting principles, in establishing their accounting policies.[90] IFRS, however, does not require the disclosure of the impact if an alternative accounting treatment had been used.

The IASB and the FASB have a joint project underway entitled "Business Combinations: Applying the Acquisition Method."[91] This project is the second phase of an overall project on business combinations. In this phase of the business combinations project, the IASB and the FASB are reconsidering their existing guidance for applying the purchase method of accounting for business combinations (now called the acquisition method). This project will converge numerous areas of application and reduce alternative

[90] IAS 1 requires an entity to disclose the measurement basis used in preparing financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

[91] For more information on this joint project, see http://www.fasb.org/project/bc_acquisition_method.shtml and http://www.iasb.org/Current+Projects/IASB+Projects/Business+Combinations/Business+Combinations+II.htm.

treatments but will not address all of the transactions discussed above. Final standards by the IASB and the FASB are expected to be issued in the third quarter of 2007.

c. Income Statements and Per Share Amounts

IFRS does not provide specific conventions as to the format or content of the income statement.[92] In addition, IFRS permits a company to present on the face of its income statement or elsewhere in its financial statements any measure on a per share basis so long as the figure is reconciled to a line item on the income statement.[93] Companies preparing IFRS financial statements are thus permitted to use numerous different income statement formats and to characterize subtotals and amounts using multiple and varied caption headings. In addition, companies using IFRS are permitted to present on the income statement and in footnotes measures that would be otherwise considered non-GAAP measures that would not be permitted under our rules.[94]

The IASB and FASB have a joint project underway entitled "Financial Statement Presentation" to establish a common, high-quality standard for the presentation of information in the financial statements, including the classification and display of line items and the aggregation of line items into subtotals and totals. A discussion paper which addresses the more fundamental issues related to the presentation of information

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[92] IAS 1 provides guidance regarding minimum required line items and provides examples to which issuers may refer.

[93] See IAS 33 "Earnings per Share."

[94] See Item 10(e) of Regulation S-K, [17 C.F.R. 229.20(E)].

on the face of the financial statements is expected to be published in the fourth quarter of 2007.

Questions

24. Are there accounting subject matter areas that should be addressed by the IASB before we should accept IFRS financial statements without a U.S. GAAP reconciliation?

25. Can investors understand and use financial statements prepared using IFRS as published by the IASB in those specific areas or other areas that IFRS does not address? If IFRS do not require comparability between companies in these areas, how should we address those areas, if at all? Would it be appropriate for the Commission to require other disclosures in these areas not inconsistent with IFRS published by the IASB?

C. Accounting and Disclosure Issues

1. Selected Financial Data

Under Item 3.A of Form 20-F, issuers must provide five years of selected financial data. As part of this proposal to accept financial statements prepared using IFRS as published by the IASB without reconciliation to U.S. GAAP, we are proposing to revise the instruction to Item 3.A to clarify that selected financial data based on the U.S. GAAP reconciliation is required only if the issuer prepares its primary financial statements using a basis of accounting other than IFRS as published by the IASB.

Question

26. Should issuers that are permitted to omit a U.S. GAAP reconciliation for their current financial year or current interim period be required to disclose in their

selected financial data previously published information based on the U.S. GAAP reconciliation with respect to previous financial years or interim periods?

2. Other Form 20-F Disclosure

a. Reference to U.S. GAAP Pronouncements in Form 20-F

Several non-financial statement disclosure items of Form 20-F make reference to specific U.S. GAAP pronouncements, including Financial Accounting Standards ("FASs") and interpretations of the FASB. For example, issuers are required to provide disclosure of off-balance sheet arrangements under Item 5 ("Operating and Financial Review and Prospects"), which expressly refers to FASB Interpretations No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," and No. 46 "Consolidation of Variable Interest Entities."[95] Also, Item 11 of Form 20-F ("Quantitative and Qualitative Disclosures About Market Risk") sets out the requirements for certain summary disclosures about market risk which refer to FAS 52 "Foreign Currency Translation," FAS 5 "Accounting for Contingencies," as well as to other FASs.

An IFRS filer that would not be required to provide a U.S. GAAP reconciliation under the proposed amendments would continue to be required to respond to those items of Form 20-F that make reference to FASs, FASB interpretations, or other specific pronouncements of U.S. GAAP for definitional purposes. In providing that disclosure, however, the issuer should apply the corresponding IFRS notion of the principles embodied in the referenced U.S. GAAP pronouncement.

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[95] See Item 5.E of Form 20-F.

In order to convey this view, we are proposing to add an instruction to Item 5 and Item 11 indicating that issuers preparing their financial statements in accordance with IFRS as published by the IASB should, in responding to paragraphs of those items that refer to specific pronouncements of U.S. GAAP, look to the appropriate corresponding standards and interpretations of IFRS that contain similar definitions. If information called for by the non-financial statement requirements of Form 20-F duplicates information that is contained in the IFRS financial statements, an issuer need not repeat such information but may cross-reference to the appropriate footnote in the audited financial statements.

b. <u>Disclosure from Oil and Gas Companies under FAS 69</u>

Pursuant to either earlier Commission rules or more recent FASB standards, public companies with significant oil and gas activities have been required to disclose reserve and other information relating to those activities. In November 1982, the FASB adopted FAS 69 "Disclosures about Oil and Gas Producing Activities," which establishes a comprehensive set of disclosures for oil and gas producing activities. Under this standard, public companies with such significant activities are required to disclose unaudited supplementary information relating to proved oil and gas reserves, and capitalized costs relating to oil and gas producing activities. As a result of the FASB's adoption of FAS 69, the Commission at first suspended the effectiveness of a rule under Regulation S-X calling for substantially similar information,[96] and then deleted the rule

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[96] The requirement was found in former Rule 4-10(k) of Regulation S-X. The application of this rule was suspended in Release 33-6444 (December 15, 1982).

altogether.[97] The Commission noted that, in light of the FASB standard, its own earlier rule requiring this disclosure was no longer necessary.

We are proposing to amend Item 18 of Form 20-F to expressly require that any company that provides disclosure under FAS 69 continue to provide the information called for under that statement even though the company is preparing financial statements in accordance with IFRS as published by the IASB without a reconciliation to U.S. GAAP. The nature of the information provided under FAS 69 is not in the nature of a U.S. GAAP reconciliation but rather is supplementary information included as an unaudited footnote to the audited financial statements. We believe that FAS 69 requires the disclosure of important information that is useful to investors and that would not otherwise be required to be disclosed under IFRS.

c. Market Risk Disclosure and the Safe Harbor Provisions

Pursuant to Item 11 of Form 20-F, foreign private issuers are required to provide disclosure of qualitative and quantitative information about market risk inherent in derivative financial instruments, other financial instruments, and derivative commodity instruments. This information, which is not included as part of the financial statements in a filing, is expressly subject to the safe harbor provided under Section 27A of the

[97] Release 33-6818 (February 17, 1989) proposed the deletion which was adopted in Release 33-6959 (September 17, 1992).

Securities Act[98] and Section 21E of the Exchange Act[99] to the extent it constitutes "forward looking statements."[100]

IFRS 7 "Financial Instruments: Disclosure" as recently amended, requires market risk disclosure that is similar to that required under Item 11.[101] In this respect, the sensitivity analysis provided under IFRS will be based on forward-looking information. This information will appear in the footnotes to audited IFRS financial statements.

Section 27A of the Securities Act and Section 21E of the Exchange Act expressly exclude from the safe harbor any information "included in a financial statement prepared in accordance with generally accepted accounting principles."[102] The safe harbor may not be available to the forward looking information included in IFRS financial statements. When we adopted the market risk disclosure requirements, the Commission considered whether the market risk disclosure could be included in a registrant's financial statements and, if so, whether the safe harbor should apply to that disclosure. The Commission decided to require that the information required under Item 11 be disclosed outside the financial statements.[103]

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[98] 15 USC 77z-2.

[99] 15 USC 78u-5

[100] See Release 33-7386 (Jan. 31, 1997) for the release adopting the derivatives disclosure requirement and the related express safe harbor.

[101] IFRS 7 will require this information beginning with the 2007 financial year.

[102] See Securities Act Section 27A(b)(2)(A) and Exchange Act Section 21E(b)(2)(A).

[103] U.S. companies are subject to the same disclosure requirement. See Item 305 of Regulation S-K [17 CFR 229.3-05].

The apparent non-availability of the safe harbor provisions to information included in financial statements, including information called for by IFRS 7, is separate and distinct from our proposed acceptance of IFRS as published by the IASB without a U.S. GAAP reconciliation. Regardless of whether we eliminate the U.S. GAAP reconciliation for IFRS filers, the financial statements filed by a registrant must comply fully with a comprehensive body of accounting principles, which includes IFRS 7 for those companies that use IFRS.

Questions

27. With regard to references to U.S. GAAP in non-financial statement disclosure requirements, should we amend the references to U.S. GAAP pronouncements that are made in Form 20-F to also reference appropriate IFRS guidance, and, if so, what should the references refer to? Would issuers be able to apply the proposed broad approach to U.S. GAAP pronouncements and would this approach elicit appropriate information for investors? Should we retain the U.S. GAAP references for definitional purposes?

28. Should foreign private issuers that prepare financial statements in accordance with IFRS as published by the IASB be required to continue to comply with the disclosure requirements of FAS 69? What alternatives may be available to elicit the same or substantially the same disclosure?

29. Should the Commission address the implications of forward-looking disclosure contained in a footnote to the financial statements in accordance with IFRS 7? For example, would some kind of safe harbor provision or other relief or statement be appropriate?

3. Other Considerations Relating to IFRS and U.S. GAAP Guidance

The Commission recognizes that an issuer that would not be required to reconcile its IFRS financial statements to U.S. GAAP may nevertheless pursuant to the application of IAS 8 look for guidance from Commission sources other than rules and regulations, including Accounting Series Releases ("ASRs") and Financial Reporting Releases ("FRRs").[104] In addition, such an issuer may look to the guidance that the Commission staff provides in Staff Accounting Bulletins ("SABs"), and, if the company is engaged in certain lines of business, various Industry Guides.[105] No changes to such guidance are planned. We believe that a company that would no longer be required to reconcile its IFRS financial statements to U.S. GAAP under the proposed amendments, and its auditor, would continue to be required to follow any Commission guidance that relates to auditing issues.[106] An issuer using IFRS as published by the IASB, although not required

[104] FRRs contain the Commission's views and interpretations relating to financial reporting. Prior to 1982, the Commission published its views and interpretations relating to financial reporting in Accounting Series Releases (ASRs). In FRR 1, Adoption of the Financial Reporting Release Series and Codification of Currently Relevant ASRs, the Commission codified certain previously issued ASRs on financial reporting matters.

[105] Staff Accounting Bulletins reflect the Commission staff's views regarding accounting-related disclosure practices. They represent interpretations and policies followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws. Industry Guides serve as expressions of the policies and practices of the Division of Corporation Finance. They are of assistance to issuers, their counsel and others preparing registration statements and reports, as well as to the Commission's staff. SABs and Industry Guides are not rules, regulations, or statements of the Commission. They have not been issued pursuant to notice and comment rulemaking, and the Commission has neither approved nor disapproved these interpretations.

[106] In addition, foreign private issuers are required to have audits conducted in accordance with the Standards of the PCAOB (U.S.)/U.S. Generally Accepted Audit Standards regardless of the comprehensive basis of accounting they use to prepare their financial statements.

to follow U.S. GAAP guidance, may find reference to FRRs, ASRs, SABs, and Industry Guides and other forms of U.S. GAAP guidance useful in the application of IAS 8.[107]

Questions

30. Are there issues on which further guidance for IFRS users that do not reconcile to U.S. GAAP would be necessary and appropriate? Should issuers and auditors consider guidance related to materiality and quantification of financial misstatements?

4. **First Time Adopters of IFRS**

In 2005 the Commission adopted amendments to Form 20-F to permit foreign private issuers, for their first year of reporting under IFRS as adopted by the IASB, to file two years rather than three years of statements of income, changes in shareholders' equity and cash flows prepared in accordance with IFRS, with appropriate related disclosure.[108] These amendments are contained in General Instruction G to Form 20-F. The proposed amendments do not affect the applicability of General Instruction G to issuers that are first-time adopters of IFRS. If adopted, however, the proposed amendments to eliminate the U.S. GAAP reconciliation will apply to eligible issuers that also may be eligible to rely on General Instruction G, which currently contains a number of references to a reconciliation to U.S. GAAP from IFRS. We therefore are proposing to amend General

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[107] Under IAS 8, in the absence of an IFRS standard or interpretation that specifically applies to a transaction or event, management should use its judgment in developing and applying a relevant and reliable accounting policy and look to other pronouncements in applying that judgment.

[108] See the 2005 Adopting Release.

Instruction G to ensure consistency with the proposed elimination of the U.S. GAAP reconciliation requirement for users of IFRS as published by the IASB.

Paragraph (d) of General Instruction G, "Information on the Company," currently refers to the basis of accounting that an issuer uses to prepare "*the* U.S. GAAP reconciliation." As the U.S. GAAP reconciliation would no longer be required of an issuer to which General Instruction G applies, we propose to change to reference to "a U.S. GAAP reconciliation." This change is intended to eliminate any potential inference that the U.S. GAAP reconciliation would still be required, and to clarify that the body of accounting principles referenced in the paragraph does not refer to a basis that the issuer used to prepare financial statements for which a U.S. GAAP reconciliation was required. Paragraph (e) of General Instruction G directs an issuer to refer to the U.S. GAAP reconciliation for the years for which financial statements were prepared in accordance with IFRS and to discuss any differences between IFRS and U.S. GAAP not otherwise discussed in the reconciliation that the issuer believes are necessary for an understanding of the financial statements. Because an issuer would no longer be required to prepare a reconciliation to U.S. GAAP under the proposed rules, we are proposing to eliminate the reference to the reconciliation in this instruction.

Paragraph (f) of General Instruction G stipulates the financial information that a first-time IFRS user must provide in a registration statement filed during the year in which it makes the change, including interim information. Sub-paragraphs (f)(2)(B)(i), (ii) and (iii) set forth three options by which the requirements of Item 8.A.5 for interim financial statements may be satisfied.[109] The first option allows for three years of financial statements prepared in accordance with Previous GAAP (as defined in Form 20-F) and reconciled to U.S. GAAP. As the proposed amendments would continue to require a reconciliation to U.S. GAAP from financial statements prepared using any basis of accounting other than IFRS as published by the IASB, we are not proposing to amend this requirement. The second option allows for two financial years of audited financial statements and interim financial statements prepared in accordance with IFRS as published by the IASB and reconciled to U.S. GAAP as required by Item 17(c) or 18. Consistent with the proposed amendments to Items 17 and 18, we also are proposing to eliminate the reconciliation requirement from this option. Under the third option, a first-time IFRS adopter may provide three years of audited financial statements prepared in accordance with the issuer's Previous GAAP, reconciled to U.S. GAAP, and two years of interim financial statements prepared in accordance with IFRS and reconciled to U.S. GAAP. We are not proposing to amend this option, which was provided as a bridge between an issuer's Previous GAAP and IFRS. Because an issuer eligible to rely on that option would not yet have provided audited IFRS financial statements in a filing with the Commission, we believe it is appropriate to continue to require the U.S. GAAP reconciliation of the interim financial statements prepared under IFRS.

Paragraph (h) of General Instruction G currently requires that financial statements prepared in accordance with IFRS for the most recent two financial years be reconciled to U.S. GAAP under Item 17 or 18. Because first-time filers of financial statements using

[109] Item 8.A.5 of Form 20-F describes the financial information for interim periods to be included in a registration statement.

IFRS as published by the IASB are a subset of the IFRS filers that would be subject to the amendments we are proposing in this release, we also propose to eliminate that requirement from General Instruction G(h) in a manner consistent with the other proposed revisions to Form 20-F. As a conforming amendment we also are proposing to revise Instruction 2.b of General Instruction G(h) to specify that disclosure on operating and financial review and prospects provided in response to Item 5 of Form 20-F need not refer to a reconciliation to U.S. GAAP. That revision is intended to eliminate ambiguity as to whether the disclosure should refer to any U.S. GAAP reconciling information prepared for previous years.

Currently, the accommodation to first-time adopters of IFRS contained in General Instruction G expires after the first financial year starting on or after January 1, 2007. That timing was intended to comport with the requirements of the EU Regulation relating to the transition to IFRS of European companies, although the accommodation is available to an eligible first-time adopter of IFRS issuer from any jurisdiction. The Commission is aware that several countries will be changing their national accounting standards to IFRS, and is therefore proposing to extend the accommodation contained in General Instruction G to Form 20-F for five years, to cover financial statements for the 2012 financial year or earlier that are included in annual reports or registration statements.

Paragraph (i) of General Instruction G contains a special instruction that requires European issuers that prepare their financial statements using IFRS as adopted by the EU to reconcile their financial statements to IFRS as published by the IASB. A U.S. GAAP reconciliation also is required. This paragraph presently applies only to issuers incorporated in an EU Member State, and would cease to be applicable after the 2007 financial year, at which time the mandatory switch to IFRS under the EU Regulation will be complete. Because the provisions would no longer be applicable after that time, we are considering whether or not to delete General Instruction G(i) as part of this rulemaking.

Questions

31. If a first-time IFRS adopter provides, in a registration statement filed during the year in which it changes to IFRS, three years of annual financial statements under a Previous GAAP and two years of interim financial statements prepared under IFRS as published by the IASB, should we continue to require that the interim financial statements be reconciled to U.S. GAAP?

32. Would a U.S. GAAP reconciliation be a useful bridge from Previous GAAP financial statements to annual financial statements prepared under IFRS as published by the IASB that are not reconciled to U.S. GAAP?

33. Should the Commission extend the duration of the accommodation contained in General Instruction G for a period longer or shorter than the proposed five years? Would seven years, ten years or an indefinite period be appropriate? If so, why?

34. Should any extension of the accommodation to first-time adopters be tied in any way to U.S. GAAP reconciliation? If so, how?

5. **Check Boxes on the Cover Page of Form 20-F**

Currently, an issuer filing a registration statement or annual report on Form 20-F is required to identify, on the cover page of its filing, whether it prepares its financial statements in accordance with Item 17 or 18. The purpose of this information is to allow the reader to identify at a glance the type of U.S. GAAP reconciliation that the filing contains. If the proposed amendments are adopted, the reconciliation requirements contained in Items 17 and 18 will not apply to a Form 20-F filer that files its financial statements using IFRS as published by the IASB. To eliminate possible confusion as to the information that an issuer would provide on the cover page of Form 20-F in response to the current check box, we are proposing to add a check box in which a Form 20-F filer would indicate whether the financial statements included in the filing have been prepared using U.S. GAAP, IFRS as published by the IASB, or another basis of accounting. If, in response to this check box, an issuer has indicated that it uses a basis of accounting other than U.S. GAAP or IFRS as published by the IASB, the issuer would then indicate in response to a subsequent check box whether it follows Item 17 or 18.

It is often difficult for the staff to communicate with foreign private issuers or their counsel, who may be located overseas. As a means of facilitating communication with foreign private issuers by the Commission staff, we also are proposing to revise the cover page of Form 20-F to require that issuers provide contact information for a person to whom enquiries may be directed.[110] This information would include the name of an individual at the company or its legal counsel and the telephone, e-mail, and/or facsimile

[110] An example of this enquiry would be a staff comment letter. Identifying the person on the cover page would not make that person an agent for service of process.

number, or other means by which that person can be contacted. Information provided on the Form 20-F in response to the proposed check boxes and the company contact information will constitute required disclosure that is subject to all applicable federal securities laws.

D. Regulation S-X

Regulation S-X contains, among other things, the form and content requirements for financial statements included in filings made with the Commission. It also includes many provisions that do not relate to U.S. GAAP, for example, requirements for auditor qualifications and reports. If the proposed rules are adopted, Regulation S-X, other than its form and content requirements, will continue to apply to the filings of all foreign private issuers, including those who file financial statements prepared using IFRS as published by the IASB without reconciliation to U.S. GAAP.

1. <u>Application of the Proposed Amendments to Rules 3-05, 3-09, and 3-16</u>

Under Rules 3-05, 3-09 and 3-16 of Regulation S-X, an issuer, in certain circumstances, must include the financial statements of another entity in its filings.[111] Although we are not proposing any specific amendments to those sections as part of this

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[111] Rule 3-05 specifies the requirements for financial statements of businesses acquired or to be acquired. Rule 3-09 specifies the requirements for financial statements of unconsolidated majority-owned subsidiaries and 50 percent or less owned investments accounted for by the equity method. Both Rule 3-05 and 3-09 require financial statements when the applicable entity is significant to the issuer.

Rule 3-16 specifies the requirement for financial statements of affiliates whose securities collateralize an issue registered or being registered. The requirement to provide separate financial statements under Rule 3-16 is based upon whether or not the securities are a substantial portion (as defined) of the collateral for the class of securities registered or being registered.

rulemaking initiative, the amendments that we are proposing in this release will apply equally in the application of Rules 3-05, 3-09 and 3-16.

a. Significance Testing

Under Rules 3-05, 3-09 and 3-16, an issuer is required to include the financial statements of another entity if the entity meets certain significance tests.[112] Requirements for significance testing are governed by the financial statements of the issuer. Generally, if a foreign private issuer prepares its own financial statements using IFRS as published by the IASB, that issuer would perform the significance tests under Rules 3-05, 3-09 and 3-16 using IFRS as published by the IASB, regardless of the basis of accounting used by the other entity. If the significance thresholds under Rule 3-05, 3-09 or 3-16 are met, then the issuer must provide on a separate basis audited annual financial statements of the subject entity.

b. Separate Historical Financial Statements of Another Entity Provided under Rules 3-05 or 3-09

Generally, the historical financial statement requirements for a foreign acquired business or investee under Rules 3-05 or 3-09 are governed by the status of that entity, and the burden of reconciling the financial statements of a non-issuer entity would be no higher than if it were the issuer. In applying the proposed amendments, if the entity's audited financial statements are in accordance with IFRS as published by the IASB, those financial statements would not be required to be reconciled to U.S. GAAP. For example, under Rule 3-05 both foreign private issuers and U.S. companies that acquire a

[112] An entity is significant to the issuer if the issuer's investment in the entity exceeds 20% of the issuer's total assets, the entity's income (as defined) exceeds 20% of the issuer's corresponding income, or (for Rule 3-05 only) the entity's total assets exceed 20% of the issuer's total assets.

"significant" foreign business would be permitted, under the proposed rules, to include the acquiree's financial statements prepared in accordance with IFRS as published by the IASB without reconciliation, U.S. GAAP, or another comprehensive basis of accounting reconciled to U.S. GAAP. The same would be true for the financial statements of a "significant" foreign investee under Rule 3-09.

An issuer that includes financial statements for a foreign entity under Rule 3-05 or Rule 3-09 currently is permitted to omit the reconciliation to U.S. GAAP for that entity, regardless of the comprehensive basis of accounting in which that entity's financial statements are presented, if the significance of that entity, as defined in Rule 1-02(w) of Regulation S-X, does not exceed 30 percent of the registrant.[113] Although we are not proposing to amend Rules 3-05 or 3-09, we are proposing to revise Items 17(c)(2)(v) and (vi) of Form 20-F to clarify, respectively, that an issuer that uses IFRS as published by the IASB to prepare the financial statements of the foreign entity under Rule 3-05 or 3-09 may omit the reconciling information specified under Item 17(c)(2)(i)-(iii) regardless of the significance of the entity.

2. Pro Forma Financial Statements Provided under Article 11

Under Article 11 of Regulation S-X, issuers are required to prepare unaudited pro forma financial information that is intended to give effect as if a particular transaction, such as a significant recent or probable business combination, had occurred at the beginning of the financial period. Requirements for pro forma financial information under Article 11 continue to be governed by the financial statements of the issuer rather

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[113] See Item 17(c)(2)(v) and (vi) of Form 20-F.

than of the acquiree or other entity, as the pro forma results must be presented using the same basis of accounting as the issuer. Similarly, these rules do not impose a higher presentation burden on pro forma financial information than would be imposed on the historical financial statements of the issuer. We are not proposing to amend Article 11, but the proposed amendments will apply in the application of Article 11. Accordingly, if the proposed amendments are adopted, a foreign private issuer using IFRS as published by the IASB as its basis of accounting would not be required to reconcile to U.S. GAAP its pro forma financial information. Therefore, an issuer using IFRS as published by the IASB would prepare the pro forma financial information by presenting its IFRS results and converting the financial statements of the business acquired (or to be acquired) into IFRS as published by the IASB.

3. Financial Statements Provided under Rule 3-10

Rule 3-10 of Regulation S-X specifies financial statement requirements for issuers of guaranteed securities and guarantors.[114] Generally, under this rule both the issuer of the guaranteed security and the guarantor must follow the financial statement requirements of a registrant. If both entities are reporting foreign private issuers filing on Form 20-F, we would accept the financial statements prepared in accordance with IFRS as published by the IASB without reconciliation from each one under the proposed rules.[115]

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[114] A guarantee of a registered security is itself a security, so a guarantor of a registered security is itself considered an issuer of a security. See Securities Act Section 2(a)(1).

[115] In this situation, when an issuer of a guaranteed security and a guarantor each file complete audited financial statements, the separate financial statements of each entity

However, Rule 3-10 permits modified reporting by subsidiary issuers of guaranteed securities and subsidiary guarantors. Separate financial statements need not be filed for subsidiaries meeting the applicable conditions contained in Rules 3-10(b) through 3-10(f). Instead, condensed consolidating financial information is presented in the parent company's reports in an additional audited footnote to the financial statements. In applying modified reporting under Rule 3-10, however, the reconciliation requirement would be based on the consolidated financial statements of the parent company, as under current rules. A parent issuer or guarantor that presents consolidated financial statements under IFRS as published by the IASB would present the condensed consolidating financial information on the basis of IFRS as published by the IASB, without reconciliation to U.S. GAAP. We do not believe that any substantive revision to Rule 3-10 is necessary to implement the acceptance of financial statements prepared using IFRS as published by the IASB without reconciliation as proposed.

The instructions for preparation of condensed consolidating financial information required by certain paragraphs of Rule 3-10 contain a reference to a reconciliation of the condensed consolidating financial information to U.S. GAAP. As a conforming amendment, we are proposing to revise this reference to clarify that we would accept the condensed consolidating financial information without a U.S. GAAP reconciliation if it is prepared using IFRS as published by the IASB.

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also may be on a different basis of accounting and, if not prepared under U.S. GAAP or IFRS as published by the IASB, must be reconciled to U.S. GAAP.

4. Conforming Amendment to Rule 4-01

Rule 4-01 of Regulation S-X sets out the general requirements for financial statements included in Commission filings and requires that foreign private issuers include an Item 18 reconciliation if they use a basis of accounting other than U.S. GAAP, except as otherwise stated in the applicable form.[116] In order to implement fully the proposed acceptance of financial statements prepared using IFRS as published by the IASB and to avoid ambiguity for issuers, we propose to revise Rule 4-01 to clarify that financial statements of foreign private issuers may be prepared using IFRS as published by the IASB without reconciliation to U.S. GAAP.

Questions

35. Are the proposed changes to Rules 3-10 and 4-01 sufficient to avoid any ambiguity about our acceptance of IFRS financial statements without reconciliation? If not, what other revisions would be necessary?

36. Are there other rules in Regulation S-X that should be specifically amended to permit the filing of financial statements prepared in accordance with IFRS as published by the IASB without a reconciliation to U.S. GAAP? If so, how would the application of those rules be unclear if there were no changes to

[116] As noted above, Item 17 reconciliation is permitted in various circumstances.

those rules, and what changes would be suggested in order to make them clear?

37. Is the application of the proposed rules to the preparation of financial statements provided under Rules 3-05, 3-09, 3-10 and 3-16 sufficiently clear? If not, what areas need to be clarified? Are any further changes needed for issuers that prepare their financial statements using IFRS as published by the IASB?

E. Application of the Proposed Amendments to other Forms, Rules and Schedules

1. <u>Conforming Amendments to Securities Act Forms F-4 and S-4</u>

In addition to being the combined registration statement and annual report for foreign private issuers under the Exchange Act, Form 20-F also sets forth the disclosure requirements for registration statements filed by foreign private issuers under the Securities Act. Because the Securities Act registration statements applicable to foreign private issuers reference the disclosure and financial statement item requirements of Form 20-F, the proposed amendments to Form 20-F to eliminate the U.S. GAAP reconciliation requirement for IFRS issuers also will serve to eliminate the reconciliation requirement from most Securities Act forms without direct revision of those forms. In order to implement fully our acceptance of financial statements prepared in accordance with IFRS as published by the IASB and to eliminate potential ambiguity, we are proposing to make conforming amendments to references to the U.S. GAAP reconciliation contained in Securities Act Forms F-4 and S-4.

Form F-4, the registration statement for securities of foreign private issuers issued in certain business combinations, contains specific references to the U.S. GAAP reconciliation.[117] We are proposing to revise these references to the U.S. GAAP reconciliation contained in Items 10, 12 and 17 of this form to make them consistent with the proposed revisions to Item 17(c) and 18(b) of Form 20-F to indicate that the referenced U.S. GAAP reconciliation would apply only to financial statements prepared using a basis of accounting other than U.S. GAAP or IFRS as published by the IASB. Form S-4, the registration statement for securities of domestic issuers issued in business combination transactions, also contains reference to the U.S. GAAP reconciliation in the instruction to Item 17 which we propose to revise in the same manner.

2. <u>Conforming Amendment to Rule 701</u>

Rule 701 under the Securities Act provides an exemption from registration for offers and sales made under certain compensatory benefit plans. The rule is generally not available to an issuer that has a reporting obligation under the Exchange Act. An issuer that offers securities in reliance on Rule 701 does not file any information with the Commission, but is required to deliver to investors certain information, including financial statements, if more than $5 million in securities are sold over a 12-month period. For foreign private issuers relying on Rule 701, these financial statements must include a reconciliation under Item 17 of Form 20-F if they are not prepared in accordance with U.S. GAAP.

To implement the proposed rules fully, we believe that a foreign private issuer that conducts an offering under Rule 701 and that uses in its financial statements IFRS as published by the IASB should not be required to present a U.S. GAAP reconciliation.

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[117] <u>See</u> Form F-4, Items 10(c), 12(b) and 17(b).

We propose to amend Rule 701 to clarify that a U.S. GAAP reconciliation will not be required in that circumstance.

3. Small Business Issuers

A Canadian foreign private issuer that qualifies as a small business issuer under Regulation S-B may elect to provide disclosure in its registration statements and annual reports, in compliance with forms based on Regulation S-B rather than on Form 20-F.[118] Regulation S-B describes the financial statement requirements for a small business issuer, which must be prepared in accordance with U.S. GAAP or, if filed by a foreign private issuer that also is a small business issuer, reconciled to U.S. GAAP in accordance with the requirements of Items 17 or 18 of Form 20-F, as appropriate.[119] At a recent meeting,[120] the Commission approved a proposal to integrate most of the substantive provisions of Regulation S-B into Regulation S-K and to eliminate current Regulation S-B as a separate disclosure system for smaller companies. If we do not adopt those proposals, we would consider making conforming changes to Regulation S-B and to small business forms to implement fully the amendments we are proposing in this release.

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[118] 17 CFR 228. A "small business issuer" is defined in Item 10 of Regulation S-B (17 CFR 228.10) as a company that (i) has revenues of less than $25,000,000, (ii) is a U.S. or Canadian issuer; and (iii) is not an investment company and is not an asset-backed issuer; and (iv) if a majority owned subsidiary, the parent corporation is also a small business issuer. An entity that meets all of these criteria is not a small business issuer if it has a public float (defined as the aggregate market value of the issuer's outstanding voting and non-voting common equity held by non-affiliates) of $25,000,000 or greater.

[119] See Notes 1 and 2 to Item 310 of Regulation S-B.

[120] The proposal that the Commission made in its meeting held May 23, 2007 is described at http://www.sec.gov/news/press/2007/2007-102.htm.

If the new small business rules are adopted as proposed, a foreign private issuer that also is eligible to rely on those rules would have a choice as to the accounting standards used to prepare its financial statements. If we adopt the proposed amendments, a small business issuer that files annual reports on Form 20-F or a Securities Act registration statement based on Form 20-F would be able to file financial statements prepared using U.S. GAAP, IFRS as published by the IASB without a U.S. GAAP reconciliation, or another comprehensive basis of accounting with a U.S. GAAP reconciliation. If that issuer chose to file annual reports on Form 10-K or a Securities Act form based on Regulation S-K, financial statements prepared using U.S. GAAP would be required.

Questions

38. Are the proposed changes in Forms F-4 and S-4, and in Rule 701, sufficient to avoid any ambiguity about our acceptance of IFRS financial statements without reconciliation? If not, how should we revise those forms or rule?

39. Under Part F/S of Form 1-A relating to offerings conducted under Regulation A, Canadian issuers may use unaudited financial statements that are reconciled to U.S. GAAP. Should we amend Form 1-A to permit the use by Canadian companies of financial statements prepared in accordance with IFRS as published by the IASB without a reconciliation? Does the fact that financial statements under Form 1-A are not required to be audited militate in favor of retaining a U.S. GAAP reconciliation whenever a Canadian issuer uses a GAAP other than U.S. GAAP?

40. Are there other rules or forms under the Securities Act that should be specifically amended to permit the filing of financial statements prepared in accordance with IFRS as published by the IASB without a reconciliation to U.S. GAAP? If so, how would the rules or forms be unclear if there were no changes to those forms, and what changes would be suggested in order to make them clear?

4. Schedule TO and Schedule 13E-3

Instruction 8 to Item 10 of Schedule TO, the tender offer statement under the Exchange Act,[121] contains a reference to reconciliation to U.S. GAAP in accordance with Item 17 of Form 20-F. Instruction 2 to Item 13 of Schedule 13E-3,[122] the transaction statement under Section 13(e) of the Exchange Act, also contains a reference to U.S. GAAP reconciliation under Item 17. Because reconciliation requirements for Schedule TO and Schedule 13E-3 are provided in Item 17 of 20-F, which we are proposing to amend, we do not believe any amendment to Schedule TO or Schedule 13E-3 is necessary to fully implement our proposed acceptance of financial statements prepared in accordance with IFRS as published by the IASB when contained without reconciliation to U.S. GAAP.

Question

41. Should Schedule TO and Schedule 13E-3 be specifically amended to permit the filing of financial statements prepared in accordance with IFRS as published by the IASB without a reconciliation to U.S. GAAP? If so, how

[121] 17 CFR 240.14d-100.

[122] 17 CFR 240.13e-100.

would the rules or forms be unclear if there were no changes to those Schedules, and what changes would be suggested in order to make them clear?

F. Quality Control Issues

On April 16, 2003, the PCAOB adopted certain pre-existing standards of the American Institute of Certified Public Accountants ("AICPA") as interim standards to be used on an initial transition basis.[123] Among these interim standards was PCAOB Rule 3400T, Interim Quality Control Standards, which consist of the AICPA's Auditing Standard Board's Statements on Quality Control Standards and the AICPA SEC Practice Section's membership requirements, in each case as in existence on April 16, 2003 and to the extent not superseded or amended by the PCAOB.

One of these membership requirements related to compliance with Appendix K, which was applicable to member firms that were members of, correspondents with, or similarly associated with international firms or international associations of firms. Appendix K provides that member firms seek adoption of policies and procedures by their international organizations or individual foreign associated firms that address the review of SEC filings by persons knowledgeable in accounting, auditing and independence standards generally accepted in the United States. This requirement seeks

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[123] See "Interim Standards" at www.pcaobus.org/Standards/Interim_Standards/index.aspx.

to enhance the quality of SEC filings by SEC registrants whose financial statements are audited by foreign associated audit firms.[124]

We are not proposing amendments to our rules that relate to the continued need for compliance with PCAOB Auditing Standards, including Appendix K. However, we believe that commenters may wish to address this area in light of our proposed acceptance of IFRS as published by the IASB without a reconciliation to U.S. GAAP.

Questions

42. Without the reconciliation to U.S. GAAP, should we be concerned about member firm requirements to have persons knowledgeable in accounting, auditing and independence standards generally accepted in the United States review IFRS financial statements filed with the Commission? Are there alternative ways in which concerns may be addressed?

G. Application to Filings under the Multijurisdictional Disclosure System

Certain Canadian foreign private issuers file registration statements and annual reports under the Multijurisdictional Disclosure System ("MJDS"), which permits eligible Canadian companies to use their disclosure documents prepared in accordance with Canadian requirements in filings with the Commission. Certain filings under the MJDS are not required to contain a reconciliation to U.S. GAAP.[125] However, a U.S.

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[124] See Appendix K at www.pcaob.org/Standards/Interim_Standards/Quality_Control_Standards/SECPS_1000.08_Appendicies_bookmarks.pdf#nameddest=k.

[125] A U.S. GAAP reconciliation is not required under Form F-7 relating to rights offers, Forms F-8 and F-80 for exchange offers and business combinations, Form F-9 relating to investment grade securities, and Form 40-F when used as an annual report relating to an issuer's Section 15(d) reporting obligations for any of the these offerings or a Section 13(a) reporting obligation relating to investment grade securities.

GAAP reconciliation is required in registration statements and annual reports on Form 40-F,[126] and registration statements on Form F-10,[127] each when used for common equity securities, securities convertible into common equity securities and other securities not rated investment grade.

At present, Canadian companies filing under the MJDS generally use either Canadian GAAP (with a U.S. GAAP reconciliation when called for) or U.S. GAAP in filings with the Commission. As discussed above, officials in Canada are considering permitting the use of IFRS as published by the IASB as the basis of accounting for all Canadian public companies. To implement the proposed rules fully, we believe that a Canadian company that uses the MJDS forms and that changes its basis of accounting to IFRS as published by the IASB should not be required to present a U.S. GAAP reconciliation. However, we do not believe any amendments to Forms 40-F and F-10 are necessary to accomplish this. Forms 40-F and F-10 already contain a cross-reference to the U.S. GAAP reconciliation requirement under Items 17 and 18 of Form 20-F, which will be amended as described above to allow the filing of IFRS financial statements without a U.S. GAAP reconciliation.

Questions

43. Should Form 40-F or F-10 be specifically amended to permit the filing of financial statements prepared in accordance with IFRS as published by the

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[126] 17 CFR 249.240f.

[127] 17 CFR 239.40.

IASB without a reconciliation to U.S. GAAP? If so, how would the forms be unclear if there were no changes to those forms, and what changes would be suggested in order to make them clear?

IV. GENERAL REQUEST FOR COMMENTS

We request and encourage any interested persons to submit comments regarding:

- the proposed changes that are the subject of this release,
- additional or different changes, or
- other matters that may have an effect on the proposals contained in this release.

In addition to providing comments on these matters, we encourage interested parties to provide comment on broader matters related to the development of a single set of globally accepted accounting standards, for example:

44. If progress does not continue towards implementing a single set of high-quality globally accepted accounting standards, will investors and issuers be served by the absence of a U.S. GAAP reconciliation for financial statements prepared using IFRS as published by the IASB?

45. Where will the incentives for continued convergence lie for standard setters, issuers, investors and other users of financial statements if the reconciliation to U.S. GAAP is eliminated for issuers whose financial statements are prepared using IFRS as published by the IASB?

46. Are there additional interim measures, beyond the proposed elimination of the U.S. GAAP reconciliation from IFRS financial statements, that would advance the adoption of a single set of high-quality globally accepted accounting standards? If so, what are they? Who should undertake them?

We request comment from the point of view of registrants, investors, accountants, accounting standard setters, users of financial statements and other market participants. With regard to any comments, we note that such comments are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

V. PAPERWORK REDUCTION ACT

A. Background

The proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[128] We are submitting the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[129] The titles for the affected collections of information are:

(1) "Form 20-F" (OMB Control No. 3235-0288);

(2) "Form F-1" (OMB Control No. 3235-0258);

(3) "Form F-4" (OMB Control No. 3235-0325);

(4) "Form S-4" (OMB Control No. 3235-0324); and

(5) "Rule 701" (OMB Control No. 3235-0522).

These forms were adopted pursuant to the Exchange Act and the Securities Act and set forth the disclosure requirements for annual reports and registration statements filed by foreign private issuers. The hours and costs associated with preparing, filing and sending

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[128] 44 U.S.C. 3501 et seq.

[129] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

these forms constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The proposed amendments, if adopted, would allow a foreign private issuer that prepares its consolidated financial statements in accordance with IFRS as published by the IASB, and meets the other eligibility requirements, to file those financial statements in its registration statements and periodic reports filed with the Commission without reconciliation to U.S. GAAP. These amendments would be collections of information for purposes of the Paperwork Reduction Act. For purposes of this Paperwork Reduction Analysis, these proposed amendments, if adopted, would result in a decrease in the hour and cost burden calculations. We believe this proposed amendment would eliminate potential burdens and costs for foreign issuers that use IFRS. The disclosure will be mandatory. There would be no mandatory retention period for the information disclosed, and responses to the disclosure requirements would not be kept confidential.

For purposes of the Paperwork Reduction Act, we estimate that the incremental decrease in the paperwork burden for all foreign private issuers that use IFRS and issuers that acquire foreign private issuers that use IFRS would be approximately 3,861 hours of company time and approximately $4,600,720 for the services of outside professionals. We estimated the average number of hours each entity spends completing the forms and the average hourly rate for outside professionals. That estimate includes the time and the cost of in-house preparers, reviews by executive officers, in-house counsel, outside counsel, independent auditors and members of the audit committee.[130] Our estimates of the number of impacted foreign private issuers are based on the number of recent filings received from issuers that we believe may be immediately eligible to rely on the proposals, if adopted.

B. Burden and Cost Estimates Related to the Proposed Accommodation

1. Form 20-F

We estimate that currently foreign private issuers file 942 Form 20-Fs each year. We assume that 25% of the burden required to produce the Form 20-Fs is borne internally by foreign private issuers, resulting in 619,601 annual burden hours borne by foreign private issuers out of a total of 2,478,404 annual burden hours. Thus, we estimate that 2,631 total burden hours per response are currently required to prepare the Form 20-F. We further assume that 75% of the burden to produce the Form 20-Fs is carried by outside professionals retained by foreign private issuers at an average cost of $400 per hour, for a total cost of $743,520,600.

We estimate that approximately 110 companies that file Form 20-F will be currently impacted by the proposal.[131] We expect that, if adopted, the proposed

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[130] In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of $400 as the cost to companies for the services of outside professionals retained to assist in the preparation of these disclosures. For Securities Act registration statements, we also consider additional reviews of the disclosure by underwriter's counsel and underwriters.

[131] We are using this figure for purposes of the Paperwork Reduction Analysis based on the number of Form 20-Fs that were filed with IFRS financial statements during the 2006 calendar year. As additional jurisdictions adopt IFRS as their basis of accounting in the future, the number of issuers that use IFRS is expected to increase.

amendment would cause those foreign private issuers to have fewer burden hours. We estimate that for each of the companies affected by the proposal, there would occur a decrease of 5% (131.55 hours) in the number of burden hours required to prepare their Form 20-F, for a total decrease of 14,471 hours. We expect that 25% of these decreased burden hours (3,618 hours) will be saved by foreign private issuers. We further expect that 75% of these decreased burden hours (10,853 hours) will be saved by outside firms, at an average cost of $400 per hour, for a total of $4,341,120 in decreased costs to the respondents of the information collection.

Thus, we estimate that the proposed amendment to Form 20-F would decrease the annual burden borne by foreign private issuers in the preparation of Form 20-F from 619,601 hours to 615,983 hours. We further estimate that the proposed amendment would decrease the total annual burden associated with Form 20-F preparation to 2,463,932 burden hours, which would decrease the average number of burden hours per response to 2,616. We further estimate that the proposed amendment would decrease the total annual costs attributed to the preparation of Form 20-F by outside firms to $739,179,600.

2. <u>Form F-1</u>

We estimate that currently foreign private issuers file 42 registration statements on Form F-1 each year. We assume that 25% of the burden required to produce a Form F-1 is borne by foreign private issuers, resulting in 18,999 annual burden hours incurred by foreign private issuers out of a total of 75,996 annual burden hours. Thus, we estimate that 1,809 total burden hours per response are currently required to prepare a registration statement on Form F-1. We further assume that 75% of the burden to produce a Form F-

1 is carried by outside professionals retained by foreign private issuers at an average cost of $400 per hour, for a total cost of $22,798,800.

We estimate that currently approximately five companies that file registration statements on Form F-1 will be impacted by the proposal.[132] We expect that, if adopted, the proposed amendment would cause those foreign private issuers to have fewer burden hours. We estimate that each company affected by the proposal would have a 5% decrease (90.45 hours) in the number of burden hours required to prepare their registration statements on Form F-1, for a total decrease of 452 hours. We expect that 25% of these decreased burden hours (113 hours) will be saved by foreign private issuers. We further expect that 75% of the decreased burden hours (339 hours) will be saved by outside firms, at an average cost of $400 per hour, for a total of $135,600 in decreased costs to the respondents of the information collection.

Thus, we estimate that the proposed amendment to Form 20-F would decrease the annual burden incurred by foreign private issuers in the preparation of Form F-1 from 18,999 hours to 18,886 hours. We further estimate that the proposed amendment would decrease the total annual burden associated with Form F-1 preparation to 75,544 burden hours, which would decrease the average number of burden hours per response to 1,799. We further estimate that the proposed amendment would decrease the total annual costs attributed to the preparation of Form F-1 by outside firms to $22,663,200.

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[132] This figure is based on our estimate of the number of Form F-1s that were filed with IFRS financial statements during the 2006 calendar year.

3. Form F-4

We estimate that currently foreign private issuers file 68 registration statements on Form F-4 each year. We assume that 25% of the burden required to produce a Form F-4 is borne internally by foreign private issuers, resulting in 24,503 annual burden hours incurred by foreign private issuers out of a total of 98,012 annual burden hours. Thus, we estimate that 1,441 total burden hours per response are currently required to prepare a registration statement on Form F-4. We further assume that 75% of the burden to produce a Form F-4 is carried by outside professionals retained by foreign private issuers at an average cost of $400 per hour, for a total cost of $29,403,600.

We estimate that currently approximately 5 companies that file registration statements on Form F-4 will be impacted by the proposal.[133] We expect that, if adopted, the proposed amendment would cause those foreign private issuers to have fewer burden hours. We estimate that each of the affected companies would have a decrease of 5% (72 hours) in the number of burden hours required to prepare their registration statements on Form F-4, for a total decrease of 360 hours. We expect that 25% of these decreased burden hours (90 hours) will be saved by foreign private issuers. We further expect that 75% of the decreased burden hours (270 hours) would be saved by outside firms at an average cost of $400 per hour, for a total of $108,000 in decreased costs to the respondents of the information collection.

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[133] This figure is based on our estimate of the number of Form F-4s that were filed with IFRS financial statements during the 2006 calendar year.

Thus, we estimate that the proposed amendment to Form 20-F would decrease the annual burden incurred by foreign private issuers in the preparation of Form F-4 from 24,503 hours to 24,413 hours. We further estimate that the proposed amendment would decrease the total annual burden associated with Form F-4 preparation to 97,652 burden hours, which would decrease the average number of burden hours per response to 1,436. We further estimate that the proposed amendment would decrease the total annual costs attributed to the preparation of Form F-4 by outside firms to $29,295,600.

4. Form S-4

When a domestic issuer files a registration statement on Form S-4 for the acquisition of a foreign private issuer, the domestic issuer must include the financial statements of the acquired company in the Form S-4. If those financial statements are prepared using a basis of accounting other than U.S. GAAP, the domestic issuer must provide a reconciliation to U.S. GAAP, unless a reconciliation is unavailable or not obtainable without unreasonable cost or expense.

We estimate that issuers file 619 registration statements on Form S-4 each year. We estimate that 1,355 total burden hours per response are currently required to prepare a registration statement on Form S-4. We assume that 75% of the burden required to produce a Form S-4 is borne by the domestic issuer, resulting in 629,059 annual burden hours incurred by issuers out of a total of 838,745 annual burden hours. We further assume that 25% of the burden to produce a Form S-4 is carried by outside professionals retained by the issuer at an average cost of $400 per hour for a total cost of $83,874,500.

We estimate that currently approximately 6 registration statements filed on Form S-4 will contain the financial statements of a foreign target that will be impacted by the proposal.[134] We expect that, if adopted, the proposed amendment would cause the domestic issuers that file the Form S-4 registration statements to have fewer burden hours. We estimate that for each of these domestic registrants, there would be a decrease of 2% (27 hours) in the number of burden hours required to prepare their registration statements on Form S-4, for a total decrease of 162 hours.[135] We expect that 75% of these decreased burden hours (122 hours) would be saved by issuers. We further expect that 75% of the decreased burden hours (40 hours) would be saved by outside professionals at an average cost of $400 per hour for a total of $16,000 in decreased costs to the respondents of the information collection.

Thus, we estimate that the proposed amendment would decrease the annual burden incurred by issuers in the preparation of Form S-4 from 629,059 hours to 628,937 hours. We further estimate that the proposed amendment would decrease the total annual burden associated with Form S-4 preparation to 838,584 burden hours, which would decrease the average number of burden hours per response to 1,354.7. We further estimate that the proposed amendment would decrease the total annual costs attributed to the preparation of Form S-4 by outside firms to $83,858,500.

5. **Rule 701**

Rule 701 provides an exemption from registration for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation.

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[134] This figure is based on our estimate of the number of Form S-4s that were filed during the 2006 calendar year that contained IFRS financial statements.

[135] We estimate the burden decrease for purposes of this Paperwork Reduction Analysis would be less for Form S-4 than for other forms described in this section because, in the case of Form S-4, the registrant is obtaining the U.S. GAAP reconciliation from the

Issuers conducting employee benefit plan offerings in excess of $5 million in reliance on Rule 701 are required to provide employees covered by the plan with certain disclosures, including financial statement disclosures. This disclosure is a collection of information.

We estimate that currently 300 issuers provide information under Rule 701, and that the estimated number of burden hours per respondent is two. Therefore, we estimate an aggregate of 600 burden hours per year. We believe that the reduction in burden hours caused by the proposed rules will be insignificant. Therefore, we do not believe the proposed rules will alter current burden estimates associated with Rule 701.

C. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- evaluate the accuracy of our estimates of the burden of the proposed collections of information;
- determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

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foreign private issuer. Further, the registrant is not required to provide the

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-13-07. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-13-07 and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street NE, Washington DC 20549. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

VI. COST-BENEFIT ANALYSIS

We are proposing amendments to existing rules and forms to accept financial statements from foreign private issuers prepared using IFRS as published by the IASB without reconciliation to U.S. GAAP. Currently, financial statements that foreign private issuers file with the Commission must be prepared either in accordance with U.S. GAAP, or in accordance with another GAAP with a reconciliation to U.S. GAAP. The amendments, if adopted, would therefore provide foreign private issuers with a third method of preparing financial statements filed with the Commission. We are not

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reconciliation if it is unavailable or unobtainable without unreasonable cost or expense.

proposing to amend the current reconciliation requirements for foreign private issuers that prepare their financial statements using a basis of accounting other than IFRS as published by the IASB.

The amendments would apply to a registrant's financial statements contained in annual reports and registration statements on Form 20-F as well as to financial statements included in the Securities Act registration statements filed by foreign private issuers or, when applicable, included in a registration statement or reported pursuant to Rules 3-05, 3-09 or 3-16 of Regulation S-X. We also are proposing a conforming amendment to Rule 701, which provides an exemption from Securities Act registration for securities offered in certain employee benefit plans, to clarify that a foreign private issuer conducting an offering in excess of $5 million in reliance on that rule may furnish investors with financial statements prepared using IFRS as published by the IASB without reconciliation.

Currently, there are between 1,000 and 1,200 foreign private issuers registered with the Commission. The proposed amendments would be available to any of those foreign private issuers that comply with IFRS as published by the IASB, whether voluntarily or pursuant to a requirement. Some foreign companies that are registered under the Exchange Act already include in their filings with the Commission financial statements that comply with IFRS as published by the IASB. We estimate that there are approximately 110 foreign private issuers that represent in the footnotes to their financial statements that the financial statements comply with IFRS as published by the IASB. This representation may be in addition to a representation that the financial statements comply with a jurisdictional variation of IFRS. If a registrant's auditors are able to opine that those financial statements are in compliance with IFRS as published by the IASB, then those registrants would be in a position to immediately file their existing financial statements under the proposed approach. Another approximately 70 foreign private issuers already include in their filings financial statements that they state are prepared in accordance with solely a jurisdictional variation of IFRS. If these companies are also able to state (and their auditors are able to opine) that their financial statements comply with IFRS as published by the IASB, the companies would be in a similar position. Lastly, approximately 50 additional foreign private issuers that are incorporated in jurisdictions that have moved to IFRS include in their filings with the Commission financial statements prepared using U.S. GAAP. Some of these issuers also may be in a position to file financial statements under the proposed approach.[136]

We recognize that other registered foreign companies include financial statements in accordance with a home country GAAP. We believe that there would be different incentives for these companies to change their basis of accounting to IFRS as published by the IASB and thus be able to omit the U.S. GAAP reconciliation under the proposed approach. Some foreign companies are required under home country law or stock exchange rule to use a home country GAAP and are not permitted for home country purposes to use IFRS. At present, these companies generally include in their SEC filings financial statements prepared under home country GAAP with a U.S. GAAP reconciliation. These companies would be able to take advantage of the proposed amendments by preparing for the purpose of Commission filings (but not for home

[136] The figures contained in this paragraph are per staff estimates based on the jurisdiction of the filers.

country purposes) financial statements in accordance with IFRS as published by the IASB. While these companies would incur the costs of preparing a separate set of financial statements, companies may elect to do so in light of benefits they may derive from preparing a set of IFRS financial statements as well as the costs of preparing the U.S. GAAP reconciliation.

Lastly, in coming years, as more countries adopt IFRS as their basis of accounting or permit companies to use IFRS as their basis of accounting, we believe that the number of foreign private issuers that would be eligible to rely on the proposed amendments will increase, although it is difficult to quantify that increase at this point in time.

In summary, while all foreign private issuers would receive a potential benefit from the third option for preparing financial statements described in this proposal, this option will not be immediately equally attractive to all such issuers. We recognize that the proposed acceptance of financial statements prepared using IFRS as published by the IASB without reconciliation does not confer an equal benefit on all foreign private issuers, as there are some issuers that will continue to find it more attractive to reconcile their financial statements to U.S. GAAP. For some foreign private issuers the proposed amendments are immediately attractive. For other foreign private issuers the option may become attractive at a later date when their situational constraints or opportunities change. For still other such issuers, the option may not become attractive or applicable at any time in the foreseeable future. The cost of preparing (or not having to additionally prepare) the relevant IFRS financial statements is one factor that may influence whether a foreign private issuer will use the option proposed, be it immediately or at some time in the future. The proposed option may be most attractive for issuers whose home jurisdiction or other capital markets in which the issuer lists securities allow financial statements prepared in accordance with IFRS. Foreign private issuers also may be concerned about public perception costs, as they may be perceived as being the outlier if companies with which they compete for capital commonly report using another basis of accounting. Such an effect is likely to be smaller if a critical mass of issuers with whom the issuer competes for capital (such as those in its industry sector) also report in IFRS. In such situations, by reporting in IFRS, the foreign private issuer has made it more efficient for investors to analyze its financial results in comparison with the results of others with whom it competes for capital.

A. Expected Benefits

Our proposed acceptance of financial statements prepared using IFRS as published by the IASB is expected to help foster the preparation of financial statements in accordance with IFRS as a way of moving to a single set of globally accepted accounting standards, which we believe will have positive effects on investors and also issuers. Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as compared to financial statements prepared under differing sets of national accounting standards. Without a common standard and without a required reconciliation, global investors must incur the time and effort to understand financial statements reported using different bases of accounting so that they can compare opportunities.

The proposals are expected to increase the likelihood of realizing the net benefits of a single set of globally accepted accounting standards. This benefit is due to potential network effects of the proposed amendments: the more issuers that use IFRS as published by the IASB and file without a U.S. GAAP reconciliation, the more benefits there may be for other issuers to do so since the utility for investors of a set of accounting standards increases as the number of issuers using it increases.

The resulting reduction of the multiplicity of accounting standards that presently exist is expected to benefit investors by allowing them to spend less time and allocate fewer resources to learning, or keeping up with developments in, myriad GAAPs of varying quality in favor of a single, high-quality set of globally accepted standards. In addition to these benefits of moving away from a multiplicity of accounting standards towards a single set of standards, investors will further benefit from better information if the single set of standards that issuers use results in higher disclosure quality.

We believe that issuers would be affected by the proposal in a number of ways, including needing fewer resources to prepare U.S. filings.[137] To the extent that an issuer relying on the proposed amendments can reallocate its cost savings from not preparing a reconciliation to U.S. GAAP or possibly a second set of financial statements in U.S. GAAP to higher earning opportunities, and not suffer a relatively greater increase in the cost of its capital as a result, then the issuer also will realize a better rate of return on its

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[137] For purposes of the Paperwork Reduction Analysis, as described above, we have estimated that the incremental decrease in the paperwork burden for all foreign private issuers that use IFRS and issuers that acquire foreign private issuers that use IFRS would be approximately 3,861 hours of company time and approximately $4,600,720 for the services of outside professionals. For purposes of these calculations, we estimated the average number of hours each entity spends completing the forms and the average hourly rate for outside professionals, including the time and the cost of in-house preparers, reviews by executive officers, in-house counsel, outside counsel, independent auditors and members of the audit committee. The impact on an individual issuer may vary, based on its specific circumstances.

capital which will benefit investors. Issuers also may enjoy greater timing flexibility in accessing the U.S. market if they can prepare IFRS financial statements more quickly without reconciliation, particularly with regard to the use of automatic shelf registration statements.

The proposed amendments are expected to benefit investors and issuers alike to the extent that they facilitate capital formation by foreign companies in the United States capital markets. Our proposed amendments to accept IFRS financial statements without reconciliation would reduce regulatory burdens for foreign private issuers that rely on them, thereby lowering the information disclosure preparation cost of raising capital in the United States for those issuers. We believe that foreign private issuers may therefore be more likely to enter the U.S. capital markets. If they do, investors would, in turn, benefit from having more investment opportunities in the United States and generally would incur lower transaction costs when trading a foreign company's securities in the United States relative to a foreign market. To the extent our acceptance of IFRS financial statements without reconciliation encourages foreign private issuers to enter or remain in the U.S. capital market, investors also will benefit from the protections of the U.S. regulatory and disclosure system relative to the protections they may receive if purchasing those securities overseas. Investors also are expected to benefit from potential reduction in the cost of capital to issuers, as discussed above.

B. Expected Costs

This proposal has no cost upon either a foreign private issuer or its investors until the issuer uses the proposed IFRS option. In so doing, the minimum required financial information the investors in the U.S. capital markets receive from any such issuer would differ from what it was previously. The extent to which this yields a different required information set will depend upon how the foreign issuer previously reported its financial statements. For instance, if the foreign issuer currently files its financial statements using U.S. GAAP and transitions to reporting in IFRS, then this may or may not represent a loss of required information in absolute terms. Whether there is an absolute loss of information would depend upon whether IFRS financial statements yielded more or less information about a particular issuer than do U.S. GAAP financial statements. On the other hand, if the foreign private issuer currently prepares its statements in IFRS and reconciles to U.S. GAAP, then a loss of information would result as U.S. GAAP information is omitted.

The proposed amendments may lead to some costs to both investors and to issuers. If the investor community prefers the information communicated by a U.S. GAAP reconciliation, a foreign private issuer that uses IFRS as published by the IASB without a reconciliation may face a reduced following in the marketplace. Investors may prefer a U.S. GAAP reconciliation, if investors are not sufficiently familiar with IFRS accounting standards. In addition, unfamiliarity with IFRS as published by the IASB may have an adverse effect on investors' confidence in what they would be investing in and thus lead them to insist on a risk premium for an investment in the company.

The proposed amendments also would entail some costs to investors. If an issuer provides IFRS financial statements without reconciliation as permitted under the proposed amendments, investors would not have the benefit of the reconciling information that previously would have been available to them as they evaluate the financial performance of that issuer. The usefulness of this information may depend on the nature of the investor and other considerations, as discussed below. Also, to the extent that an investor is not accustomed to working with IFRS financial statements, that investor also may be required to dedicate more time and resources to gaining familiarity with IFRS and financial statements prepared using them.

Based in part on comments we received from participants at the Commission's IFRS roundtable held in March 2007, however, we believe that some investors are familiar with IFRS as a basis of accounting and therefore may make limited use of the reconciliation from IFRS to U.S. GAAP. However, because various investors may be differently situated in the market and have varying levels of familiarity with IFRS - for example, institutional investors may be more familiar with IFRS than retail investors - they may not all bear the cost from the proposed amendments equally. We are aware that investor familiarity with IFRS and the use that a particular investor may make of the reconciliation will depend on many factors. We believe that these factors may include, among other things, the size and nature of the investor, the size of the investment, the size of the issuer, the industry to which the issuer in question belongs. We also believe that the costs to investors of working without the reconciliation would be reduced over time as the use of IFRS as published by the IASB becomes even more widespread and investors gain increasing familiarity in working with IFRS financial statements.

Given these considerations, in this proposal we are soliciting comment on how familiar investors are with IFRS, the use they make of the U.S. GAAP reconciliation of IFRS financial statements, and how their ability to assess and compare investment opportunities would be impacted by the proposed amendment to permit the filing of financial statements prepared using IFRS as published by the IASB without reconciliation to U.S. GAAP.

Questions

47. Do you agree with our assessment of the costs and benefits as discussed in this section? Are there costs or benefits that we have not considered? Are you aware of data and/or estimation techniques for attempting to quantify these costs and/or benefits? If so, what are they and how might the information be obtained?

48. Which foreign private issuers would have the incentive to avail themselves of the proposed amendments, if adopted? Are there any reasons for which an issuer that is eligible to file IFRS financial statements without reconciliation under the proposed amendments would elect to file a reconciliation? If so, what are they?

49. Are there particular industry sectors for which a critical mass of the issuers who raise capital globally already report in IFRS? If so, which industries are they and why?

VII. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Commission hereby certifies pursuant to 5 U.S.C. 605(b), that the amendments to Form 20-F under the Exchange Act, Forms F-4 and S-4 and Rule 701 under the Securities Act and Regulation S-X contained in this release, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposal would amend Form 20-F, Form F-4, Form S-4, Rule 701 and Regulation S-X to allow foreign private issuers that use as their basis of accounting IFRS as published by the IASB to file their financial statements without reconciliation to U.S. GAAP as described under Items 17 and 18 of Form 20-F. Based on an analysis of the language and legislative history of the Act, Congress does not appear to have intended the Regulatory Flexibility Act to apply to foreign issuers. For this reason, the proposed amendment should not have a significant economic impact on a substantial number of small entities.

We solicit written comments regarding this certification. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

VIII. CONSIDERATION OF IMPACT ON THE ECONOMY, BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION ANALYSIS

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[138] we solicit data to determine whether the proposals constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposals on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views if possible.

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[138] Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

Section 2(b) of the Securities Act[139] and Section 3(f) of the Exchange Act[140] require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. When adopting rules under the Exchange Act, Section 23(a)(2) of the Exchange Act[141] requires us to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The purpose of the proposed amendments to Form 20-F under the Exchange Act, Forms F-4 and S-4 and Rule 701 under the Securities Act, and Regulation S-X is to allow foreign private issuers that use as their basis of accounting IFRS as published by the IASB to include those financial statements in their annual reports and registration statements filed with the Commission without reconciliation to U.S. GAAP. This proposal is designed to increase efficiency, competition and capital formation by helping to move towards a single set of globally accepted accounting standards, as well as by alleviating the burden and cost that eligible companies would face if required to prepare a U.S. GAAP reconciliation for inclusion in annual reports and registration statements filed with us. Due to the cost to issuers of preparing the reconciliation to U.S. GAAP from IFRS, we believe that the proposed amendment would be likely to promote efficiency by

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[139] 15 U.S.C. 77b(b).

[140] 15 U.S.C. 78c(f).

[141] 15 U.S.C. 78w(a)(2).

eliminating financial disclosure that is costly to produce. We believe that investors would have adequate information on which to base their investment decisions and that capital may be allocated on a more efficient basis.

The proposed amendments are expected to facilitate capital formation by foreign companies in the U.S. capital markets by reducing regulatory compliance burdens for foreign private issuers that rely on the proposed amendments. Reduced compliance burdens are expected to lower the cost of preparing disclosure for purposes of raising capital in the United States for those issuers.

The proposed amendments also may have other impacts on efficiency and capital formation, which may not be felt equally by all market participants. For example, the amendments may have a more favorable competitive impact on foreign private issuers from jurisdictions in which the use of IFRS is already required or permitted. Issuers from such jurisdictions may be able to benefit from the amendments more quickly than issuers from jurisdictions that do not permit the use of IFRS. Also, some foreign private issuers may be concerned about the public perception costs of not including a U.S. GAAP reconciliation, particularly if they compete for capital with other foreign companies that provide a reconciliation or that prepare financial statements that comply with U.S. GAAP.

The proposed amendments also may have effects on efficiency and capital formation to the extent that investors need to increase their familiarity with IFRS in order to compare investment opportunities without reference to a U.S. GAAP reconciliation. If investors prefer the information provided in a U.S. GAAP reconciliation, a foreign private issuer that uses IFRS as published by the IASB without reconciliation may face adverse competitive effects in the capital markets. For example, investor unfamiliarity with IFRS may adversely affect investor confidence in issuers that prepare IFRS financial statements without reconciliation to U.S. GAAP. This may lead investors to insist on a risk premium in those companies, which would affect their competitiveness in the capital markets. Also, if investors must incur costs in order to understand IFRS financial statements without a U.S. GAAP reconciliation, there may be an incentive for intermediary parties to provide U.S. GAAP reconciliation services.

We solicit comment on whether the proposed rules would impose a burden on competition or whether they would promote efficiency, competition and capital formation. For example, would the proposals have an adverse effect on competition that is neither necessary nor appropriate in furtherance of the purposes of the Exchange Act? Would the proposals create an adverse competitive effect on U.S. issuers or on foreign issuers that are not in a position to rely immediately on the accommodation? Would the proposed amendments, if adopted, promote efficiency, competition and capital formation? Commenters are requested to provide empirical data and other factual support for their views if possible.

IX. STATUTORY BASIS AND TEXT OF PROPOSED AMENDMENTS

We propose the amendment to Exchange Act Form 20-F pursuant to Sections 6, 7, 10, and 19 of the Securities Act of 1933 as amended, and Sections 3, 12, 13, 15, 23 and 36 of the Securities Exchange Act of 1934.

Text of Proposed Amendments

List of Subjects

17 CFR Parts 210, 230, 239 and 249

Accounting, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 210 - FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for Part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w(a), 78ll, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202 and 7262, unless otherwise noted.

2. Section 210.3-10 is amended by:

a. Revising the introductory text of paragraph (i), and

b. Revising paragraph (i)(12).

The revisions read as follows.

§210.3-10 Financial statements of guarantors and issuers of guaranteed securities registered or being registered.

* * * * *

(i) Instructions for preparation of condensed consolidating financial information required by paragraphs (c), (d), (e) and (f) of this section.

* * * * *

(12) Where the parent company's consolidated financial statements are prepared on a comprehensive basis other than U.S. Generally Accepted Accounting Principles or the English language version of International Financial Reporting Standards as published by the International Accounting Standards Board, reconcile the information

in each column to U.S. Generally Accepted Accounting Principles to the extent necessary to allow investors to evaluate the sufficiency of the guarantees. The reconciliation may be limited to the information specified by Item 17 of Form 20-F (§ 249.220f of this chapter). The reconciling information need not duplicate information included elsewhere in the reconciliation of the consolidated financial statements.

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3. Amend §210.4-01 by revising paragraph (a)(2) to read as follows:

§210.4-01 Form, order and terminology.

(a) * * *

(2) In all filings of foreign private issuers (see § 230.405 of this chapter), except as stated otherwise in the applicable form, the financial statements may be prepared according to a comprehensive set of accounting principles, other than those generally accepted in the United States <u>or the English language version of International Financial Reporting Standards as published by the International Accounting Standards Board</u>, if a reconciliation to United States generally accepted accounting principles and the provisions of Regulation S-X of the type specified in Item 18 of Form 20-F (§ 249.220f of this chapter) is also filed as part of the financial statements. Alternatively, the financial statements may be prepared according to United States generally accepted accounting principles <u>or the English language version of International Financial Reporting Standards as published by the International Accounting Standards Board</u>.

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PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

4. The authority citation for Part 230 continues to read as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

5. Amend §230.701 by revising the introductory text of paragraph (e) and revising paragraph (e)(4) to read as follows:

§230.701 Exemption for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation.

* * * * *

e. Disclosure that must be provided. The issuer must deliver to investors a copy of the compensatory benefit plan or the contract, as applicable. In addition, if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds $5 million, the issuer must deliver the following disclosure to investors a reasonable period of time before the date of sale:

* * * * *

(4) Financial statements required to be furnished by Part F/S of Form 1-A (Regulation A Offering Statement) (§ 239.90 of this chapter) under Regulation A (§§ 230.251 – 230.263). Foreign private issuers as defined in Rule 405 must provide a reconciliation to generally accepted accounting principles in the United States (U.S. GAAP) if their financial statements are not prepared in accordance with U.S. GAAP or the English language version of IFRS as published by the IASB (Item 17 of Form 20-F (§ 249.220f of this chapter)). The financial statements required by this section must be as of a date no more than 180 days before the sale of securities in reliance on this exemption.

* * * * *

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

6. The general authority citation for part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll(d), 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

7. Amend Form F-4 (referenced in §239.34) by:

a. Revising Item 10(c)(2);

b. Revising Item 10(c)(3);

c. Revising Item 12(b)(2)(iii);

d. Revising the Instruction to Item 17(b)(5) and (b)(6).

The revisions read as follows.

Note: The text of Form F-4 does not and this amendment will not appear in the Code of Federal Regulations.

FORM F-4

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Item 10. Information With Respect to F-3 Companies.

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(c) * * * * *

(1) * * * * *

(2) Restated financial statements prepared in accordance with or, if prepared using a basis of accounting other than the English language version of IFRS as published by the IASB, reconciled to U.S. GAAP and Regulation S-X if there has been a change in accounting principles or a correction of an error where such change or correction requires a material retroactive restatement of financial statements;

(3) Restated financial statements prepared in accordance with or, if prepared using a basis of accounting other than the English language version of IFRS as published by the IASB, reconciled to U.S. GAAP and Regulation S-X where one or more business combinations accounted for by the pooling of interest method of accounting have been consummated subsequent to the most recent fiscal year and the acquired businesses, considered in the aggregate, are significant pursuant to Rule 11-01(b) of Regulation S-X (§210.11-01(b) of this chapter); or

* * * * *

Item 12. Information With Respect to F-3 Registrants.

* * * * *

(b) * * * * *

(2) * * * * *

(iii) Restated financial statements prepared in accordance with or, if prepared using a basis of accounting other than the English language version of IFRS as published by the IASB, reconciled to U.S. GAAP and Regulation S-X if there has been a change in accounting principles or a correction of an error where such change or correction requires a material retroactive restatement of financial statements;

(iv) Restated financial statements prepared in accordance with or, if prepared using a basis of accounting other than the English language version of IFRS as published by the IASB, reconciled to U.S. GAAP and Regulation S-X where one or more business combinations accounted for by the pooling of interest method of accounting have been consummated subsequent to the most recent fiscal year and the acquired businesses, considered in the aggregate, are significant pursuant to Rule 11-01(b) of Regulation S-X; and

* * * * *

Item 17. Information With Respect to Foreign Companies Other Than F-3 Companies.

* * * * *

Instructions to paragraph (b)(5) and (b)(6): If the financial statements required by paragraphs (b)(5) and (b)(6) are prepared on the basis of a comprehensive body of accounting principles other than U.S. GAAP or the English language version of IFRS as published by the IASB, provide a reconciliation to U.S. GAAP in accordance with Item 17 of Form 20-F (§249.220f of this chapter) unless a reconciliation is unavailable or not obtainable without unreasonable cost or expense. At a minimum, provide a narrative description of all material variations in accounting principles, practices and methods used in preparing the non-U.S. GAAP financial statements from those accepted in the U.S. when the financial statements are prepared on a basis other than U.S. GAAP.

* * * * *

8. Amend Form S-4 (referenced in §239.34) by revising the instruction to Item 17 to read as follows:

Note: The text of Form S-4 does not and this amendment will not appear in the Code of Federal Regulations.

FORM S-4

* * * * *

Item 17. Information with Respect to Companies other than S-3 Companies.

* * * * *

Instructions:

1. * * * * *

2. If the financial statements required by this paragraph are prepared on the basis of a comprehensive body of accounting principles other than U.S. GAAP or the English language version of IFRS as published by the IASB, provide a reconciliation to U.S. GAAP in accordance with Item 17 of Form 20-F (§249.220f of this chapter) unless a reconciliation is unavailable or not obtainable without unreasonable cost or expense. At a minimum, provide a narrative description of all material variations in accounting principles, practices and methods used in preparing the non-U.S. GAAP financial statements from those accepted in the U.S. when the financial statements are prepared on a basis other than U.S. GAAP.

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

9. The authority citation continues to read, in part, as follows:

Authority: 15 U.S.C. 78a et seq., 7202, 7233, 7241, 7262, 7264, and 7265; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

10. Amend Form 20-F (referenced in § 249.220f) as follows:

a. Add a check box to the cover page indicating the basis of accounting used to prepare the financial statements;

b. Revise the check box on the cover page indicating whether Item 17 or Item 18 was used;

c. Revise the cover page to require contact information for the issuer;

d. Revise General Instruction G(d);

e. Revise General Instruction G(e);

f. Revise General Instruction G(f)(2)(B)(ii);

g. Revise General Instruction G(f)(2)(B)(iii);

h. Revise General Instruction G(h)(2);

i. Revise Instruction 2.b to General Instruction G(h);

j. Revise Item 3.A, Instruction 2;

k. Add an Instruction to Item 5;

l. Revise Item 8.A.5, Instruction 2;

m. Revise Item 8.A.5, Instruction 3;

n. Add an Instruction to Item 11;

o. Revise Item 17(c);

p. Remove Item 17(c)(2)(iv)(B);

q. Remove Item 17(c)(2)(iv)(C);

r. Add text at the end of Item 17(c)(2)(v);

s. Add text at the end of Item 17(c)(2)(vi);

t. Remove Item 17(c)(2)(viii);

u. Remove Item 17, Instruction 6;

v. Revise Item 18(b).

Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 20-F

* * * * *

(Exact name of Registrant as specified in its charter)

(Translation of Registrant's name into English)

(Jurisdiction of incorporation or organization)

(Address of principal executive offices)

(Name, Telephone and Address of Company Contact Person)

Large accelerated filer ________ Accelerated filer _________ Non-accelerated filer __________

Indicate by check which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP . . . . International Financial Reporting Standards as published by the International Accounting Standards Board (in English) . . . . Other . . . .

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 . . . . Item 18 . . . .

* * * * *

GENERAL INSTRUCTIONS

* * * * *

G. First-Time Application of International Financial Reporting Standards

* * * * *

(b) Applicable Documents. This General Instruction shall be available only for the following registration statements and annual reports:

(1) Registration Statements. This instruction shall be available for registration statements if:

(A) the issuer's most recent audited financial statements required by Item 8.A.2 are for the 2012 financial year or an earlier financial year;

* * * * *

(2) Annual Reports. This instruction shall be available for annual reports if:

(A) the annual report relates to the 2012 financial year or an earlier financial year;

* * * * *

(d) Information on the Company. The reference in Item 4.B to the "body of accounting principles used in preparing the financial statements," means IFRS and not the basis of accounting that was previously used ("Previous GAAP") or accounting principles used only to prepare a U.S. GAAP reconciliation.

(e) Operating and Financial Review and Prospects. The issuer shall present the information provided pursuant to Item 5. The discussion should focus on the financial statements for the two most recent financial years prepared in accordance with IFRS. No part of the discussion should relate to financial statements prepared in accordance with Previous GAAP.

(f) Financial Information.

* * * * *

(2)(B)(i) * * * * *

(ii) Two financial years of audited financial statements and interim financial statements (which may be unaudited) for the current and comparable prior year period, prepared in accordance with IFRS;

(iii) Three financial years of audited financial statements prepared in accordance with Previous GAAP and reconciled to U.S. GAAP as required by Item 17(c) or 18, as applicable; interim statements (which may be unaudited) for the current and comparable prior year period prepared in accordance with IFRS; and condensed financial information prepared in accordance with U.S. GAAP for the most recent financial year and the current and comparable prior year interim period (the form and content of this financial information shall be in a level of detail substantially similar to that required by Article 10 of Regulation S-X.

* * * * *

(h) Financial Statements.

* * * * *

(2) U.S. GAAP Information. The U.S. GAAP reconciliation referenced in Item 17(c) or 18 shall not be required for periods presented in accordance with the English language version of IFRS as published by the IASB.

Instructions:

* * * * *

b. Present or incorporate by reference operating and financial review and prospects information pursuant to Item 5 that focuses on the financial statements for the two most recent financial years prior to the most recent financial year that were prepared in accordance with Previous GAAP. The discussion should not refer to a reconciliation to U.S. GAAP. No part of the discussion should relate to financial statements prepared in accordance with IFRS.

* * * * *

Item 3. Key Information

* * * * *

Instructions to Item 3.A:

* * * * *

2. You may present the selected financial data on the basis of the accounting principles used in your primary financial statements. If you use a basis of accounting other than the English language version of IFRS as published by the IASB ("IFRS"), however, you also must include in this summary any reconciliations of the data to U.S. generally accepted accounting principles and Regulation S-X, pursuant to Item 17 or 18 of this Form. For financial statements prepared using a basis of accounting other than IFRS, you only have to provide selected financial data on a basis reconciled to U.S. generally accepted accounting principles for (i) those periods for which you were required to reconcile the primary annual financial statements in a filing under the Securities Act or the Exchange Act, and (ii) any interim periods.

* * * * *

Item 5. Operating and Financial Review and Prospects

* * * * *

Instructions to Item 5:

* * * * *

5. Issuers preparing their financial statements in accordance with the English language version of IFRS as published by the IASB ("IFRS") should, in providing information in response to paragraphs of this Item 5 that refer to specific provisions of U.S. GAAP, refer to appropriate provisions of IFRS that contain the definitional principles embodied in the referenced U.S. GAAP items. In responding to this Item 5, issuers need not repeat information contained in financial statements prepared in accordance with IFRS.

* * * * *

Item 8. Financial Information

* * * * *

Instructions to Item 8.A.5:

* * * * *

3. * * * * *

A registrant using the English language version of IFRS as published by the IASB as its basis of accounting is not required to provide the information described in paragraphs 3(a) and (b) to this Instruction to Item 8.A.5.

* * * * *

Item 11. Quantitative and Qualitative Disclosures About Market Risk

* * * * *

Instruction: Issuers preparing their financial statements in accordance with the English language version of IFRS as published by the IASB should, in providing information in response to paragraphs of this Item that refer to specific provisions of U.S.

GAAP, follow the appropriate provisions of IFRS that contain the principles embodied in the referenced U.S. GAAP items. In responding to this Item, issuers need not repeat information contained in financial statements prepared in accordance with the English language version of IFRS as published by the IASB.

* * * * *

Item 17. Financial Statements

* * * * *

(c): The financial statements and schedules required by paragraph (a) above may be prepared according to U.S. generally accepted accounting principles or the English language version of IFRS as published by the IASB. If the financial statements comply with the English language version of IFRS as published by the IASB, (i) it must be clearly stated in the notes to the financial statements and (ii) the auditor's report must include an opinion on whether the financial statements comply with the English language version of IFRS as published by the IASB. If the notes and auditor's report of an issuer do not contain the information in the preceding sentence, then the U.S. GAAP reconciliation information described in paragraphs (c)(1) and (c)(2) must be provided. Alternatively, such financial statements and schedules may be prepared according to a comprehensive body of accounting principles other than those generally accepted in the United States or the English language version of IFRS as published by the IASB if the following are disclosed:

* * * * *

(c)(2)(v): * * * Issuers that prepare financial statements using the English language version of IFRS as published by the IASB that are furnished pursuant to §

210.3.05 may omit the disclosures specified by paragraphs (c)(2)(i), (c)(2)(ii), and (c)(2)(iii) of this Item regardless of the size of the business acquired or to be acquired.

(c)(2)(vi): * * * Issuers that prepare financial statements using the English language version of IFRS as published by the IASB that are furnished pursuant to § 210.3.09 may omit the disclosures specified by paragraphs (c)(2)(i), (c)(2)(ii), and (c)(2)(iii) of this Item regardless of the size of the investee.

(c)(2)(vii): * * * * *

Instructions to Item 17(C)(2):

* * * * *

Item 18. Financial Statements

* * * * *

(b) If the financial statements are prepared using a basis of accounting other than the English language version of IFRS as published by the IASB, all other information required by U.S. generally accepted accounting principles and Regulation S-X unless such requirements specifically do not apply to the registrant as a foreign issuer. However, information may be omitted (i) for any period in which net income has not been presented on a basis reconciled to United States generally accepted accounting principles, or (ii) if the financial statements are furnished pursuant to § 210-3-05 or less-than-majority owned investee pursuant to § 210-3-09 of this chapter.

Instructions to Item 18:

1. All of the instructions to Item 17 also apply to this Item, except Instruction 3 to Item 17, which does not apply.

2. An issuer that is required to provide disclosure under FASB, Statement of Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities," shall do so regardless of the basis of accounting on which it prepares its financial statements.

* * * * *

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: July 2, 2007

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55997; File No. PCAOB-2007-01)

July 2, 2007

Public Company Accounting Oversight Board; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Adjusting Implementation Schedule of Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on April 3, 2007, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "SEC" or "Commission") the proposed rule change described in Items I and II below, which items have been prepared by the Board. The PCAOB has designated the proposed rule change as "constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule" under Section 19(b)(3)(A)(i) of the Securities Exchange Act of 1934 (as incorporated, by reference, into Section 107(b)(4) of the Act), which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

I. <u>Board's Statement of the Terms of Substance of the Proposed Rule</u>

The PCAOB is filing with the SEC an adjustment of the implementation schedule for Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles. Specifically the Board will not apply Rule 3523 to tax services provided on or before July 31, 2007, when those services are provided during the audit period and are completed

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before the professional engagement period begins. The PCAOB is not proposing any textual changes to the Rules of the PCAOB.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rule and discussed any comments it received on the proposed rule. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose Of, and Statutory Basis for, the Proposed Rule

(a) Purpose

On July 26, 2005, the Board adopted certain rules related to registered public accounting firms' provision of tax services to public company audit clients. The rules were designed to address certain concerns related to auditor independence when auditors sell personal tax services to individuals who play a direct role in preparing the financial statements of public company audit clients or market or otherwise opine in favor of aggressive tax shelter schemes. As part of this rulemaking, the Board adopted Rule 3523, which provides that a registered firm, subject to certain exceptions, is not independent of an audit client if the firm, or an affiliate of the firm, provides tax services during the audit and professional engagement period[1] to a person in, or an immediate

[1] Consistent with the SEC's independence rules, 17 CFR § 210.2-01(f)(5), the phrase "audit and professional engagement period" is defined to include two discrete periods of time. The "audit period" is the period covered by any financial statements being audited or reviewed. Rule 3501(a)(iii)(1). The "professional engagement period" is the period beginning when the accounting firm either signs the initial

family member of a person in, a financial reporting oversight role at an audit client. Rule 3523 was approved by the Securities and Exchange Commission ("SEC") on April 19, 2006.

On October 31, 2006, the Board adjusted the implementation schedule for Rule 3523, as it applies to tax services provided during the period subject to audit but before the professional engagement period, so that the Board could revisit this aspect of the rule.[2] On April 3, 2007, the Board issued a concept release to solicit comment on the possible effects on a firm's independence of providing tax services to a person covered by Rule 3523 during the portion of the audit period that precedes the beginning of the professional engagement period, and other practical consequences of applying the restrictions imposed by Rule 3523 to that portion of the audit period. The Board has determined to further adjust the implementation schedule for Rule 3523 in order to allow sufficient time for consideration of commenters' views. Specifically, the Board will not apply Rule 3523 to tax services provided on or before July 31, 2007, when those services are provided during the audit period and are completed before the professional engagement period begins.

No other aspect of the Board's rules on independence and tax services is affected by this extension. As of November 1, 2006, registered firms have been required to comply with Rule 3523 as it relates to tax services provided while they serve as auditor of record for an audit client – that is, during the "professional engagement

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engagement letter or begins audit procedures and ends when the audit client or the accounting firm notifies the SEC that the client is no longer that firm's audit client. Rule 3501(a)(iii)(2).

[2] See PCAOB Release No. 2006-006 (October 31, 2006), at 2. Specifically, the Board stated that Rule 3523 will not apply to tax services provided on or before April 30, 2007, when those services are provided during the audit period and are completed before the professional engagement period begins.

period." In addition, with one exception, all other PCAOB rules concerning independence, tax services, and contingent fees that were adopted by the Board on July 26, 2005 and approved by the SEC on April 19, 2006 are now in effect.[3]

(b) Statutory Basis

The statutory basis for the proposed rule change is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Board's Statement on Comments on the Proposed Rule Received from Members, Participants or Others

The Board did not solicit or receive written comments on the proposed rule change.

III. <u>Date of Effectiveness of the Proposed Rule and Timing for Commission Action</u>

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 (as incorporated, by reference, into Section 107(b)(4) of the Act) and paragraph (f) of Rule 19b-4 thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in

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[3] With respect to tax services provided to audit clients whose audit committees pre-approve tax services pursuant to policies and procedures, Rule 3524 will not apply to any such tax service that is begun by April 20, 2007. See PCAOB Release No. 2006-001 (March 28, 2006), at 2-3, PCAOB Release No. 2005-020 (November 22, 2005) at 2-3, and PCAOB Release No. 2005-14 (July 26, 2005) at 47-48.

furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule is consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/pcaob.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number PCAOB-2007-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB-2007-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/pcaob.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number PCAOB-2007-01 and should be submitted on or before **[insert date 21 days from publication in the Federal Register]**.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 56012 / July 5, 2007

Admin. Proc. File No. 3-12288

In the Matter of

DAVID HENRY DISRAELI
and
LIFEPLAN ASSOCIATES, INC.

ORDER GRANTING PARTIAL PROTECTIVE ORDER

On May 25, 2007, David Henry Disraeli submitted personal financial information to the Commission and requested a protective order limiting disclosure of this information under Rule of Practice 322. 1/ Under Rule 322, any party "may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that contain confidential information." 2/ "A motion for a protective order shall be granted only upon a finding that the harm resulting from disclosure would outweigh the benefits of disclosure." 3/ The Division of Enforcement has not opposed Disraeli's request for a protective order.

The Commission recognizes that the documents Disraeli submitted contain sensitive information. At this stage in the proceeding, we believe that the harm resulting from complete disclosure outweighs the benefits. However, we have determined that disclosure of certain information included in the documents will be necessary to the resolution of the issues before us.

Accordingly, IT IS HEREBY ORDERED that:

1. Except as otherwise provided in this Order, the documents Disraeli provided shall be disclosed only to the parties to this action, their counsel, the Commission, any staff advising the Commission in its deliberative processes with respect to this proceeding, and in the event of an

1/ 17 C.F.R. § 201.322.

2/ Id.

3/ Id.

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appeal of the Commission's determination, any staff acting for the Commission in connection with that appeal.

2. All persons who receive access to these documents or the information contained in these documents shall keep them confidential and, except as provided in this Order, shall not divulge the documents or information to any person.

3. No person to whom the documents or information covered by this Order is disclosed shall make any copies or otherwise use such documents or information, except in connection with this proceeding or any appeal thereof.

4. The Office of the Secretary shall place the documents in sealed envelopes or other sealed containers marked with the title of this action, identifying each document and marked "CONFIDENTIAL."

5. The requirements of sealing and confidentiality shall not apply to any reference to the existence of the documents or to citation of particular information contained therein in testimony, oral argument, briefs, opinions, or in any other similar use directly connected with this action or any appeal thereof.

6. The Commission expressly reserves the authority to reach a different conclusion regarding the confidentiality of the documents or information covered by this Order at any time before it determines the issues raised in the proceeding.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-56010; International Series Release No. 1303;

File No. S7-14-07]

RIN 3235-AJ91

EXEMPTION OF COMPENSATORY EMPLOYEE STOCK OPTIONS FROM REGISTRATION UNDER SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is proposing two exemptions from the registration requirements of the Securities Exchange Act of 1934 for compensatory employee stock options. The first exemption would be available to issuers that are not required to file periodic reports under the Exchange Act. The proposed exemption would apply only to the issuer's compensatory employee stock options and would not extend to the class of securities underlying those options. The second exemption would be available to issuers that are required to file those reports because they have registered under Exchange Act Section 12 the class of securities underlying the compensatory employee stock options.

DATES: Comments must be received on or before [insert date 60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

• Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or

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• Send an e-mail to rule-comments@sec.gov. Please include File Number S7-14-07 on the subject line; or

• Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

• Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-14-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site http://www.sec.gov/rules/proposed.shtml. Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Amy M. Starr, Senior Special Counsel to the Director, at (202) 551-3115, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing amendments to rule 12h-1[1] under the Securities Exchange Act of 1934.[2]

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1 17 CFR 240.12h-1.

2 15 U.S.C. 78a et. seq.

I. INTRODUCTION AND BACKGROUND

A. Introduction

In the 1980s, private, non-reporting issuers began using compensatory employee stock options[3] to compensate a broader range of employees, including executive, middle, and lower-level employees, directors, and consultants.[4] Compensatory employee stock options provide a method to use non-cash compensation to attract, retain, and motivate company employees, directors, and consultants.[5] Since the 1990s, a number of private, non-reporting issuers have granted compensatory employee stock options to 500 or more employees, directors, and consultants.[6]

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3 Throughout this release, we use the term "compensatory employee stock options" to refer to stock options issued to employees, directors, consultants, and advisors (to the extent permitted under Securities Act Rule 701 [17 CFR 230.701]).

4 The National Center for Employee Ownership surveyed 275 venture capital-backed private businesses in the technology and telecommunications businesses. Of these firms, 77% provided options to all employees while 23% provided them to only select employees. "New Data Show Venture-Backed Companies Still Issue Options Broadly," http://www.nceo.org/library/option_venturebacked.html; See also J. Hand, 2005 "Give Everyone a Prize? Employee Stock Options in Private Venture-Backed Firms," Working Paper, Kenan-Flagler Business School, UNC Chapel Hill, available at http://ssrn.com/abstracts=599904 ("Hand Paper") (study investigating the impacts on the equity values of private venture-backed firms of the organizational depth to which they grant employee stock options).

Rule 701, which provides an exemption from Securities Act registration for non-reporting issuers for offerings of securities to employees, directors, consultants and advisors, and specified others, pursuant to written compensatory benefit plans or agreements, has given private issuers great flexibility in granting compensatory employee stock options to employees (and other eligible persons) at all levels. See Rule 701(d) [17 CFR 230.701(d)]; Rule 701 Exempt Offerings Pursuant to Compensatory Arrangements, Release No. 33-7645, 64 FR 11095 (March 8, 1999) ("Rule 701 Release"); See also Compensatory Benefit Plans and Contracts, Release No. 33-6768, 53 FR 12918 (April 14, 1988).

5 See Hand Paper, note 4 supra.

6 See e.g., no-action letters to Starbucks Corporation (available April 2, 1992); Kinko's, Inc. (available Nov. 30, 1999); Mitchell International Holding, Inc. (available Dec. 27, 2000) ("Mitchell International"); AMIS Holdings, Inc. (available July 30, 2001) ("AMIS Holdings"); Headstrong Corporation (available Feb. 28, 2003); and VG Holding Corporation (available Oct. 31, 2006) ("VG Holding").

Under Section 12(g)[7] of the Exchange Act, an issuer with 500 or more holders of record of a class of equity security and assets in excess of $10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration.[8] Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security for purposes of the Exchange Act.[9] Accordingly, an issuer with 500 or more optionholders and more than $10 million in assets is required to register that class of options under the Exchange Act, absent an available exemption. While there is an exemption from Exchange Act Section 12(g) registration for interests and participations in certain other types of employee compensation plans involving securities,[10] currently there is no exemption for compensatory employee stock options.

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7 15 U.S.C. 78l(g).

8 The asset threshold was set originally at $1 million in Section 12(g). Pursuant to its authority under Section 12(h) of the Exchange Act, the Commission has increased the amount three times; from $1 million to $3 million in 1982 [System of Classification for Purposes of Exempting Smaller Issuers From Certain Reporting and Other Requirements, Release No. 34-18647 (April 13, 1982)], from $3 million to $5 million in 1986 [Reporting by Small Issuers, Release No. 34-23406 (July 8, 1986)], and from $5 million to $10 million in 1996 [Relief from Reporting by Small Issuers, Release No. 34-37157 (May 1, 1996)].

9 Exchange Act Section 3(a)(11) [15 U.S.C. 78c(11)] defines equity security to include any right to purchase a security (such as options) and Exchange Act Rule 3a-11 [17 CFR 240.3a-11] explicitly includes options in the definition of equity security for purposes of Exchange Act Sections 12(g) and 16 [15 U.S.C. 78l(g) and 78p]. Exchange Act Section 12(g)(5) [15 U.S.C. 78l(g)(5)] defines class to include "all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges."

10 The exemption from registration under Exchange Act Section 12(g) which is contained in Exchange Act Rule 12h-1(a), was adopted in 1965, for "[a]ny interest or participation in an employee stock bonus, stock purchase, profit sharing, pension, retirement, incentive, thrift, savings or similar plan which is not transferable by the holder except in the event of death or mental incompetency, or any security issued solely to fund such plans." Rule 12h-1 is intended to exempt from Section 12(g) registration the same types of employee benefit plan interests as Section 3(a)(2) [15 U.S.C. 77c(a)(2)] of the Securities Act of 1933 [15 U.S.C. 77a et. seq.] exempts from Securities Act registration and, thus, does not cover stock options. See e.g., L. Loss and J. Seligman, Securities Regulations, 3d., at §6-A-4.

We are proposing an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans. We also are proposing an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of issuers that have registered under Exchange Act Section 12 the class of equity security underlying those options.

B. Overview of Applicable Exchange Act Provisions

The addition of Section 12(g) to the Exchange Act was intended "to extend to investors in certain over-the-counter securities the same protection now afforded to those in listed securities by providing that the issuers of certain securities now traded over the counter shall be subject to the same requirements that now apply to issuers of securities listed on an exchange."[11] Further, Section 12(g) extended the disclosure and other Exchange Act safeguards to unlisted securities as a means to prevent fraud.[12] The Commission has noted that the registration requirement of Section 12(g) was aimed at issuers that had "sufficiently active trading markets and public interest and consequently were in need of mandatory disclosure to ensure the protection of investors."[13]

Exchange Act Section 12(h)[14] provides the Commission with exemptive authority with regard to certain provisions of the Exchange Act. Included in Exchange Act Section 12(h) is the authority to create appropriate exemptions from the Exchange Act

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11 House of Representatives Report No. 1418 (1964), 88th Cong., 2d Sess., HR 679, p.1. See also Section 3(c) of the Securities Act Amendments of 1964, Pub.L. 88-467; 78 Stat. 565.

12 Senate Committee Report, No. 379 (1963), 88th Cong., 1st Sess., p. 63.

13 Reporting by Small Issuers, Release No. 34-23407 (July 8, 1986).

14 15 U.S.C. 78l(h).

registration requirements. Under Exchange Act Section 12(h), the Commission may exempt a class of securities by rules and regulations or by exemptive order if it "finds, by reason of the number of public investors, amount of trading interest in the securities, the number and extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors."[15]

C. Historical Treatment of Compensatory Employee Stock Options under Exchange Act Section 12(g)

A number of private, non-reporting issuers faced with registration under Exchange Act Section 12(g) due solely to their compensatory employee stock options being held by 500 or more holders of record (as well as having more than $10 million in assets) at the end of their fiscal year have requested registration relief from our Division of Corporation Finance.[16] Since 1992, the Division has provided relief through no-action letters[17] to these private issuers when specified conditions were present.

Before 2001, the Division's no-action relief in this area was conditioned on, among other things, the options terminating at the time employment terminated. Further, that relief was conditioned on the compensatory employee stock options not being exercisable until after either the issuer's initial public offering or the time at which the

15 Exchange Act Section 12(h) [15 U.S.C. 78l(h)].

16 The Division has delegated authority to grant (but not deny) applications for exemption under Exchange Act Section 12(h). See Rule 200.30-1(e)(7) [17 CFR 200.30-1].

17 For the conditions necessary to receive relief under these letters and orders see, for example, the no-action letter to Mitchell International, note 6 supra (for the pre-2001 relief) and the no-action letters to AMIS Holdings, note 6 supra; ISE Labs, Inc. (available June 2, 2003); Jazz Semiconductor, Inc. (available Nov. 21, 2005) ("Jazz Semiconductor"); and VG Holding, note 6 supra (for the modified relief beginning in 2001).

issuer was no longer relying on the relief.[18] Beginning in 2001, the Division announced modified conditions to registration relief for compensatory employee stock options of private, non-reporting issuers that, due to market conditions, were delayed in their plans to go public.[19] Because the Division's no-action relief applies only to the private, non-reporting issuer's compensatory employee stock options, once that issuer has 500 or more holders of record of any other class of equity security (including, for example, common stock outstanding as a result of stock issuances, including option exercises), it would be required to register that other class of equity security under Exchange Act Section 12(g).

The Division's no-action letters providing Exchange Act Section 12(g) registration relief to private, non-reporting issuers currently include the following parameters:[20]

Scope of Relief:

- The relief is limited solely to compensatory employee stock options granted under stock option plans; and

- No security appreciation rights or other rights may be issued in connection with the compensatory employee stock options.

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18 See e.g., no-action letters to Kinko's, Inc., note 6 supra; General Roofing Services, Inc. (available April 5, 2000); and Mitchell International, note 6 supra.

19 See Division of Corporation Finance, Current Issues and Rulemaking Outline Quarterly Update (March 31, 2001).

20 Following the announcement of the modified conditions to relief in 2001, issuers were still able to request relief under the former conditions. Since 2002, however, issuers have received relief based on the modified factors only. See e.g., no-action letters to Jazz Semiconductor, note 17 supra; Network General Corporation (available May 22, 2006); Avago Technologies Limited (available Oct. 6, 2006); and VG Holding, note 6 supra. Our discussion regarding the current conditions to relief under the no-action letters refers only to the modified conditions set forth in the most recently issued no-action letters.

Eligible Participants:

- The compensatory employee stock options may be issued to a broad class of participants comprised only of employees, directors, and consultants (to the extent permitted under Securities Act Rule 701) of the issuer, its parents, or of majority-owned, direct or indirect, subsidiaries of the issuer or its parents.

Exercisability:

- The exercisability of the compensatory employee stock options need not be limited while the optionholder is an employee, director, or consultant; however, if the compensatory employee stock options are not exercisable, there are modified information conditions.

Transferability and Ownership Restrictions:

- There may be no means through which optionholders may receive compensation or consideration for the compensatory employee stock options (or the securities to be received on exercise of the compensatory employee stock options) before exercise;[21]

- The compensatory employee stock options must remain non-transferable in most cases, but the compensatory employee stock options may transfer on death or

[21] This would not include payments received on exercise by an issuer or its affiliates of a repurchase right or obligation with regard to the options or the shares received on exercise of the options. See e.g., no-action letter to VG Holding, note 6 supra.

disability of the optionholder or to family members (as defined in Securities Act Rule 701) by gift or pursuant to domestic relations orders. These permitted transferees are not allowed to further transfer compensatory employee stock options. There may be no other pledging, hypothecation or donative transfer of compensatory employee stock options or the securities underlying the options;

- The securities received on exercise of the compensatory employee stock options may not be transferable, except back to the issuer (or to affiliates of the issuer if the issuer is unable to repurchase the shares), to family members under Rule 701 by gift or pursuant to domestic relations orders, or in the event of death or disability. These permitted transferees are not allowed to further transfer these securities. There may be no other pledging, hypothecation or donative transfer of these securities; and

- The ability of former employees to retain and exercise their vested compensatory employee stock options for a period of time following termination of employment need not be limited.

Information Requirements:

- The issuer must provide optionholders and holders of shares received on exercise of compensatory employee stock options with essentially the same Exchange Act registration statement, annual report, and quarterly report information they would receive if the issuer registered the class of securities under Exchange Act Section

12, including audited annual financial statements (prepared in accordance with generally accepted accounting principles ("GAAP")) and unaudited quarterly financial information, with the following specific conditions:

- The registration statement-type document must be delivered promptly after the issuer receives no-action relief;

- The annual report must be delivered within 90 days after the issuer's fiscal year end;[22]

- The quarterly reports must be delivered within 45 days after the end of the issuer's fiscal quarter;[23]

- The issuer may condition delivery of the information to an optionholder on the optionholder signing an appropriate confidentiality agreement but it must make the information available for examination at the issuer's offices by optionholders and holders of shares received on exercise of options unwilling to enter into confidentiality agreements;

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22 Since 2006, the time period to deliver the annual report and the quarterly report was shortened to 90 days and 45 days, respectively, from the 120 days for the annual report and 60 days for the quarterly report that was allowed in the earlier no-action letters relying on the modified conditions. See no-action letters to VG Holding, note 6 supra and AMIS Holdings, note 6 supra.

23 Id.

- The issuer must provide certifications similar to those required of reporting issuers;[24] and

- The issuer must provide specified information relating to option vesting and changes in the stock option plan.[25]

D. Recommendation of the Advisory Committee on Smaller Public Companies

The Advisory Committee on Smaller Public Companies, in its Final Report, recommended that the Commission provide Exchange Act Section 12(g) registration relief for compensatory employee stock options.[26] In this regard, the Advisory Committee stated:

> [H]olders of employee stock options received in compensatory transactions are less likely to require the full protections afforded under the registration requirements of the federal securities laws. Therefore, we believe that such stock options should not be a factor in determining the point an issuer becomes subject to the burdens of a reporting company under the Exchange Act.[27]

E. Overview of the Proposed Exemptions

We believe that it is appropriate at this time to propose two new exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options issued under employee stock option plans that are limited to employees,

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24 The certification condition requires that the issuer's chief executive officer and chief financial officer include a certification as required by the first three paragraphs of the certification required under Item 601(b)(31) of Regulation S-K [17 CFR 229.601(b)(31)]. See e.g., no-action letter to VG Holding, note 6 supra.

25 See e.g., no-action letter to VG Holding, note 6 supra.

26 Final Report of the Advisory Committee on Smaller Public Companies to the Securities and Exchange Commission, April 23, 2006 ("Final Report of the Advisory Committee").

27 Id at p. 87.

directors, consultants, and advisors of the issuer, its parents, and majority-owned subsidiaries of the issuer or its parents.[28] Given the differences between issuers that are required to file reports under the Exchange Act and those issuers that do not have such an obligation, including the nature of the trading markets and the amount of publicly available information, we believe that it is appropriate to propose separate exemptions for these different types of issuers.

1. Exemption for Issuers That Are Not Exchange Act Reporting Issuers

We believe that an exemption from Exchange Act registration of compensatory employee stock options for private, non-reporting issuers will provide useful certainty to those issuers in their compensation decisions and will help them avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders.[29] Based on the factors identified in Exchange Act Section 12(h), we believe that it is appropriate to provide an exemption from Exchange Act

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28 The proposed exemptions would allow compensatory employee stock options to be held only by those persons described in Securities Act Rule 701(c) [17 CFR 230.701(c)]. Securities Act Rule 701(c) lists the categories of persons to whom offers and sales of securities under written compensatory benefit plans or contracts may be made in reliance on Rule 701 by an issuer, its parents, and majority-owned subsidiaries of the issuer or its parents. The categories of persons are: employees (including specified insurance agents); directors; general partners; trustees (where the issuer is a business trust); officers; consultants and advisors (under certain conditions); family members who acquire their securities from such persons through gifts or domestic relations orders; and former employees, directors, general partners, trustees, officers, consultants and advisors only if such persons were employed by or providing services to the issuer at the time the securities were offered. As we note, the proposed amendments use the term "those persons described in Rule 701(c)" to refer to these permitted holders. For ease of discussion, in this release we use the phrase "employees, directors, consultants and advisors of the issuer" to refer to those persons described in Securities Act Rule 701(c).

29 While we agree that an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options is appropriate, in this regard, we do not agree with the Advisory Committee statement that holders of employee stock options received in compensatory transactions do not require the full protections afforded under the registration requirements of the federal securities laws.

Section 12(g) registration to a specified class of compensatory employee stock options.[30] We believe that the conditions to the proposed exemption and the existing statutory provisions and rules provide holders of compensatory employee stock options in private, non-reporting issuers appropriate disclosure and investor protections under the federal securities laws, given the compensatory circumstances of the securities issuance and the restrictions on transferability of the compensatory employee stock options and shares received on exercise of those options. As such, we are proposing to amend Exchange Act Rule 12h-1 to provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options issued under written compensatory stock option plans of an issuer that does not have a class of securities registered under Exchange Act Section 12 and is not subject to the reporting requirements of Exchange Act Section 15(d), where the following conditions are present:[31]

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30 We believe that our proposal is consistent with the exemption provided for other employee benefit plans in Exchange Act Rule 12h-1, which is not available for stock option plans, the compensatory employee stock options issued pursuant to such plans, or the securities issued on exercise of such compensatory employee stock options. We believe that the characteristics of many employee benefit plans, which are by their own terms limited to employees, not available to the general public, and subject to transfer restrictions, obviate the need for applicability of all the rules and regulations aimed at public trading markets. In addition, because many of the proposed conditions refer to certain Securities Act Rule 701 definitions and requirements, we believe that the proposed exemption from Exchange Act Section 12(g) registration will allow non-reporting issuers to continue to rely on Securities Act Rule 701 in offering and selling compensatory employee stock options and the shares issued on exercise of those options.

31 The conditions build on and modify the current conditions to relief in the no-action requests discussed above. For example, the transferability restrictions in the proposed exemption are more clearly defined; there is no proposed restriction on the exercisability of the compensatory employee stock options; and the level of disclosure required to be provided to optionholders and holders of shares received on exercise of those options is the same level of information that private, non-reporting issuers relying on Securities Act Rule 701 for the offers and sales of those options and securities may be required to provide, rather than the level of information an issuer with public shareholders is required to provide. See the discussion under "Proposed Exemption For Compensatory Employee Stock Options of Issuers That Are Not Exchange Act Reporting Issuers," below.

- Eligible optionholders are limited to employees, directors, consultants, and advisors of the issuer;

- Transferability by optionholders and holders of shares received on exercise of the options of compensatory employee stock options, shares received, or to be received, on exercise of those options, and shares of the same class as those underlying those options is restricted; and

- Risk and financial information is provided to optionholders and holders of shares received on exercise of those options that is of the type that would be required under Rule 701 if securities sold in reliance on Rule 701 exceeded $5 million in a 12-month period.[32]

The proposed exemption would apply only to a private, non-reporting issuer's compensatory employee stock options and would not extend to the class of securities underlying those options.[33]

The proposed restrictions on the type of issuer eligible to rely on the exemption, the limitation on who may be granted and hold the compensatory employee stock options, the transferability restrictions, and the limitation of the exemption to the compensatory employee stock options are intended to assure that there is no trading in the options or

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32 See the discussion under "Required Information," below.

33 A private, non-reporting issuer would have to apply the registration requirements of Exchange Act Section 12 to the class of equity security underlying the compensatory employee stock options without regard to the proposed exemption. For the class of equity security underlying the options, for which there could be public shareholders, no transferability restrictions, and trading interest, we do not believe a Section 12 registration exemption would be appropriate.

shares received on exercise of the options and that there are no public investors in the compensatory employee stock options that need the full range of protections that Exchange Act registration and reporting afford. In light of the circumstances under which private, non-reporting issuers issue compensatory employee stock options, the terms of those options, and the information provision requirements of the proposed exemption, we believe that the proposed amended rule contains appropriate conditions to an exemption of such compensatory employee stock options of private, non-reporting issuers from registration under Exchange Act Section 12(g). As such, we believe that the proposed exemption is in the public interest, in that it would clarify and routinize the basis for an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options so private, non-reporting issuers would be able to continue to issue compensatory employee stock options and would provide appropriate investor protections for optionholders and holders of shares received on exercise of the options.

2. Exemption for Exchange Act Reporting Issuers

We are proposing to amend Exchange Act Rule 12h-1 to provide an exemption for compensatory employee stock options of issuers that are required to file reports under the Exchange Act because they have registered under Exchange Act Section 12 the class of equity security underlying those options. The proposed exemption would be available only where the options were issued pursuant to a written compensatory stock option plan and the class of persons eligible to receive or hold the options is limited appropriately. We believe that the proposed exemption of compensatory employee stock options from Exchange Act registration is appropriate for purposes of investor protection and the public interest because the optionholders would have access to the issuer's publicly filed

Exchange Act reports and the appropriate provisions of Exchange Act Sections 13, 14, and 16[34] would apply to the compensatory employee stock options and the securities issuable on exercise of the compensatory employee stock options.

II. DISCUSSION OF PROPOSALS

We are proposing two amendments to Exchange Act Rule 12h-1. These amendments would:

- provide an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans; and

- provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options issued by issuers that have registered under Exchange Act Section 12 the class of equity security underlying the compensatory employee stock options.

A. Proposed Exemption For Compensatory Employee Stock Options of Issuers That Are Not Exchange Act Reporting Issuers

We believe it is appropriate to provide an exemption from Exchange Act registration for compensatory employee stock options of issuers that are not required to file reports under the Exchange Act. The availability of this proposed exemption would be subject to specified limitations, including limitations concerning permitted optionholders, transferability and provision of information.

1. Eligible Issuers

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[34] 15 U.S.C. 78m, 78n, and 78p.

The proposed amendment would provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of the following types of issuers:

- Issuers that do not have a class of securities registered under Exchange Act Section 12; and

- Issuers that are not subject to the reporting requirements of Exchange Act Section 15(d).[35]

The proposed exemption is intended to be available only to those issuers that are not reporting under the Exchange Act. As such, the proposed exemption would terminate once the issuer became subject to the reporting requirements of the Exchange Act.[36]

Request for Comment

- Should the proposed exemption be available to any private, non-reporting issuer? If not, which categories of non-reporting issuers should be ineligible for the exemption?

- Should the proposed exemption be available to those issuers that file Exchange Act reports and, thus, hold themselves out as Exchange Act reporting issuers, but

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35 Under Section 15(d) of the Exchange Act, an issuer's "duty to file [reports under Section 15(d) is] automatically suspended if and so long as any issue of securities of such issuer is registered pursuant to section 12 of this title."[15 U.S.C. 780(d)].

36 The proposed exemption under Exchange Act Section 12 would allow issuers 60 calendar days to register the class of options once an issuer was no longer able to rely on the proposed exemption. Currently, the no-action letter relief terminates once an issuer becomes subject to the Exchange Act reporting requirements. See e.g., no-action letter to VG Holding, note 6 supra.

who have neither a class of securities registered under Exchange Act Section 12 nor an existing reporting obligation under Exchange Act Section 15(d) (also known as "voluntary filers")? Should "voluntary filers" be treated differently under the proposed exemption if they do not have any public shareholders of any class of their equity securities?

2. Eligible Compensatory Employee Stock Options

The proposed exemption for compensatory employee stock options would:

- Apply only to compensatory employee stock options that are issued under a written compensatory stock option plan[37] that is limited to employees, directors, consultants, and advisors of the issuer;[38]

- Apply to all compensatory employee stock options issued under all of the issuer's written compensatory stock option plans on a combined basis where the securities underlying the compensatory employee stock options are of the same class of securities, with the proposed exemptive conditions applying to the compensatory employee stock options issued under each option plan; and

[37] Securities Act Rule 701 is available only for offers and sales of compensatory employee stock options and the shares issuable upon exercise of those options that are issued under written compensatory employee benefit plans of an issuer, its parents, or majority-owned subsidiaries of the issuer or its parents. See Securities Act Rule 701(c) [17 CFR 230.701(c)]. Thus, the proposed requirement that the options be issued under written compensatory stock option plans would not impose a new obligation on issuers relying on Securities Act Rule 701 in offering and selling its compensatory employee stock options or the shares issued on exercise of those options.

[38] The proposed exemption for the compensatory employee stock options would not extend to other rights issued in connection with the compensatory employee stock options, such as stock appreciation rights. Any such other rights would be evaluated separately for purposes of Exchange Act Section 12(g) registration.

- Not extend to any class of securities received or to be received on exercise of the compensatory employee stock options.

The proposed exemption would cover all compensatory employee stock options of an issuer meeting the conditions of the exemption, even if the compensatory employee stock options were issued under separate written option plans. For this purpose, the compensatory employee stock options would be considered to belong to the same class of equity security if the same class of securities would be issuable on exercise of the compensatory employee stock options.[39]

The proposed exemption would apply to the compensatory employee stock options only and not to the securities issued (or to be issued) on exercise of the compensatory employee stock options. Thus, the issuer would have to apply the registration requirements of Exchange Act Section 12 to the class of equity security underlying the compensatory employee stock options without regard to the proposed exemption.[40]

Request for Comment

- Should the exemption cover all compensatory employee stock options issued under all employee stock option plans of a private, non-reporting issuer?

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39 See Exchange Act Section 12(g)(5) [15 U.S.C. 78l(g)(5)].

40 For example, if an issuer had more than $10 million in assets and 500 or more holders of a class of equity security underlying the compensatory employee stock options as of the end of its fiscal year, it would have to register under Exchange Act Section 12 that class of equity security.

- Are there employee stock option plans that are not written that should be included? If so, what types of unwritten plans should be included and why?

- Are there employee stock options issued under written stock option contracts, other than written stock option plans, that should be included? If so, what types of written stock option contracts should be included and why?

- We have proposed to provide that the exemption would apply to all of the issuer's option plans on a combined basis where the securities underlying the compensatory employee stock options are of the same class of securities, while the options may be held by employees, directors, consultants, or advisors of an issuer, its parents, or majority-owned subsidiaries of the issuer or its parents. Should the class of options covered by the proposed exemption include only options issued by the issuer under its written compensatory plans or should the class of options covered by the proposed exemption also include options on the issuer's securities that are issued under written compensatory plans of the issuer's parent, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer? Please explain.

3. Eligible Option Plan Participants

The proposed exemption would be available only where the class of persons eligible to receive compensatory employee stock options under the stock option plans is limited to those persons described in the exemption. These eligible optionholders would be the same as those participants permitted under Rule 701 and would include:[41]

- Employees of the issuer, its parents, or majority-owned, direct or indirect, subsidiaries of the issuer or its parents;

- Directors of the issuer, its parents, or majority-owned, direct or indirect, subsidiaries of the issuer or its parents; and

- Consultants and advisors of the issuer, its parents, or majority-owned, direct or indirect, subsidiaries of the issuer or its parents.

We have proposed that the exemption be limited to those situations where compensatory employee stock options may be held only by those persons who are permitted to hold or be granted compensatory employee stock options under Securities Act Rule 701. We believe that the experience of issuers and their counsels with Rule 701 will ease compliance with and limit uncertainty regarding the exemption.[42]

Just as Securities Act Rule 701 was designed specifically not to be available for capital-raising transactions, the proposed exemption would apply only to employee stock options issued for compensatory purposes. The restrictions on the eligible participants in

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41 See the discussion at note 28 supra.

42 In this regard, we note that this category of eligible optionholders is broader than the category of persons to whom employee benefit securities, including compensatory employee stock options may be offered and sold by reporting issuers using a Form S-8 registration statement. See General Instruction 1(a) to Form S-8 [17 CFR 239.16b].

the stock option plans are intended to assure that the proposed exemption is limited to employee stock options issued solely for compensatory purposes.[43]

Request for Comment

- Should the proposal limit further the types of persons eligible to hold compensatory employee stock options for purposes of the exemption? If so, what types of persons should not be eligible?

- Is the use of the Securities Act Rule 701 definitions of eligible participants appropriate for purposes of the proposed exemption? If not, what definitions should be used to characterize the optionholders who have received the compensatory employee stock options solely for compensatory purposes and why should another definition be used?

- Would the proposed eligibility conditions affect an issuer's ability to rely on compensatory employee stock options to attract, retain, and motivate employees, directors, consultants, and advisors of the issuer?

4. Option Terms

a. Compensatory Employee Stock Option and Share Transferability Restrictions

The proposed exemption would be available only where there are certain restrictions on the transferability by an optionholder or holder of shares received on exercise of a compensatory employee stock option of those options, the shares issuable

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43 All option grants and exercises must, of course, comply with the requirements of the Securities Act.

on exercise of those options, or shares of the same class of equity security as those underlying those options.[44] Specifically, the proposed exemption would be available only if:[45]

- The compensatory employee stock options and the shares received or to be received on exercise of those options could not be transferred except:[46]
  - to family members (as defined in Rule 701) by gift or pursuant to domestic relations orders; or
  - on death or disability of the optionholder;[47]

- Optionholders or holders of shares received on exercise of the compensatory employee stock options through a permitted transfer from the original holder could not transfer those options or shares further;

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44 The proposed exemption would not impose any limitations on the ability of current or former employees, directors, consultants, or advisors of an issuer to retain or exercise their compensatory employee stock options. The current no-action letters do, however, contain certain limitations on retention of both vested and unvested compensatory employee stock options. See e.g., no-action letter to VG Holding, note 6 supra.

45 The current no-action letters contain similar conditions on transferability, although the proposed rule clarifies the limitations on the ability to engage in certain derivative transactions, such as restrictions on an optionholder or holder of shares received on exercise of options from entering into a "put equivalent position" or "call equivalent position" until the issuer become subject to the reporting requirements of the Exchange Act. See e.g., no-action letter to VG Holding, note 6 supra.

46 The proposed transferability restrictions would not supersede other transferability restrictions imposed for other reasons, including under the Internal Revenue Code of 1986, as amended [26 U.S.C. 422(b)(5)].

47 These permitted transferees are intended to be the same as those permitted under Securities Act Rule 701(c). See note 28 supra.

- There could be no other permitted pledges, gifts, hypothecations, or other transfers of the compensatory employee stock options, shares issued or issuable on exercise of those options, or shares of the same class of equity security as those underlying those options by the optionholder or holder of shares received on exercise of an option, other than transfers back to the issuer (or to affiliates of the issuer if the issuer is unable to repurchase those options or shares received on exercise of those options), until the issuer becomes subject to the reporting requirements of the Exchange Act;[48]

- The compensatory employee stock options, the securities issued or issuable upon exercise of those options, or shares of the same class of equity security as those underlying those options could not be the subject of a short position, a "put equivalent position"[49] or a "call equivalent position"[50] by the optionholder or holder of shares received on exercise of an option until the issuer becomes subject to the reporting requirements of the Exchange Act; and

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48 If an express prohibition on transfer is not permitted under applicable state law, the proposed exemption would be available if the issuer retained the obligation, either directly or by assignment to an affiliate of the company, to repurchase the option or the shares issued on exercise of the options until the issuer becomes subject to the reporting requirements of the Exchange Act. This repurchase obligation would have to be contained in the stock option agreement pursuant to which the option is exercised, in a separate stockholders agreement, in the issuer's by-laws, or certificate of incorporation. See the discussion under "Issuer Obligation to Impose the Conditions to the Proposed Exemption," below.

49 17 CFR 240.16a-1(h). Rule 16a-1(h) defines a "put equivalent position" as a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option position.

50 17 CFR 240.16a-1(b). Rule 16a-1(b) defines a "call equivalent position" as a derivative security position that increases in value as the value of the underlying equity increases, including, but not limited to, a long convertible security, a long call option, and a short put option position.

- There could be no market or available process or methodology that would permit optionholders or holders of shares received on exercise of an option to receive any consideration or compensation for the options, the shares issuable on exercise of the options, or shares of the same class of equity security as those underlying the options, except from permitted transfers to the issuer or its affiliates as discussed above, until the issuer becomes subject to the reporting requirements of the Exchange Act.

Under the proposal, the exemption would not be available if optionholders and holders of shares received on exercise of compensatory employee stock options could enter into agreements, prior to or after the exercise of those options, that would allow those holders to monetize or receive compensation from or consideration for such compensatory employee stock options, the shares to be received upon exercise of those options, or shares of the same class of equity security as those underlying those options. Thus, the proposed conditions provide that, except with regard to the limited permitted transfers specified in the proposed conditions, an optionholder cannot be permitted to pledge, hypothecate, or otherwise transfer the compensatory employee stock options, the shares underlying those options, or shares of the same class of equity security as those underlying those options, including through a short position, a "put equivalent position," or a "call equivalent position," until the issuer becomes subject to the reporting requirements of the Exchange Act. The proposed exemption would be conditioned on a similar restriction on the holders of shares received on exercise of the options.

The proposed restrictions on transfer of the compensatory employee stock options, the shares underlying those options, and shares of the same class of equity security as those underlying those options by an optionholder or holder of shares received on exercise of an option are intended to limit the possibility for a trading market to develop for the compensatory employee stock options or the securities issued on exercise of those options while the issuer is relying on the proposed exemption. These restrictions also are intended to assure that an optionholder or holder of shares received on exercise of an option is not able to profit from the compensatory employee stock options or the securities received or to be received on exercise of those options (except from permitted transfers to the issuer or its affiliates as discussed above), until the issuer becomes subject to the reporting requirements of the Exchange Act.

While, in most cases, the securities of private, non-reporting issuers that are issued on exercise of compensatory employee stock options are deemed to be restricted securities as defined in Securities Act Rule 144,[51] we believe that the proposed transferability restrictions are necessary to limit further the possibility of a market developing in the securities issued or issuable on exercise of immediately exercisable compensatory employee stock options while the issuer is not reporting under the Exchange Act. Thus, the proposed amendments would require that the issuer's securities received on exercise of compensatory employee stock options be restricted as to transfer until the issuer becomes subject to the reporting requirements of the Exchange Act.[52]

The proposed transfer restrictions for the compensatory employee stock options and the shares received or to be received on exercise of those options are consistent in

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51 17 CFR 230.144. See, e.g., Securities Act Rule 701(g).

52 After an issuer becomes subject to the reporting requirements of the Exchange Act, the issuer would be able to rely on the exemption for Exchange Act reporting issuers only if it becomes subject to Exchange Act reporting as a result of its Exchange Act Section 12 registration of the class of equity security underlying the compensatory employee stock options.

most respects with the transfer restrictions on compensatory securities in Securities Act Rule 701.[53] In addition, we understand that private, non-reporting issuers generally restrict the transferability of shares received on exercise of compensatory employee stock options until the issuer becomes subject to the reporting requirements of the Exchange Act. As such, we believe that transferability restrictions should not impose additional constraints on such private, non-reporting issuers.

Request for Comment

- Should there be any other restrictions on the transferability by the optionholder or holder of shares received on exercise of the options of the compensatory employee stock options, the shares received on exercise of those options, or shares of the same class of equity security as those underlying those options prior to the issuer becoming subject to the reporting requirements of the Exchange Act?

- Should there be any other restrictions on the transferability of the securities received or to be received on exercise of the compensatory employee stock options or shares of the same class of equity security as the shares underlying those options?

- Should an optionholder be allowed to enter into agreements to transfer the shares to be received on exercise of the compensatory employee stock options or shares of the same class of equity security as the shares underlying those options prior to

53 Securities Act Rule 701(c) and (g). The securities sold in Rule 701 transactions are deemed to be restricted securities as defined in Securities Act Rule 144 [17 CFR 230.144]. The transfer restrictions in the proposed exemption are more restrictive than those in Rule 701.

the exercise of those options while the issuer is relying on the exemption? If yes, why should an optionholder be able to enter into such arrangements and how would such arrangements affect whether an optionholder has received value for the compensatory employee stock options?

- Should there be restrictions on permitted transferees of compensatory employee stock options being able to further transfer such options? Should the permitted transferees be able to further transfer such options to other permitted transferees by gift, pursuant to domestic relations orders, or on death or disability? What types of other transfers, if any, should be permitted and why?

- Do the proposed restrictive provisions sufficiently cover hedging transactions by optionholders or holders of shares received on exercise of the options that would permit such persons to circumvent the proposed transferability conditions in the proposed exemption?

- Should the proposed exemption provide explicitly that the issuer may repurchase the compensatory employee stock options or shares received on exercise of those options if the issuer is unable to prohibit transfers of such options or shares under state law?

- Should the restrictive provisions of the proposed exemption apply to the securities received on exercise of the compensatory employee stock options for so long as the issuer is relying on the proposed exemption? If not, please explain.

- Should the transfer restrictions on the shares received on exercise of the compensatory employee stock options, following such exercise, be a condition to the proposed exemption only if the issuer does not restrict the transferability of any of the shares of the same class of its equity security prior to the issuer becoming subject to the reporting requirements of the Exchange Act?

- The proposed exemption provides that there can be no market or methodology that would permit optionholders or holders of shares received on exercise of an option to profit from or monetize the options, the shares received on exercise of the options, or shares of the same class of equity security as those underlying the options. These proposed restrictions are not intended to interfere with any means by which the issuer values its compensatory employee stock options for purposes of Statement of Financial Accounting Standards No. 123R ("Statement No. 123R").[54] Do the proposed conditions affect an issuer's ability to value compensatory employee stock options for purposes of Statement 123R? If so, how would the valuation ability be affected? If affected, what alternative provisions should we consider that would not interfere with such valuation, yet not permit an optionholder or holder of shares received on exercise of an option to

[54] See Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment.

monetize or profit from the option, the shares received or to be received on exercise of the options, or shares of the same class of equity security as those underlying the options, prior to the issuer becoming subject to the reporting requirements of the Exchange Act?

b. Permitted Exercisability of Compensatory Employee Stock Options

The proposed exemption would not require that there be any restriction on the timing of the exercise of the compensatory employee stock options:

- by the optionholder (regardless of whether the optionholder continues to be an employee, director, consultant or advisor of the issuer);

- in the event of the death or disability of the optionholder, by the estate or guardian of the optionholder; or

- by a family member (as defined in Rule 701) who acquired the options through a gift or domestic relations order.

Request for Comment

- Should there be any restriction on the exercisability of the compensatory employee stock options while an issuer is relying on the proposed exemption?

- Should the compensatory employee stock options be required to terminate if the optionholder is no longer an employee, director, consultant or advisor of the issuer? If so, under what conditions should the options terminate?

- Should the proposed exemption be available only if the compensatory employee stock options are exercisable only for a limited time period after the optionholder ceases to be an employee, director, consultant or advisor of the issuer? If so, should such a limitation on exercise be different if such a cessation is because of death or disability, or because of a termination with cause or without cause? What limited time period should apply and why?

5. Required Information

The proposed exemption would require the issuer to provide information to optionholders and holders of shares received on exercise of compensatory employee stock options. This condition would require the issuer, for purposes of the proposed exemption, to provide the following information to optionholders (and holders of shares received on exercise of compensatory employee stock options):[55]

- The same risk and financial information that would be required to be provided under Securities Act Rule 701 if securities sold in reliance on Securities Act Rule 701 in a 12-month period exceeded $5 million, with the optionholders and holders of shares received on exercise of the compensatory employee stock options always having been provided required financial statements that are not more than 180 days old;[56] and

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55 The information conditions may terminate once the company becomes subject to the reporting requirements of the Exchange Act.

56 See Securities Act Rule 701(e) [17 CFR 230.701(e)] for a description of the risk factor and financial statement requirements. The required information would have to be provided under the terms of the proposed exemption regardless of whether the issuer would be required to provide the information under Rule 701 (for example because the issuer did not sell $5 million in securities in a 12-month period in reliance on Rule 701).

- The issuer's books and records, including corporate governance documents, to the same extent that they are available to other shareholders of the issuer.

The issuer would be permitted to provide the required information (other than the issuer's books and records) to the optionholders and holders of shares received on exercise of compensatory employee stock options either by:

- Physical or electronic[57] delivery of the information; or

- Notice to the optionholders and holders of shares received on exercise of compensatory employee stock options of:
  - the availability of the information on a password-protected Internet site; and
  - any password needed to access the information.

The basis of the information requirement in the proposed exemption is the information that would be required to be provided pursuant to the exemption from Securities Act registration provided in Securities Act Rule 701 if securities sold in reliance on Securities Act Rule 701 in a 12-month period exceeded $5 million. In Securities Act Rule 701, we established the type of information that employees holding compensatory employee stock options must be provided before the exercise of those options.[58] The Securities Act Rule 701 information provisions provide optionholders and

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57 Electronic delivery of such information would have to be made in compliance with the Commission's interpretations regarding the electronic delivery of information. See e.g., "Use of Electronic Media," Release No. 34-42728 (April 28, 2000).

58 See Rule 701 Release, note 4 supra. "The type and amount of disclosure needed in a compensatory securities transaction differs from that needed in a capital-raising transaction. In a

other persons who purchase securities without registration under Rule 701 with important information. We believe that the ongoing provision of the same information is necessary and appropriate for purposes of the proposed exemption from Exchange Act registration.[59]

Securities Act Rule 701 provides that the required information must be provided to an optionholder a reasonable period of time before the date of exercise of the compensatory employee stock options. Rule 701 also requires that the required financial statements must be as of a date no more than 180 days before the sale of the securities (which in the case of compensatory employee stock options is the date of exercise of the options). We believe that the proposed exemption from Exchange Act registration presents the need for ongoing information to be provided to optionholders and holders of shares received on exercise of those options. As such, the proposed exemption would require that the optionholders and holders of shares received on exercise of the compensatory employee stock options always be provided the required financial statements that are not more than 180 days old.

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bona fide compensatory arrangement, the issuer is concerned primarily with compensating the employee-investor rather than maximizing its proceeds from the sale. Because the compensated individual has some business relationship, perhaps extending over a long period of time, with the securities issuer, that person will have acquired some, and in many cases, a substantial amount of knowledge about the enterprise. The amount and type of disclosure required for this person is not the same as for the typical investor with no particular connection with the issuer." Id.

59 As the Commission reminded issuers when it adopted the amendments to Securities Act Rule 701 in 1999, issuers should be aware that compliance with the minimum disclosure standards for Rule 701 may not necessarily satisfy the antifraud standards of the securities laws. See Rule 701 Release, note 4 supra. (Preliminary Note 1 to Rule 701 states that issuers and other persons acting on their behalf have an obligation to provide investors with disclosure adequate to satisfy the antifraud provisions of the federal securities laws.) We recognize that the Advisory Committee has recommended modifications to Rule 701 that would affect the thresholds that would trigger the disclosure provisions of that rule. Our proposals do not address the Advisory Committee's recommendations regarding Rule 701. See Final Report of the Advisory Committee, at p. 92-93.

While requiring private, non-reporting issuers to provide information, the proposed exemption would allow flexibility in the means of providing the information by permitting physical, electronic, or Internet-based delivery. Under the proposal, the issuer would be required to make its books and records available for inspection by the optionholder and holders of shares received on exercise of compensatory employee stock options to the same extent that they are available to other shareholders of the issuer.

To permit issuers to safeguard proprietary or confidential information that may be contained in the information to be provided, the proposed exemption would permit provision of the disclosure to be conditioned on the optionholder (or holder of shares received on exercise of compensatory employee stock options) agreeing to maintain the confidentiality of the information.[60] As proposed, if an optionholder (or holder of shares) chooses not to enter into such a confidentiality agreement, the exemption would permit the issuer to choose to not provide the information to that optionholder or holder of shares received on exercise of options if it allows inspection of the documents at one of the described issuer offices.

In the no-action registration relief provided to issuers to date, the staff of the Division of Corporation Finance has provided that relief only where the issuer commits to providing essentially the same Exchange Act information and reports as if it was subject to the Exchange Act reporting requirements. We believe that our experience with Securities Act Rule 701 and the combined conditions of the proposed exemption, including the eligibility and transferability provisions, alleviate the need for that level of information in the context of an on-going reporting exemption relating to compensatory

60 This proposed provision is consistent with the related information required under Securities Act Rule 701.

employee stock options.[61] As such, we believe that the scope of information that the optionholders and holders of shares will be provided under the proposed exemption is not inconsistent with investor protection and the public interest.[62]

Request for Comment

- Should the proposed exemption require additional information to be provided? If so, what additional information should be required?

- Should the proposed exemption require that audited financial statements be provided in all cases, even if the issuer does not otherwise prepare audited financial statements?

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61 As the Commission also recognized when it adopted the Securities Act Rule 701 amendments in 1999, and because many issuers that have 500 or more optionholders and more than $10 million in assets are likely to have received venture capital financing (see for example the data in the Hand Paper, note 4 supra), we believe that many of these issuers already have prepared the type of disclosure required in their normal course of business, either for using other exemptions, such as Regulation D, or for other purposes. As a result, the disclosure requirement generally would be less burdensome for them. In adopting the amendments to Rule 701, we stated that a minimum level of disclosure was essential to meet even the reduced level of information needed to inform compensatory-type investors such as employees and consultants. See Rule 701 Release, note 4 supra.

62 For a private, non-reporting issuer with a significant number of optionholders (and with more than $10 million in assets at the end of its fiscal year), we believe it is likely that such issuer either already is obligated to provide the same information to optionholders due to sales of securities in reliance on Securities Act Rule 701 or already prepares and, as such, provides such information to its shareholders. As a result, it is likely that optionholders and holders of shares received on exercise of those options already will have received such disclosures in connection with the option grants and exercises and, because of the proposed transferability restrictions on the compensatory employee stock options and the shares received or to be received on exercise of those options, will not have further investment decisions to make, until the issuer becomes subject to the reporting requirements of the Exchange Act. Consequently, we believe that the disclosure required under the proposed exemption is the appropriate level of disclosure to be provided option holders and holders of shares received on exercise of those options until the issuer become subject to the reporting requirements of the Exchange Act.

- Should the proposed exemption also require that the information be provided in specified time frames prior to the exercise of the compensatory employee stock options?

- Should the proposed exemption require that the information be provided to holders of shares received on exercise of the compensatory employee stock options until the issuer becomes subject to the reporting requirements of the Exchange Act or for so long as the issuer is relying on the proposed exemption? If not, should there be restrictions on the information provided and, if so, what restrictions should be imposed and why?

- Should the proposed exemption apply to holders of shares received on exercise of compensatory employee stock options only if the issuer has a repurchase right in the event of an attempted transfer of the shares? If so, what information would be provided to a holder of shares prior to the issuer becoming a reporting issuer under the Exchange Act?

- As proposed, the issuer could provide the required information by physical, electronic, or Internet-based delivery. Is it appropriate to allow issuers to choose how to satisfy this requirement by using these alternate means? What role should investor preference play?

- Should the condition specifying the manner in which the information should be provided mandate that the information be available through a password-protected Internet site?

- The proposed exemption would require that issuers make their books and records available to optionholders and to holders of shares received on exercise of the options to the same extent they are available to other shareholders of the issuer. Is this an appropriate information requirement for the proposed exemption? If not, why not? What books and records and corporate governance documents do private, non-reporting issuers provide to optionholders and holders of shares received on exercise of options? Would this condition affect issuers' practices of granting options to consultants and advisors? If so, why?

- As proposed, the exemption does not require private, non-reporting issuers to provide optionholders or holders of shares received on exercise of an option with the information that would be required to be disclosed by our issuer tender offer rules (Exchange Act Rule 13e-4)[63] or going private transaction rules (Exchange Act Rule 13e-3)[64] if the compensatory employee stock options (or shares received on exercise of those options) were registered pursuant to Exchange Act Section 12(g). Should the information disclosure requirements of the proposed exemption be expanded to require disclosure of additional information such as any

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63 17 CFR 240.13e-4.

64 17 CFR 240.13e-3.

information that would otherwise be required by Rule 13e-3 or Rule 13e-4? If so, what information should be required to be provided?

- In addition, beneficial ownership of compensatory employee stock options not Exchange Act Section 12-registered in reliance on the proposed exemption would not trigger the beneficial ownership reporting requirements in Exchange Act Regulation 13D-G[65] unless the options were exercisable for Section 12 registered securities within 60 days. Is this the correct result?

6. Issuer Obligation to Impose the Conditions to the Proposed Exemption

For the proposed exemption to be available, a private, non-reporting issuer would be required to include the necessary limitations and conditions either in the written stock option plans or within the terms of the individual written option agreements. In addition, the transferability restrictions on the shares received on exercise of the compensatory employee stock options also must be included in the issuer's by-laws, certificate of incorporation, or a stock purchase or stockholder agreement between the issuer and the exercising optionholder or holder of shares received on exercise of an option. We believe that the self-executing nature of the proposed exemption necessitates the inclusion of the conditions to the exemption in an enforceable agreement between the issuer, the optionholders, and the holders of shares received on exercise of an option, or in the issuer's by-laws or certificate of incorporation.

Request for Comment

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[65] 17 CFR 240.13d-1 through 240.13d-102.

- Should the proposed exemption require that the conditions be contained in a particular written document or should the proposed exemption allow the conditions to be contained in any agreement between the issuer, the optionholders, and the holders of shares received on exercise of an option?

- Should the proposed exemption permit any of the conditions, including the transferability restrictions on the shares received on exercise of the compensatory employee stock options, to be included in the issuer's by-laws or certificate of incorporation?

B. Proposed Exemption for Compensatory Employee Stock Options of Exchange Act Reporting Issuers

To provide certainty regarding the obligations of issuers that already have registered the securities underlying the compensatory employee stock options under the Exchange Act, we believe it is appropriate to provide an exemption from Exchange Act registration for compensatory employee stock options of these reporting issuers.[66] The proposed exemption would be available only for an issuer that has registered under Exchange Act Section 12 the class of equity security underlying the compensatory employee stock options. Such a registration gives rise to a requirement to file the reports required under Exchange Act Section 13.[67] The filing of these reports is essential to the

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66 Public reporting issuers may be unclear regarding the need to comply with the Exchange Act Section 12(g) registration requirements for compensatory employee stock options if the issuer has registered under Exchange Act Section 12 the class of equity security underlying those options or has registered under the Securities Act the offer and sale of the options and the shares issuable on exercise of the options on Form S-8. Consequently, we believe the proposed exemption will provide important guidance regarding, and an appropriate exemption to eligible issuers from, the Exchange Act registration requirement for compensatory employee stock options.

67 15 U.S.C. 78m.

proposed exemption, as we believe the exemption is appropriate because the Exchange Act reports of those issuers will provide the appropriate information to optionholders.

As with the proposed exemption for private, non-reporting issuers, the proposed exemption for issuers subject to the reporting requirements of the Exchange Act would be available only where the options were issued pursuant to a written compensatory stock option plan and where the class of persons eligible to receive or hold compensatory employee stock options under the stock option plans was limited to those participants permitted under Securities Act Rule 701.[68] The proposed exemption from Section 12(g) registration for compensatory employee stock options of Exchange Act reporting issuers would not include any information conditions, other than those arising from the registration of the class of equity security underlying the options.

As proposed, the availability of the exemption would not be conditioned on the issuer being current in its Exchange Act reporting. We have not proposed such a condition, as it would seem inappropriate for the issuer to lose the exemption, and be required to register a class of compensatory employee stock options under Exchange Act Section 12(g), because it was late in filing a required Exchange Act report and, for the days before that report was filed, was not "current" in its Exchange Act reporting. We are requesting comment as to whether it would be appropriate to include a requirement in the exemption regarding the issuer's ongoing satisfaction of its Exchange Act reporting obligations.

While the proposed exemption would apply to the registration of compensatory employee stock options as a separate class of equity security, the protections of Exchange

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[68] See the discussion under "Eligible Option Plan Participants," above, for a description of the eligible optionholders.

Act Sections 13(e) and 14(e) will continue to apply to offers for those compensatory employee stock options. Further, the requirements of Exchange Act Section 16 also will apply to the equity securities underlying the compensatory employee stock options and the beneficial ownership reporting requirements of Exchange Act Sections 13(d) and 13(g)[69] will continue to apply if the compensatory employee stock options are exercisable for Exchange Act Section 12 registered securities.[70] The proposed exemption, therefore, would be available only to an issuer that had registered under Exchange Act Section 12 the class of equity security to be issued on exercise of the compensatory employee stock options. As a result, the proposed exemption would not be available to an issuer that is required to file Exchange Act reports solely pursuant to Exchange Act Section 15(d).

Request for Comment

- Should the proposed exemption apply to any issuer that is required to file Exchange Act periodic reports, whether or not the issuer has registered the class of equity security underlying the compensatory employee stock options under Exchange Act Section 12? If so, why?

- Should the proposed exemption be available only to issuers that are current in their Exchange Act reporting obligations? Should the proposed exemption be available only to issuers that, at the end of their fiscal years, are current in their Exchange Act reporting obligations? If so, why? If not, why not?

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69 15 U.S.C. 78m(d) and (g).

70 The provisions of Exchange Act Section 16 would apply to the options if the securities to be issued upon exercise of the options are registered as a class of equity security under Section 12. See 15 U.S.C. 78p and the rules promulgated thereunder. As a result, we do not believe it is

- Should the proposed exemption be available to issuers that are required to file reports under the Exchange Act solely pursuant to Section 15(d)? If so, why?

- How would the exclusion from the proposed exemption affect issuers required to file reports solely pursuant to Section 15(d) of the Exchange Act? How many issuers would be affected?

- Should the proposed exemption be available to those issuers that are not required to file Exchange Act reports but file such reports on a voluntary basis (also known as "voluntary filers") and, if so, why?

- Should the proposed exemption apply only to the reporting obligations under Section 13(a) of the Exchange Act and not to the application of other Exchange Act provisions, such as the tender offer provisions of Section 13(e) and Section 14(e) of the Exchange Act? Please explain.

- Is the use of the Securities Act Rule 701 definitions of eligible participants appropriate for purposes of the proposed exemption? If not, what definitions should be used to characterize the eligible optionholders? Should the eligible optionholders only be those persons permitted to be offered and sold options pursuant to a registration statement on Form S-8? If so, why?

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necessary for compensatory employee stock options to be subject to Section 16 as a separate class

- Should there be any restrictions on the transferability or ownership of the compensatory employee stock options, the shares received on exercise of those options, or shares of the same class of equity security as those underlying those options under the proposed exemption for reporting issuers?

C. Transition Provisions

The proposed exemption from Exchange Act Section 12(g) registration for compensatory employee stock options for private, non-reporting issuers would not affect the no-action relief from Exchange Act Section 12(g) registration of compensatory employee stock options that issuers have received from our Division of Corporation Finance. While the existing no-action letters will remain unaffected by the proposed exemption if adopted, issuers who have received such letters would be able, of course, to rely instead on the proposed exemption.

The proposed exemptions are self-executing. If the issuer becomes ineligible to rely on an applicable proposed exemption, the issuer would be permitted up to 60 calendar days from the date it became ineligible to rely on the proposed exemption to file a registration statement to register under Exchange Act Section 12(g) the class of compensatory employee stock options or, in the case of a reporting issuer, the class of equity security underlying such options.

Request for Comment

- Do the proposed transition provisions of 60 calendar days provide enough time for private, non-reporting and reporting issuers to comply with the Exchange Act

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of equity security.

Section 12 registration requirements upon the loss of an exemption for the compensatory employee stock options? Should it be 30 calendar days? 90 calendar days? If not, what time frame should be provided and why?

- Should the proposed exemptions be exclusive exemptions for Section 12 registration of compensatory employee stock options?

D. General Request for Comment

We request and encourage any interested person to submit comments on the proposed exemptions and any other matters that might have an impact on the proposed exemptions. With respect to any comments, we note that such comments are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

III. PAPERWORK REDUCTION ACT ANALYSIS

A. Background

Certain provisions of the proposed amendments to Rule 12h-1[71] contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[72] We are submitting these to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA.[73] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of

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[71] 17 CFR 240.12h-1.

[72] 44 U.S.C. 3501 et. seq.

[73] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

information unless it displays a currently valid OMB control number. The title for this information is:

- Exchange Act Rule 12h-1.

The hours and costs associated with preparation of notices, maintaining Internet sites, and preparation of information to be disclosed to optionholders and holders of shares received on exercise of compensatory employee stock options for private, non-reporting issuers relying on the proposed exemption from Exchange Act Section 12(g)[74] registration constitute cost burdens imposed by the collection of information. The proposed exemption available to reporting issuers would not constitute new collections of information. The proposed amendments would not affect existing collections of information.

The proposed exemptions from Exchange Act Section 12(g) registration would be adopted pursuant to the Exchange Act. The information collection requirements related to the proposed exemption for private, non-reporting issuers would be a condition to reliance on the exemption. There is no mandatory retention period for the information disclosed and the information disclosed is not required to be filed with the Commission.

B. Summary of Collection of Information

Our proposed amendments to Exchange Act Rule 12h-1 would provide an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans. The proposed amendments also would provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of

74 15 U.S.C. 78l(g).

issuers that have registered under Exchange Act Section 12 the class of equity security underlying those options.

The proposed requirements regarding notice of information availability, Internet availability of information, and, for certain issuers, the preparation of information related to the proposed exemption from Exchange Act Section 12(g) for compensatory employee stock options of private, non-reporting issuers would, if adopted, constitute a new collection of information under the Exchange Act. The proposed information provision in the proposed exemption for private, non-reporting issuers would not be a new collection of information for those private, non-reporting issuers that also are required to provide such information to optionholders pursuant to Securities Act Rule 701[75] or that already prepare and provide such information to their shareholders.

The collection of information would be required for those private, non-reporting issuers that rely on the proposed exemption because they had 500 or more optionholders and more than $10 million in assets at the end of their fiscal year. The issuers likely to use the proposed exemption would be those private, non-reporting issuers that had more than $10 million in assets and had used stock options to compensate employees, directors, consultants, and advisors on a broad basis. The proposed exemption from Section 12(g) registration for compensatory employee stock options of reporting issuers that have registered under Exchange Act Section 12(g) the class of equity security underlying such options does not impose any new collection of information on these reporting issuers.

C. Paperwork Reduction Act Burden Estimates

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75 17 CFR 230.701.

If the proposed exemption for private, non-reporting issuers is adopted, we estimate that the annual burden for responding to the collection of information in the proposed exemption would not increase significantly for most private, non-reporting issuers, due to the current disclosure provisions of Securities Act Rule 701 and the probability that such issuers already prepare such information for other purposes. The costs may increase for those private, non-reporting issuers who are not relying on Securities Act Rule 701 when they grant compensatory employee stock options or who do not prepare the information for other purposes. The cost of providing such information may increase because of the requirement in the proposed exemption for private, non-reporting issuers to provide the required information. We seek comment on the number of private, non-reporting issuers that would rely on the proposed exemption that already prepare the information required by the proposed exemption for other purposes.

Our estimates represent the burden for private, non-reporting issuers eligible to rely on the proposed exemption. Because the registration provisions of Section 12(g) apply only to an issuer with 500 or more holders of record of a class of equity security and assets in excess of $10 million at the end of its most recently ended fiscal year, only those private, non-reporting issuers satisfying those thresholds would be subject to the collection of information. The Division of Corporation Finance has granted no-action relief from registration of compensatory employee stock options to 30 private, non-reporting issuers during the period 1992 through 2006. If we assume that approximately 3 new private, non-reporting issuers would be relying on the proposed exemption each year and that a certain number of private, non-reporting issuers will no longer be relying on the exemption because they have become reporting issuers, have been acquired, or have terminated business, we estimate that approximately 40 private, non-reporting issuers each year may be relying on the exemption. The proposed exemption for private, non-reporting issuers would terminate once such issuer became subject to the reporting requirements of the Exchange Act. Thus, the number of private, non-reporting issuers that may rely on the proposed exemption may vary from year to year.

For purposes of the PRA, we estimate the annual paperwork burden for private, non-reporting issuers desiring to rely on the proposed exemption and to comply with our proposed collection of information requirements to be approximately 20 hours of in-house issuer personnel time and to be approximately $24,000 for the services of outside professionals.[76] These estimates include the time and the cost of preparing and reviewing the information and making the information available to optionholders and holders of shares received on exercise of the options. We assume that the same number of private, non-reporting issuers would rely on the proposed exemption each year.

We estimate that 25% of the burden of preparation and provision of the information required by the proposed exemption is carried by the issuer internally and that 75% of the burden is carried by outside professionals retained by the issuer at an average cost of $400 per hour.[77] The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. We request comment and supporting empirical data on

76 For administrative convenience, the presentation of the totals related to the paperwork burden hours have been rounded to the nearest whole number and the cost totals have been rounded to the nearest hundred.

77 In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of $400 as the average cost of outside professionals that assist issuers in preparing disclosures for offerings.

the number of private, non-reporting issuers that would rely on the proposed exemption and the burden and cost of preparing and providing the information required by the proposed exemption.

D. Request for Comment

We request comment in order to evaluate the accuracy of our estimate of the burden of the collections of information.[78] Any member of the public may direct to us any comments concerning the accuracy of these burden estimates. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington DC 20503, and should send a copy of the comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington DC 20549-1090, with reference to File No. S7-14-07. Requests for materials submitted to the OMB by us with regard to this collection of information should be in writing, refer to File No. S7-14-07, and be submitted to the Securities and Exchange Commission, Office of Filings and Information Services, Branch of Records Management, 6432 General Green Way, Alexandria, VA 22312. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

IV. COST-BENEFIT ANALYSIS

A. Background

78 Comments are requested pursuant to 44 U.S.C. 3506(c)(2)(B).

Compensatory stock options provide a method to use non-cash compensation to attract, retain, and motivate issuer employees, directors and consultants. Since the 1990s, a number of private, non-reporting issuers have granted compensatory employee stock options to 500 or more employees, directors, and consultants. Compensatory employee stock options also are used routinely by issuers required to report under the Exchange Act.

Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security for purposes of the Exchange Act. Under Section 12(g) of the Exchange Act, an issuer with 500 or more holders of record of a class of equity security and assets in excess of $10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration. While there is an exemption from Exchange Act Section 12(g) registration for interests and participations in certain other types of employee compensation plans involving securities, currently there is no exemption for compensatory employee stock options.

B. Summary of Proposed Amendments

We are proposing two exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options issued under employee stock option plans that are limited to employees, directors, consultants, and advisors of the issuer.

One proposed amendment to Rule 12h-1 would provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of an issuer that does not have a class of securities registered under Section 12 and is not subject to the reporting requirements of Exchange Act Section 15(d), where the following conditions are present:

- Eligible optionholders are limited to employees, directors, consultants, and advisors of the issuer;

- Transferability by optionholders and holders of shares received on exercise of the options of compensatory employee stock options, the shares received, or to be received, on exercise of those options, and shares of the same class as those underlying those options is restricted; and

- Risk and financial information is provided to optionholders and holders of shares received on exercise of those options that is of the type that would be required under Rule 701 if securities sold in reliance on Rule 701 exceeded $5 million in a 12-month period.

The second proposed amendment to Exchange Act Rule 12h-1 would provide an exemption for compensatory employee stock options of issuers that are required to file reports under the Exchange Act because they have registered under Exchange Act Section 12 the class of equity security underlying those options.

1. Expected Benefits

Benefits of the proposed exemption for private, non-reporting issuers are likely to include the following: (1) lower costs to, and reduced uncertainty for, private, non-reporting issuers desiring relief from registration under Section 12(g) for compensatory employee stock options issued to employees, directors, consultants, and advisors for compensatory purposes; (2) benefits to private, non-reporting issuers in designing and implementing employee stock option plans without regard to concerns arising from Exchange Section 12(g) registration of the compensatory employee stock options; (3) benefits to private, non-reporting issuers arising from the use of electronic or Internet-based methods of providing the information necessary to satisfy the information requirement of the proposed exemption; and (4) benefits to optionholders and holders of shares received on exercise of options of private, non-reporting issuers arising from the required provision of information under the proposed exemption.

Private, non-reporting issuers would benefit from cost savings as a result of the proposed exemption from Section 12(g) registration of their compensatory employee stock options. A number of private, non-reporting issuers that have 500 or more optionholders and assets in excess of $10 million have hired attorneys and requested no-action relief from the Division of Corporation Finance with regard to the registration of the options. The conditions to no-action relief from the Division include information provision conditions that are more extensive than in the proposed exemption. The proposed exemption, which would be self-executing if the provisions of the exemption were satisfied, would reduce the legal and other costs to a private, non-reporting issuer arising from the no-action request and relief. Such cost savings include reduced legal and accounting fees arising from both the request for no-action relief and for preparation of reports equivalent to Exchange Act reports of a reporting issuer on an ongoing basis. Because we expect that a number of the issuers that may take advantage of the proposed exemption may be smaller issuers, these cost savings could be significant relative to revenues.

The proposed amendments would require the same information that the issuer otherwise would be required to provide if securities sold in reliance on Securities Act Rule 701 exceeded $5 million during any consecutive 12-month period. Thus, for private, non-reporting issuers with a significant number of optionholders (and with more than $10 million in assets at the end of its fiscal year), it is likely that such issuer either already is obligated to provide the same information to optionholders due to sales of securities in reliance on Securities Act Rule 701, or already prepares and, as such, provides such information to its shareholders. Further, any private, non-reporting issuer that has received no-action relief regarding registration of its compensatory employee stock options will face reduced disclosure costs under the proposed exemption.

The proposed amendment also would benefit private, non-reporting issuers by providing the less expensive alternative of electronic or Internet-based methods of providing the information necessary to satisfy the information requirement of the proposed exemption.

Private, non-reporting issuers also would benefit from the certainty that the proposed exemption would provide in designing and implementing compensation programs and employee stock option plans. The proposed amendments would identify the eligibility provisions and transfer restrictions that would need to be contained in compensatory stock option plans or agreements, thereby lessening the need for issuers, at the time that Section 12(g) registration relief is needed for the compensatory employee stock options, to amend their stock option plans and outstanding options to include provisions that would be necessary to obtain no-action relief. The proposed exemption would help private, non-reporting issuers avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders.

Optionholders and holders of shares received on exercise of options also would benefit from the proposed exemption. The proposed exemption assures the provision of the information, including financial information that is not more than 180 days old, to optionholders and holders of shares received on exercise of options. Employees, directors, consultants, and advisors would benefit from the proposed exemption because private, non-reporting issuers would be able to use options for compensatory purposes without concern that the option grants would subject the issuer to Exchange Act registration.

The proposed exemption for reporting issuers also would benefit optionholders and holders of shares received on exercise of options. Optionholders and holders of shares received on exercise of options would have access to the issuer's publicly filed Exchange Act reports. Further, certain provisions of Sections 13, 14, and 16 would apply to the options and the securities issuable on exercise of the options. Holders of shares issued on exercise of those options would have the same rights as other shareholders of the issuer. Thus, the proposed exemption eliminates a possible disincentive for issuers to use certain compensatory employee stock options. This may be a benefit if this type of compensation is useful in attracting and retaining qualified employees that increase the issuer's competitiveness.

2. Expected Costs

Issuers would be required to satisfy the provisions of the proposed amendments, if adopted, to avoid registering under Section 12(g) their compensatory employee stock options if the registration thresholds are met at the end of the issuer's fiscal year. Private, non-reporting issuers may incur certain costs to rely on the proposed exemption including (1) costs to amend their existing employee stock option plans if the plans and option grants do not contain the restrictive and information provisions of the proposed exemption; (2) costs arising from preparing and providing the information required by the proposed exemption to the extent that the issuer does not already prepare or provide such information for other purposes; and (3) costs of maintaining an Internet site on which the information may be available if the issuer chooses to use that method to provide the required information to optionholders and holders of shares received on exercise of options.

We believe that the provisions of the proposed exemption are consistent in many respects with the restrictive provisions of other laws and rules governing option grants and, thus, the costs to private, non-reporting issuers should not be increased. The proposed exemption provisions also are consistent with or are more flexible than the existing conditions for obtaining no-action relief from the Division of Corporation Finance. Therefore, the costs to private, non-reporting issuers to prepare the information required by the proposed exemption may be the same or less than the current costs to the issuer relying on registration relief provided in a no-action letter issued by the Division of Corporation Finance.

Those private, non-reporting issuers who do not already prepare the required information will face costs if they desire to avail themselves of the proposed exemption. In addition to the costs discussed in the Paperwork Reduction Act Analysis,[79] as

[79] See discussion under "PAPERWORK REDUCTION ACT ANALYSIS," above.

described below, issuers may face costs in maintaining the confidentiality of the information required to be provided, including preparation and enforcement of confidentiality agreements entered into with optionholders and holders of shares received on exercise of options. It should be noted, however, that these increased costs would be borne voluntarily, as it is within the issuer's control as to the number of optionholders it may have. Issuers would be able to perform their own cost-benefit analysis to determine whether to comply with the conditions to the exemption or avoid issuing options to 500 or more optionholders.

Private, non-reporting issuers may incur costs in providing the information required under the exemption. These costs may include printing and sending the information or making the information available on an Internet site. We request comment on the magnitude of these potential costs and whether there are any other additional potential costs.

The Division of Corporation Finance has granted no-action relief from registration of compensatory employee stock options to 30 private, non-reporting issuers during the period 1992 through 2006. If we assume that approximately 3 new private, non-reporting issuers would be relying on the proposed exemption each year and that a certain number of private, non-reporting issuers will no longer be relying on the exemption because they have become reporting issuers, have been acquired, or have terminated business, we estimate that approximately 40 private, non-reporting issuers each year may be relying on the exemption. The proposed exemption for private, non-reporting issuers would terminate once such issuer became subject to the reporting requirements of the Exchange Act. Thus, the number of private, non-reporting issuers that may rely on the proposed exemption may vary from year to year.

For purposes of the Paperwork Reduction Act, the Commission staff has estimated that the annual paperwork burden for private, non-reporting issuers desiring to rely on the proposed exemption and to comply with our proposed collection of information requirements to be approximately 20 hours of in-house issuer personnel time, which is equivalent to $3,500, and to be approximately $24,000 for the services of outside professionals, for a total paperwork burden cost of $27,500.[80] These estimates include the time and the cost of preparing and reviewing the information and making the information available to optionholders and holders of shares received on exercise of the options. The Commission staff assumed that the same number of private, non-reporting issuers would rely on the proposed exemption each year. The Commission staff estimated that 25% of the burden of preparation and provision of the information required by the proposed exemption would be carried by the private, non-reporting issuer internally and that 75% of the burden would be carried by outside professionals retained by the private, non-reporting issuer at an average cost of $400 per hour.[81]

Although a private, non-reporting issuer relying on the proposed exemption would benefit from cost savings associated with not having to register the compensatory employee stock options as a separate class of equity security under the Exchange Act, or

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80 For administrative convenience, the presentation of the totals related to the paperwork burden hours have been rounded to the nearest whole number and the cost totals have been rounded to the nearest hundred.

81 In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of $400 as the average cost of outside professionals that assist issuers in preparing disclosures and conducting registered offerings. Consistent with recent rulemaking releases, we estimate the value of work performed by the company internally at a cost of $175 per hour.

obtaining no-action relief, by not doing so, an optionholder or holder of shares received on exercise of an option would not have the benefit of the disclosures contained in Exchange Act reports that the issuer otherwise would be obligated to file with us, including audited financial statements, or the disclosures required to be provided under the terms of the no-action relief.

Optionholders and holders of shares received on exercise of options also would not be able to freely sell their options or shares received on exercise of such options while the private, non-reporting issuer is relying on the proposed exemption. Optionholders and holders of shares received on exercise of such options would not be able realize value from the options or shares until after the private, non-reporting issuer becomes subject to the reporting requirements of the Exchange Act. Many private, non-reporting issuers that grant options, however, currently restrict the transfer of securities held by holders of shares received on exercise of options, in most cases until after the issuer becomes subject to the reporting requirements of the Exchange Act or unless the issuer is acquired by another entity. In some cases, private, non-reporting issuers retain the right to repurchase options or shares received on exercise of an option. Any exercise of such repurchase right by the issuer would be a cost to such issuer.

Request for Comment

We request comment on the costs and benefits to optionholders, holders of shares received on exercise of compensatory employee stock options, private, non-reporting issuers, reporting issuers, and others who may be affected by the proposed exemptions in Rule 12h-1. We request your views on the costs and benefits described above as well as on any other costs and benefits that could result from adoption of the proposed exemptions. We also request data to quantify the costs and value of the benefits identified.

V. CONSIDERATION OF IMPACT ON THE ECONOMY, BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION ANALYSIS

Section 23(a)(2)[82] of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. We are proposing an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans. We also are proposing an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of issuers that have registered under Exchange Act Section 12 the class of equity security underlying those options.

We expect that the proposed exemption for private, non-reporting issuers from Exchange Act registration of compensatory employee stock options will provide necessary certainty to those issuers in their compensation decisions and will help them avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders. We anticipate that the exemption would save such private, non-reporting issuers significant costs and would not require that their confidential issuer information become public prior to the issuer voluntarily determining to become a public reporting issuer. Further, we anticipate that the proposed

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82 15 U.S.C. 78w(a)(2).

exemption would continue to provide private, non-reporting issuers freedom to determine appropriate methods of compensating their employees, directors, consultants, and advisors without concern that they would be required to register their compensatory employee stock options as a class of equity security under Exchange Act Section 12. Thus, the proposed exemption eliminates a possible disincentive for issuers to use certain compensatory employee stock options. This may be a benefit if this type of compensation is useful in attracting and retaining qualified employees that increase the private, non-reporting issuer's competitiveness.

The proposed exemption for reporting issuers will provide certainty regarding the obligations of issuers that already have registered under the Exchange Act the securities underlying compensatory employee stock options to register those options under the Exchange Act. In addition, in the case of these reporting issuers, the optionholders would have access to the issuer's publicly filed Exchange Act reports and the appropriate provisions of Sections 13, 14, and 16 would apply to the compensatory employee stock options and the equity securities issuable on exercise of those options.

Section 3(f)[83] of the Exchange Act requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

We anticipate that the proposed amendments, if adopted, would allow private, non-reporting issuers to continue to maintain the confidentiality of information regarding their business and operations through the use of confidentiality agreements with

[83] 15 U.S.C. 78c(f).

optionholders and holders of shares received on exercise of the options. For issuers that are voluntarily reporting under the Exchange Act or those reporting issuers that are subject to Exchange Act reporting under Section 15(d), the proposed exemption from Section 12(g) for compensatory employee stock options would be unavailable and such issuers would be required to register under Exchange Act Section 12 the class of equity security underlying the options in order to take advantage of the proposed exemption.

We believe that the proposed exemption from Exchange Act registration for the compensatory stock options may beneficially affect the issuer's ability to compete for employees because it will allow such issuers to continue to use employee stock options in their compensation programs, thus enabling them to compete for such employees with both private, non-reporting issuers and public reporting issuers. The proposed exemption also will provide an eligible issuer a more efficient, self-executing exemption from Exchange Act Section 12(g) registration of compensatory employee stock options, instead of such issuer having to seek no-action relief.

The proposed exemptions do not relate to or affect capital formation, as the compensatory employee stock options covered by the proposed exemptions are issued for compensatory and not capital raising purposes.

The proposed exemptions would allow eligible issuers to continue to have freedom to determine appropriate methods of compensating their employees, directors, consultants, and advisors. For private, non-reporting issuers, these compensation decisions could be made without concern that the issuer would become subject to the Exchange Act reporting requirements before they had public shareholders.

Request for Comment

We request comment on whether the proposed rule would impose a burden on competition or whether it would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

VI. INITIAL REGULATORY FLEXIBILITY ANALYSIS

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed amendments to Rule 12h-1 that would provide two exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options issued under employee stock option plans that are limited to employees, directors, consultants, and advisors of the issuer, its parents, and the majority-owned subsidiaries of the issuer or its parents.

A. Reasons for the Proposed Action

Compensatory stock options provide a method to use non-cash compensation to attract, retain, and motivate issuer employees, directors and consultants. Since the 1990s, a number of private, non-reporting issuers have granted compensatory employee stock options to 500 or more employees, directors, and consultants. Compensatory employee stock options routinely are used by issuers required to report under the Exchange Act as well.

Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security for purposes of the Exchange Act. Under Section 12(g) of the Exchange Act, an issuer with 500 or more holders of record of a class of equity security and assets in excess of $10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration. While there is an exemption from Section 12(g) registration for interests and participations in certain other types of employee compensation plans involving securities, currently there is no exemption for compensatory employee stock options.

B. Objectives

The primary objective of the proposed amendments is to provide two exemptions from Exchange Act Section 12(g) registration for compensatory employee stock options. One proposed exemption would be for compensatory employee stock options of issuers that do not have a class of securities registered under Section 12 and are not subject to the reporting requirements of Exchange Act Section 15(d). The second proposed exemption would be for compensatory employee stock options of issuers that are required to file reports under the Exchange Act because they have registered under Exchange Act Section 12 the class of equity security underlying those options.

Codifying an exemption from registration for compensatory employee stock options will provide necessary certainty to issuers in their compensation decisions and will help private non-reporting issuers avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders. For reporting issuers that have registered under Section 12 the class of security underlying the compensatory employee stock options, we believe the proposed exemption of compensatory employee stock options from Exchange Act registration is appropriate because the optionholders would have access to the issuer's publicly filed Exchange Act reports and the appropriate provisions of Sections 13, 14, and 16 would apply to the compensatory employee stock options and the equity securities issuable on exercise of those options. The proposed exemptions would allow private, non-reporting issuers, as well as reporting issuers, to continue to reward and retain employees with the issuers' securities.

C. Legal Basis

We are proposing the amendments to Rule 12h-1 under the authority set forth in Sections 12,[84] 23,[85] and 36[86] of the Securities Exchange Act of 1934, as amended.

D. Small Entities Subject to the Proposed Rules

The proposed exemptions would not affect issuers that are small entities. Exchange Act Rule 0-10(a)[87] defines an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. The registration requirements of Section 12(g) arise only if an issuer has more than $10 million in assets and has 500 or more holders of a class of equity security at the end of its most recently ended fiscal year. Small entities do not satisfy the asset threshold of Section 12(g) and therefore the proposed exemptions would not be needed by such entities until their asset size increased to more than $10 million at the end of a fiscal year.

Because the registration requirements of Section 12(g) are not implicated unless an entity has assets in excess of $10 million at the end of a fiscal year, we conclude that there are not a large number of small entities that may be impacted. We request comment on this conclusion, including any available empirical data.

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84 15 U.S.C. 78l.

85 15 U.S.C. 78w.

86 15 U.S.C. 78mm.

87 17 CFR 240.0-10(a).

E. Reporting, Recordkeeping and Other Compliance Requirements

The proposed exemptions would not affect small entities. The proposed amendments would require the same information that the issuer otherwise would be required to provide if securities sold in reliance on Securities Act Rule 701 exceeded $5 million during any consecutive 12-month period. Thus, for private, non-reporting issuers with a significant number of optionholders (and with more than $10 million in assets at the end of its fiscal year), it is likely that such issuer either already is obligated to provide the same information to optionholders due to sales of securities in reliance on Securities Act Rule 701 or already prepares and provides such information to its shareholders.

F. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no rules that conflict with or duplicate the proposed amendments to Exchange Act Rule 12h-1.

G. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. Insofar as the amendments only apply to entities that are subject to Section 12(g) registration with regard to a class of equity security and, therefore, do not apply to small entities, we did not consider any alternatives to the proposed amendments specifically with respect to small entities. In connection with the proposed exemptions, we considered alternatives related to the scope of issuers eligible for the exemption, the information required to be provided, and transfer restrictions on the options and shares issuable on exercise of the options.

H. Request for Comment

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of any impact on small entities. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996[88] ("SBREFA"), a rule is "major" if it has resulted, or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposed exemptions would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment or innovation.

VIII. STATUTORY BASIS AND TEXT OF PROPOSED RULE AMENDMENTS

We are proposing to amend Exchange Act Rule 12h-1 under the authority in Sections 12, 23, and 36 of the Securities Exchange Act of 1934, as amended.

List of Subjects

88 Pub. L. 104-121, Title II, 110 Stat. 857 (1996).

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE

For the reasons set out in the preamble, we propose to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

2. Amend §240.12h-1 to add paragraphs (f) and (g) to read as follows:

§240.12h-1 Exemptions from registration under section 12(g) of the Act

* * * * *

(f)(1) Stock options issued under written compensatory stock option plans of an issuer under the following conditions:

(i) The issuer of the stock options does not have a class of security registered under section 12 of the Act and is not required to file reports pursuant to section 15(d) of the Act;

(ii) The stock options have been issued by the issuer pursuant to one or more written compensatory stock option plans established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents;

Note to paragraph (f)(1)(ii): All stock options issued under all of the issuer's written compensatory stock option plans on the same class of equity security will be considered part of the same class of equity security for purposes of the provisions of this section.

(iii) The stock options are held only by those persons described in Rule 701(c) under the Securities Act (17 CFR 230.701(c));

(iv) The stock options and the shares issuable upon exercise of such stock options are restricted as to transfer by the optionholder or holder of the shares received on exercise of the option other than to persons who are family members (as defined in Rule 701(c)(3) under the Securities Act (17 CFR 230.701(c)(3)) through gifts or domestic relations orders, or to an executor or guardian of the optionholder or holder of shares received on exercise of such stock option upon the death or disability of the optionholder or holder of shares, until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act; provided that the optionholder or holder of shares may transfer the options or shares to the issuer (or its designated affiliate if the issuer is unable to repurchase the options or shares) if applicable law prohibits a restriction on transfer;

Note to paragraph (f)(1)(iv): For purposes of this section, optionholders and holders of shares received on exercise of an option may include any permitted transferee under paragraph (f)(1)(iv) of this section; provided that such permitted transferees may not further transfer the stock options or shares issuable upon exercise of such stock options;

(v) The stock options, the shares issuable upon exercise of such stock options, and shares of the same class of equity security as those underlying the options are restricted as to any pledge, hypothecation, or other transfer, including any short position, any "put equivalent position" (as defined in §240.16a-1(h) of this chapter), or any "call equivalent position" (as defined in §240.16a-1(b) of this chapter) by the optionholder or holder of shares received on exercise of an option, except as permitted in paragraph (f)(1)(iv) of this section, until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act;

(vi) There can be no market or available process or methodology that permits an optionholder or holder of shares received on exercise of an option to receive any consideration or compensation for the options, the shares issuable on exercise of the options, or shares of the same class of equity security as those underlying the options, except as permitted in paragraph (f)(1)(iv) of this section, until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act ;

Note to paragraphs (f)(1)(iv), (f)(1)(v), and (f)(1)(vi): The transferability restrictions in paragraphs (f)(1)(iv), (f)(1)(v), and (f)(1)(vi) of this section must be contained in either the written compensatory stock option plan, individual written compensatory stock option agreement, or other stock purchase or stockholder agreement to which the issuer and the optionholder or holder of shares are a signatory or party, or in the issuer's by-laws, certificate of incorporation; and

(vii) The issuer has agreed in the written compensatory stock option plan or the individual written compensatory stock option agreement to provide the following information to optionholders and holders of shares received on exercise of an option until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act:

(A) The information described in Rules 701(e)(3), (4), and (5) under the Securities Act (17 CFR 230.701(e)(3), (4), and (5)), with such information provided either by physical or electronic delivery to the optionholders and holders of shares received on exercise of an option or by written notice to the optionholders and holders of shares received on exercise of an option of the availability of the information on a password-protected Internet site and of any password needed to access the information; and

(B) Access to the issuer's books and records, including corporate governance documents, to the same extent that they are available to other shareholders of the issuer.

Note to paragraph (f)(1)(vii): The issuer may request that the optionholder or holder of shares received on exercise of an option agree to keep the information to be provided pursuant to this section confidential. If an optionholder or holder of shares received on exercise of an option does not agree to keep the information to be provided pursuant to this section confidential, then the issuer is not required to provide the information; provided, that the issuer must then allow the optionholder or holder of shares received on exercise of an option to inspect the information and documents at one of the issuer's offices that is at or near where the optionholder or holder of shares received on exercise of an option is or was employed or retained by the issuer.

(2) If the exemption provided by paragraph (f)(1) of this section ceases to be available, the issuer of the compensatory stock options that is relying on the exemption provided by this section must file a registration statement to register the class of options under section 12 of the Act within 60 calendar days after the conditions in paragraph (f)(1) of this section are no longer satisfied.

(g) (1) Stock options issued under written compensatory stock option plans of an issuer under the following conditions:

(i) The issuer of the stock options has registered the class of equity security issuable on exercise of the options under section 12 of the Act;

(ii) The stock options have been issued by the issuer pursuant to one or more written compensatory stock option plans established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents;

Note to paragraph (g)(1)(ii): All stock options issued under all of the issuer's written compensatory stock option plans on the same class of equity security will be considered part of the same class of equity security for purposes of the provisions of this section; and

(iii) The stock options are held only by those persons described in Rule 701(c) under the Securities Act (17 CFR 230.701(c)).

(2) If the exemption provided by paragraph (g)(1) of this section ceases to be available, the issuer of the compensatory stock options that is relying on the exemption provided by this section must file a registration statement to register the class of options or the class of equity security issuable on exercise of the options under section 12 of the Act within 60 calendar days after the conditions in paragraph (g)(1) of this section are no longer satisfied.

By the Commission.

Nancy M. Morris
Secretary

July 5, 2007

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 210, 228, 229, 230, 239, 240, 249, 260, and 269

RELEASE NOS. 33-8819; 34-56013; 39-2447; FILE NO. S7-15-07

RIN 3235-AJ86

SMALLER REPORTING COMPANY REGULATORY RELIEF AND SIMPLIFICATION

AGENCY: Securities and Exchange Commission.

ACTION: Proposed amendments.

SUMMARY: The Securities and Exchange Commission is proposing rule amendments relating to our disclosure and reporting requirements for smaller companies under the Securities Act of 1933 and the Securities Exchange Act of 1934. We propose to extend the benefits of our current optional disclosure and reporting requirements for smaller companies to a much larger group of companies. The proposals would allow companies with a public float of less than \$75 million to qualify for the smaller company requirements, up from \$25 million for most companies today. The proposals also would combine for most purposes the "small business issuer" and "non-accelerated filer" categories of smaller companies into a single category of "smaller reporting companies." In addition, the proposals would maintain the current disclosure requirements for smaller companies contained in Regulation S-B, but integrate them into Regulation S-K. We also are soliciting suggestions for additional ways in which we could better scale our disclosure and reporting requirements to the needs of smaller reporting companies and their investors.

DATES: Comments should be received on or before [insert date 60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

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- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-15-07 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-15-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Gerald J. Laporte, Chief, Kevin M. O'Neill, Special Counsel, or Johanna Vega Losert, Attorney-Advisor, Office of Small Business Policy, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628, (202) 551-3460.

SUPPLEMENTARY INFORMATION: We propose amendments to Regulation S-K,[1] and

[1] 17 CFR 229.10–229.1123.

rules and forms under the Securities Act of 1933,[2] Securities Exchange Act of 1934,[3] and Trust Indenture Act of 1939.[4] In Regulation S-K, we propose to amend Items 10, 101, 201, 301, 302, 303, 305, 401, 402, 404, 407, 503, 504, 512, 601, 701, and 1118.[5] We propose to add a new Item 310 to Regulation S-K. We propose to amend Securities Act Rules 110, 138, 139, 158, 175, 405, 415, 428, 430B, 430C, 455, and 502.[6] Further, we propose to repeal Regulation S-B[7] and eliminate the forms associated with it, which include Forms SB-1, SB-2, 10-SB, 10-QSB, and 10-KSB.[8] We propose to amend Securities Act Forms 0-1, S-1, S-3, S-4, S-8, S-11, 1-A, and F-X.[9] We also propose to amend Exchange Act Rules 0-2, 0-12, 3b-6, 10A-1, 10A-3, 12b-2, 12b-23, 12b-25, 12h-3, 13a-10, 13a-13, 13a-14, 13a-16, 13a-20, 14a-3, 14a-5, 14a-8, 14c-3, 14d-3, 15d-10, 15d-13, 15d-14, 15d-20, and 15d-21[10] and Exchange Act Forms 0-1, 8-A, 8-K, 10, 10-Q, 10-K, 11-K, 20-F, and SE.[11] We also propose to amend Schedules 14A and 14C.[12] Under Regulation S-X,[13] we propose to amend Rules 210.3-01, 210.3-10, 210.3-12, 210.3-14, 210.4-01, and 210.10-01.[14] Finally, we propose to amend Trust Indenture Act Rules 0-11, 4d-9,

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2 15 U.S.C. 77a et seq.

3 15 U.S.C. 78a et seq.

4 15 U.S.C. 77aaa et seq.

5 17 CFR 229.10, 229.101, 229.201, 229.301, 229.302, 229.303, 229.305, 229.401, 229.402, 229.404, 229.407, 229.503, 229.504, 229.512, 229.601, 229.701, and 229.1118.

6 17 CFR 230.110, 230.138, 230.139, 230.158, 230.175, 230.405, 230.415, 230.428, 230.430B, 230.430C, 230.455, and 230.502.

7 17 CFR 228.10–228.703.

8 17 CFR 239.9, 239.10, 249.210b, 249.308b, and 249.310b.

9 17 CFR 239.0-1, 239.11, 239.13, 239.25, 239.16b, 239.18, 239.90, and 239.42.

10 17 CFR 240.0-2, 240.0-12, 240.3b-6, 240.10A-1, 240.10A-3, 240.12b-2, 240.12b-23, 240.12b-25, 240.12h-3, 240.13a-10, 240.13a-13, 240.13a-14, 240.13a-16, 240.13a-20, 240.14a-3, 240.14a-5, 240.14a-8, 240.14c-3, 240.14d-3, 240.15d-10, 240.15d-13, 240.15d-14, 240.15d-20, and 240.15d-21.

11 17 CFR 249.0-1, 249.208a, 249.210, 249.308, 249.308a, 239.310, 249.311, 249.220f, and 249.444.

12 17 CFR 240.14a-101 and 240.14c-101.

13 17 CFR 210.3-01–210.12-29.

14 17 CFR 210.3-01, 210.3-10, 210.3-12, 210.3-14, 210.4-01, and 210.10-01.

10a-5,[15] and § 269.0-1 of the Trust Indenture Act Forms.[16]

[15] 17 CFR 260.0-11, 260.4d-9, and 260.10a-5.

[16] 17 CFR 269.0-1.

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I. Background

Since the federal securities laws were first enacted, the Commission has made special efforts not to subject smaller companies and their investors to unduly burdensome federal securities regulation.[17] This special concern for small business in part reflects recognition of the special role that small business historically has played as a driver of economic activity, innovation, and job creation in the United States. In March 2005, we chartered the Advisory Committee on Smaller Public Companies and asked that panel to assess the current regulatory system for smaller companies under the federal securities laws and to recommend changes to that system.[18] The major proposals we are making in this release stem from the Advisory Committee's recommendations.

Our rules currently include two major categories of smaller companies – "small business issuers" and "non-accelerated filers" – for purposes of scaling our disclosure and reporting requirements to the needs of smaller companies and their investors. These two categories of smaller companies are defined as follows:

- "Small business issuers" essentially are companies with both a public float and revenues of less than $25 million. Of the 11,898 companies that filed annual reports under the Exchange Act in 2006, 3,749 had a public float of less than $25 million.[19]
- "Non-accelerated filers" are companies that do not qualify as "large accelerated filers" or

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17 See SEC Advisory Committee on Smaller Public Companies, Final Report 20-21 (2006) ("Advisory Committee Final Report"), available at http://www.sec.gov/info/smallbus/acspc.shtml.

18 See Advisory Committee Final Report 1, App. B (Advisory Committee Charter).

19 Of these 11,898 filers, 3,395 filed a Form 10-KSB, the annual report filed by small business issuers. We determined that there were an additional 354 filers with a public float of less than $25 million that did not file a Form 10-KSB because they opted to use Form 10-K, the form prescribed for most larger companies, instead. We have not attempted to provide information on companies with revenues of less than $25 million because, as discussed below, we propose to eliminate the revenue test for purposes of the primary determination of whether smaller companies qualify for scaled regulation under our disclosure requirements.

"accelerated filers" under our rules.[20] Non-accelerated filers essentially are companies with a public float of less than \$75 million. Of the 11,898 companies that filed annual reports under the Exchange Act in 2006, 4,976 had a public float of less than \$75 million.[21]

The scaled disclosure and reporting requirements available to these smaller companies apply to companies filing registration statements covering offerings of securities under the Securities Act and companies required to file annual and other reports under Exchange Act Sections 13 and 15(d).[22]

"Small business issuers" are eligible to make required disclosures based on the requirements in Regulation S-B,[23] which sets forth disclosure standards for small business issuers that must file documents with the Commission under the Securities Act, Exchange Act, or Trust Indenture Act. In most cases, small business issuers may make disclosures based on Regulation S-B only if they use one of the forms we have designated with the letters "SB" – Form 10-SB, Form 10-QSB, Form 10-KSB, Form SB-1, and Form SB-2. One of the most important provisions of Regulation S-B is Item 310, which governs the form, content, and preparation of financial statements for companies that provide disclosure pursuant to Regulation S-B. The requirements in Item 310 of Regulation S-B are less detailed than the requirements in Regulation S-X, the regulation that governs the financial statements of most companies that do not rely on Regulation S-B. Regulation S-B also contains a number of disclosure requirements

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20 The terms "large accelerated filer" and "accelerated filer" are defined in Exchange Act Rule 12b-2 (17 CFR 240.12b-2).

21 Statistics are based on 2006 data from the Commission's computerized filing system and Thomson Financial (Datastream). Datastream data includes all registered public firms trading on the New York Stock Exchange, the American Stock Exchange, the Nasdaq, the Over-the-Counter Bulletin Board, and the Pink Sheets and excludes closed end funds, exchange traded funds, American depository receipts, and direct foreign listings.

22 15 U.S.C. 78m and 15 U.S.C. 78o(d).

23 The term "small business issuer" is defined in Item 10(a)(1) of Regulation S-B (17 CFR 228.10(a)(1)), among other places. The Commission adopted Regulation S-B in 1992. See Release No. 33-6949 (July 30, 1992) [57

that are scaled to the characteristics of smaller companies, including requirements on executive compensation, related person transactions, and management's discussion and analysis of financial condition and results or plan of operation.[24]

Smaller companies qualifying as "non-accelerated filers" may file their annual reports no later than 90 days after fiscal year end and their quarterly reports no later than 45 days after the end of each fiscal quarter.[25] This contrasts with the 60-day and 75-day deadlines for the annual reports of large accelerated filers and accelerated filers, respectively, and the 40-day deadline for quarterly reports of those larger companies. Non-accelerated filers also are treated differently with regard to the compliance dates applicable to the internal control over financial reporting provisions in Section 404 of the Sarbanes-Oxley Act of 2002.[26]

Our proposals have three primary objectives, each of which is consistent with investor protection:

- Expanding eligibility for our scaled disclosure and reporting requirements for smaller companies by making those requirements available to most companies with a public float of less than $75 million;
- Simplifying our rules for smaller companies by combining the two categories of small business issuers and non-accelerated filers into one category called "smaller reporting companies;" and

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FR 36442].

[24] For a more complete survey of the disclosure requirements for small business issuers in Regulation S-B, see Section II.B.2 below.

[25] See Release No. 33-8644 (Dec. 21, 2005) [70 FR 76626].

[26] Pub. L No. 107-204, 116 Stat. 745 (July 30, 2002); see also Release No. 33-8760 (Dec. 15, 2006) [71 FR 76580].

- Simplifying and improving our disclosure and reporting rules for smaller companies by maintaining the Regulation S-B disclosure requirements for smaller companies but integrating them into the disclosure requirements in Regulation S-K.

The Advisory Committee on Smaller Public Companies addressed these objectives in the following recommendations:

- Recommendation II.P.1: Establish a new system of scaled or proportional securities regulation for smaller public companies using the following six determinants to define a "smaller public company":
  - the total market capitalization of the company;
  - a measurement metric that facilitates scaling of regulation;
  - a measurement metric that is self-calibrating;
  - a standardized measurement and methodology for computing market capitalization;
  - a date for determining total market capitalization; and
  - clear and firm transition rules, i.e., small to large and large to small.

  Develop specific scaled or proportional regulation for companies under the system if they qualify as "microcap companies" because their equity market capitalization places them in the lowest 1% of total U.S. equity market capitalization or as "smallcap companies" because their equity market capitalization places them in the next lowest 1% to 5% of total U.S. equity market capitalization, with the result that all companies comprising the lowest 6% would be considered for scaled or proportional regulation;[27]
- Recommendation IV.P.1: Incorporate the scaled disclosure accommodations currently available to small business issuers under Regulation S-B into Regulation S-K, make them

[27] See Advisory Committee Final Report 14-22.

available to all microcap companies, and cease prescribing separate specialized disclosure forms for smaller companies;[28] and

- Recommendation IV.P.2: Incorporate the primary scaled financial statement accommodations currently available to small business issuers under Regulation S-B into Regulation S-K or Regulation S-X and make them available to all microcap and smallcap companies.[29]

It has been maintained that regulation and disclosure standards are proportional when compliance requirements are flexible enough to be modified and scaled according to the size, resources, operations, and financial complexities of the reporting company without sacrificing investor protection.[30] We believe that our proposals meet this standard. We also believe these proposals maintain investor protection while providing greater capital formation opportunities for smaller reporting companies and encouraging more robust smaller company participation in the United States capital markets.

II. Explanation of Proposals

The proposals that we publish for comment today would simplify, and increase significantly the number of companies eligible for our scaled disclosure and reporting rules for smaller reporting companies, consistent with investor protection. Our proposals largely would implement several of the recommendations of our Advisory Committee on Smaller Public Companies in these areas.

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28 See Advisory Committee Final Report 60-64.

29 See Advisory Committee Final Report 65-68.

30 See generally C. Steven Bradford, Does Size Matter? An Economic Analysis of Small Business Exemptions from Regulation, 8 J. Small & Emerging Bus. L. 1, 2 (1999) (providing an economic analysis of costs and benefits associated with small business exemptions).

A. Expanding Eligibility for Smaller Company Scaled Regulation

The proposals would expand the availability of our disclosure and reporting requirements for smaller companies to most companies with a public float of less than $75 million.[31] We are proposing a new term – "smaller reporting company" – to replace the term "small business issuer" and proposing to make available to these "smaller reporting companies"[32] the disclosure and reporting standards that we make available to small business issuers and most non-accelerated filers.[33] Our proposals would provide further regulatory simplification and relief for smaller reporting companies by integrating into Regulation S-K the salient "small business issuer" disclosure requirements currently found in Regulation S-B. Finally, our proposals would eliminate all "SB" forms associated with Regulation S-B.

1. Quantitative Standards in the Proposed Definition of "Smaller Reporting Company"

a. Proposed Standard

The smaller reporting company definition would include a public float eligibility ceiling of $75 million for most companies. Other companies, for example, companies that do not have a public float as defined or are unable to calculate it, would be eligible for scaled treatment if their revenues are below $50 million annually.[34] At present, 3,395 reporting companies use our

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[31] See proposed Item 10(f)(1) of Regulation S-K. We propose to continue to exclude investment companies and asset-backed issuers from eligibility for scaled reporting and disclosure regulation.

[32] The definition would replace the almost identical definitions of the term "small business issuer" in Securities Act Rule 405 and Exchange Act Rule 12b-2. We also would insert the new definition as a new paragraph in Item 10(f) of Regulation S-K.

[33] Under our proposals, we would continue to use the term "non-accelerated filer" to refer to companies that are not subject to our accelerated filing requirements for their annual and quarterly reports under the Exchange Act and are currently eligible to use different compliance dates applicable to internal control over financial reporting and different periodic report deadlines.

[34] See proposed Item 10(f)(1) of Regulation S-K.

current scaled disclosure and reporting requirements for smaller companies.[35] If the proposals are adopted, a total of 4,976 companies would be eligible to use the scaled disclosure item requirements. The 4,976 eligible companies represent 42% of the 11,898 companies that filed annual reports under the Exchange Act in 2006.[36]

The term "smaller reporting company" would replace the term "small business issuer," which defines the companies eligible currently to use the Regulation S-B disclosure requirements.[37] The proposed definition of smaller reporting company also would include most non-accelerated filers, which generally are those filers with a public float of less than $75 million.[38] Non-accelerated filers are the companies currently eligible to use different compliance dates applicable to internal control over financial reporting and different periodic report deadlines. By using the same term to refer to both current groups of companies, we would effectively combine the two groups of scaled requirements into a single group – companies with a public float of less than $75 million, or revenues below $50 million if their public float cannot be calculated. As proposed, the $75 million and $50 million ceilings would be adjusted for inflation on September 1, 2012, and every fifth year thereafter, to reflect any changes in the value of the Personal Consumption Expenditures Chain-Type Price Index (PCECTP Index) (or any successor index thereto), as published by the Department of Commerce, from December 31, 2006.[39]

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35 See footnote 19 above.

36 See footnote 21 above.

37 See Item 10(a)(1) of Regulation S-B, Securities Act Rule 405, and Exchange Act Rule 12b-2.

38 Although the term "non-accelerated filer" is not defined in our rules, we allude to it in Exchange Act Rule 12b-2 and have used it throughout several releases to refer to an Exchange Act reporting company that does not meet the Exchange Act Rule 12b-2 definitions of either an "accelerated filer" or a "large accelerated filer." See Release No. 33-8760 n.15 (Dec. 15, 2006) [71 FR 76580].

39 Each adjustment would be rounded to the nearest multiple of $5,000,000. We propose to use the PCECTP Index because it is a widely used and broad indicator of inflation in the U.S. economy.

We propose to set the initial ceiling for smaller reporting companies at $75 million in public float because we now have several rules using the $75 million public float metric to distinguish smaller companies. In addition to the use of this public float metric in the definition of accelerated filer, the $75 million public float requirement is used to determine expanded eligibility in Form S-3 and Form F-3.[40] Further, issuers are required to provide their public float on the cover page of their Exchange Act annual reports.

Our proposed definition of "smaller reporting company" does not include a revenue test for most companies. While our current definition of "small business issuer" includes a revenue standard, the classification of an issuer as a large accelerated filer, an accelerated filer, or (by default) a non-accelerated filer does not involve a revenue standard. We chose not to propose a revenue standard to qualify for "smaller reporting company" status for most companies to provide greater simplicity, consistency, and certainty.

While our proposed definition of "smaller reporting company" does not generally apply a revenue standard, where an issuer has no common equity public float or market price, we propose a revenue test.[41] If an issuer has no common equity public float or market price and it has reported annual revenues of less than $50 million in the most recently completed fiscal year for which audited financial statements are available, then it would qualify initially for scaled regulation as a smaller reporting company for the fiscal year in which it files a registration statement under the Securities Act or Exchange Act with the Commission as a smaller reporting company.[42]

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40 17 CFR 239.33 and 239.13.

41 An issuer may have no public float or market price because it has no significant public equity outstanding or no public market for its equity. For example, a company with only debt publicly outstanding would use the revenue test.

42 The issuer would refer to its most recently audited financial statements available at the time it files with the Commission as a smaller reporting company.

As proposed, the determination date for calculating a company's public float to establish eligibility for smaller reporting company status would be the same date used to determine accelerated filer status today – the last business day of a company's second fiscal quarter.[43] The public float of a reporting company would be calculated by using the price at which the shares of its common equity were last sold or the average of the bid and asked prices of such shares in the principal market for the shares as of the last business day of the company's second fiscal quarter, multiplied by the number of outstanding shares held by non-affiliates.[44]

With regard to a Securities Act registration statement for an initial public offering of common equity securities, however, a company would calculate its public float as of a date within 30 days of the date it files the initial registration statement. These companies would compute public float by multiplying the aggregate worldwide number of such shares held by non-affiliates before the offering plus the number of such shares included in the registration statement by the estimated public offering price of the shares.[45] The proposed method of calculating public float with regard to a Securities Act registration statement for an initial public offering would operate consistently with the following example:

- Company X has 50,000,000 shares of common stock outstanding;
- Company X has 25,000,000 shares of common stock outstanding that are held by non-affiliates;
- Company X files a Securities Act registration statement for its initial public offering – in that registration statement, Company X registers 7,000,000 shares of common stock to be sold at an estimated offering price of $10 per share; and

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[43] See proposed Item 10(f)(1)(i) of Regulation S-K.

[44] Id.

[45] See proposed Item 10(f)(1)(ii) of Regulation S-K.

- For purposes of the smaller reporting company definition, Company X's "public float" would be $320,000,000 ((25,000,000 shares + 7,000,000 shares) x $10 per share).

Currently, Regulation S-B requires a company preparing an initial public offering of securities to calculate its public float for purposes of determining small business issuer status on the basis of the total number of equity shares outstanding before the offering and the estimated public offering price of the securities. Our proposed change to this rule is intended to more accurately reflect the company's public float by requiring companies to include the number of shares registered to be offered to the public in calculating the public float.

With regard to a company's initial registration statement under the Exchange Act covering a class of securities, the company would calculate its public float as of a date within a 30-day window of the registration statement being filed. Because such an Exchange Act registration statement would not directly affect the issuer's public float, if an issuer that files such an Exchange Act registration statement does not have a public float or its public float cannot be calculated because there is no market price for the issuer's equity securities, the issuer's eligibility for the scaled disclosure and reporting would be based on its revenue.

b. Comparison of the Proposed Standard to the Advisory Committee's Recommendation

The proposal to broaden the number of smaller companies eligible for our scaled disclosure and reporting requirements is consistent with, but not identical to the Advisory Committee recommendation. The Advisory Committee recommended that we make the majority of our smaller company requirements available to companies whose equity market capitalization places them in the lowest 1% of total U.S. market capitalization, which it called "microcap companies." The Advisory Committee indicated that, based on the information it relied upon, the ceiling for that category was $128 million in market capitalization.[46] We have chosen to propose using public float rather than market capitalization to set the ceiling for several reasons:

- The Commission has consistently used public float in this context,[47] rather than market capitalization;
- Each reporting company already is required to disclose its public float on the cover page of its annual report on Form 10-K or Form 10-KSB;
- The use of market capitalization would require us to establish new standards for reporting companies to calculate that information and a new obligation for those companies to disclose that information; and
- The overlap between reporting companies with $128 million in market capitalization and reporting companies with $75 million in public float is approximately 98%.[48]

We have not proposed a standard based on a company's ranking within a specified percentage of total U.S. market capitalization because we believe that such a standard may make the smaller reporting company system unduly complicated and create confusion among both smaller companies and their investors. Our proposal to adjust the $75 million public float and $50 million in revenue ceilings every five years to account for inflation, however, responds to the Advisory Committee's concern that our regulatory metrics should be adjusted in a timely manner to reflect changes in our economy.

The Advisory Committee received numerous comments to the effect that the $25 million

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46 The Advisory Committee relied on data derived from Center for Research in Security Prices (CRSP) for 9,428 New York and American Stock Exchange companies as of March 31, 2005 and from Nasdaq for NASDAQ Stock Market and Over-the-Counter Bulletin Board firms as of June 10, 2005. See Advisory Committee Final Report, at 15 n.36.

47 In our adopting release for public securities offering reform, we provided the historical background for the use of public float as a measure for determining Form S-3 or F-3 eligibility. See Release No. 33-8591, at 26 n.50 (July 19, 2005) [70 FR 148].

48 This estimate was calculated from data obtained from Thomson Financial (Datastream).

public float and revenue standards in Regulation S-B are too low and should be increased to permit a broader range of smaller companies to be eligible for its benefits, particularly in light of the increased costs associated with Exchange Act reporting obligations.[49] A group responding to the Advisory Committee's request for comments on its proposed agenda noted that the $25 million standards resulted in Regulation S-B being available only to the very smallest public companies.[50] This group also expressed the view to the Advisory Committee that, for Regulation S-B to have any meaningful benefit to new and smaller public companies, the threshold needed to be raised to $100 million in both revenue and market capitalization. Another commentator has argued that the standard should be less concerned with market capitalization and more concerned with revenue, which in part indicates the ability of small companies to shoulder the burdens of regulation.[51] The Advisory Committee rejected a revenue-based metric in determining general eligibility for scaling, however, stating that market capitalization should be the primary metric for determining eligibility for scaling regulations and that including revenues would introduce unnecessary additional complexity.[52]

The Advisory Committee recommended that we extend eligibility for scaled disclosure to two tiers of companies – what the Advisory Committee called "microcap companies" and "smallcap companies." More specifically, the Committee recommended that we develop scaled or proportional regulation for companies that qualify as "microcap companies" because their equity market capitalization places them in the lowest 1% of total U.S. market capitalization and

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49 See Advisory Committee Final Report 64 n.132.

50 See Letter from Subcommittee on Smaller Public Companies, Securities Law Committee, Society of Corporate Secretaries & Governance Professionals (June 7, 2005) (on file in Commission Rulemaking File No. 256-23), available at http://www.sec.gov/info/smallbus/acspc.shtml.

51 Paul Rose, Balancing Public Market Benefits and Burdens for Smaller Companies Post Sarbanes-Oxley, 41 Willamette L. Rev. 707, 740 (2005).

52 The Advisory Committee did recommend that we adopt a revenue ceiling for companies to be eligible for certain scaled regulations under Section 404 of the Sarbanes-Oxley Act. See Advisory Committee Final Report 43.

"smallcap companies" because their equity market capitalization places them in the next lowest 1% to 5% of total U.S. equity market capitalization, with the result being that all companies comprising the lowest 6% would be eligible for scaled or proportional regulation.[53] Based on the statistics relied upon by the Advisory Committee, companies with less than $787 million in market capitalization would have been included in the lowest 6% of market capitalization as of March 31, 2005.[54] Our proposals do not extend the scaled disclosure regime or develop another scaled disclosure regime for companies between $75 million and $787 million in market capitalization at this time. We solicit comment below on the appropriateness of scaled disclosure requirements for companies with a public float greater than $75 million.

2. Exclusions from the Definition of "Smaller Reporting Company"

The current definition of "small business issuer" excludes companies that are not organized in the United States or Canada, investment companies, and asset-backed issuers.[55] Under the proposed amendments, all foreign companies that meet the criteria would be able to qualify as smaller reporting companies. Foreign companies could, therefore, take advantage of the scaled standards available to domestic smaller reporting companies if they otherwise qualify for that status and file a form that permits disclosure based on the standards for smaller reporting companies, such as Forms S-1, S-3, S-4, and Forms 10-Q and 10-K. In this regard, the forms available only to "foreign private issuers," such as Form F-1,[56] Form F-3[57], Form F-4,[58] and Form 20-F,[59] would not permit disclosure based on the standards for smaller reporting

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53 See Advisory Committee Final Report 14-19.

54 Id.

55 See Item 10(a)(1)(ii) through (iii) of Regulation S-B.

56 17 CFR 239.31.

57 17 CFR 239.33.

58 17 CFR 239.34.

59 17 CFR 249.220f.

companies.[60] Foreign private issuers who qualify for smaller reporting company status could choose whether to use the domestic forms and be able to provide disclosure based on these standards or to use the "F" forms and comply with the disclosure requirements of those forms.

We propose to continue to exclude investment companies and asset-backed issuers from eligibility for scaled reporting and disclosure regulation. Investment companies are subject to separate disclosure and reporting requirements.[61] Asset-backed issuers have a separate disclosure system that applies to them and do not use Regulation S-K for their disclosure requirements.[62]

Request for Comments

- Should the definition of smaller reporting company include tests based on both public float and revenue? Should the definition contain only a revenue test, rather than the proposed public float test? If the definition contained a revenue test, should the standard be $50 million, $75 million, $100 million, or some other amount? Please explain in detail and provide a reasoned basis for your views.
- Is a public float of less than $75 million the appropriate standard for defining a "smaller reporting company?" Should the public float standard be $50 million, $150 million, or some other amount? Please explain in detail and provide a reasoned basis for your views.
- Is it appropriate to compute public float for an initial public offering by a smaller reporting company by multiplying the aggregate worldwide number of such shares held by non-affiliates before the offering plus the number of shares included in the registration

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60 The term "foreign private issuer" is defined in Securities Act Rule 405 and Exchange Act Rule 12b-2.

61 See, e.g., Form N-1A (17 CFR 239.15A; 274.11A), N-2 (17 CFR 239.14; 274.11a-1), and N-3 (17 CFR 239.17a; 274.11b), the registration forms used by management investment companies to register under the Investment Company Act of 1940, (15 U.S.C. 80a-1 et seq.) and to register their securities under the Securities Act. Business development companies, which are a category of investment companies that are not required to register under the Investment Company Act, register their securities under the Securities Act on Form N-2.

62 See Regulation AB (17 CFR 229.1100 through 229.1123).

statement by the estimated public offering price of the shares? Is it appropriate to permit the calculation of public float on any date within 30 days of a filing?

- Is it appropriate to require companies to estimate the public offering price of the securities before filing an initial registration statement that would qualify them for smaller reporting company status, as has been required in the past under Regulation S-B and as we propose to continue to require? For purposes of calculating the estimated public offering price per share, should we require issuers to rely on the high, low, or mid-point of the price range for the securities?
- Is there an alternative standard that would more accurately calculate a company's public float before it files its initial Securities Act registration statement with the Commission to determine smaller reporting company eligibility? Please provide details and reasoned support for your position.
- Should the definition of smaller reporting company be based on market capitalization, as suggested by the Advisory Committee, rather than public float? If so, should the market capitalization standard be $150 million, $125 million, $100 million, or some other level? Please discuss the benefits and burdens of your suggested standard and provide reasoned support for your position.
- Should a system of scaled or proportional regulation be made available to companies in the lowest 1% of total U.S. market capitalization (less than $128 million as of March 31, 2005) or the lowest 6% of total U.S. market capitalization ($787 million as of March 31, 2005), as suggested by the Advisory Committee? Please provide reasoned support for your position.
- Is the $50 million revenue threshold an appropriate level for companies without a public float or market price, or should the test be $75 million or $25 million in revenue or some

other standard?

- Should any public float and/or revenue ceilings be indexed to adjust for inflation? Should any ceilings be indexed using a different index than the PCECTP Index, the one we propose to use? Please provide details and reasoned support for your position.
- Should the Commission allow asset-backed issuers and investment companies, including business development companies, or business development companies only, to qualify as smaller reporting companies?
- Is it appropriate to permit all non-U.S. companies to qualify for smaller reporting company status?
- Are there companies reporting as small business issuers that have only public debt outstanding and have little or no publicly-held common equity? Are there companies with one or more classes of public debt outstanding but no significant amount of outstanding common equity held by non-affiliates that should qualify as smaller reporting companies? If so, should we permit such companies to qualify as smaller reporting companies on the basis of a revenue test? Does the proposed revenue test meet the needs of smaller companies?
- What benefits would flow to investors if the Commission adopted these proposals? For example, would the possible cost savings for the company provide a net benefit to shareholders? Please provide details and reasoned support for your position.
- If adopted, would these proposals have any negative effect on investors? For example, would investors in companies that have a public float of between \$25 million and \$75 million be harmed if a company chose to provide the disclosure required of a smaller reporting company rather than the disclosure currently required under Regulation S-K? If so, please describe the negative effect in detail, providing data and support where

possible.

B. Integrating Requirements of Current Regulation S-B into Regulation S-K

1. Policy Objectives of Proposal

We have maintained a separate registration, reporting, and qualification system for small business issuers under the Securities Act, Exchange Act, and Trust Indenture Act since 1992.[63] The centerpiece of this system, Regulation S-B, followed the model of Regulation S-K. When adopting Regulation S-B, we incorporated some concepts from Form S-18, which was a simplified registration form for smaller companies under the Securities Act that we replaced with Forms SB-1 and SB-2.[64]

Regulation S-B was designed to provide small business issuers with a single source for their SEC disclosure requirements. Our objectives in adopting a disclosure system for smaller companies were to reduce compliance costs while maintaining adequate investor protection, to improve the ability of start-ups and other small businesses to obtain financing through the public capital markets, and to encourage those companies to provide their investors with the benefits of trading in those markets.[65]

We propose to integrate the substantive provisions of Regulation S-B into Regulation S-K for a number of reasons. We believe integration will simplify regulation for small business and lower costs. The current dual system scheme is complex, and we believe this complexity may deter smaller companies from taking advantage of scaled regulation. We also are aware of anecdotal reports that securities lawyers recommend against using the Regulation S-B system because it results in increased legal costs. The Advisory Committee, in recommending that we

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63 See Release No. 33-6949 (Jul. 30, 1992) [57 FR 36442].

64 See Release No. 33-6949 (Jul. 30, 1992) [57 FR 36442] and Release No. 33-6924 (Mar. 20, 1992) [57 FR 9768].

65 See Release No. 33-6924.

integrate the scaled disclosure requirements available to small business issuers into Regulation S-K and make them available to microcap companies, heard testimony that Regulation S-B was not used for two principal reasons. The first reason is that lawyers assert that they cannot use prior examples of filings involving companies that are not relying on Regulation S-B. The second reason is that the lawyers must maintain expertise in two different disclosure systems.[66] Maintaining two separate but largely similar systems also results in increased burdens on the Commission staff.

Request for Comments

- Assuming we should revise Regulation S-B, should we do so in some way other than integrating its substantive provisions into Regulation S-K? Please be as specific as possible with your comments.
- Might integrating our two disclosure systems make it more difficult to maintain scaled securities regulation for smaller companies? How should we maintain scaled regulation over time? Please provide opposing or supporting views and clearly explain the bases for your views.
- Will this proposal simplify the disclosure obligations of smaller companies? Please provide details to support your view.
- If these proposals are adopted, would smaller companies experience lower costs for legal assistance and other services?
- If adopted, would these proposals have any effect on investors, either positive or negative? Please provide a detailed explanation of your views, with supporting data if possible.

[66] See Advisory Committee Final Report 64.

2. Specific Integration Proposals

a. Financial Statements

We propose to add a new Item 310 (Financial Statements of Smaller Reporting Companies) to Regulation S-K to set forth the alternative requirements on form and content of financial statements for smaller companies that now appear in Item 310 of Regulation S-B. Item 310 of Regulation S-B constitutes perhaps the most significant example of scaling for smaller companies in all of Regulation S-B, as it bases the requirements on form, content, and preparation of financial statements for smaller companies solely on generally accepted accounting principles ("GAAP"). It does not require smaller companies to conform their financial statements to the Commission's Regulation S-X.[67] Item 310 of Regulation S-B allows smaller companies to provide an audited balance sheet for the latest fiscal year only and audited statements of income, cash flows, and changes in stockholders' equity for each of the latest two fiscal years only, rather than an audited balance sheet for the latest two fiscal years and audited statements of income, cash flows, and changes in stockholders' equity for each of the latest three fiscal years, as required in Regulation S-X. Item 310 of Regulation S-B also differs from Regulation S-X in its requirements for historical and pro forma financial statements for significant acquired businesses, the maximum age of financial statements, and limited partnerships.[68]

We propose one substantive change in Item 310 that would differentiate it from the current Item 310 in Regulation S-B. Currently, in Note 2 preceding the Item, foreign private issuers are permitted to prepare and present financial statements in accordance with Item 17 of Form 20-F. Item 17 of Form 20-F allows an issuer to provide alternative financial statements

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[67] See Rule 1.01 of Regulation S-X (17 CFR 210.1-01).

[68] The requirements of Item 310 of Regulation S-B were consistent with the requirements of Form S-18, which governed the form and content of financial statements of smaller companies choosing to use that form before

prepared according to a comprehensive body of accounting principles other than those generally accepted in the United States if certain conditions are met. Regulation S-B currently is available only to U.S. and Canadian issuers, so permitting non-U.S. GAAP for Canadian foreign private issuers was a modest adjustment in terms of the number of companies eligible to use this adjustment. Because we propose to expand the definition of smaller reporting company to include all foreign companies, we do not feel that non-U.S. GAAP financial statements would be appropriate for a larger number of issuers. Therefore, we propose that foreign issuers who elect to use Item 310 disclosure for smaller reporting companies be required to present financial statements pursuant to U.S. GAAP. Currently, all financial statements in registration statements that may be used by domestic issuers, other than Canadian small business issuers using Forms SB-1 and SB-2, are required to conform to U.S. GAAP.[69]

Request for Comments

- Should the Commission incorporate the requirements on form and content of financial statements of smaller companies now in Item 310 of Regulation S-B into Regulation S-X, as proposed? Should the Commission modify proposed Item 310 in any way?
- Is it appropriate to require U.S. GAAP for foreign private issuers and other foreign issuers who take advantage of the smaller reporting company requirements? Or is the option of filing a registration statement on Form 20-F an acceptable alternative? What effect, if any, will this have on foreign private issuers?
- The Advisory Committee believed that a second year of audited balance sheet data would provide investors with a basis for comparison with the current period, without

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Regulation S-B was adopted in 1992. See Release No. 33-6949 (Jul. 30, 1992) [57 FR 36442].

69 As noted previously, foreign private issuers may use the forms and disclosure standards available only for such issuers.

substantially increasing audit costs.[70] Should we consider following the Advisory Committee recommendation to require smaller reporting companies to provide two years of audited balance sheet data in annual reports and registration statements?

b. Proposed Changes to Other Regulation S-K Disclosure Items

As a general rule, we propose to integrate the individual Regulation S-B disclosure items (other than Item 310 as discussed immediately above) into Regulation S-K. To do this, we propose to add a new paragraph to each item of Regulation S-K that will contain separate disclosure standards for smaller reporting companies, to the extent that a particular item permits such disclosure.[71] To ease navigation, each new paragraph would have a heading reading "Smaller reporting companies," so readers can easily find the requirements tailored for smaller reporting companies. At this time, we do not propose any major substantive changes to the items that we are moving from Regulation S-B into Regulation S-K. Where the disclosure standards of identically numbered items in Regulation S-B and Regulation S-K are substantially the same for smaller reporting companies and larger companies, we propose no change to the existing Regulation S-K disclosure items.[72] We discuss our proposed treatment of specific Regulation S-K disclosure items below.

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70 See Advisory Committee Final Report 65-66.

71 We propose to add the new paragraphs at the end of items in Regulation S-K as they exist today. If we add additional paragraphs to items of Regulation S-K in the future, we may or may not move the smaller reporting company paragraph to the end of the item at that time.

72 We propose no changes to the following items of Regulation S-K because the disclosure standards are currently substantially the same: Item 102 (Description of Property), Item 103 (Legal Proceedings), Item 202 (Description of Registrant's Securities), Item 304 (Changes In and Disagreements with Accountant on Accounting and Financial Disclosure), Item 307 (Disclosure Controls and Procedures), Item 308 (Internal Control Over Financial Reporting), Item 308T (Internal Control Over Financial Reporting), Item 401 (Directors, Executive Officers, Promoters and Control Persons), Item 403 (Security Ownership of Certain Beneficial Owners and Management), Item 405 (Compliance with Section 16(a) of the Exchange Act), Item 406 (Code of Ethics), Item 501(Forepart of Registration Statement and Outside From Cover Page of Prospectus), Item 502 (Inside Front and Outside Back Cover Pages of Prospectus), Item 505 (Determination of Offering Price), Item 506 (Dilution), Item 507 (Selling Security Holders), Item 508 (Plan of Distribution), Item 509 (Interest of Named Experts and Counsel), Item 510 (Disclosure of Commission Position on Indemnification for Securities Act Liabilities), Item 511 (Other Expenses of Issuance and Distribution), Item 701 (Recent Sales of

Item 101 (Description of Business). We propose to add a new paragraph (h) to Item 101 of Regulation S-K to set forth the alternative disclosure standards for smaller companies that appear now in Item 101 of Regulation S-B. Under Item 101 of Regulation S-B, smaller companies are required to provide a description of their business that is less detailed than the description that larger companies provide and to disclose business development activities for only three years, instead of the five-year disclosure required of larger companies by Item 101 of Regulation S-K.

Item 201 (Market Price of and Dividends on Registrant's Common Equity and Related Stockholder Matters). We propose only a minor change in wording to this item because Instruction 6 to paragraph (e) of Item 201 of Regulation S-K currently contains a provision permitting smaller companies to use the alternative disclosure standards of Regulation S-B when preparing documents under Regulation S-K. Therefore, no substantive change is necessary. We propose to replace the reference to a "small business issuer" with a reference to a "smaller reporting company" and add a heading to Instruction 6.

Items 301 (Selected Financial Data) and 302 (Supplementary Financial Information). Regulation S-B currently does not require smaller companies to disclose Item 301 (Selected Financial Data) or Item 302 (Supplementary Financial Information) data. We therefore propose to add a new paragraph (c) to Items 301 and 302 in Regulation S-K, providing that smaller reporting companies are not required to present the information required by these items.

Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations). We propose to add a new paragraph (d) to Item 303 of Regulation S-K to reflect the alternative disclosure standards for smaller companies now in Item 303 of Regulation S-B. Regulation S-B provides more streamlined disclosure requirements for a smaller company's

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Unregistered Securities; Use of Proceeds from Registered Securities), Item 702 (Indemnification of Directors management to present its discussion and analysis of the company's financial condition and results of operations. It requires only two years of analysis if the company is presenting only two years of financial statements instead of the three years of analysis required of larger companies as required in Regulation S-X. Further, Regulation S-B does not require smaller companies to provide tabular disclosure of contractual obligations, as required for companies reporting under Item 303(a)(5) of Regulation S-K.[73]

Item 305 (Quantitative and Qualitative Disclosures about Market Risk). Regulation S-B currently does not require smaller companies to disclose Item 305 (Quantitative and Qualitative Disclosures about Market Risk) information. We therefore propose to add a new paragraph (e) to Item 305 of Regulation S-K providing that smaller reporting companies are not required to respond to this item.

Item 402 (Executive Compensation). We propose to add a new paragraph (l) to Item 402 of Regulation S-K to add the alternative standards for smaller reporting companies for disclosure of compensation of executives and directors now in Item 402 of Regulation S-B. Under Item 402 of Regulation S-B, a smaller company is allowed to provide executive compensation disclosure for only three officers, rather than the five required under Item 402 of Regulation S-K, and Summary Compensation Table disclosure for only two years, rather than the three years required under Regulation S-K. A smaller company does not need to provide a Compensation Discussion and Analysis, is required to provide only three of the seven tables prescribed by Item 402 of Regulation S-K, and is required to provide alternative narrative disclosures. In the Director Compensation Table, a smaller company need not include footnote disclosure of the

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and Officers), and Item 703 (Purchases of Equity Securities by the Issuer and Affiliated Purchasers).

73 17 CFR 229.303(a)(5).

grant date fair value of equity awards, given that no corresponding Grants of Plan-Based Award Table disclosure for named executive officers of smaller companies is required.[74]

Item 404 (Transactions with Related Persons, Promoters and Certain Control Persons).

We propose to add a new paragraph (d) to Item 404 of Regulation S-K to add the alternative standards for disclosure of related person transactions now available to smaller companies in Item 404 of Regulation S-B. A smaller reporting company would not be required to disclose policies and procedures for approving related person transactions, which is required of other companies under paragraph (b). Item 404 of Regulation S-B requires disclosure regarding transactions where the amount exceeds the lesser of 1% of a smaller company's total assets or $120,000. Companies using Regulation S-K are required to disclose information only about transactions above $120,000 in amount. As such, for smaller companies with an asset level such that 1% of its assets would equal a dollar amount lower than $120,000, related person disclosure under Item 404 is more rigorous than for larger companies. Further, smaller companies are required to disclose additional specific information about underwriting discounts and commissions and corporate parents. We propose, however, to change the calculation of total assets for smaller reporting companies from 1% percent of their total assets based on the average of total assets at year end for the last three completed fiscal years to the last two completed fiscal years. This standard is more consistent with the two years of financial statements required of smaller reporting companies in the filings containing these disclosures.

Item 407 (Corporate Governance). We propose to add a new paragraph (g) to Item 407 of Regulation S-K to add the corporate governance disclosure standards now available to smaller companies in Item 407 of Regulation S-B. Smaller reporting companies would not be required to provide Compensation Committee Interlock and Insider Participation disclosure or a

[74] See Release No. 8732A (Aug. 8, 2006) [71 FR 53158] and Release No. 33-8765 (Dec. 22, 2006) [71 FR

Compensation Committee Report. In addition, smaller reporting companies would not be required to provide an Audit Committee Report until the first annual report after their initial registration statement is filed with the Commission.

Item 503 (Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges). We propose to add a new paragraph (e) to Item 503 of Regulation S-K to add the alternative standards for disclosure now available to smaller companies in Item 503 of Regulation S-B. Item 503 of Regulation S-B does not require smaller companies to provide the information required by paragraph (d) of Item 503 regarding the ratio of earnings to fixed charges when a registrant issues debt, or the ratio of combined fixed charges and preference dividends to earnings when a registrant issues preference equity securities.

Item 504 (Use of Proceeds). We propose no change to the primary text of Item 504 of Regulation S-K because the disclosure standards of Regulation S-K and Regulation S-B currently are substantially the same. We propose a minor change to the instructions to the item, however, to clarify that new Item 310 of Regulation S-K, rather than Regulation S-X, will govern whether financial statements of businesses proposed to be acquired are to be included in the filings of smaller reporting companies relying on Item 310 of Regulation S-K rather than Regulation S-X. We recognize that the instructions to Item 504 in Regulation S-K are more specific than and more than twice as long as those in Item 504 of Regulation S-B. We do not propose to substitute the shorter instructions of Regulation S-B for smaller reporting companies complying with Item 504 because we do not regard the longer instructions as necessarily more burdensome or not scaled to the needs of smaller companies.

Item 512 (Undertakings). We propose to add a new paragraph (m) to Item 512 of Regulation S-K to add the alternative standards for disclosure now available to smaller

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companies in Item 512 of Regulation S-B. Item 512 of Regulation S-B does not require smaller companies to provide the information about asset-backed securities, foreign private issuers, and trust indenture offerings now required by Regulation S-K.

Item 601 (Exhibits). We propose to add a new paragraph (c) to Item 601 of Regulation S-K to incorporate the standards currently in Item 601 of Regulation S-B. The paragraph would clarify that a smaller reporting company is not required to provide Exhibit 12 (Statements re Computation of Ratios) unless it discloses one of the ratios discussed in the requirement upon the registration of debt or preference equity securities. The paragraph also would clarify that, for purposes of Exhibit 7 (Correspondence from an Independent Accountant Regarding Non-Reliance on a Previously Issued Audit Report or Completed Interim Review), new Item 310 of Regulation S-K, rather than Regulation S-X, may govern the form, content, and preparation of financial statements provided by a smaller reporting company. Our proposal also would revise Item 601 of Regulation S-K to delete references to several "SB" forms and to Regulation S-B, all of which would be deleted from our rules and regulations.

Request for Comments

- Would a different format in the proposed integrated Regulation S-K more clearly identify the provisions that are different for smaller reporting companies?
- Is the proposed Item 101 (Description of Business) requirement adequate for most smaller reporting companies? Please be as specific as possible and provide details to support your position.
- Should the Commission consider requiring smaller reporting companies to provide tabular disclosure of contractual obligations required in paragraph (5) of Regulation S-K Item 303? Would this disclosure provide meaningful information for investors or would it be overly burdensome for smaller reporting companies?

- Should smaller reporting companies be required to fully comply with any other items of Regulation S-K to which we do not propose to subject them?
- Are there any other provisions in current Regulation S-B that should be carried over for smaller reporting companies into Regulation S-K that we have not proposed to be carried over?
- Conversely, are any of the current Regulation S-B items that we propose to carry over inappropriate for the larger group of companies we propose to define as smaller reporting companies?

c. A La Carte Approach

We propose to allow a company that qualifies as a smaller reporting company to choose, on an item-by-item or "a la carte" basis, to comply with either the scaled disclosure requirements made available in Regulation S-K for smaller reporting companies or the disclosure requirements for other companies in Regulation S-K, when the requirements for other companies are more rigorous.[75] A smaller reporting company would have the option to take advantage of the smaller reporting company requirements for one, some, all or none of the items, at its election, in any one filing, in such cases. We would require, however, that a smaller reporting company provide its financial statements on the basis of either Item 310 of Regulation S-K or Regulation S-X for an entire fiscal year, and not be permitted to switch back and forth from one to the other in different filings within a single fiscal year. If this approach is adopted, we would expect that our staff, in reviewing filings of smaller reporting companies, would be instructed to evaluate item-by-item compliance only with the Regulation S-K requirements applicable to smaller reporting companies, and not with the requirements applicable to larger companies, even if the company

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[75] As proposed, Item 404 would be the only disclosure requirement in Regulation S-K that would be more rigorous for smaller reporting companies than for other companies.

whose filing is being reviewed chooses to comply with the larger company requirements.[76] The staff also would continue to seek clarity in disclosure provided by smaller reporting companies.

Our objective in proposing the "a la carte" approach is to provide maximum flexibility for smaller reporting companies without disadvantaging investors. While establishing a baseline of required disclosure, we want to encourage smaller reporting companies to determine for themselves the proper balance and mix of disclosure for their investors within the boundaries of the law, given the costs of compliance and the market demand for information.

We propose to add a check box to the cover page of all filings in which smaller reporting companies may take advantage of the alternative disclosure requirements. The check box would require smaller reporting companies to indicate that they are eligible for "Smaller Reporting Company" status. Investors and others reviewing the filing would be able to tell from the check box that the disclosing company is eligible to comply with the scaled disclosure available to smaller reporting companies.

In proposing to require smaller reporting to companies to check a box identifying themselves as such on the cover page of their filings, we are attempting to strike the appropriate balance among investor protection, transparency, and the legitimate needs of smaller companies. We are aware that, as discussed by the Advisory Committee, a major reason our current Regulation S-B system has not worked as well as intended is that it requires filing on "SB" forms that may not have achieved an optimal level of market acceptance.[77] By requiring a company to check a box on the front of its filings, we are trying to address the legitimate needs of investors who may want to know if a company is eligible to comply with standards scaled for smaller companies. We are attempting, however, to avoid unduly stigmatizing smaller companies. We

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[76] These proposals would have no effect on the legal requirements and liabilities that would continue to apply to all disclosures made by issuers.

[77] See Advisory Committee Final Report 63-64.

believe that, if we have scaled our disclosure and reporting requirements to properly reflect the characteristics of smaller companies, investors will be adequately protected by our rules and should not be unduly concerned that a company may be providing information under a different, scaled standard.

Request for Comments

- Should the Commission adopt the a la carte approach, allowing smaller reporting companies to take advantage of the adjusted disclosure requirements available to them on an item-by-item basis?
- Have smaller companies filing on "SB" forms not achieved greater market acceptance because investors believe that the disclosure required by Regulation S-K is valuable? Please provide a detailed explanation and a reasoned basis for your view.
- Does the proposal to scale disclosure for smaller reporting companies strike the proper balance between imposing proportional costs and burdens on smaller reporting companies while adequately protecting investors?
- Should the Commission adopt an approach requiring smaller reporting companies to comply with all disclosure requirements for larger companies if they elect to comply with any of those requirements? Should we require smaller reporting companies that choose to no longer follow the disclosure requirements for larger companies to separately disclose that change?
- Is the Commission creating a situation in which newly eligible companies could selectively choose not to disclose information that may be beneficial to investors?
- Does requiring smaller reporting companies to check a box indicating their "Smaller Reporting Company" status on the cover page of filings unduly penalize or stigmatize

smaller reporting companies? Is a check box necessary for investor protection? Is another alternative preferable to a check box?

- Should the proposal require a smaller reporting company to check the box only if it is choosing to comply with at least one item in Regulation S-K scaled for smaller reporting companies, rather than requiring all eligible companies to check the box even if they choose not to comply with any scaled items?
- What should be the impact on a smaller reporting company that attempts to satisfy the disclosure requirements of larger companies but fails to satisfy those requirements? Please provide details to support your views.
- Instead of a check box indicating the size of the company, would it be preferable to have check boxes or some other form of identification indicating what smaller reporting company items the company has relied upon in preparing its filing?
- How would the a la carte approach affect the ability of investors to compare disclosures of smaller reporting companies?

d. Eliminating "SB" Forms

We anticipate that the elimination of forms associated with Regulation S-B (Forms 10-SB, 10-QSB, 10-KSB, SB-1, and SB-2) will result in regulatory simplification by mainstreaming smaller reporting company filers into the Regulation S-K framework. We anticipate that legal practitioners, accountants, and other individuals preparing disclosure forms will appreciate the convenience of referring to only one set of disclosure requirements.

The Advisory Committee noted that elimination of the "SB" forms would reduce the complexity of federal securities regulations. The Advisory Committee recognized that the drawbacks associated with Regulation S-B included a lack of acceptance of "SB" filers in the marketplace.[78] Also, North American Securities Administrators Association officials representing state securities regulators have commented that small businesses issuing securities were especially vulnerable to loss of investor confidence if some issuers "poisoned the well" with material misstatements.[79]

The elimination of the forms associated with Regulation S-B would result in most smaller reporting companies using Securities Act Form S-1 to offer securities to the public. Since 2005, an issuer using Form S-1 that is subject to the requirement to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act may be permitted to incorporate by reference its previously filed Exchange Act reports if it has filed an annual report for its most recently completed fiscal year, has filed all reports and other materials required to be filed by Sections 13(a), 14, or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and makes available all incorporated materials on its Web site.[80] We believe that this ability to incorporate previously filed reports by reference would result in some cost savings and efficiencies in preparing registration statements for smaller reporting companies.

It is our intention that the integration of the disclosure standards of Regulation S-B into Regulation S-K will mitigate the reported lack of market acceptance associated with smaller filers. As one commentator has explained, it is not enough to establish that small business should at times be treated separately from larger business; the manner in which the distinction is made is equally important, "for a misguided partition may be worse than no partition at all."[81] We expect that adoption of our proposal to eliminate the forms associated with Regulation S-B

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78 Id.

79 U.S. General Accounting Office, Small Business: Efforts to Facilitate Equity Capital Formation 190 (2000).

80 See Release No. 33-8591 (Jul. 19, 2005) [70 FR 44722].

81 See Larry T. Garvin, Small Business and the False Dichotomies of Contract Law, 40 Wake Forest L. Rev. 295, 373 (2005).

will further our goals of eliminating unwarranted negative perceptions of the smaller reporting company disclosure regime.

Request for Comments

- Is it appropriate to eliminate all "SB" forms associated with Regulation S-B?
- Should we maintain some or all of the "SB" forms, even if we integrate the provisions of Regulation S-B into Regulation S-K?
- If adopted, would elimination of the "SB" forms provide significant benefits to legal practitioners, accountants, and other individuals preparing disclosure for smaller companies? Would there be any impact on investors? Please provide details to support your views.

e. Transition to and from Smaller Reporting Company Status

As discussed above, we propose to significantly expand eligibility for smaller company scaled regulation by combining our two current smaller company regulatory categories, "small business issuer" and "non-accelerated filer," into a new category called "smaller reporting company." These companies would have their own eligibility standards and rules for transitioning up to a category of larger companies once a company exceeds the limitations for the smaller reporting company designation. In addition, each category of larger companies has rules for transitioning down to a smaller company category. This ordinarily would occur if the company drops below the ceiling marking the boundary between the smaller and larger company categories.

Currently, a small business issuer that exceeds the $25 million revenue and $25 million public float standards for that status at the end of two consecutive fiscal years must transition out of small business issuer status, effective immediately for filings covering events and completed fiscal periods in the next fiscal year. A non-accelerated filer ceases to qualify for that status and must transition to accelerated filer status in the next fiscal year after its public float first rises above $75 million as of the last business day of its most recently completed second fiscal quarter.[82] For smaller reporting companies, we propose to follow the transition model currently used to determine "accelerated filer" status. Under our proposal, smaller reporting companies would lose eligibility to claim that status in the first fiscal year following a fiscal year in which the smaller reporting company's public float rises above $75 million as of the last business day of the second fiscal quarter.[83]

We also propose to follow the accelerated filer model in establishing rules for companies to transition to smaller reporting company status. Under our current rules, a reporting company may transition to small business issuer status in the next fiscal year if its public float and revenue fall below $25 million at the end of two consecutive fiscal years.[84] An accelerated filer may transition to non-accelerated filer status in the next fiscal year if its public float falls below $50 million as of the last business day of the company's second fiscal quarter. We propose that a reporting company that does not file reports claiming smaller reporting company status be required to transition to that status in the next fiscal year if its public float falls below $50 million as of the last business day of the company's second fiscal quarter.[85]

Where an issuer does not have a public float or no public market for its common equity securities exists and it has less than $50 million in revenue, we propose to allow it to use the scaled disclosure item requirements until it exceeds $50 million in annual revenue. Once an

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82 Exchange Act Rule 12b-2 (paragraph (3)(i) of the definition of "accelerated filer") provides:

> The determination at the end of the issuer's fiscal year for whether a non-accelerated filer becomes an accelerated filer, or whether a non-accelerated filer or accelerated filer becomes a large accelerated filer, governs the deadlines for the annual report to be filed for that fiscal year, the quarterly and annual reports to be filed for the subsequent fiscal year and all annual and quarterly reports to be filed thereafter while the issuer remains an accelerated filer or large accelerated filer.

83 See proposed Item 10(f) of Regulation S-K.

84 See Item 10 of Regulation S-B.

85 See proposed Item 10(f) of Regulation S-K.

issuer fails to qualify for smaller reporting status under the revenue test, it would remain unqualified unless its annual revenues fall below $40 million during the previous fiscal year.

The determination as to whether a company qualifies for smaller reporting company treatment would be made at the beginning of a fiscal year on the basis of the information in a quarterly report on Form 10-Q or an initial registration statement under the Securities Act or Exchange Act, whichever is the first to be filed during that year. If an issuer that qualified on the basis of revenue develops a public float or its public float increases during the year, the issuer would remain a smaller reporting company for the entire fiscal year.

Our purpose in proposing these transition rules is to provide both predictability and flexibility to smaller companies, while at the same time assuring that investors have access to the appropriate level of disclosure. We do not wish to have the rules under which a smaller company is reporting change too frequently. It also is our intention to provide smaller reporting companies with the ability to take advantage of scaled regulation in the appropriate circumstances.

Request for Comments

- Should the transition rules to and from smaller reporting company status be more similar to the current transition rules for small business issuer status?
- Should we provide a two-year test period, rather than a single determination date, for transitioning from smaller reporting company status, as is the case for transitioning from small business issuer status today?
- Should the Commission consider a threshold other than $50 million in public float to transition into smaller reporting company status? Should we set the public float level for transitioning into smaller reporting company status at $40 million, $60 million, $75 million, or some other level?

- Is there a better way for smaller reporting companies to transition to or from that status? Please be as specific as possible and provide details with your comments.

f. Eliminating Transitional Small Business Issuer Format

As part of the adoption of Regulation S-B, and later additional small business initiatives, the Commission developed a transitional registration statement, Form SB-1, and annual report, Form 10-KSB, allowing disclosure based on Model A or B found in Regulation A.[86] The Commission allowed the question-and-answer format for small business issuers to make an easy transition from a non-reporting company to a reporting company under the Securities Act or Exchange Act. A small business issuer may use this transitional disclosure format until it:

- registers more than $10 million under the Securities Act in any continuous 12-month period, other than on a Form S-8;
- elects to graduate to a non-transitional disclosure system; or
- is no longer a small business issuer.

The number of companies that registered on Form SB-1 and followed the transitional disclosure format within Form 10-KSB has declined over time. During the past five years, the Commission has received only 56 Form SB-1 registration statements.[87] The number of companies that file their Form 10-KSB using the transitional disclosure format is also small. For the calendar years 2000 to 2005, two small business issuers out of 56 filed a Form 10-KSB using the transitional disclosure format.

Because the transitional disclosure format is not commonly understood and infrequently used, we propose to eliminate this disclosure option. Accordingly, smaller reporting companies

86 The transitional registration statement and annual report on Form 10-KSB allow some small business issuers to provide alternative disclosure. The Commission also allowed some small business issuers to provide Regulation A model disclosure on Form SB-1 to raise up to $10 million of securities in a continuous 12-month period. See Release No. 33-6949; see also Release No. 33-6996 (Apr. 28, 1993) [58 FR 26509].

87 We calculated the number of Forms SB-1 filed by adding those received from 2002 through 2006.

no longer would have the option to use Form SB-1 and the transitional format version of Form 10-KSB. Instead, they would use Form S-1 and 10-K. Our proposal would remove all references to transitional filer status, including removing paragraph 4 of General Instruction D in Form S-4, the Note to Small Business Issuers in Rules 14a-3 and 14c-3, and General Instructions G in Schedule 14A. We are not proposing to alter the disclosure format permitted in Regulation A offerings on Form 1-A.

Request for Comments

- Should the Commission maintain the transitional disclosure format option? If so, please indicate the reasons why the option should be maintained.

g. Other Proposals

We also are soliciting suggestions for additional ways in which we could better scale our disclosure and reporting requirements to the needs of smaller companies and their investors. All suggestions that ease the burdens of smaller companies without compromising investor protection are welcome.

We also propose several minor and technical amendments to our rules and forms to conform them to the regulatory changes we propose today. Most of these amendments are deletions of references to Regulation S-B or a small business issuer rule and substitutions of references to Regulation S-K. In a few instances, we propose to amend rules to reflect the Commission's current address of 100 F Street, NE, Washington, DC 20549.

Request for Comments

- Are there additional ways in which we could better scale our disclosure and reporting requirements to the needs of smaller reporting companies and their investors, while continuing to take investor protection into account? Please be as specific as possible and provide detailed support for your suggestions.

III. General Request for Comments

We request and encourage any interested person to submit comments on any aspect of our proposals and any of the matters that might have an impact on the proposed amendments. We request comment from investors and companies that may be affected by the proposals. We also request comment from service professionals, such as law and accounting firms, and facilitators of capital formation, such as underwriters and placement agents, and other regulatory bodies, such as state securities regulators. We are especially interested in comments from service professionals that regularly work with smaller reporting companies. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiatives if accompanied by supporting data and analysis of the issues addressed and by alternatives to our proposals where appropriate.

IV. Paperwork Reduction Act

A. Background

The proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.[88] We are submitting a request for approval of the proposed amendments to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act and its implementing regulations.[89] The titles of the collections of information are:[90]

(1) "Regulation S-B" (OMB Control No. 3235-0417);

(2) "Regulation S-K" (OMB Control No. 3235-0071);

(3) "Regulation C" (OMB Control No. 3235-0074);

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88 44 USC 3501 et seq.

89 44 USC 3507(d); 5 CFR 1320.11.

90 The paperwork burden from Regulation S-K and S-B is imposed through the forms that are subject to the requirements in those regulations and is reflected in the analysis of those forms. To avoid a Paperwork

(4) "Form SB-1" (OMB Control No. 3235-0423);

(5) "Form SB-2" (OMB Control No. 3235-0418);

(6) "Form S-1" (OMB Control No. 3235-0065);

(7) "Form S-3" (OMB Control No. 3235-0073);

(8) "Form S-4" (OMB Control No. 3235-0324);

(9) "Form S-8" (OMB Control No. 3235-0066);

(10) "Form S-11" (OMB Control No. 3235-0067);

(11) "Form 1-A" (OMB Control No. 3235-0286);

(12) "Form 10" (OMB Control No. 3235-0064);

(13) "Form 10-SB" (OMB Control No. 3235-0419);

(14) "Form 10-K" (OMB Control No. 3235-0063);

(15) "Form 10-KSB" (OMB Control No. 3235-0420);

(16) "Form 8-K" (OMB Control No. 3235-0060);

(17) "Form 8-A" (OMB Control No. 3235-0056);

(18) "Form 10-Q" (OMB Control No. 3235-0070);

(19) "Form 10-QSB" (OMB Control No. 3235-0416);

(20) "Form 11-K" (OMB Control No. 3235-0082); and

(21) "Form SE" (OMB Control No. 3235-0327).

We adopted all of the existing regulations and forms pursuant to the Securities Act, the Exchange Act, and the Trust Indenture Act. These regulations and forms set forth the disclosure requirements for annual, periodic, and current reports and registration statements that are prepared by issuers to provide investors information to make informed investment decisions in registered offerings of securities and in secondary market transactions.

Reduction Act inventory reflecting duplicative burdens and for administrative convenience, we assign a one-

Our proposed amendments to existing forms and regulations and the proposed elimination of Regulation S-B, Form SB-1, Form SB-2, Form 10-SB, Form 10-KSB, and Form 10-QSB are intended to:

- make proportional and scaled disclosure options available to a larger number of smaller companies;
- promote regulatory simplification; and
- integrate current Regulation S-B disclosure requirements for smaller companies into disclosure requirements of Regulation S-K.

These proposed amendments are intended to result in regulatory simplification for a greater number of entities that would be eligible for scaled disclosure item requirements. These proposals should not increase the disclosure requirements for any registrant, but will require some registrants to file different forms than they currently use. These proposals do not affect any disclosure requirements for any company with a public float over $75 million.

The hours and costs associated with preparing disclosure, filing information required by forms, and retaining records constitute reporting and cost burdens imposed by collection of information requirements. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid control number.

The information collections related to annual, periodic, and current reports and registration statements would be mandatory for larger reporting companies; some of the requirements, however, would be voluntary for smaller reporting companies.

hour burden to Regulations S-K and S-B.

B. Summary of Information Collections

Our proposals would amend the forms listed above as collections of information but focus primarily on the forms discussed below.

The proposals would increase existing collection of information total burden estimates for reports on Form 10-K and Form 10-Q as well as registration statements on Form 10, Form S-1, and Form S-11 for the following reasons:

- the elimination of Form 10-KSB would cause an increase in the number of companies that are required to file an annual report on Form 10-K;[91]
- the elimination of Form 10-QSB would cause an increase in the number of companies that are required to file quarterly reports on Form 10-Q;[92]
- the elimination of Form SB-1 would cause an increase in the number of registration statements filed on Form S-1;[93]
- the elimination of Form SB-2 would cause an increase in the number of registration statements filed on Form S-1;[94] and
- the elimination of Form SB-2 would cause real estate companies that had previously used that form to use Form S-11 instead, thereby increasing the number of registration statements filed on Form S-11.[95]

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91 We estimate that approximately 3,504 small business issuers would file their annual reports on Form 10-K, rather than Form 10-KSB.

92 We estimate that approximately 11,299 reports on Form 10-QSB that were filed in the last fiscal year would be filed on Form 10-Q.

93 We estimate that approximately 24 registration statements in the last fiscal year were filed on Form SB-1 and would be required to be filed on Form S-1.

94 We estimate that approximately 1,028 registration statements were filed on Form SB-2 in the last fiscal year and that the number of Form S-1 registration statements would increase by the same number.

95 We estimate that approximately 15 registration statements were filed on Form SB-2 in the last fiscal year covering real estate transactions that would be required to be registered on Form S-11 if these proposals were adopted.

At the same time, the proposals would decrease existing collection of information total burden estimates for annual reports on Form 10-KSB, quarterly reports on Form 10-QSB, and registration statements on Form 10-SB, Form SB-1, and Form SB-2 by:

- eliminating Form SB-1, Form SB-2, Form 10-SB, Form 10-KSB, and Form 10-QSB and integrating the disclosure requirements of Regulation S-B into Regulation S-K, thereby simplifying the disclosure requirements by combining them into one regulation.

In addition, the proposals may decrease existing collection of information total burden estimates, or not affect them at all, for some reports filed on Form 10-K and Form 10-Q and some registration statements on Form 10, Form S-1, and Form S-11, depending on the company's particular circumstances, by:

- replacing the definition of small business issuer with a broader category of smaller reporting companies comprised of most non-accelerated filers with a public float between $25 million and $75 million, and providing these smaller reporting companies with the option of scaled disclosure;
- allowing smaller reporting companies to provide a three-year discussion of their business development (Item 101), rather than five years as required of larger companies;
- allowing smaller reporting companies to provide more streamlined disclosure for management's discussion and analysis of financial condition and results of operations (Item 303) by requiring two years of analysis if the company is presenting only two years of financial statements rather than three years as required of larger companies. Further, smaller reporting companies would not

have to provide tabular disclosure of contractual obligations as required for larger companies under Item 303(a)(5);

- allowing smaller reporting companies to provide an audited balance sheet for the most recent fiscal year and audited statements of income, cash flows, and changes in stockholders' equity for each of the latest two fiscal years rather than an audited balance sheet for the latest two fiscal years and audited statements of income, cash flows and changes in stockholders' equity for each of the latest three fiscal years as required by Regulation S-X for larger companies;
- allowing smaller reporting companies to provide information about the chief executive officer and two other highly compensated executive officers (Item 402), rather than information about the chief executive officer, chief financial officer, and three other highly compensated executive officers as required for larger companies and to provide only a summary compensation table, an outstanding equity awards table, and a director compensation table, rather than the seven tables required for larger companies. Furthermore, a smaller reporting company would not be required to provide a Compensation Discussion and Analysis, as required of larger companies; and
- allowing smaller reporting companies to disclose related person transactions that exceed the lower of 1% of their total assets or $120,000 in amount. In this instance, a smaller reporting company for which 1% of its assets is less than $120,000 may have a more rigorous disclosure burden than a larger registrant if it chose to provide the scaled disclosure available to smaller reporting companies. Smaller reporting companies also would provide the related person disclosure for two years rather than the three years required for larger companies. A smaller

reporting company would not be required to disclose its policies and procedures for approving related person transactions.

C. Paperwork Reduction Act Burden Estimates

For purposes of the Paperwork Reduction Act, we believe that if these proposals were adopted, the burden changes would be insignificant for companies that currently meet the small business issuer definition.

We estimate that the total increase in burden hours for Form 10-K, Form 10-Q, Form 10, Form S-1, and Form S-11 would be 6,151,112 and that the total increase in cost would be $933,954,800. These increases are offset by the total decrease in burden hours for Form 10-KSB, Form 10-QSB, Form 10-SB, Form SB-1, and Form SB-2 of 6,149,012 burden hours and a total decrease in cost of $927,927,800. The net difference between the increase and decrease is an increase of 2,100 burden hours and a cost of $6,027,000. The reason for the net difference is that small real estate companies, which are currently eligible to use Form SB-2, would be required to use Form S-11 if these proposals are adopted. Form S-11 is a form tailored to the real estate industry that requires more internal burden hours and increased professional costs. The net increase of 2,100 burden hours and costs of $6,027,000 is outweighed by the possible decrease of 356,390 burden hours and costs of $47,479,000, as discussed in detail below.

Our methodologies for deriving the burden hour and cost estimates presented below represent the average burdens for all issuers, both large and small. For Exchange Act annual reports and quarterly reports on Form 10-K and 10-Q, we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden is carried by outside professionals retained by the issuer at an average cost of $400 per hour.[96]

For purposes of the Paperwork Reduction Act, we estimate that over a three-year period[97] the annual increased incremental disclosure burden imposed by the proposed revisions would average 4,457,088 hours per Form 10-K, 7,387 hours per Form 10, 1,155,209 hours per Form 10-Q, 138,765 hours per Form S-1, and 7,413.75 hours per Form S-11. The plain English requirements would apply to these disclosure statements and is factored into the incremental burden of preparing these forms.

These estimates were based on the following assumptions:

Form 10-K

- The elimination of Form 10-KSB would cause the number of Form 10-Ks filed to increase. We estimate there were approximately 3,504 Form 10-KSBs filed in the last fiscal year so there would be a corresponding increase of 3,504 Form 10-Ks filed.
- We estimate that an increase of 3,504 Form 10-Ks filed would result in an increase in the compliance burden by an estimated 4,457,088 hours (3,504 companies x 1,272 internal hours per company) and an annual cost increase of $594,278,400 ($169,600 cost per response x 3,504 annual responses) with respect to the current Form 10-K.[98]

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96 In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of $400 as the average cost of outside professionals that assist issuers in preparing disclosure and conducting registered offerings.

97 We calculated an annual average over a three-year period because OMB approval of Paperwork Reduction Act submissions cover a three year period.

98 Our current PRA inventory for completing a Form 10-KSB is 1,272 burden hours and a cost of $169,600 (424 professional hours x $400/hour) per report.

Form 10-Q

- The elimination of Form 10-QSB would cause the number of Form 10-Qs to increase. We estimate that there were approximately 11,299 Form 10-QSBs filed last fiscal year so there would be a corresponding increase of 11,299 more Form 10-Qs filed.
- We estimate that an increase of 11,299 to the number of Form 10-Qs filed would result in an increase in the compliance burden by 1,155,209 hours (11,299 responses by companies x 102.24 internal hours per response) and an annual cost increase of $154,027,968 (34.08 professional hours x $400 per hour = $13,632 cost per response x 11,299 responses annually) with respect to the current Form 10-Q.

Form 10

- The elimination of Form 10-SB would cause the number of Form 10s to increase. We estimate that approximately 166 Form 10-SBs were filed in the last fiscal year so there would be a corresponding increase of 166 Form 10s.
- We estimate that an increase of 166 to the number of Form 10s filed would result in an increase in the compliance burden by 7,387 hours (166 responses by companies x 44.5 internal hours per response) and an annual cost increase of $8,864,000 (133.5 professional hours x $400 per hour = $53,400 cost per response x 166 responses annually) with respect to the current Form 10.

Form S-1

- The elimination of Form SB-1 would cause the number of Form S-1s to increase. We estimate there were approximately 17 Form SB-1s filed in the last fiscal year so there would be a corresponding increase of 17 Form S-1s filed.
- We estimate that 17 more Form S-1s would increase the compliance burden by 3,009 hours (17 company responses x 177 internal hours per response) and increase the

annual cost by $3,610,800 (531 professional hours x $400 per hour = $212,400 cost per response x 17 responses annually).

- The elimination of Form SB-2 would cause the number of Form S-1s to increase. We estimate that there were approximately 870 Form SB-2s filed in the last fiscal year so there would be a corresponding increase of 870 more Form S-1s filed.
- We estimate that 870 more Form S-1s would result in an increase in the compliance burden by 138,765 hours (870 company responses x 159.5 internal hours per response) and an annual cost of $166,518,000 (478.5 professional hours x $400 per hour = $191,400 cost per response x 870 responses annually) increase to the current Form S-1.

Form S-11

- The elimination of Form SB-2 would also cause the number of Form S-11s to increase. We estimate there were approximately 15 Form SB-2s filed by real estate companies in the last fiscal year so that there would be a corresponding increase of 15 Form S-11s filed.
- We estimate that 15 more Form S-11s would result in an increase in the compliance burden by 7,414 hours (15 company responses x 494.25 internal hours per response) and an annual cost of $8,898,000 (1,483 professional hours x $400 per hour = $593,200 cost per response x 15 responses annually) increase in the current Form S-11.

The annual decrease in incremental disclosure burden resulting from the proposed revisions would average 4,457,000 hours per Form 10-KSB, 7,387 hours per Form 10-SB, 1,540,458 hours per Form 10-QSB, 3,009 hours per Form SB-1, and 141,158 hours per Form SB-2. The annual decrease in incremental cost burden resulting from the proposed revisions would average

$594,278,000 per Form 10-KSB, $8,864,000 per Form 10-SB, $151,786,000 per Form 10-QSB, $3,610,800 per Form SB-1, and $169,389,000 per Form SB-2. The plain English requirements would apply to these disclosure statements and is factored into the incremental burden of preparing these forms.

These estimates were based on the following assumptions:

Form 10-KSB

- We estimate that the elimination of 3,504 Form 10-KSBs filed would result in a decrease in the compliance burden by 4,457,088 hours (3,504 responses by companies x 1,272 internal hours per response) and an annual cost decrease of $594,278,400 (424 professional hours x $400 per hour = $169,600 cost per response x 3,504 responses annually).

Form 10-QSB

- We estimate that the elimination of 11,299 Form 10-QSBs filed would result in a decrease in the compliance burden by 1,155,209 hours (11,299 responses by companies x 102.24 internal hours per response) and an annual cost decrease of $154,027,968 (34.08 professional hours x $400 per hour = $13,632 cost per response x 11,299 filings annually).

Form 10-SB

- We estimate that the elimination of 166 Form 10-SBs filed would result in a decrease in the compliance burden by 7,387 hours (166 responses by companies x 44.5 internal hours per response) and an annual cost decrease of $8,864,000 (133.5 professional hours x $400 per hour = $53,400 cost per response x 166 responses annually).

Form SB-1

- We estimate that the elimination of 17 Form SB-1s would result in a decrease in the compliance burden by 3,009 hours (17 company responses x 177 internal hours per response) and an annual cost decrease of $3,610,800 (531 professional hours x $400 per hour = $212,400 cost per response x 17 responses annually).

Form SB-2

- We estimate the elimination of 885 Form SB-2s would result in a decrease in the compliance burden by 141,157.5 hours (885 company responses x 159.5 internal hours) and an annual cost decrease of $169,389,000 (478.5 professional hours x $400 per hour = $191,400 cost per response x 885 responses annually).

Additionally, we estimate that approximately 1,581 companies would become newly eligible to use scaled disclosure for smaller reporting companies or have a new opportunity to assess whether they should avail themselves of scaled regulation under the restructured regime and could experience significant burden and cost savings if these proposals are adopted.[99] We estimate that if these smaller reporting companies use all of the scaled smaller reporting company requirements, they would save 713,031 burden hours and an aggregate cost of $95,018,100.[100] We do not expect all of the 1,581 companies, however, to use all of the scaled disclosure available to smaller reporting companies.

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99 We estimate that 1,227 companies would be newly eligible to use the scaled disclosure available to smaller reporting companies in addition to another 354 companies that currently are eligible for scaled disclosure but do not use it, resulting in a total of 1,581 companies. Approximately 1,227 companies have a public float between $25 and $75 million, in addition to approximately 354 companies with a public float below $25 million that currently use the "SK" forms rather than the "SB" forms.

100 A smaller reporting company generally may choose to comply with one, some, all, or none of the scaled disclosure requirements available for smaller reporting companies under our proposals. If a smaller reporting company used all scaled disclosure available, it would decrease the compliance burden by up to 713,031 hours (1,581 responses by companies using regular Regulation S-K disclosure x 1,723 internal hours per company = 2,724,063 hours minus 1,581 responses by companies using scaled disclosure x 1,272 internal hours per company = 2,011,032 hours for smaller reporting companies) and decrease the annual cost by up to $95,018,100 (574.25 professional hours x $400 per hour = $229,700 cost per response using the regular Regulation S-K disclosure x 1,581 annual responses minus 424 professional hours x $400 per hour = $169,600 cost per response x 1,581 annual responses).

While we are unsure how many of the 1,581 smaller reporting companies would use the scaled disclosure requirements, for purposes of this analysis, we estimate that approximately 50% of these companies would use the proposed scaled disclosure available to smaller reporting companies. As a result, we estimate that these 790 smaller reporting companies could save 356,390 internal burden hours and costs of $47,479,000 as indicated in the table below showing our estimates if 50% of the companies used the scaled disclosure in preparing their Form 10-K.[101]

Totals

The tables below illustrate the incremental annual compliance burden in the collection of information in hours and cost for Exchange Act periodic reports, Exchange Act registration statements, and Securities Act registration statements.

Calculation of Paperwork Reduction Act Burden Estimates for Exchange Act Reports, Exchange Act Registration Statements, and Securities Act Registration Statements

Table 1-Decreases

Form	Annual Responses	Burden Hours	Annual Costs
10-KSB	3,504	4,457,000	$594,278,000
10-QSB	11,299	1,540,458	$151,786,000
10-SB	166	7,387	$8,864,000
SB-1	17	3,009	$3,610,800
SB-2	885	141,158	$169,389,000
Total		6,149,012	$927,927,800

[101] This estimate of a decrease in the compliance burden by 356,290 hours is based upon 790 responses by companies using regular Regulation S-K disclosure x 1,723 internal hours per company = 1,361,170 hours minus 790 responses by companies x 1,272 internal hours per company = 1,004,880 hours for smaller reporting companies and a decrease in the annual cost by $47,479,000 (574.25 professional hours x $400 per hour= $229,700 cost per response using regular Regulation S-K disclosure x 790 responses minus 424 professional hours X $400 per hour = $169,600 cost per response using the scaled disclosure x 790 annual responses).

Table 2-Increases

Form	Current Annual Responses	Increased Annual Responses	Proposed Annual Responses	Current Burden Hours	Increase in Burden Hours	Proposed Burden Hours	Current Professional Costs	Increase in Professional Costs	Proposed Professional Costs
10-K	8,602	3,504	12,106	14,819,096	4,457,088	19,276,184	$1,975,879,000	$594,278,000	2,570,157,000
10-Q	20,264	11,299	31,563	2,918,263	1,540,458	4,458721	$291,826,000	$151,786,000	$443,612,000
10	72	166	238	4,338	7,387	11,725	$5,206,000	$8,864,000	$14,070,000
S-1	528	887	1,415	155,232	138,765	293,997	$186,278,000	$170,128,800	$356,406,800
S-11	60	15	75	29,655	7,414	37,069	$35,586,000	$8,898,000	$44,484,000
Total					6,151,112			$933,954,800	

Table 1- Decreases for Newly Eligible Companies

Companies between $25 Million and $75 Million	Current Burden Hours under Standard Regulation S-K	Proposed Burden Hours using Scaled Disclosure	Decrease in Burden Hours using Scaled Disclosure	Current Professional Costs under Standard Regulation S-K	Proposed Professional Costs using Scaled Disclosure	Decrease in Professional Costs using Scaled Disclosure
790	1,361,170	1,004,880	356,290	$181,463,000	$133,984,000	$47,479,000

D. Request for Comment

We request comment in order to (a) evaluate whether the collections of information are necessary for the proper performance of our functions, including whether the information will have practical utility; (b) evaluate the accuracy of our estimate of the burden of collections of information; (c) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (d) evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology.[102]

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the

[102] Comments are requested pursuant to 44 U.S.C. 3506(c)(2)(B).

Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-15-07. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-15-07, and be submitted to the Securities and Exchange Commission, Records Management, 6432 General Green Way, Alexandria, VA 22312. Because OMB is required to make a decision concerning the collection of information requirements between 30 and 60 days after publication of this release, your comments are best assured of having their full effect if OMB receives them within 30 days of publication.

V. Cost-Benefit Analysis

A. Background

We are proposing to eliminate our "SB" forms and integrate Regulation S-B item requirements into amended Regulation S-K. We propose to amend all relevant rules and forms under the Securities Act, the Exchange Act, and the Trust Indenture Act to replace the existing definition of "small business issuer" with the new definition of a "smaller reporting company." The "smaller reporting company" would replace the current "small business issuer" eligibility standards to allow a broader range of public companies to provide disclosure based on the scaled disclosure requirements. The proposed new definition for smaller reporting company would include companies with a public float of less than $75 million and would therefore provide a significant increase from the $25 million levels for public float and revenue under the current "small business issuer" definition.

B. Summary of Proposals

As noted above, our proposals would eliminate the separate disclosure framework of Regulation S-B by integrating those requirements into Regulation S-K. The proposed new definition for "smaller reporting company" would expand the number of filers that would qualify to provide disclosure under the more scaled item requirements of the current Regulation S-B framework. As proposed, smaller reporting companies and non-accelerated filers would both be subject to Regulation S-K, but smaller reporting companies would have the option to provide disclosure on an item-by-item basis according to the scaled item requirements of amended Regulation S-K.

New Definition of Smaller Reporting Company in Regulation S-K

Under the proposals, the newly defined term "smaller reporting company" would include previously excluded companies with public float levels of between $25 and $75 million. Additionally, companies that do not have a public float as defined, or are unable to calculate it, would be eligible for scaled disclosure if their revenues are below $50 million annually. A smaller reporting company would have the option to prepare disclosure based on the scaled disclosure item requirements of amended Regulation S-K. The proposed amendments to Regulation S-K would foster regulatory flexibility because eligible filers would be able to choose the level of disclosure to provide on an item-by-item basis. We believe providing disclosure choice is consistent with a principles-based approach, which encourages filers to provide more meaningful and relevant disclosure that is specific to the needs of the company and its investors.

Description of Business

Under the proposal, companies with public float levels of less than $75 million would be able to elect to provide disclosure regarding the development of their business for three years rather than the current requirement applicable to companies between $25 million and $75 million in public float to disclose the general development of the business for the past five years.

Financial Information

As part of our proposals to reduce costs associated with regulatory compliance, we are proposing to simplify financial statement disclosure requirements for smaller reporting companies.

As proposed, the current financial statement requirements in Item 310 of Regulation S-B would be available to smaller reporting companies. As proposed, Item 310 of Regulation S-K would permit smaller reporting companies to provide an audited balance sheet for the last fiscal year and audited statements of income, cash flows, and changes in stockholders' equity for each of the latest two fiscal years. In addition, the expanded category of smaller reporting companies (companies with public float levels between $25 and $75 million) would no longer be required to provide an audited balance sheet for the latest two fiscal years and audited statements of income, cash flows, and changes in stockholders' equity for each of the latest three fiscal years as required by Regulation S-X. Other simplified aspects under proposed Item 310 of Regulation S-K would include:

- the historical and pro forma financial statements for significant acquired businesses;
- the maximum age of financial statements; and
- limited partnerships financial statement disclosure of general partners.

Executive Compensation

As proposed to be amended, Item 402 of Regulation S-K would require smaller reporting companies to provide:

- disclosure about the chief executive officer and two other highly compensated executive officers only, rather than the information for the Chief Executive Officer, Chief Financial Officer and three other executive officers required of larger registrants; and

- only three of the seven tables (Summary Compensation, Outstanding Equity Awards, and Director Compensation) required of larger reporting companies.

Transactions with related persons, promoters, and certain control persons

Under the proposals, smaller reporting companies would be able to use the scaled disclosure requirements for transactions with related persons currently in Item 404 of Regulation S-B. Unlike Item 404 of Regulation S-K, Item 404 of Regulation S-B does not require disclosure regarding the company's policies and procedures for approving related person transactions. Smaller reporting companies would be required, however, to report transactions occurring within the last two years, whereas Item 404 of Regulation S-K requires disclosure for the last fiscal year, unless the information is included in a Securities Act or Exchange Act registration statement, where information as to the last three fiscal years is required.

C. Benefits

As discussed above, our proposals would promote regulatory simplification by eliminating all "SB" forms and consolidating the Regulation S-B disclosure item requirements into Regulation S-K. The integrated Regulation S-K regime would enable a larger category of public companies to have more flexibility in tailoring disclosure standards to fit the realities of their company. The proposed increased public float standards in the definition of smaller reporting company would provide more companies the flexibility to choose between scaled item requirements such as financial statement information and executive compensation disclosure.

Eliminating the "SB" forms would mitigate the perceived notion that smaller companies are currently reporting under a completely different disclosure framework. Integrating smaller reporting companies into the Regulation S-K framework and importing Regulation S-B disclosure standards into Regulation S-K would provide regulatory flexibility and reduce compliance costs for companies. We believe that these proposals will benefit the capital markets by encouraging private companies to consider offerings that are registered under the Securities Act or to enter the Exchange Act reporting system.

As proposed, an integrated disclosure system for all companies filing forms using Regulation S-K would promote efficiency because practitioners and investors would refer to one disclosure framework. Filers and their practitioners would have one consolidated regulation to find all relevant disclosure item requirements, which would reduce complexity and improve regulatory efficiencies.

The disclosure requirements will not change for current small business issuers that have filed under Regulation S-B. We nonetheless believe that the benefits of increased flexibility and efficiency and mitigating the perceived notion that small business issuers are reporting under a different framework are important to small business issuers.

As discussed earlier in this release, we estimate that approximately 1,581 companies would have a new opportunity to use the restructured scaled disclosure requirements for smaller reporting companies and could experience significant burden and cost savings if these proposals are adopted.[103] If all 1,581 smaller reporting companies provided scaled disclosure, they could save 713,031 burden hours and costs of $95,018,100, using the assumptions from our Paperwork Reduction Analysis.[104] However, we do not expect all of the 1,581 companies to use all of the scaled disclosure available to smaller reporting companies.

For purposes of the Paperwork Reduction Analysis, we assumed that approximately 50% of the 1,581 companies (or 790 companies) would use the scaled disclosure requirements. We

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[103] See footnote 100 above.

[104] Id.

estimate that these 790 smaller reporting companies could save 356,390 internal burden hours and costs in the amount of $47,479,000 by using the scaled disclosure requirements.[105]

We believe investors would benefit from the proposed scaled and proportional disclosure amendments to Regulation S-K because the proposals would allow issuers to make disclosure based on the size, business operations, and financial condition of the smaller reporting company. Allowing smaller reporting companies to choose scaled disclosure on an item-by-item basis allows companies to tailor their disclosure to meet their own needs.

Finally, another benefit to smaller reporting companies is that by using Registration Statement Form S-1 a company may be permitted to incorporate by reference its previously filed periodic reports. We believe that this would result in some minor cost savings and efficiencies in preparing registration statements for smaller reporting companies.

D. Costs

In our view, the proposed elimination of the "SB" forms and the proposed consolidation of the Regulation S-B disclosure standards into Regulation S-K would not increase significantly the costs of complying with the Commission's rules. For current "SB" filers, we estimate the net difference of reporting under Regulation S-K would be an increase of 2,100 burden hours and a cost of $6,027,000.[106] The reason for the net difference is that small real estate companies, which are currently eligible to use Form SB-2, would be required to use Form S-11 if these proposals are adopted. Form S-11 is a form tailored to the real estate industry and requires more internal burden hours and increased professional costs.

As proposed, we are not creating new rules or item requirements that would increase burdens or impose new requirements other than requiring foreign private issuers that elect to file

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[105] See footnote 101 above.

[106] See Section C. Paperwork Reduction Act Burden Estimates.

reports as smaller reporting companies to provide financial statements according to U.S. GAAP. We believe that combining disclosure standards into one centralized source in amended Regulation S-K would streamline and simplify the disclosure burdens associated with the registration process for many filers. Under the proposed amendments, our intention is to provide regulatory relief to a broader category of filers consistent with investor protection. We anticipate that companies would be able to reduce costs associated with the preparation of disclosure.

We recognize that some of the 1,581 companies may choose to avail themselves of the scaled disclosure requirements when they have complied with standard Regulation S-K previously. These companies may be providing less information to the marketplace. But more information is not necessarily better if the cost to provide the information is greater than the benefit. These companies would be providing scaled disclosure to fit the characteristics of their company while balancing the burdens of providing information with their benefits.

Request for Comments

We solicit comments, especially quantitative data, to assist in our assessment of the benefits and costs of scaled disclosure resulting from:

- expanding the category of filers that may be eligible for "smaller reporting company" status by increasing the public float threshold to a level of less than $75 million in public float;
- eliminating all forms associated with Regulation S-B;
- allowing smaller reporting companies to provide disclosure based on the scaled item requirements of amended Regulation S-K, which would include Items 101, 303, 310, 402, 404, and any others that would be amended based on the current scaled standards set forth in Regulation S-B;

- indexing the public float threshold for "smaller reporting company" eligibility to provide for periodic adjustments based on inflation; and
- making the scaled disclosure requirements in current Regulation S-B Items 101, 303, 310, 402, and 404 available to more companies eligible for "smaller reporting company" status."

Additionally, we request comments on the following:

- Do members of the public have comments, especially quantitative data, to assist our assessment of the benefits and costs of scaled disclosure resulting from our proposed amendments?
- Are there costs or benefits to our proposals that we have not identified?
- Some companies with a public float between $25 million and $75 million may choose to use the scaled disclosure to provide less information to investors than they have in the past. Would this loss of information have a negative or positive effect on investors? Would it affect the cost of capital?
- It may be more difficult under the current proposal for a smaller reporting company that filed as a Regulation S-K filer in the past to differentiate itself from other smaller companies. Would the lack of differentiation affect investors and, if so, what impact will it have? Would it affect the cost of capital?
- Would any reporting companies that would newly qualify for scaled disclosure requirements incur increased costs as a result of adoption of our proposed amended and scaled item requirements of Regulation S-K?

VI. Consideration of Impact on the Economy, Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act requires us to consider the impact that any new rule would have on competition.[107] Section 23(a)(2) also prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate to carry out the purposes of the Exchange Act.

Securities Act Section 2(b) and Exchange Act Section 3(f) require us to consider or determine, when engaged in rulemaking, whether an action is necessary or appropriate in the public interest and whether the action will promote efficiency, competition, and capital formation.

The proposed amendments to Regulation S-K are intended to result in regulatory simplification and efficiency by removing the duplicative sections of Regulation S-B and consolidating the scaled item requirements of Regulation S-B, such as financial statement information and executive compensation, into amended Regulation S-K. As proposed, amended Regulation S-K would consolidate into a single framework the disclosure requirements applicable to all filers that are subject to the reporting requirements of Sections 13 and 15 of the Exchange Act and companies filing registration statements under the Securities Act. To comply with disclosure item requirements, practitioners and companies would no longer need to refer to two disclosure frameworks. Practitioners and companies would benefit from the ease of reference that a single disclosure framework would provide.

It is intended that the proposed amendments would promote capital formation for smaller reporting companies and improve their ability to compete with larger companies for capital. For

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[107] 15 USC 78 w(a)(2).

example, we believe capital formation would be improved by providing more flexibility to smaller reporting companies to tailor their disclosure to their investors' needs. In addition, the costs to raise capital could be reduced to the extent compliance costs would be reduced as a result of the proposed scaled disclosure requirements. If smaller reporting companies allocate the capital they raise and save as a result of our proposed scaled disclosure requirements to business development in an effective manner, these companies could be more competitive.

The proposed amendments to Regulation S-K are intended to make the scaled disclosure requirements of the current Regulation S-B regime available to a broader category of filers on an optional basis. More companies would be able to take advantage of more scaled disclosure item requirements such as those contained currently in Item 310 and Item 402 of Regulation S-B. Smaller reporting companies that avail themselves of the scaled disclosure requirements would provide tailored disclosure that may better meet the needs of their investors. The proposed amendments to Regulation S-K are intended to provide more disclosure choice without adding additional requirements.

We request comment on whether the proposals, if adopted, would promote efficiency, competition and capital formation or have an impact or burden on competition. Commenters are requested to provide empirical data and other factual support for their view, if possible.

VII. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. The following analysis relates to proposed revisions to the rules and forms under the Securities Act and Exchange Act, which would include a new definition of smaller reporting company under Regulation S-K. The new definition would expand the group of smaller companies that qualify to provide disclosure in accordance with the scaled requirements of the current Regulation S-B disclosure framework.

As proposed, a smaller reporting company would be defined as a company that meets all of the following criteria: is not an investment company, an asset-backed issuer, or the majority-owned subsidiary of a parent that was not a smaller reporting company and that had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter, and in the case of an issuer whose public float was zero because the issuer had no significant equity outstanding or no market price for its equity, had annual revenues of less than $50 million during its most recently completed fiscal year for which audited financial statements are available on the date of the filing that establishes whether or not the issuer is a smaller reporting company for any fiscal year.

The proposed revisions also would eliminate the separate disclosure regime of Regulation S-B by removing all related "SB" forms and merging the Regulation S-B item requirements into Regulation S-K. The proposed revisions to Regulation S-K include revising item requirements to offer smaller reporting companies optional disclosure alternatives that are designed to provide flexibility, cost efficiencies and regulatory simplification. The revisions would result in greater uniformity of rules and regulations and compliance simplification for filers.

A. Reasons for and Objectives of the Proposed Action

1. The Advisory Committee on Smaller Public Companies Recommended Scaled Federal Securities Regulation for Smaller Companies

In March 2005, the Commission chartered the Advisory Committee on Smaller Public Companies to assess the current regulatory system for smaller companies under the federal securities laws and to make recommendations for changes to improve regulatory conditions for smaller companies. The Commission directed the Advisory Committee on Smaller Public

Companies to consider the impact that the Sarbanes-Oxley Act of 2002[108] and several other areas, including the disclosure and reporting requirements applicable to smaller companies under the federal securities laws.

In 2005, the Advisory Committee received numerous comments stating that the $25 million eligibility thresholds in the Regulation S-B definition of small business issuer are too low. The comments also indicated that the $25 million thresholds for public float and revenue in the current definition for small business issuer should be increased to permit a much larger group of smaller public companies to qualify for the scaled disclosure benefits of Regulation S-B, particularly in light of the increased costs associated with reporting obligations under the Exchange Act since passage of the Sarbanes-Oxley Act.

The Advisory Committee made three recommendations in this area, which included expanding the definition of smaller public company, incorporating Regulation S-B into Regulation S-K, and incorporating Item 310 of Regulation S-B into Regulation S-K to make the scaled financial statement accommodations available to a much larger group of smaller companies.

2. Expanding Eligibility for Smaller Company Scaled Regulation Under Amended Regulation S-K

To make the scaled requirements of the Regulation S-B disclosure framework applicable to many more companies, the Advisory Committee recommended revising the definition of "small business issuer" to include a company with a higher public float threshold than the $25 million ceiling currently required in the small business issuer definition found in Item 10 of Regulation S-B.

[108] Pub. L. No. 107-204, 116 Stat. 745 (2002).

Although the Advisory Committee did not recommend that we use a public float threshold, increased to $75 million, as we propose today, the proposed $75 million public float threshold is based on the reference to that number in the accelerated filer definition set forth in Rule 12b-2 of the Exchange Act. To maintain uniformity with current regulation, we believe setting a public float threshold based on the current levels established for non-accelerated filers is practical and avoids regulatory complexity.

3. Integrating Substantive Requirements of Regulation S-B into Regulation S-K

The overall goal of the rule proposals is to integrate the most substantive provisions of Regulation S-B into Regulation S-K and make these scaled disclosure requirements available to more companies as smaller reporting companies. We believe that the proposals would:

- further the goals of regulatory simplification by eliminating the current Regulation S-B framework as a separate stand-alone disclosure standard for the smallest reporting companies;
- update the public float threshold and eliminate the revenue threshold restriction in the current "small business issuer" definition to accommodate many more companies that are contemplating an offering registered under the Securities Act or entry into the Exchange Act reporting system;
- streamline and modernize forms under the Securities Act and the Exchange Act by eliminating all of the "SB" forms; and
- provide regulatory flexibility by permitting smaller reporting companies to provide financial statement information in accordance with Item 310 of Regulation S-K instead of Regulation S-X.

B. Legal Basis

We are proposing the amendments pursuant to Sections 6, 7, 10 and 19(a) of the Securities Act, Sections 12, 13, 14(a), 15(d), and 23(a) of the Exchange Act, and Section 319(a) of the Trust Indenture Act, as amended.

C. Small Entities Subject to the Rule

The proposals would affect small entities, the securities of which are registered under Section 12 of the Exchange Act or that are required to file reports under Section 15(d) of the Exchange Act. The proposals also would affect small entities that file, or have filed, a registration statement that has not yet become effective under the Securities Act and that has not been withdrawn. Securities Act Rule 157[109] and Exchange Act Rule 0-10(a)[110] define an issuer to be a "small entity" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. We believe the proposals would affect some small entities. We estimate that there are approximately 1,100 issuers that may be considered small entities.[111]

D. Reporting, Recordkeeping, and Other Compliance Requirements

As proposed, integrating Regulation S-B requirements into Regulation S-K and rescinding all of the "SB" forms would shift the location of disclosure requirements and would require that smaller reporting companies adapt to new formats in preparing their disclosure for Form S-1. The proposed amendments to Regulation S-K would include a new definition for smaller reporting company, which would broaden the category of filers preparing disclosure to comply with the scaled item requirements of amended Regulation S-K. Companies with public

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109 17 CFR 230.157.

110 17 CFR 240.0-10(a).

111 The estimated number of reporting small entities is based on 2007 data including the Commission's internal computerized filing system and Thomson Financial's Worldscope database. This represents an update from the number of reporting small entities estimated in prior rulemakings.

floats between $25 and $75 million would be included in the class of filers that is eligible to provide disclosure based on the scaled requirements of proposed revisions to amended Regulation S-K. Under the proposals, the scope and presentation of information disclosed based on the item requirements of amended Regulation S-K would differ in a number of significant ways from the current Regulation S-K disclosure framework. Under amended Regulation S-K, smaller reporting companies would:

- provide three years rather than five years of business development activities and not be required to provide segment disclosure under amended Item 101 of Regulation S-K;
- not be required to provide disclosure required by Items 301 and 302 relating to selected financial data and supplementary financial information;
- provide more streamlined disclosure for management's discussion and analysis of financial condition and results of operation found in Item 303 by requiring only two years of analysis if the company is presenting only two years of financial statements instead of the three years currently required of larger companies;
- provide an audited balance sheet as of the end of the last fiscal year and audited statements of income, cash flows and changes in stockholders' equity for each of the last two fiscal years in new Item 310 instead of an audited balance sheet as of the end of the last two fiscal years and audited statement of income, cash flows and changes in stockholders' equity for each of the last three fiscal years as required by Regulation S-X;
- under Item 402, limit the named executive officers for whom disclosure will be required to a smaller group, consisting of the principal executive officer and the other

two highest paid executive officers, require that the Summary Compensation Table disclose the two most recent fiscal years, require a Outstanding Equity Awards at Fiscal Year-End Table, and require the Director Compensation Table;

- under Item 402, smaller reporting companies would not be required to provide a Compensation Discussion and Analysis or a Compensation Committee Report; information regarding two additional executive officers; the third fiscal year of Summary Compensation Table disclosure; or the supplementary Grants of Plan-Based Awards Table, the Option Exercises and Stock Vested Table, the Pension Benefits Table, and the Nonqualified Deferred Compensation Table and the separate Potential Payments Upon Termination or Change-in-Control narrative section; and
- under Item 404, a smaller reporting company would be required to describe any transaction where the amount involved exceeds the lesser of $120,000 or 1% of the average of the smaller reporting company's total assets at the year-end for the last two completed fiscal years, and in which any related person had or will have a direct or indirect material interest. A smaller reporting company need not provide disclosure relating to policies and procedures for reviewing related person transactions.

The proposed amendments to Regulation S-K would not increase the disclosure requirements for former small business issuers and could substantially decrease the disclosure required for issuers with public float levels between $25 million and $75 million.

Proposed amended Item 404 of Regulation S-K is the only example where it is possible that the disclosure required for smaller reporting companies could be more extensive than for standard Regulation S-K filers. Item 404 would contain a provision that would require disclosure of transactions with related persons that exceed the lesser of $120,000 or 1% of the average of the smaller reporting company's total assets at the fiscal year end for the last two completed fiscal years. This requirement may be more burdensome to a smaller reporting company if 1% of total assets are less than $120,000. We believe transactions involving related persons are important to disclose, especially for smaller reporting companies, which may generally have lower materiality thresholds. While larger companies are bound by the higher $120,000 threshold, we believe this difference is important for the protection of investors. This disclosure issue would only affect smaller reporting companies that have related person transactions.

E. Overlapping or Conflicting Federal Rules

We do not believe any current federal rules duplicate, overlap or conflict with the proposed amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives:

(a) establishing different compliance or reporting requirements which take into account the resources available to smaller entities;

(b) the clarification, consolidation or simplification of disclosure for small entities;

(c) use of performance standards rather than design standards; and

(d) exempting smaller entities from coverage of the disclosure requirements or any part thereof.

As proposed, our amendments are intended to maintain current disclosure standards for small entities while further expanding the scope of eligibility for companies that would elect to comply with the scaled disclosure item requirements currently set forth in Regulation S-B. Our proposals do not exempt smaller entities from coverage of the disclosure requirements; but rather, they would provide a greater number of smaller reporting companies the choice to provide scaled disclosure as set forth in the proposed smaller reporting company amendments to Regulation S-K.

As amended, a new definition for smaller reporting company would eliminate the current $25 million revenue threshold and increase the public float threshold requirement up to $75 million from the $25 million level currently set forth in the small business issuer definition of Regulation S-B.

We considered alternatives such as including a revenue cap in the new definition of smaller reporting company but currently believe that only requiring less than $75 million in public float was preferable, given its ease of reference and uniformity with current rules under the Securities Act and the Exchange Act.

As proposed, we would consolidate, clarify and simplify disclosure requirement compliance by integrating Regulation S-B into Regulation S-K. The proposed amendments would include a new definition of smaller reporting company, which would greatly expand the number of small entities that would qualify to provide disclosure based on the scaled disclosure item requirements of the current Regulation S-B framework. We considered maintaining the Regulation S-B framework and making it available to many more companies, but believe a single disclosure framework would be more efficient. The proposed amendments also would eliminate all "SB" forms, which would result in regulatory simplification for smaller entities by requiring that all registrants rely on one set of forms, such as Forms S-1, S-3, 10-K and 10-Q, for example. These forms would include scaled item requirements for smaller reporting companies under proposed amended Regulation S-K.

Finally, we considered the use of performance rather than design standards and concluded that it would be inconsistent with the purposes of the Securities Act and Exchange Act and investor protection to specify different requirements other than those set forth in the item requirements of Regulation S-B and Regulation S-K.

Request for Comments:

- Are there any other significant alternatives we should consider in our final regulatory flexibility analysis?

G. Solicitation of Comments

We encourage the submission of written comments with respect to any aspect of this initial regulatory flexibility analysis, especially empirical data on the impact on small businesses. In particular, we request comment on: (1) the number of small entities that would be affected by the proposed amendments of Form 10-K, Form 10-Q, Form 10, Form S-1, and Form S-11 as well as the elimination of Regulation S-B and Form 10-KSB, Form 10-QSB, Form 10-SB, Form SB-1, and Form SB-2; and (2) whether these amendments would increase the reporting, record keeping and other compliance requirements for small businesses. Such written comments will be considered in the preparation of the final regulatory flexibility analysis if the proposed amendments are adopted.

VIII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996[112] a rule is "major" if it has resulted, or is likely to result in:

- an annual effect on the economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a "major rule" for purposes of the Small Business Regulatory Enforcement Fairness Act. We solicit comment and empirical data

112 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

on (a) the potential effect on the U.S. economy on an annual basis; (b) any potential increase in costs or prices for consumers or individual industries; and (c) any potential effect on competition, investment or innovation.

IX. Statutory Basis and Text of Proposal

We are proposing rule amendments pursuant to Sections 6, 7, 10, and 19(a) of the Securities Act, as amended, Sections 12, 13, 14(a), 15(d), and 23(a) of the Exchange Act, as amended, and Section 319(a) of the Trust Indenture Act, as amended.

List of Subjects

17 CFR Part 228

Reporting and recordkeeping requirements, Securities, Small businesses.

17 CFR Parts 210, 229, 230, 239, 240, 249, 260, and 269

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, under the authority of 15 U.S.C. 19(a) Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 210—-FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for Part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w(a), 78ll, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202 and 7262, unless otherwise noted.

2. Amend § 210.3–01 by revising paragraphs (b), the introductory text of paragraph (c) and (f) to read as follows:

§ 210.3–01 Consolidated balance sheets.

* * * * *

(b) If the filing, other than a filing on Form 10–K or Form 10, is made within 45 days after the end of the registrant's fiscal year and audited financial statements for the most recent fiscal year are not available, the balance sheets may be as of the end of the two preceding fiscal years and the filing shall include an additional balance sheet as of an interim date at least as current as the end of the registrant's third fiscal quarter of the most recently completed fiscal year.

(c) The instruction in paragraph (b) of this section is also applicable to filings, other than on Form 10–K or Form 10, made after 45 days but within the number of days of the end of the registrant's fiscal year specified in paragraph (i) of this section: Provided, That the following conditions are met:

* * * * *

(f) Any interim balance sheet provided in accordance with the requirements of this section may be unaudited and need not be presented in greater detail than is required by § 210.10–01. Notwithstanding the requirements of this section, the most recent interim balance sheet included in a filing shall be at least as current as the most recent balance sheet filed with the Commission on Form 10–Q.

* * * * *

3. Amend § 210.3–10 by revising paragraphs (h)(3) and (h)(4) to read as follows:

§ 210.3–10 Financial statements of guarantors and issuers of guaranteed securities registered or being registered.

* * * * *

(h) * * *

(1) * * *

(3) Annual report refers to an annual report on Form 10–K or Form 20–F (§ 249.310 or 249.220f of this chapter).

(4) Quarterly report refers to a quarterly report on Form 10–Q (§ 249.308a of this chapter).

* * * * *

4. Amend § 210.3–12 by revising paragraphs (a) and (d) to read as follows:

§ 210.3–12 Age of financial statements at effective date of registration statement or at mailing date of proxy statement.

(a) If the financial statements in a filing are as of a date the number of days specified in paragraph (g) of this section or more prior to the date the filing is expected to become effective or proposed mailing date in the case of a proxy statement, the financial statements shall be updated, except as specified in the following paragraphs, with a balance sheet as of an interim date within the number of days specified in paragraph (g) of this section and with statements of income and cash flows for the interim period between the end of the most recent fiscal year and the date of the interim balance sheet provided and for the corresponding period of the preceding fiscal year. Such interim financial statements may be unaudited and need not be presented in greater detail than is required by § 210.10–01. Notwithstanding the above requirements, the most recent interim financial statements shall be at least as current as the most recent financial statements filed with the Commission on Form 10–Q.

* * * * *

(d) The age of the registrant's most recent audited financial statements included in a registration statement filed under the Securities Act of 1933 or filed on Form 10 (17 CFR 249.210) under the Securities Exchange Act of 1934 shall not be more than one year and 45 days old at the date the registration statement becomes effective if the registration statement relates to the security of an issuer that was not subject, immediately prior to the time of filing the registration statement, to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934.

* * * * *

5. Amend § 210.3–14 by removing the authority citations following the section and revising paragraph (b) to read as follows:

§ 210.3–14 Special instructions for real estate operations to be acquired.

* * * * *

(b) Information required by this section is not required to be included in a filing on Form 10–K.

* * * * *

6. Amend § 210.4–01 by revising paragraphs (a)(3)(i)(A) and (a)(3)(i)(B) to read as follows:

§ 210.4–01 Form, order, and terminology.

(a) * * *

(3)(i) * * *

(A) The first interim or annual reporting period of the registrant's first fiscal year beginning on or after June 15, 2005, provided the registrant does not file as a smaller reporting company; and

(B) The first interim or annual reporting period of the registrant's first fiscal year beginning on or after December 15, 2005, provided the registrant files as a smaller reporting company.

* * * * *

7. Amend § 210.10–01 by revising paragraphs (b)(6) and the introductory text of paragraph (c) to read as follows:

§ 210.10–01 Interim financial statements.

* * * * *

(b) * * *

(6) In addition to meeting the reporting requirements specified by existing standards for accounting changes, the registrant shall state the date of any material accounting change and the reasons for making it. In addition, for filings on Form 10–Q, a letter from the registrant's independent accountant shall be filed as an exhibit (in accordance with the provisions of Item 601 of Regulation S-K, 17 CFR 229.601) in the first Form 10–Q subsequent to the date of an accounting change indicating whether or not the change is to an alternative principle which in the accountant's judgment is preferable under the circumstances; except that no letter from the accountant need be filed when the change is made in response to a standard adopted by the Financial Accounting Standards Board which requires such change.

* * * * *

(c) Periods to be covered. The periods for which interim financial statements are to be provided in registration statements are prescribed elsewhere in this Regulation (see §§ 210.3–01 and 3–02). For filings on Form 10–Q, financial statements shall be provided as set forth in this paragraph (c):

* * * * *

8. Part 228 is removed and reserved.

PART 229- STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 - REGULATION S-K

9. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 777iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; 18 U.S.C. 1350, unless otherwise noted.

* * * * *

10. Amend § 229.10 by adding paragraph (f) before the Instructions to Item 10 to read as follows:

§ 229.10 (Item 10) General.

* * * * *

(f) Smaller reporting companies. The requirements of this part apply to smaller reporting companies. Where an item of this part sets forth requirements for smaller reporting companies that are different from the requirements applicable to other companies, a smaller reporting company may comply with either the requirement applicable to smaller reporting companies or the requirement applicable to other companies:

(1) Definition of smaller reporting company. As used in this part, the term smaller reporting company means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:

(i) Had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or

(ii) In the case of an initial registration statement under the Securities Act for shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus the number of such shares included in the registration statement by the estimated public offering price of the shares; or

(iii) In the case of an issuer whose public float as calculated under paragraph (i) or (ii) of this definition was zero because the issuer had no significant public common equity outstanding or no market price for its common equity existed, had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available on the date of the filing that establishes whether or not the issuer is a smaller reporting company for any fiscal year.

(2) Determination: Whether or not an issuer is a smaller reporting company is determined for an entire fiscal year on the basis of the information in a quarterly report on Form 10-Q or an initial registration statement under the Securities Act or the Exchange Act, whichever is the first to be filed that year. Once an issuer fails to qualify for smaller reporting company status, it will remain unqualified unless it determines that its public float, as calculated in accordance with paragraph (f)(1) of this definition was less than $50 million as of the last business day of its second fiscal quarter or, if that calculation results in zero because the issuer had no significant public equity outstanding or no market price for its equity existed, if the issuer had annual revenues of less than $40 million during its previous fiscal year. An issuer making this determination becomes a smaller reporting company for the purpose of filings for the next fiscal year.

* * * * *

11. Amend § 229.101 by:

a. Revising the introductory text of paragraph (a)(2); and

b. Adding paragraph (h).

The revision and addition read as follows:

§ 229.101 (Item 101) Description of business.

* * * * *

(a) (1) * * *

(2) Registrants:

(i) Filing a registration statement on Form S-1 (§ 239.11 of this chapter) under the Securities Act or on Form 10 (§ 249.210 of this chapter) under the Exchange Act:

(ii) Not subject to the reporting requirements of section 13(a) or 15(d) of the Exchange Act immediately prior to the filing of such registration statement; and

(iii) That (including predecessors) have not received revenue from operations during each of the 3 fiscal years immediately prior to the filing of registration statement, shall provide the following information:

* * * * *

(h) Smaller reporting companies. A smaller reporting company, as defined by § 229.10(f)(1), may satisfy its obligations under this item by describing the development of its business during the last three years. If the smaller reporting company has not been in business for three years, give the same information for predecessor(s) of the smaller reporting company if there are any. This business development description should include:

(1) Form and year of organization;

(2) Any bankruptcy, receivership or similar proceeding; and

(3) Any material reclassification, merger, consolidation, or purchase or sale of a significant amount of assets not in the ordinary course of business.

(4) Business of the smaller reporting company. Briefly describe the business and include, to the extent material to an understanding of the smaller reporting company:

(i) Principal products or services and their markets;

(ii) Distribution methods of the products or services;

(iii) Status of any publicly announced new product or service;

(iv) Competitive business conditions and the smaller reporting company's competitive position in the industry and methods of competition;

(v) Sources and availability of raw materials and the names of principal suppliers;

(vi) Dependence on one or a few major customers;

(vii) Patents, trademarks, licenses, franchises, concessions, royalty agreements or labor contracts, including duration;

(viii) Need for any government approval of principal products or services. If government approval is necessary and the small reporting company has not yet received that approval, discuss the status of the approval within the government approval process;

(ix) Effect of existing or probable governmental regulations on the business;

(x) Estimate of the amount spent during each of the last two fiscal years on research and development activities, and if applicable, the extent to which the cost of such activities are borne directly by customers;

(xi) Costs and effects of compliance with environmental laws (federal, state and local); and

(xii) Number of total employees and number of full time employees.

(5) Reports to security holders. Disclose the following in any registration statement you file under the Securities Act of 1933:

(i) If you are not required to deliver an annual report to security holders, whether you will voluntarily send an annual report and whether the report will include audited financial statements;

(ii) Whether you file reports with the Securities and Exchange Commission. If you are a reporting company, identify the reports and other information you file with the Commission; and

(iii) That the public may read and copy any materials you file with the Commission at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. State that the public may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330. State that the Commission maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the Commission and state the address of that site (http://www.sec.gov). You are encouraged to give your Internet address, if available.

(6) Canadian issuers. Provide the information required by Items 101(f)(2) and 101(g) of Regulation S-K (§229.101(f)(2) and (g)):

* * * * *

12. Amend § 229.201 by:

a. Revising paragraph (a)(2); and

b. Revising Instruction 6. to Item 201(e).

The revision and addition read as follows:

§ 229.201 (Item 201) Market price of and dividends on the registrant's common equity and related stockholder matters.

(a) * * *

(2) If the information called for by this paragraph (a) is being presented in a registration statement on Form S-1 (§ 239.11 of this chapter) under the Securities Act or on Form 10

(§ 249.210 of this chapter) under the Exchange Act relating to a class of common equity for which at the time of filing there is no established United States public trading market, indicate the amount(s) of common equity:

(i) That is subject to outstanding options or warrants to purchase, or securities convertible into, common equity of the registrant;

(ii) That could be sold pursuant to § 230.144 of this chapter or that the registrant has agreed to register under the Securities Act for sale by security holders; or

(iii) That is being, or has been publicly proposed to be, publicly offered by the registrant (unless such common equity is being offered pursuant to an employee benefit plan or dividend reinvestment plan), the offering of which could have a material effect on the market price of the registrant's common equity.

* * * * *

Instructions to Item 201(e):

* * * * *

(6) Smaller reporting companies. A registrant that qualifies as a smaller reporting company, as defined by § 229.10(f)(1), is not required to provide the information required by paragraph (e) of this Item.

* * * * *

13. Amend § 229.301 by removing the authority citation following the section and adding paragraph (c) before the Instruction to Item 301 to read as follows:

§ 229.301 (Item 301) Selected financial data.

* * * * *

(c) Smaller reporting companies. A registrant that qualifies as a smaller reporting company, as defined by § 229.10(f)(1), is not required to provide the information required by this Item.

* * * * *

14. Amend § 229.302 by adding paragraph (c) to read as follows:

§ 229.302 (Item 302) Supplementary financial information.

* * * * *

(c) Smaller reporting companies. A registrant that qualifies as a smaller reporting company, as defined by § 229.10(f)(1), is not required to provide the information required by this Item.

15. Amend § 229.303 by adding paragraph (d) to read as follows:

§ 229.303 (Item 303) Management's discussion and analysis of financial condition and results of operations.

* * * * *

(d) Smaller reporting companies. A smaller reporting company, as defined by § 229.10(f)(1), may provide the information required in paragraph (a)(3)(iv) for the last two most recent fiscal years of the registrant if it provides financial information on net sales and revenues and on income from continuing operations for only two years. A smaller reporting company is not required to provide the information required by paragraph (a)(5) of this Item.

16. Amend § 229.305 by revising paragraph (e) to read as follows:

§ 229.305 (Item 305) Quantitative and qualitative disclosures about market risk.

* * * * *

(e) Smaller reporting companies. A smaller reporting company, as defined by § 229.10(f)(1), is not required to provide the information required by this Item.

* * * * *

17. Add § 229.310 to read as follows:

§ 229.310 (Item 310) Financial statements for smaller reporting companies.

Note 1 to § 229.310: Financial statements of a smaller reporting company, as defined by § 229.10(f)(1), its predecessors or any businesses to which the smaller reporting company is a successor shall be prepared in accordance with generally accepted accounting principles in the United States.

Note 2 to § 229.310: Regulation S-X (17 CFR 210.1-01 through 210.12-29) Form and Content of and Requirements for Financial Statements shall not apply to the preparation of such financial statements, except that the report and qualifications of the independent accountant shall comply with the requirements of Article 2 of Regulation S-X (17 CFR 210.2-01), Item 8.A of Form 20–F (17 CFR 249.220f) and Article 210.3–20 of Regulation S-X (17 CFR 210.3–20) shall apply to financial statements of foreign private issuers, the description of accounting policies shall comply with Article 4–08(n) of Regulation S-X (17 CFR 210.4–08(n)), and smaller reporting companies engaged in oil and gas producing activities shall follow the financial accounting and reporting standards specified in Article 4–10 of Regulation S-X (17 CFR 210.4–10) with respect to such activities. To the extent that Article 11–01 (17 CFR 210.11–01) (Pro Forma Presentation Requirements) offers enhanced guidelines for the preparation, presentation and disclosure of pro forma financial information, smaller reporting companies may wish to consider these items.

Note 3 to § 229.310: Financial statements for a subsidiary of a smaller reporting company that issues securities guaranteed by the smaller reporting company or guarantees securities issued by the smaller reporting company must be presented as required by Rule 3–10 of Regulation S-X (17 CFR 210.3–10), except that the periods presented are those required by paragraph (a) of this Item.

Note 4 to § 229.310: Financial statements for a smaller reporting company's affiliates whose securities constitute a substantial portion of the collateral for any class of securities registered or being registered must be presented as required by Rule 3–16 of Regulation S-X (17 CFR 210.3–16), except that the periods presented are those required by paragraph (a) of this Item.

Note 5 to § 229.310: The Commission, where consistent with the protection of investors, may permit the omission of one or more of the financial statements or the substitution of appropriate statements of comparable character. The Commission by informal written notice may require the filing of other financial statements where necessary or appropriate.

Note 6 to § 229.310: Rule 4–01(a)(3) of Regulation S-X, 17 CFR 210.4–01(a)(3), shall apply to the preparation of financial statements of smaller reporting companies.

(a) Annual financial statements. Smaller reporting companies shall file an audited balance sheet as of the end of the most recent fiscal year, or as of a date within 135 days if the issuers existed for a period less than one fiscal year, and audited statements of income, cash flows and changes in stockholders' equity for each of the two fiscal years preceding the date of such audited balance sheet (or such shorter period as the registrant has been in business).

(b) Interim financial statements. Interim financial statements may be unaudited; however, prior to filing, interim financial statements included in quarterly reports on Form 10–Q (17 CFR § 229.310) must be reviewed by an independent public accountant using professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission. If, in any filing, the issuer states that interim financial statements have been reviewed by an independent public accountant, a report of the accountant on the review must be filed with the interim financial statements. Interim financial statements shall include a balance sheet as of the end of the issuer's most recent fiscal quarter and income statements and statements of cash flows for the interim period up to the date of such balance sheet and the comparable period of the preceding fiscal year.

(1) Condensed format. Interim financial statements may be condensed as follows:

(i) Balance sheets should include separate captions for each balance sheet component presented in the annual financial statements which represents 10% or more of total assets. Cash and retained earnings should be presented regardless of relative significance to total assets. Registrants which present a classified balance sheet in their annual financial statements should present totals for current assets and current liabilities.

(ii) Income statements should include net sales or gross revenue, each cost and expense category presented in the annual financial statements which exceeds 20% of sales or gross revenues, provision for income taxes, discontinued operations, extraordinary items and cumulative effects of changes in accounting principles or practices. (Financial institutions should substitute net interest income for sales for purposes of determining items to be disclosed.) Dividends per share should be presented.

(iii) Cash flow statements should include cash flows from operating, investing and financing activities as well as cash at the beginning and end of each period and the increase or decrease in such balance.

(iv) Additional line items may be presented to facilitate the usefulness of the interim financial statements including their comparability with annual financial statements.

(2) Disclosure required and additional instructions as to content. —

(i) Footnotes. Footnote and other disclosures should be provided as needed for fair presentation and to ensure that the financial statements are not misleading.

(ii) Material subsequent events and contingencies. Disclosure must be provided of material subsequent events and material contingencies notwithstanding disclosure in the annual financial statements.

(iii) Significant equity investees. Sales, gross profit, net income (loss) from continuing operations and net income must be disclosed for equity investees which constitute 20% or more of a registrant's consolidated assets, equity or income from continuing operations.

(iv) Significant dispositions and purchase business combinations. If a significant disposition or purchase business combination has occurred during the most recent interim period and the transaction required the filing of a Form 8–K (§249.308 of this chapter), pro forma data must be presented which reflects revenue, income from continuing operations, net income and income per share for the current interim period and the corresponding interim period of the preceding fiscal year as though the transaction occurred at the beginning of the periods.

(v) Material accounting changes. Disclosure must be provided of the date and reasons for any material accounting change. The registrant's independent accountant must provide a letter in the first Form 10–Q (§ 249.308a of this Chapter) filed subsequent to the change indicating whether or not the change is to a preferable method. Disclosure must be provided of any retroactive change to prior period financial statements, including the effect of any such change on income and income per share.

(vi) Development stage companies. A registrant in the development stage must provide cumulative financial information from inception.

Instruction 1 to Item 310(b): Where Item 310 is applicable to a Form 10–Q and the interim period is more than one quarter, income statements must also be provided for the most recent interim quarter and the comparable quarter of the preceding fiscal year.

Instruction 2 to Item 310(b): Interim financial statements must include all adjustments which in the opinion of management are necessary in order to make the financial statements not misleading. An affirmative statement that the financial statements have been so adjusted must be included with the interim financial statements.

(c) Financial statements of businesses acquired or to be acquired. (1) If a business combination accounted for as a "purchase" has occurred or is probable, financial statements of the business acquired or to be acquired shall be furnished for the periods specified in paragraph (c)(3) of this Item.

(i) The term "purchase" encompasses the purchase of an interest in a business accounted for by the equity method.

(ii) Acquisitions of a group of related businesses that are probable or that have occurred subsequent to the latest fiscal year end for which audited financial statements of the issuer have been filed shall be treated as if they are a single business combination for purposes of this Item. The required financial statements of related businesses may be presented on a combined basis for any periods they are under common control or management. A group of businesses are deemed to be related if:

(A) They are under common control or management;

(B) The acquisition of one business is conditional on the acquisition of each other business; or

(C) Each acquisition is conditioned on a single common event.

(iii) Annual financial statements required by this paragraph (c) shall be audited. The form and content of the financial statements shall be in accordance with paragraphs (a) and (b) of this Item.

(2) The periods for which financial statements are to be presented are determined by comparison of the most recent annual financial statements of the business acquired or to be acquired and the smaller reporting company's most recent annual financial statements filed at or prior to the date of acquisition to evaluate each of the following conditions:

(i) Compare the smaller reporting company's investments in and advances to the acquiree to the total consolidated assets of the smaller reporting company as of the end of the most recently completed fiscal year. (ii) Compare the smaller reporting company's proportionate share of the total assets (after intercompany eliminations) of the acquiree to the total consolidated assets of the smaller reporting company as of the end of the most recently completed fiscal year.

(iii) Compare the smaller reporting company's equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principles of the acquiree to such consolidated income of the smaller reporting company for the most recently completed fiscal year.

Computational note to paragraph (c)(2): For purposes of making the prescribed income test the following guidance should be applied: If income of the smaller reporting company and its subsidiaries consolidated for the most recent fiscal year is at least 10 percent lower than the average of the income for the last five fiscal years, such average income should be substituted for purposes of the computation. Any loss years should be omitted for purposes of computing average income.

(3)(i) If none of the conditions specified in paragraph (c)(2) of this Item exceeds 20%, financial statements are not required. If any of the conditions exceed 20%, but none exceeds

40%, financial statements shall be furnished for the most recent fiscal year and any interim periods specified in paragraph (b) of this Item. If any of the conditions exceed 40%, financial statements shall be furnished for the two most recent fiscal years and any interim periods specified in paragraph (b) of this Item.

(ii) The separate audited balance sheet of the acquired business is not required when the smaller reporting company's most recent audited balance sheet filed is for a date after the acquisition was consummated.

(iii) If the aggregate impact of individually insignificant businesses acquired since the date of the most recent audited balance sheet filed for the registrant exceeds 50%, financial statements covering at least the substantial majority of the businesses acquired shall be furnished. Such financial statements shall be for the most recent fiscal year and any interim periods specified in paragraph (b) of this Item.

(iv) Registration statements not subject to the provisions of § 230.419 of this chapter (Regulation C) and proxy statements need not include separate financial statements of the acquired or to be acquired business if it does not meet or exceed any of the conditions specified in paragraph (c)(2) of this Item at the 50 percent level, and either:

(A) The consummation of the acquisition has not yet occurred; or

(B) The effective date of the registration statement, or mailing date in the case of a proxy statement, is no more than 74 days after consummation of the business combination, and the financial statements have not been filed previously by the registrant.

(v) An issuer that omits from its initial registration statement financial statements of a recently consummated business combination pursuant to paragraph (c)(3)(iv) of this Item shall furnish those financial statements and any pro forma information specified by paragraph (d) of this Item under cover of Form 8–K (§249.308 of this chapter) no later than 75 days after consummation of the acquisition.

(4) If the smaller reporting company made a significant business acquisition subsequent to the latest fiscal year end and filed a report on Form 8–K, which included audited financial statements of such acquired business for the periods required by paragraph (c)(3) of this Item and the pro forma financial information required by paragraph (d) of this Item, the determination of significance may be made by using pro forma amounts for the latest fiscal year in the report on Form 8–K rather than by using the historical amounts of the registrant. The tests may not be made by "annualizing" data.

(d) Pro forma financial information. (1) Pro forma information showing the effects of the acquisition shall be furnished if financial statements of a business acquired or to be acquired are presented.

(2) Pro forma statements should be condensed, in columnar form showing pro forma adjustments and results and should include the following:

(i) If the transaction was consummated during the most recent fiscal year or subsequent interim period, pro forma statements of income reflecting the combined operations of the entities for the latest fiscal year and interim period, if any; or

(ii) If consummation of the transaction has occurred or is probable after the date of the most recent balance sheet required by paragraph (a) or (b) of this Item, a pro forma balance sheet giving effect to the combination as of the date of the most recent balance sheet. For a purchase, pro forma statements of income reflecting the combined operations of the entities for the latest fiscal year and interim period, if any, are required.

(e) Real estate operations acquired or to be acquired. If, during the period for which income statements are required, the smaller reporting company has acquired one or more properties which in the aggregate are significant, or since the date of the latest balance sheet required by paragraph (a) or (b) of this Item, has acquired or proposes to acquire one or more properties which in the aggregate are significant, the following shall be furnished with respect to such properties:

(1) Audited income statements (not including earnings per unit) for the two most recent years, which shall exclude items not comparable to the proposed future operations of the property such as mortgage interest, leasehold rental, depreciation, corporate expenses and federal and state income taxes; Provided, however, that such audited statements need be presented for only the most recent fiscal year if:

(i) The property is not acquired from a related party;

(ii) Material factors considered by the smaller reporting company in assessing the property are described with specificity in the registration statement with regard to the property, including source of revenue (including, but not limited to, competition in the rental market, comparative rents, occupancy rates) and expenses (including but not limited to, utilities, ad valorem tax rates, maintenance expenses, and capital improvements anticipated); and

(iii) The smaller reporting company indicates that, after reasonable inquiry, it is not aware of any material factors relating to the specific property other than those discussed in response to paragraph (e)(1)(ii) of this Item that would cause the reported financial information not to be necessarily indicative of future operating results.

(2) If the property will be operated by the smaller reporting company, a statement shall be furnished showing the estimated taxable operating results of the smaller reporting company based on the most recent twelve-month period including such adjustments as can be factually supported. If the property will be acquired subject to a net lease, the estimated taxable operating results shall be based on the rent to be paid for the first year of the lease. In either case, the

estimated amount of cash to be made available by operations shall be shown. Disclosure must be provided of the principal assumptions which have been made in preparing the statements of estimated taxable operating results and cash to be made available by operations.

(3) If appropriate under the circumstances, a table should be provided which shows, for a limited number of years, the estimated cash distribution per unit indicating the portion reportable as taxable income and the portion representing a return of capital with an explanation of annual variations, if any. If taxable net income per unit will be greater than the cash available for distribution per unit, that fact and approximate year of occurrence shall be stated, if significant.

(f) Limited partnerships. (1) Smaller reporting companies which are limited partnerships must provide the balance sheets of the general partners as described in paragraphs (f)(2) through (f)(4) of this Item.

(2) Where a general partner is a corporation, the audited balance sheet of the corporation as of the end of its most recently completed fiscal year must be filed. Receivables, other than trade receivables, from affiliates of the general partner should be deducted from shareholders' equity of the general partner. Where an affiliate has committed itself to increase or maintain the general partner's capital, the audited balance sheet of such affiliate must also be presented.

(3) Where a general partner is a partnership, there shall be filed an audited balance sheet of such partnership as of the end of its most recently completed fiscal year.

(4) Where the general partner is a natural person, there shall be filed, as supplemental information, a balance sheet of such natural person as of a recent date. Such balance sheet need not be audited. The assets and liabilities should be carried at estimated fair market value, with provisions for estimated income taxes on unrealized gains. The net worth of such general partner(s), based on such balance sheet(s), singly or in the aggregate, shall be disclosed in the registration statement.

(g) Age of financial statements. At the date of filing, financial statements included in filings other than filings on Form 10–K must be not less current than financial statements, which would be required in Forms 10–K and 10–Q if such reports were required to be filed. If required financial statements are as of a date 135 days or more prior to the date a registration statement becomes effective or proxy material is expected to be mailed, the financial statements shall be updated to include financial statements for an interim period ending within 135 days of the effective or expected mailing date. Interim financial statements should be prepared and presented in accordance with paragraph (b) of this Item:

(1) When the anticipated effective or mailing date falls within 45 days after the end of the fiscal year, the filing may include financial statements only as current as the end of the third fiscal quarter; Provided, however, that if the audited financial statements for the recently completed fiscal year are available or become available prior to effectiveness or mailing, they must be included in the filing; and

(2) If the effective date or anticipated mailing date falls after 45 days but within 90 days of the end of the smaller reporting company's fiscal year, the smaller reporting company is not required to provide the audited financial statements for such year end provided that the following conditions are met:

(i) If the smaller reporting company is a reporting company, all reports due must have been filed;

(ii) For the most recent fiscal year for which audited financial statements are not yet available, the smaller reporting company reasonably and in good faith expects to report income from continuing operations before taxes; and

(iii) For at least one of the two fiscal years immediately preceding the most recent fiscal year the smaller reporting company reported income from continuing operations before taxes.

18. Amend § 229.401 by revising Instruction 3 to paragraph (b) to read as follows:

§ 229.401 (Item 401) Directors, executive officers, promoters and control persons.

* * * * *

(b) * * *

Instructions to Paragraph (b) of Item 401:

* * * * *

3. The information regarding executive officers called for by this Item need not be furnished in proxy or information statements prepared in accordance with Schedule 14A under the Exchange Act (§ 240.14a-101 of this Chapter) by those registrants relying on General Instruction G of Form 10-K under the Exchange Act(§ 249.310 of this Chapter); Provided, that such information is furnished in a separate item captioned "Executive officers of the registrant" and included in Part I of the registrant's annual report on Form 10-K.

* * * * *

19. Amend § 229.402 by adding paragraph (l) before the Instruction to Item 402 to read as follows:

§ 229.402 (Item 402) Executive Compensation.

* * * * *

(l) Smaller reporting companies. A registrant that qualifies as a "smaller reporting company," as defined by § 229.10(f)(1), is required to:

(1) Provide information only with respect to the following persons (the "named executive officers") in lieu of the persons determined under paragraphs (a)(3)(i) - (iii) of this Item substituting the Instruction to Items 402(l)(1)(i) - (iii) for Instruction 2 to Item 402(a)(3), and substituting paragraph (l)(1)(iv) for paragraph (a)(4):

(i) All individuals serving as the smaller reporting company's principal executive officer or acting in a similar capacity during the last completed fiscal year ("PEO"), regardless of compensation level;

(ii) The smaller reporting company's two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year; and

(iii) Up to two additional individuals for whom disclosure would have been provided pursuant to paragraph (l)(1)(ii) of this Item but for the fact that the individual was not serving as an executive officer of the smaller reporting company at the end of the last completed fiscal year.

Instruction to Items 402(l)(1)(i) - (iii):

Determination of most highly compensated executive officers. The determination as to which executive officers are most highly compensated shall be made by reference to total compensation for the last completed fiscal year (as required to be disclosed pursuant to paragraph (c)(2)(x) of this Item) reduced by the amount required to be disclosed pursuant to paragraph (c)(2)(viii) of this Item, provided, however, that no disclosure need be provided for any executive officer, other than the PEO, whose total compensation, as so reduced, does not exceed $100,000.

(iv) If the PEO served in that capacity during any part of a fiscal year with respect to which information is required, information should be provided as to all of his or her compensation for the full fiscal year. If a named executive officer (other than the PEO) served as an executive officer of the smaller reporting company (whether or not in the same position) during any part of the fiscal year with respect to which information is required, information shall be provided as to all compensation of that individual for the full fiscal year.

(2) Provide the information required by paragraph (c) of this Item only for each of the registrant's last two completed fiscal years, without providing the information required by paragraph (c)(2)(viii)(A), without applying Instructions 1 and 3 to paragraph (c)(2)(viii), and substituting:

(i) The following for Instruction 2 to Item 402(c)(2)(iii) and (iv): Registrants shall include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based or other forms of non-cash compensation instead have been received by the named executive officer. However, the receipt of any such form of non-cash compensation instead of salary or bonus must be disclosed in a footnote added to the salary or bonus column and, where applicable, referring to the narrative disclosure to the Summary Compensation Table (required by paragraph (l)(3) of this Item) where the material terms of the stock, option or non-equity incentive plan award elected by the named executive officer are reported.

(ii) The following for Item 402(c)(2)(ix)(G): The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value for the stock or option award;

(iii) The following for Instruction 2 to Item 402(c)(2)(ix): Benefits paid pursuant to defined benefit and actuarial plans are not reportable as All Other Compensation in column (i) unless accelerated pursuant to a change in control; information concerning these plans is reportable pursuant to paragraph (l)(5)(i) of this Item.

(iv) The following for Instructions 3 and 4 to Item 402(c)(2)(ix): Reimbursements of taxes owed with respect to perquisites or other personal benefits must be included in the columns as tax reimbursements (paragraph (c)(2)(ix)(B) of this Item) even if the associated perquisites or other personal benefits are not required to be included because the aggregate amount of such compensation is less than $10,000. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the registrant.

(3) Provide a narrative description of any material factors necessary to an understanding of the information disclosed in the Table required by paragraph (c) of this Item. Examples of such factors may include, in given cases, among other things:

(i) The material terms of each named executive officer's employment agreement or arrangement, whether written or unwritten;

(ii) If at any time during the last fiscal year, any outstanding option or other equity-based award was repriced or otherwise materially modified (such as by extension of exercise periods, the change of vesting or forfeiture conditions, the change or elimination of applicable performance criteria, or the change of the bases upon which returns are determined), a description of each such repricing or other material modification;

(iii) The waiver or modification of any specified performance target, goal or condition to payout with respect to any amount included in non-stock incentive plan compensation or payouts reported in column (g) to the Summary Compensation Table required by paragraph (c) of this Item, stating whether the waiver or modification applied to one or more specified named executive officers or to all compensation subject to the target, goal or condition;

(iv) The material terms of each grant, including but not limited to the date of exercisability, any conditions to exercisability, any tandem feature, any reload feature, any tax-reimbursement feature, and any provision that could cause the exercise price to be lowered;

(v) The material terms of any non-equity incentive plan award made to a named executive officer during the last completed fiscal year, including a general description of the formula or criteria to be applied in determining the amounts payable and vesting schedule;

(vi) The method of calculating earnings on nonqualified deferred compensation plans including nonqualified defined contribution plans; and

(vii) An identification to the extent material of any item included under All Other Compensation (column (i)) in the Summary Compensation Table. Identification of an item shall not be considered material if it does not exceed the greater of $25,000 or 10% of all items included in the specified category in question set forth in paragraph (c)(2)(ix) of this Item. All items of compensation are required to be included in the Summary Compensation Table without regard to whether such items are required to be identified.

Instruction to Item 402(l)(3).

The disclosure required by paragraph (l)(3)(ii) of this Item would not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.

(4) Provide this information required by paragraph (f) of this Item;

(5) Provide a narrative description of the following to the extent material:

(i) The material terms of each plan that provides for the payment of retirement benefits, or benefits that will be paid primarily following retirement, including but not limited to tax-qualified defined benefit plans, supplemental executive retirement plans, tax-qualified defined contribution plans and nonqualified defined contribution plans.

(ii) The material terms of each contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) to a named executive officer at, following, or in connection with the resignation, retirement or other termination of a named executive officer, or a change in control of the registrant or a change in the named executive officer's responsibilities following a change in control, with respect to each named executive officer.

(6) Provide the information required by paragraph (k) of this Item, without providing the information required by paragraph (k)(2)(vi)(A), without applying Instructions 2 and 3 to Item 402(k)(2)(vii), and by substituting:

(i) The following for Item 402(k)(2)(i): The name of each director unless such director is also a named executive officer under paragraph (a) of this Item and his or her compensation for service as a director is fully reflected in the Summary Compensation Table pursuant to paragraph (c) of this Item and otherwise as required pursuant to paragraphs (f), (l)(3) and (l)(5) of this Item (column (a));

(ii) The following for the Instruction to Item 402(k)(2)(iii) and (iv): For each director, disclose by footnote to the appropriate column, the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end; and

(iii) The following for the Instruction to Item 402(k): In addition to Instruction 1 to paragraph (k)(2)(vii) of this Item, the following apply equally to paragraph (k) of this Item: Instructions 2 and 4 to paragraph (c) of this Item; the Instructions to paragraphs (c)(2)(iii) and (iv) of this Item, modifying Instruction 2 to paragraphs (c)(2)(iii) and (iv) as provided by paragraph (l)(2)(i) of this Item; the Instruction to paragraphs (c)(2)(v) and (vi) of this Item; the Instructions to paragraph (c)(2)(vii) of this Item; Instruction 2 to paragraph (c)(2)(viii) of this Item; the Instructions to paragraph (c)(2)(ix) of this Item, modifying Instruction 2 to paragraph (c)(2)(ix) as provided by paragraph (l)(2)(iii) of this Item and modifying Instructions 3 and 4 to paragraph (c)(2)(ix) as provided by paragraph (l)(2)(iv) of this Item; and paragraph (l)(3)(vii) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (k) of this Item that correspond to analogous disclosures provided for in paragraph (c) of this Item to which they refer. Further, each Item reported pursuant to paragraph (k)(2)(vii) of this Item must be identified and quantified in a footnote if it is deemed material in accordance with paragraph (l)(3)(vii) of this Item.

* * * * *

20. Amend § 229.404 by revising the introductory text of paragraph (c)(1) and adding paragraph (d) before the Instruction to Item 404 to read as follows:

§ 229.404 (Item 404) Transactions with related persons, promoters and certain control persons.

* * * * *

(c) Promoters and certain control persons. (1) Registrants that are filing a registration statement on Form S–1 under the Securities Act (§ 239.11 of this chapter) or on Form 10 under the Exchange Act (§ 249.210 of this chapter) and that had a promoter at any time during the past five fiscal years shall:

* * * * *

(d) Smaller reporting companies. A registrant that qualifies as a "smaller reporting company," as defined by § 229.10(f)(1), will be deemed to comply with this Item if it provides:

(i) The information required by paragraph (a) of this Item for the period specified there and, in addition, for the fiscal year preceding the smaller reporting company's last fiscal year, for a transaction in which the amount involved exceeds the lesser of $120,000 or one percent of the average of the smaller reporting company's total assets at year end for the last two completed fiscal years; and

(ii) A list of all parents of the smaller reporting company showing the basis of control and as to each parent, the percentage of voting securities owned or other basis of control by its immediate parent, if any.

Instruction to Item 404(d)

Include the information for any material underwriting discounts and commissions upon the sale of securities by the smaller reporting company where any of the persons specified in paragraph (a) was or is to be a principal underwriter or is a controlling person or member of a firm that was or is to be a principal underwriter.

* * * * *

21. Amend § 229.407 by revising paragraph (d)(4)(i)(B) and adding paragraph (g) before the Instructions to Item 407 to read as follows:

§ 229.407 (Item 407) Corporate Governance.

* * * * *

(d) * * *

(4) (i) * * *

(B) The registrant is filing an annual report on Form 10-K (17 CFR 249.310) or a proxy statement or information statement pursuant to the Exchange Act (15 U.S.C. 78a et seq.) if action is to be taken with respect to the election of directors; and

* * * * *

(g) Smaller reporting companies. A registrant that qualifies as a "smaller reporting company," as defined by § 229.10(f)(1), is not required to provide:

(i) The disclosure required in paragraph (d)(5) of this Item in its first annual report filed pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m (a) or 78o(d)) following the effective date of its first registration statement filed under the Securities Act (15 U.S.C. 77a et seq.) or Exchange Act (15 U.S.C. 78a et seq.); and

(ii) Need not provide the disclosures required by paragraphs (g)(4) and (g)(5) of this Item.

* * * * *

22. Amend § 229.503 by adding paragraph (e) before the Instruction to Item 503 to read as follows:

§ 229.503 (Item 503) Prospectus summary, risk factors, and ratio of earnings to fixed charges.

* * * * *

(e) Smaller reporting companies. A smaller reporting company need not comply with paragraph (d) of this Item.

* * * * *

23. Amend § 229.504 by revising Instruction 6 to read as follows:

§ 229.504 (Item 504) Use of proceeds.

* * * * *

Instructions to Item 504:

* * * * *

6. Where the registrant indicates that the proceeds may, or will, be used to finance acquisitions of other businesses, the identity of such businesses, if known, or, if not known, the nature of the businesses to be sought, the status of any negotiations with respect to the acquisition, and a brief description of such business shall be included. Where, however, pro forma financial statements reflecting such acquisition are not required by Regulation S-X (17 CFR 210.01 through 210.12-29) (or by § 229.310 in the case of a smaller reporting company, as defined in § 229.10(f)(1)), to be included, in the registration statement, the possible terms of any transaction, the identification of the parties thereto or the nature of the business sought need not be disclosed, to the extent that the registrant reasonably determines that public disclosure of such information would jeopardize the acquisition. Where Regulation S-X or §229.310, as applicable,

would require financial statements of the business to be acquired to be included, the description of the business to be acquired shall be more detailed.

* * * * *

24. Amend § 229.512 by adding paragraph (m) to read as follows:

§ 229.512 (Item 512) Undertakings.

* * * * *

(m) Smaller reporting companies. A smaller reporting company is not required to provide information under paragraphs (a)(1)(iii)(C), (a)(4), (e), (j), (k), and (l) of this Item.

25. Amend § 229.601 by:

(a) Revising paragraph (a)(4); the Exhibit Table; and paragraphs (b)(4) (ii), (b)(4)(v), (b)(7), (b)(10)(iii)(C)(6), (b)(13)(i), (b)(15), (b)(19), and (b)(22); and

(b) Adding paragraph (c) to read as follows:

§ 229.601 (Item 601) Exhibits.

(a) * * *

(4) If a material contract or plan of acquisition, reorganization, arrangement, liquidation or succession is executed or becomes effective during the reporting period reflected by a Form 10-Q or Form 10-K, it shall be filed as an exhibit to the Form 10-Q or Form 10-K filed for the corresponding period. Any amendment or modification to a previously filed exhibit to a Form 10, 10-K or 10-Q document shall be filed as an exhibit to a Form 10-Q and Form 10-K. Such amendment or modification need not be filed where such previously filed exhibit would not be currently required.

* * * * *

Exhibit Table

* * * * *

EXHIBIT TABLE

	Securities Act Forms								Exchange Act Forms			
	S-1	S-3	S-4[1]	S-8	S-11	F-1	F-3	F-4[1]	10	8-K[2]	10-Q	10-K
(1) Underwriting agreement	X	X	X	---	X	X	X	X	---	X	---	---
(2) Plan of acquisition, reorganization, arrangement, liquidation or succession	X	X	X	---	X	X	X	X	X	X	X	X
(3) (i) Articles of incorporation	X	---	X	---	X	X	---	X	X	X	X	X
(ii) Bylaws	X	---	X	---	X	X	---	X	X	X	X	X
(4) Instruments defining the rights of security holders, including indentures	X	X	X	X	X	X	X	X	X	X	X	X
(5) Opinion re legality	X	X	X	X	X	X	X	X	---	---	---	---
(6) [Reserved]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
(7) Correspondence from an independent accountant regarding non-reliance on a previously issued audit report or completed interim review	---	---	---	---	---	---	---	---	---	X	---	---
(8) Opinion re tax matters	X	X	X	---	X	X	X	X	---	---	---	---
(9) Voting trust agreement	X	---	X	---	X	X	---	X	X	---	---	X
(10) Material contracts	X	---	X	---	X	X	---	X	X	---	X	X
(11) Statement re computation of per share earnings	X	---	X	---	X	X	---	X	X	---	X	X
(12) Statements re computation of ratios	X	X	X	---	X	X	---	X	X	---	---	X
(13) Annual report to security holders, Form 10-Q or quarterly report to security holders[3]	---	---	X	---	---	---	---	---	---	---	---	X
(14) Code of Ethics										X		X
(15) Letter re unaudited interim financial information	X	X	X	X	X	X	X	X	---	---	X	---
(16) Letter re change in certifying accountant[4]	X	---	X	---	X	---	---	---	X	X	---	X
(17) Correspondence on departure of director	---	---	---	---	---	---	---	---	---	X	---	---
(18) Letter re change in accounting principles	---	---	---	---	---	---	---	---	---	---	X	X
(19) Report furnished to security holders	---	---	---	---	---	---	---	---	---	---	X	---
(20) Other documents or statements to security holders	---	---	---	---	---	---	---	---	---	X	---	---
(21) Subsidiaries of the registrant	X	---	X	---	X	X	---	X	X	---	---	X

(22) Published report regarding matters submitted to vote of security holders	---	---	---	---	---	---	---	---	---	---	X	X
(23) Consents of experts and counsel	X	X	X	X	X	X	X	X	---	X[5]	X[5]	X[5]
(24) Power of attorney	X	X	X	X	X	X	X	X	X	X	X	X
(25) Statement of eligibility of trustee	X	X	X	---	---	X	X	X	---	---	---	---
(27) through (30) [Reserved]												
(31) Rule 13a-14(a)/15d-14(a) Certifications	---	---	---	---	---	---	---	---	---	---	X	X
(32) Section 1350 Certifications[6]	---	---	---	---	---	---	---	---	---	---	X	X
(33) through (98) [Reserved]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
(99) Additional exhibits	X	X	X	X	X	X	X	X	X	X	X	X

[1] An exhibit need not be provided about a company if: (1) With respect to such company an election has been made under Form S-4 or F-4 to provide information about such company at a level prescribed by Forms S-3 or F-3 and (2) the form, the level of which has been elected under Forms S-4 or F-4, would not require such company to provide such exhibit if it were registering a primary offering.

[2] A Form 8-K exhibit is required only if relevant to the subject matter reported on the Form 8-K report. For example, if the Form 8-K pertains to the departure of a director, only the exhibit described in paragraph (b)(17) of this section need be filed. A required exhibit may be incorporated by reference from a previous filing.

[3] Where incorporated by reference into the text of the prospectus and delivered to security holders along with the prospectus as permitted by the registration statement; or, in the case of the Form 10-K, where the annual report to security holders is incorporated by reference into the text of the Form 10-K.

[4] If required pursuant to Item 304 of Regulation S-K.

[5] Where the opinion of the expert or counsel has been incorporated by reference into a previously filed Securities Act registration statement.

[6] Pursuant to §§ 240.13-13(b)(3) and 240.15d-13(b)(3) of this chapter, asset-backed issuers are not required to file reports on Form 10-Q.

* * * * *

(b) * * *

(4) * * *

(ii) Except as set forth in paragraph (b)(4)(iii) of this Item for filings on Forms S-1, S-4, S-11, N-14, and F-4 under the Securities Act (§ 239.11, 239.25, 239.18, 239.23 and 239.34 of this chapter) and Forms 10 and 10-K under the Exchange Act (§ 249.210 and 249.310 of this chapter) all instruments defining the rights of holders of long-term debt of the registrant and its consolidated subsidiaries and for any of its unconsolidated subsidiaries for which financial statements are required to be filed.

* * * * *

(v) With respect to Forms 8-K and 10-Q under the Exchange Act which are filed and which disclose, in the text of the Form 10-Q, the interim financial statements, or the footnotes thereto the creation of a new class of securities or indebtedness or the modification of existing rights of security holders, file all instruments defining the rights of holders of these securities or indebtedness. However, there need not be filed any instrument with respect to long-term debt not being registered which meets the exclusion set forth in paragraph (b)(4)(iii)(A) of this Item.

* * * * *

(7) <u>Correspondence from an independent accountant regarding non-reliance on a previously issued audit report or completed interim review.</u> Any written notice from the registrant's current or previously engaged independent accountant that the independent accountant is withdrawing a previously issued audit report or that a previously issued audit report or completed interim review, covering one or more years or interim periods for which the registrant is required to provide financial statements under Regulation S-X (part 210 of this chapter), or Item 310 if the registrant is a smaller reporting company, should no longer be relied upon. In addition, any letter, pursuant to Item 4.02(c) of Form 8-K (§ 249.308 of this chapter), from the independent accountant to the Commission stating whether the independent accountant agrees with the statements made by the registrant describing the events giving rise to the notice.

* * * * *

(10) * * *

(iii) (A) * * *

(C) * * *

(6) Any compensatory plan, contract, or arrangement if the registrant is a wholly owned subsidiary of a company that has a class of securities registered pursuant to section 12 or files reports pursuant to section 15(d) of the Exchange Act and is filing a report on Form 10-K or registering debt instruments or preferred stock which are not voting securities on Form S-2.

* * * * *

(13) Annual report to security holders, Form 10-Q or quarterly report to security holders.

(i) The registrant's annual report to security holders for its last fiscal year, its Form 10-Q (if specifically incorporated by reference in the prospectus) or its quarterly report to security holders, if all or a portion thereof is incorporated by reference in the filing. Such report, except for those portions thereof which are expressly incorporated by reference in the filing, is to be furnished for the information of the Commission and is not to be deemed "filed" as part of the filing. If the financial statements in the report have been incorporated by reference in the filing, the accountant's certificate shall be manually signed in one copy. See Rule 411(b) (§ 230.411 (b) of this chapter).

* * * * *

(15) Letter re unaudited interim financial information. A letter, where applicable, from the independent accountant which acknowledges awareness of the use in a registration statement of a report on unaudited interim financial information which pursuant to Rule 436(c) under the Securities Act (§ 230.436(c) of this chapter) is not considered a part of a registration statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of sections 7 and 11 of that Act. Such letter may be filed with the registration statement, an amendment thereto, or a report on Form 10-Q which is incorporated by reference into the registration statement.

* * * * *

(19) Report furnished to security holders. If the registrant makes available to its security holders or otherwise publishes, within the period prescribed for filing the report, a document or statement containing information meeting some or all of the requirements of Part I of Form 10-Q, the information called for may be incorporated by reference to such published document or statement, provided copies thereof are included as an exhibit to the registration statement or to Part I of the Form 10-Q report.

* * * * *

(22) Published report regarding matters submitted to vote of security holders. Published reports containing all of the information called for by Item 4 of Part II of Form 10-Q or Item 4 of Part I of Form 10-K which is referred to therein in lieu of providing disclosure in Form 10-Q or 10-K, which are required to be filed as exhibits by Rule 12b-23(a)(3) under the Exchange Act (§ 240.12b-23(a)(3) of this chapter).

* * * * *

(c) Smaller reporting companies. A smaller reporting company need not provide the disclosure required in paragraph (b)(12) of this Item, Statements re computation of ratios. Correspondence from an independent accountant under paragraph (b)(7) concerning financial statements of a smaller reporting company shall be made using the financial disclosure required in § 229.310.

26. Amend § 229.701 by revising paragraph (e) to read as follows:

§ 229.701 (Item 701) Recent sales of unregistered securities; use of proceeds from registered securities.

* * * * *

(e) Terms of conversion or exercise. If the information called for by this paragraph (e) is being presented on Form 8-K, Form 10-Q, or Form 10-K under the Exchange Act (§ 249.308, § 249.308(a), and § 240.310) of this chapter, and where the securities sold by the registrant are convertible or exchangeable into equity securities, or are warrants or options representing equity securities, disclose the terms of conversion or exercise of the securities.

* * * * *

27. Amend § 229.1118 by revising paragraph (b)(2) to read as follows:

§ 229.1118 (Item 1118) Reports and additional information.

* * * * *

(b) * * *

(2) State that the public may read and copy any materials filed with the Commission at the Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. State that the public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1–800–SEC–0330. State that the Commission maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the Commission and state the address of that site (http://www.sec.gov).

* * * * *

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

28. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll, 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

29. Amend § 230.110 by revising paragraph (a) to read as follows:

§ 230.110 Business hours of the Commission.

(a) General. The principal office of the Commission, at 100 F Street, NE, Washington, DC 20549, is open each day, except Saturdays, Sundays, and Federal holidays, from 9 a.m. to 5:30 p.m., Eastern Standard Time or Eastern Daylight Saving Time, whichever is currently in effect, provided that hours for the filing of documents pursuant to the Act or the rules and regulations thereunder are as set forth in paragraphs (b), (c) and (d) of this section.

* * * * *

30. Amend § 230.138 by revising paragraph (a)(2)(i) to read as follows:

§ 230.138 Publications or distributions of research reports by brokers or dealers about securities other than those they are distributing.

(a) * * *

(2) * * *

(i) Is required to file reports, and has filed all periodic reports required during the preceding 12 months (or such shorter time that the issuer was required to file such reports) on Forms 10–K (§ 249.310 of this chapter), 10–Q (§ 249.308a of this chapter), and 20–F (§ 249.220f of this chapter) pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); or

* * * * *

31. Amend § 230.139 by revising paragraph (a)(2) to read as follows:

§ 230.139 Publications or distributions of research reports by brokers or dealers distributing securities.

(a) * * *

(2) As of the date of reliance on this section, has filed all periodic reports required during the preceding 12 months on Forms 10–K (§ 249.310 of this chapter), 10–Q (§ 249.308a of this chapter), and 20–F (§ 249.220f of this chapter) pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); or

* * * * *

32. Amend § 230.158 by revising paragraphs (a)(1)(i), (a)(2)(i), and (b)(2) to read as follows.

§ 230.158 Definitions of certain terms in the last paragraph of section 11(a).

(a) * * *

(1) * * *

(i) In Item 8 of Form 10-K (§ 239.310 of this chapter), part I, Item 1 of Form 10-Q (§ 240.308a of this chapter), or Rule 14a-3(b) (§ 240.14a-3(b) of this chapter) under the Securities Exchange Act of 1934;

* * * * *

(2) * * *

(i) On Form 10–K, Form 10–Q, Form 8–K (§ 249.308 of this chapter), or in the annual report to security holders pursuant to Rule 14a–3 under the Securities Exchange Act of 1934 (§ 240.14a-3 of this chapter); or

* * * * *

(b) * * *

(2) Has filed its report or reports on Form 10-K, Form 10-Q, Form 8-K, Form 20-F, Form 40-F, or Form 6-K, or has supplied to the Commission copies of the annual report sent to security holders pursuant to Rule 14a-3(c) under the Securities Exchange Act of 1934 (§ 240.14a-3(c) of this chapter), containing such information.

* * * * *

33. Amend § 230.175 by revising paragraphs (b)(1), (b)(1)(i), and (b)(2) to read as follows:

§ 230.175 Liability for certain statements by issuers.

* ** * *

(b) * * *

(1) A forward-looking statement (as defined in paragraph (c) of this section) made in a document filed with the Commission, in Part I of a quarterly report on Form 10-Q, § 249.308a of this chapter, or in an annual report to shareholders meeting the requirements of Rule 14a-3(b) and (c) or 14c-3(a) and (b) under the Securities Exchange Act of 1934 (§ 240.14a-3 of this chapter), a statement reaffirming such forward-looking statement subsequent to the date the document was filed or the annual report was made publicly available, or a forward-looking statement made prior to the date the document was filed or the date the annual report was publicly available if such statement is reaffirmed in a filed document, in Part I of a quarterly report on Form 10-Q, or in an annual report made publicly available within a reasonable time after the making of such forward-looking statement; Provided, that

(i) At the time such statements are made or reaffirmed, either the issuer is subject to the reporting requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and has complied with the requirements of Rule 13a-1 or 15d-1 (§239.13a-1 or 239.15d-1 of this chapter) thereunder, if applicable, to file its most recent annual report on Form 10-K, Form 20-F, or Form 40-F; or if the issuer is not subject to the reporting requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, the statements are made in a registration statement filed under the Act, offering statement or solicitation of interest written document or broadcast script under Regulation A or pursuant to sections 12(b) or (g) of the Securities Exchange Act of 1934; and

* * * * *

(2) Information which is disclosed in a document filed with the Commission, in Part I of a quarterly report on Form 10–Q (§ 249.308a of this chapter) or in an annual report to shareholders meeting the requirements of Rules 14a–3 (b) and (c) or 14c–3 (a) and (b) under the

Securities Exchange Act of 1934 (§§ 240.14a–3(b) and (c) or 240.14a–3(a) and (b) of this chapter) and which relates to:

(i) The effects of changing prices on the business enterprise, presented voluntarily or pursuant to Item 303 of Regulation S-K (§ 229.303 of this chapter) "Management's Discussion and Analysis of Financial Condition and Results of Operations, or Item 5 of Form 20–F, Operating and Financial Review and Prospects, (§ 249.220f of this chapter)" or Item 302 of Regulation S-K (§ 229.302 of this chapter), "Supplementary financial information," or Rule 3-20(c) of Regulation S-X (§ 210.3–20(c) of this chapter); or

(ii) The value of proved oil and gas reserves (such as a standardized measure of discounted future net cash flows relating to proved oil and gas reserves as set forth in paragraphs 30–34 of Statement of Financial Accounting Standards No. 69) presented voluntarily or pursuant to Item 302 of Regulation S-K (§ 229.302 of this chapter).

* * * * *

34. Amend § 230.405 by removing the definition of small business issuer and adding the definition of smaller reporting company in alphabetical order to read as follows:

§ 230.405 Definitions of Terms.

* * * * *

Smaller reporting company: As used in this part, the term smaller reporting company means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:

(1) Had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price

at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or

(2) In the case of an initial registration statement under the Securities Act for shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus the number of such shares included in the registration statement by the estimated public offering price of the shares; or

(3) In the case of an issuer whose public float as calculated under paragraph (1) or (2) of this definition was zero because the issuer had no significant public common equity outstanding or no market price for its common equity existed, had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available on the date of the filing that establishes whether or not the issuer is a smaller reporting company for any fiscal year.

(4) Determination: Whether or not an issuer is a smaller reporting company is determined for an entire fiscal year on the basis of the information in a quarterly report on Form 10-Q or an initial registration statement under the Securities Act or Exchange Act, whichever is the first to be filed during that year. Once an issuer fails to qualify for smaller reporting company status, it will remain unqualified unless it determines that its public float, as calculated in accordance with paragraph (1) of this definition was less than $50 million as of the last business day of its second fiscal quarter or, if that calculation results in zero because the issuer had no significant public equity outstanding or no market price for its equity existed, if the issuer had annual revenues of less than $40 million during its previous fiscal year. An issuer making

this determination becomes a smaller reporting company for the purpose of filings for the next fiscal year.

* * * * *

35. Amend § 230.415 by revising paragraph (a)(3) to read as follows:

§ 230.415 Delayed or continuous offerings and sale of securities.

(a) * * *

(3) The registrant furnishes the undertakings required by Item 512(a) of Regulation S-K (§ 229.512(a) of this chapter), except that a registrant that is an investment company filing on Form N-2 must furnish the undertakings required by Item 34.4 of Form N-2 (§ 239.14 and § 274.11a-1 of this chapter).

* * * * *

36. Amend § 230.428 by revising paragraphs (b)(2)(ii), (b)(2)(iii), (b)(2)(iv), and (b)(4) to read as follows:

§ 230.428 Documents constituting a section 10(a) prospectus for Form S–8 registration statement; requirements relating to offerings of securities registered on Form S–8.

* * * * *

(b) * * *

(2) * * *

(ii) The registrant's annual report on Form 10–K (§ 249.310 of this chapter), 20–F (§ 249.220f of this chapter) or, in the case of registrants described in General Instruction A.(2) of Form 40–F (§ 249.240f of this chapter), for its latest fiscal year;

(iii) The latest prospectus filed pursuant to Rule 424(b) (§ 230.424(b) of this chapter) under the Act that contains audited financial statements for the registrant's latest fiscal year, Provided that the financial statements are not incorporated by reference from another filing, and Provided further that such prospectus contains substantially the information required by Rule

14a–3(b) (§ 240.14a-3(b) of this chapter) or the registration statement was on Form S-1 (§ 239.11 of this chapter) or F–1 (§ 239.31 of this chapter); or

(iv) The registrant's effective Exchange Act registration statement on Form 10 (§ 249.210 of this chapter), 20–F or, in the case of registrants described in General Instruction A.(2) of Form 40–F, containing audited financial statements for the registrant's latest fiscal year.

* * * * *

(4) Where interests in a plan are registered, the registrant shall deliver or cause to be delivered promptly, without charge, to each employee to whom information is required to be delivered, upon written or oral request, a copy of the then latest annual report of the plan filed pursuant to section 15(d) of the Exchange Act, whether on Form 11–K (§ 249.311 of this chapter) or included as part of the registrant's annual report on Form 10–K.

* * * * *

37. Amend § 230.430B by revising the introductory text of paragraphs (f)(4), (f)(4)(ii), and (i) to read as follows:

§ 230.430B Prospectus in a registration statement after effective date.

* * * * *

(f)(1) * * *

(4) Except for an effective date resulting from the filing of a form of prospectus filed for purposes of including information required by section 10(a)(3) of the Act or pursuant to Item 512(a)(1)(ii) of Regulation S-K (§ 229.512(a)(1)(ii) of this chapter), the date a form of prospectus is deemed part of and included in the registration statement pursuant to this paragraph shall not be an effective date established pursuant to paragraph (f)(2) of this section as to:

* * * * *

(ii) Any person signing any report or document incorporated by reference into the registration statement, except for such a report or document incorporated by reference for purposes of including information required by section 10(a)(3) of the Act or pursuant to Item 512(a)(1)(ii) of Regulation S-K (such person except for such reports being deemed not to be a person who signed the registration statement within the meaning of section 11(a) of the Act).

* * * * *

(i) Issuers relying on this section shall furnish the undertakings required by Item 512(a) of Regulation S-K.

* * * * *

38. Amend § 230.430C by revising paragraph (d) to read as follows:

§ 230.430C Prospectus in a registration statement pertaining to an offering other than pursuant to Rule 430A or Rule 430B after the effective date.

* * * * *

(d) Issuers subject to paragraph (a) of this section shall furnish the undertakings required by Item 512(a) of Regulation S-K (§ 229.512(a) of this chapter) or Item 34.4 of Form N–2 (§§ 239.14 and 274.11a–1 of this chapter), as applicable.

* * * * *

39. Revise § 230.455 to read as follows:

§ 230.455 Place of filing.

All registration statements and other papers filed with the Commission shall be filed at its principal office. Such material may be filed by delivery to the Commission through the mails or otherwise; provided, however, that only registration statements and post-effective amendments thereto filed pursuant to Rule 462(b) (§ 230.462(b)) and Rule 110(d) (§ 230.110(d)) may be filed by means of facsimile transmission.

40. Amend § 230.502 by revising paragraphs (b)(2)(i)(B)(1), (b)(2)(i)(B)(2), (b)(2)(ii)(A), (b)(2)(ii)(B), and (b)(2)(iii) to read as follows:

§ 230.502 General conditions to be met.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(B) Financial statement information. (1) Offerings up to $2,000,000. The information required in Item 310 of Regulation S-K (§ 229.310 of this chapter), except that only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited.

(2) Offerings up to $7,500,000. The financial statement information required in Form S-1 (§ 239.10 of this chapter) for smaller reporting companies. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.

* * * * *

(ii) * * *

(A) The issuer's annual report to shareholders for the most recent fiscal year, if such annual report meets the requirements of § 240.14a–3 or § 240.14c–3 under the Exchange Act, the definitive proxy statement filed in connection with that annual report, and if requested by the purchaser in writing, a copy of the issuer's most recent Form 10–K (17 CFR 249.310) under the Exchange Act.

(B) The information contained in an annual report on Form 10–K (§ 249.310 of this chapter) under the Exchange Act or in a registration statement on Form S–1 (§ 239.11 of this chapter) or S–11 (§ 239.18 of this chapter) under the Act or on Form 10 (§ 249.210 of this chapter) under the Exchange Act, whichever filing is the most recent required to be filed.

* * * * *

(iii) Exhibits required to be filed with the Commission as part of a registration statement or report, other than an annual report to shareholders or parts of that report incorporated by reference in a Form 10–K report, need not be furnished to each purchaser that is not an accredited investor if the contents of material exhibits are identified and such exhibits are made available to a purchaser, upon his written request, a reasonable time prior to his purchase.

* * * * *

PART 239-FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

41. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

42. Amend § 239.0-1 by revising paragraph (b) to read as follows:

§239.0-1 Availability of forms.

* * * * *

(b) Any person may obtain a copy of any form prescribed for use in this part by written request to the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

Any persons may inspect the forms at this address and at the Commission's regional offices. (See § 200.11 of this chapter for the addresses of the SEC regional offices.)

* * * * *

43. By removing and reserving §§ 239.9 and 239.10 and removing Forms SB-1 and Form SB-2.

Note- The text of Forms SB-1 and SB-2 does not appear in the Code of Federal Regulations.

44. Amend Form S-1 (referenced in § 239.11) by:

a. Adding to the cover page, above the calculation of the registration fee table, check boxes requesting the registrant to indicate whether it is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company; and

b. Revising Items 11(e), 11A, and 12(a)(1) in Part I.

The revisions and addition read as follows:

Note- The text of Form S-1 does not and this amendment will not appear in the Code of Federal Regulations.

* * * * *

FORM S-1

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

PART I-INFORMATION REQUIRED IN PROSPECTUS

* * * * *

Item 11. Information with Respect to the Registrant.

* * * * *

(e) Financial statements meeting the requirements of Regulation S-X (17 CFR Part 210) (Schedules required under Regulation S-X shall be filed as "Financial Statements Schedules" pursuant to Item 15, Exhibits and Financial Statement Schedules, of this form), as well as any financial information required by Rule 3-05 and Article 11 of Regulation S-X. A smaller reporting company may provide the information in Item 310 of Regulation S-K in lieu of the financial information required by Rule 3-05 and Article 11 of Regulation S-X;

* * * * *

Item 11A. Material Changes.

If the registrant elects to incorporate information by reference pursuant to General Instruction VII. describe any and all material changes in the registrant's affairs which have occurred since the end of the latest fiscal year for which audited financial statements were included in the latest Form 10-K and which have not been described in a Form 10-Q, or Form S-8 filed under the Exchange Act.

* * * * *

Item 12. Incorporation of Certain Information by Reference.

* * * * *

(a) * * *

(1) The registrant's latest annual report on Form 10-K filed pursuant to Section 13(a) or Section 15(d) of the Exchange Act which contains financial statements for the registrant's latest fiscal year for which a Form 10-K was required to have been filed; and

* * * * *

45. Amend Form S-3 (referenced in § 239.13) by adding to the cover page, above the calculation of the registration fee table, check boxes requesting the registrant to indicate whether it is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company and revising General Instruction II C., and in Part I, Items 11(a) and 12(a)(1) to read as follows.

Note- The text of Form S-3 does not and this amendment will not appear in the Code of Federal Regulations.

* * * * *

FORM S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

GENERAL INSTRUCTIONS

* * * * *

II. Application of General Rules and Regulations

* * * * *

C. A smaller reporting company, defined in Rule 405 (17 CFR 230.405), that is eligible to use Form S-3 shall use the disclosure items in Regulation S-K (17 CFR 229.10 et .seq.) with specific attention to the subparagraph describing scaled disclosure, if any. Smaller reporting companies may provide the financial information called for by Item 310 of Regulation S-K in lieu of the financial information called for by Item 11 in this form.

* * * * *

Part I

INFORMATION REQUIRED IN PROSPECTUS

* * * * *

Item 11. Material Changes.

(a) Describe any and all material changes in the registrant's affairs which have occurred since the end of the latest fiscal year for which certified financial statements were included in the latest annual report to security holders and which have not been described in a report on Form 10-Q (§ 249.308a of this chapter) or Form 8-K (§ 249.308 of this chapter) filed under the Exchange Act.

* * * * *

Item 12. Incorporation of Certain Information by Reference.

a. * * *

(1) the registrant's latest annual report on Form 10-K (17 CFR 249.310) filed pursuant to Section 13(a) or 15(d) of the Exchange Act which contains financial statements for the registrant's latest fiscal year for which a Form 10-K was required to be filed; and

* * * * *

46. Amend Form S-8 (referenced in § 239.16b) by adding to the cover page, above the calculation of registration fee table, check boxes requesting the registrant to indicate whether a registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company and revising General Instructions A.1(a)(6) and B.3. to read as follows:

Note- The text of Form S-8 does not and this amendment will not appear in the Code of Federal Regulations.

FORM S-8

REGISTRATION OF SECURITIES UNDER THE SECURITIES ACT OF 1933

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

GENERAL INSTRUCTIONS

A. Rule as to Use of Form S-8

1. * * *

(a) * * *

(6) The term "Form 10 information" means the information that is required by Form 10 or Form 20-F (§ 249.210 or § 249.220f of this chapter), as applicable to the registrant, to register under the Securities Exchange Act of 1934 each class of securities being registered using this form. A registrant may provide the Form 10 information in another Commission filing with respect to the registrant.

* * * * *

B. Application of General Rules and Regulations

* * * * *

3. A “smaller reporting company,” defined in § 230.405, shall refer to the disclosure items in Regulation S-K (17 CFR 229.10 et seq.) and may use the scaled disclosure provided for smaller reporting companies.

* * * * *

47. Amend Form S-11 (referenced in § 229.18) by:

a. Adding to the cover page, above the calculation of registration fee table, check boxes requesting the registrant to indicate whether it is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company; and

b. Revising Item 27.

The revision and addition read as follows:

Note- The text of Form S-11 does not and this amendment will not appear in the Code of Federal Regulations.

FORM S-11

FOR REGISTRATION UNDER THE SECURITIES ACT OF 1933 OF SECURITIES OF CERTAIN REAL ESTATE COMPANIES

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

Item 27. Financial Statements and Information.

Include in the prospectus the financial statements required by Regulation S-X, the supplementary financial information required in Item 302 of Regulation S-K (§ 229.302 of this chapter) and the information concerning changes in and disagreements with accountants on accounting and financial disclosure required by Item 304 of Regulation S-K (§ 229.304 of this chapter). Although all schedules required by Regulation S-X are to be included in the registration statement, all such schedules other than those prepared in accordance with Rules 12-12, 12-28, and 12-29 of the Regulation may be omitted from the prospectus. A smaller reporting company may provide the information in Item 310 of Regulation S-K (§ 229.310 of this chapter), in lieu of the financial information required by Regulation S-X and need not provide the supplementary financial information required in Item 302 of Regulation S-K.

* * * * *

48. Amend Form S-4 (referenced in § 239.25) by:

a. Adding to the cover page, above the calculation of the registration fee table, check boxes requesting the registrant to indicate whether it is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company;

b. Removing paragraph 4 of General Instruction D; and

c. Revising paragraph 1 of General Instruction I and in Part I Item 5, Item 12(a) before the Instruction, the introductory text of Item 12(b), paragraph 3 of Item 12(c), Item 17(b)(8), Item 18(b), and Item 19(c).

The addition and revisions read as follows:

* * * * *

Note- The text of Form S-4 does not and this amendment will not appear in the Code of Federal Regulations.

* * * * *

FORM S-4

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

GENERAL INSTRUCTIONS

* * * * *

I. Roll-Up Transactions.

1. If securities to be registered on this Form will be issued in a roll-up transaction as defined in Item 901(c) of Regulation S-K (17 CFR 229.901(c)), then the disclosure provisions of Subpart 229.900 of Regulation S-K (17 CFR 229.900) shall apply to the transaction in addition to the provisions of this Form. A smaller reporting company, defined in § 230.405, that is engaged in a roll-up transaction shall refer to the disclosure items in subpart 900 of Regulation S-K. To the extent that the disclosure requirements of Subpart 229.900 are inconsistent with the disclosure requirements of any other applicable forms or schedules, the requirements of Subpart 229.900 are controlling.

* * * * *

PART I

INFORMATION REQUIRED IN THE PROSPECTUS

* * * * *

Item 5. Pro Forma Financial Information.

Furnish financial information required by Article 11 of Regulation S-X (§ 210.11-01 et.seq. of this chapter) with respect to this transaction. A smaller reporting company may provide the information in Item 310 of Regulation S-K (§ 229.310 of this chapter) in lieu of the financial information required by Article 11 of Regulation S-X.

* * * * *

Item 12. Information with Respect to S-3 Registrants.

* * * * *

(a) If the registrant elects to deliver this prospectus together with a copy of either its latest Form 10-K filed pursuant to Sections 13(a) or 15(d) of the Exchange Act or its latest annual report to security holders, which at the time of original preparation met the requirements of either Rule 14a-3 or Rule 14c-3:

(1) Indicate that the prospectus is accompanied by either a copy of the registrant's latest Form 10-K or a copy of its latest annual report to security holders, whichever the registrant elects to deliver pursuant to paragraph (a) of this Item.

(2) Provide financial and other information with respect to the registrant in the form required by Part I of Form 10-Q as of the end of the most recent fiscal quarter which ended after the end of the latest fiscal year for which certified financial statements were included in the latest Form 10-K or the latest report to security holders (whichever the registrant elects to deliver pursuant to paragraph (a) of this Item), and more than forty-five days prior to the effective date of this registration statement (or as of a more recent date) by one of the following means:

(i) including such information in the prospectus;

(ii) providing without charge to each person to whom a prospectus is delivered a copy of the registrant's latest Form 10-Q; or

(iii) providing without charge to each person to whom a prospectus is delivered a copy of the registrants latest quarterly report that we delivered to security holders and which included the required financial information.

(3) If not reflected in the registrant's latest Form 10-K or its latest annual report to security holders (whichever the registrant elects to deliver pursuant to paragraph (a) of this Item) provide information required by Rule 3-05 (§ 210.3-05 of this chapter) and Article 11 (§ 210.11-01 through 210.11.03 of this chapter) of Regulation S-X.

(4) Describe any and all material changes in the registrant's affairs which have occurred since the end of the latest fiscal year for which audited financial statements were included in the latest Form 10-K or latest annual report to security holders (whichever the registrant elects to deliver pursuant to paragraph (a) of this Item) and that were not described in a Form 10-Q or quarterly report delivered with the prospectus in accordance with paragraphs (a)(2)(ii) or (iii) of this Item.

* * * * *

(b) If the registrant does not elect to deliver its latest Form 10-K or its latest annual report to security holders:

* * * * *

(c) * * *

(3) such restatement of financial statements or disposition of assets was not reflected in the registrant's latest annual report to security holders and/or in its latest Form 10-K filed pursuant to Section 13(a) or 15(d) of the Exchange Act.

* * * * *

Item 17. Information with Respect to Companies Other than S-3 Companies.

* * * * *

(b) * * *

(8) the quarterly financial and other information as would have been required had the company being acquired been required to file Part I of Form 10-Q (§ 249.308a of this chapter) for the most recent quarter for which such a report would have been on file at the time of the registration statement becomes effective or for a period ending as of a more recent date.

* * * * *

Item 18. Information if Proxies, Consents or Authorizations are to be solicited.

* * * * *

(b) If the registrant or the company being acquired meets the requirements for use of Form S-3, any information required by paragraphs (a)(5)(ii) and (7) of this Item with respect to such company may be incorporated by reference from its latest annual report on Form 10-K.

Item 19. Information if Proxies, Consents or Authorizations are not to be Solicited or in an Exchange Offer.

* * * * *

(c) If the registrant or the company being acquired meets the requirements for use of Form S-3, any information required by paragraphs (a)(5) and (7) of this Item with respect to such company may be incorporated by reference from its latest annual report on Form 10-K.

* * * * *

49. Revise §239.42 to read as follows:

§ 239.42 Form F-X, for appointment of agent for service of process and undertaking for issuers registering securities on Form F–8, F–9, F–10, or F–80 (§§239.38, 239.39, 239.40, or 239.41), or registering securities or filing periodic reports on Form 40–F (§ 249.240f), or by any issuer or other non-U.S. person filing tender offer documents on Schedule 13E–4F, 14D–1F, or 14D–9F (§§ 240.13e–102, 240.14d–102, or 240.14d–103 of this chapter), by any non-U.S. person acting as trustee with respect to securities registered on Form F–7 (§ 239.37), F–8, F–9, F–10, or by a Canadian issuer qualifying an offering statement pursuant to Regulation A (§ 230.251 et seq.) on Form 1–A (§ 239.90), or by any non-U.S. issuer providing Form CB (§ 249.480) of this chapter to the Commission in connection with a tender offer, rights offering or business combination.

Form F-X shall be filed with the Commission:

(a) By any issuer registering securities on Form F–8, F–9, F–10, or F–80 under the Securities Act of 1933;

(b) By any issuer registering securities on Form 40–F under the Securities Exchange Act of 1934;

(c) By any issuer filing a periodic report on Form 40–F, if it has not previously filed a Form F-X in connection with the class of securities in relation to which the obligation to file a report on Form 40–F arises;

(d) By any issuer or other non-U.S. person filing tender offer documents on Schedule 13E–4F, 14D–1F, or 14D–9F;

(e) By any non-U.S. person acting as trustee with respect to securities registered on Form F–7, F–8, F–9, F–10, or F–80;

(f) By a Canadian issuer qualifying an offering statement pursuant to the provisions of Regulation A; and

(g) By any non-U.S. issuer providing Form CB to the Commission in connection with a tender offer, rights offering or business combination.

50. Amend Form F-X (referenced in § 239.42) by revising General Instructions I.(e) and II. F. (a) and (c) to read as follows:

Note- The text of Form F-X does not and this amendment will not appear in the Code of Federal Regulations.

FORM F-X

APPOINTMENT OF AGENT FOR SERVICE OF PROCESS AND UNDERTAKING

GENERAL INSTRUCTIONS

I. * * *

* * * * *

(e) by any non-U.S. person acting as trustee with respect to securities registered on Form F-7, F-8, F-9, F-10, or F-80; and

* * * * *

II. * * *

F. Each person filing this Form in connection with:

(a) the use of Form F-9, F-10, or 40-F or Schedule 13E-4F, 14D-1F, or 14D-9F stipulates and agrees to appoint a successor agent for service of process and file an amended Form F-X if the Filer discharges the Agent or the Agent is unwilling or unable to accept service on behalf of the Filer at any time until six years have elapsed from the date the issuer of the securities to which such Forms and Schedules relate has ceased reporting under the Exchange Act;

* * * * *

(c) its status as trustee with respect to securities registered on Form F-7, F-8, F-9, F-10, or F-80 stipulates and agrees to appoint a successor agent for service of process and file an amended Form F-X if the Filer discharges the Agent or the Agent is unwilling or unable to accept service on behalf of the Filer at any time during which any of the securities subject to the indenture remain outstanding; and

* * * * *

51. Amend Form 1-A (referenced in § 239.90) by revising paragraph B in Part II to read as follows:

Note- The text of Form 1-A does not and this amendment will not appear in the Code of Federal Regulations.

FORM 1-A
REGULATION A OFFERING STATEMENT
UNDER THE SECURITIES ACT OF 1933

* * * * *

PART II— OFFERING CIRCULAR

* * * * *

B. For all other issuers and for any issuer that so chooses — the information required by either Part I of Form S-1, (17 CFR 239.11), except for the financial statements called for there, or Model B of this Part II of Form 1-A. Offering circulars prepared pursuant to this instruction need not follow the order of the items or other requirements of the disclosure form. Such information shall not, however, be set forth in such a fashion as to obscure any of the required information or information necessary to keep the required information from being incomplete or misleading. Information requested to be presented in a specified tabular format shall be given in substantially the tabular form specified in the item.

* * * * *

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

52. The authority citations for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

53. Amend § 240.0-2 by revising paragraph (a) to read as follows:

§ 240.0-2 Business hours of the Commission.

(a) The principal office of the Commission, at 100 F Street, NE, Washington, DC 20549, is open each day, except Saturdays, Sundays, and Federal holidays, from 9 a.m. to 5:30 p.m., Eastern Standard Time or Eastern Daylight Saving Time, whichever currently is in effect in Washington, DC, provided that hours for the filing of documents pursuant to the Act or the rules and regulations thereunder are as set forth in paragraphs (b) and (c) of this section.

* * * * *

54. Amend § 240.0-12 by revising the second section of paragraph (c) to read as follows:

§ 240.0-12 Commission procedures for filing applications for orders for exemptive relief under Section 36 of the Exchange Act.

* * * * *

(c) * * * An applicant also may submit a request in paper format. Five copies of every paper application and every amendment to such an application must be submitted to the Office of the Secretary at 100 F Street, NE, Washington, DC 20549. * * *

* * * * *

55. Amend § 240.3b-6 by revising the introductory text of paragraph (b)(1), paragraphs (b)(1)(i) and (b)(2) to read as follows:

§ 240.3b-6 Liability for certain statements by issuers.

* * * * *

(b) * * *

(1) A forward-looking statement (as defined in paragraph (c) of this section) made in a document filed with the Commission, in Part I of a quarterly report on Form 10–Q, § 249.308a of this chapter, or in an annual report to share holders meeting the requirements of Rules 14a–3(b) and (c) or 14c–3(a) and (b)(§§ 240.14a-3(b) and (c) or 240.14c-3(a) and (b)), a statement reaffirming such forward-looking statement subsequent to the date the document was filed or the annual report was made publicly available, or a forward-looking statement made prior to the date the document was filed or the date the annual report was made publicly available if such statement is reaffirmed in a filed document, in Part I of a quarterly report on Form 10–Q, or in an annual report made publicly available within a reasonable time after the making of such forward-looking statement; <u>Provided</u>, that:

(i) At the time such statements are made or reaffirmed, either the issuer is subject to the reporting requirements of section 13(a) or 15(d) of the Act and has complied with the requirements of Rule 13a–1 or 15d–1 thereunder, if applicable, to file its most recent annual report on Form 10–K, Form 20–F or Form 40–F; or if the issuer is not subject to the reporting requirements of Sections 13(a) or 15(d) of the Act, the statements are made in a registration statement filed under the Securities Act of 1933 offering statement or solicitation of interest written document or broadcast script under Regulation A or pursuant to Section 12 (b) or (g) of the Securities Exchange Act of 1934; and

* * * * *

(2) Information that is disclosed in a document filed with the Commission in Part I of a quarterly report on Form 10–Q (§ 249.308a of this chapter) or in an annual report to security holders meeting the requirements of Rules 14a–3(b) and (c) or 14c–3(a) and (b) under the Act (§§ 240.14a–3(b) and (c) or 240.14c–3(a) and (b) of this chapter) and which relates to:

(i) The effects of changing prices on the business enterprise, presented voluntarily or pursuant to Item 303 of Regulation S-K (§ 229.303 of this chapter) "Management's Discussion and Analysis of Financial Condition and Results of Operations" or Item 5 of Form 20–F, "Operating and Financial Review and Prospects," or Item 302 of Regulation S-K (§ 229.302 of this chapter), "Supplementary financial information" or Rule 3–20(c) of Regulation S-X (§ 210.3–20(c)) of this chapter); or

(ii) The value of proved oil and gas reserves (such as a standardized measure of discounted future net cash flows relating to proved oil and gas reserves as set forth in paragraphs 30–34 of Statement of Financial Accounting Standards No. 69) presented voluntarily or pursuant to Item 302 of Regulation S-K (§ 229.302 of this chapter).

* * * * *

56. Amend § 240.10A-1 by revising paragraphs (a)(4)(ii) and (b)(3) to read as follows:

§ 240.10A-1 Notice to the Commission Pursuant to Section 10A of the Act.

(a)(1) * * *

(4) * * *

(ii) The disclosure requirements of item 304 of Regulation S-K, § 229.304 of this chapter.

(b)(1) * * *

(3) Submission of the report (or documentation) by the independent accountant as described in paragraphs (b)(1) and (b)(2) of this section shall not replace, or otherwise satisfy the need for, the newly engaged and former accountants' letters under items 304(a)(2)(D) and 304(a)(3) of Regulation S-K, §§ 229.304(a)(2)(D) and 229.304(a)(3) of this chapter, respectively, and shall not limit, reduce, or affect in any way the independent accountant's obligations to comply fully with all other legal and professional responsibilities, including, without limitation, those under generally accepted auditing standards and the rules or interpretations of the Commission that modify or supplement those auditing standards.

* * * * *

57. Amend § 240.10A-3 by revising paragraph (a)(5)(i)(A) to read as follows:

§ 240.10A-3 Listing standards relating to audit committees.

(a) * * *

(5) * * *

(i) * * *

(A) July 31, 2005 for foreign private issuers and smaller reporting companies (as defined in § 240.12b–2); and

* * * * *

58. Amend § 240.12b-2 by:

a. Revising paragraphs (1)(iv) and (2)(iv) in the definition of accelerated filer;

b. Removing the definition of Small business issuer; and

c. Adding the definition of Smaller reporting company in alphabetical order.

The revisions and addition to read as follows:

§ 240.12b-2 Definitions

* * * * *

Accelerated filer and large accelerated filer

(1) Accelerated filer. * * *

(i) * * *

(iv) The issuer is not eligible to use the requirements for smaller reporting companies in Part 229 of this chapter for its annual and quarterly reports.

* * * * *

(2) Large accelerated filer. * * *

(i) * * *

(iv) The issuer is not eligible to use the requirements for smaller reporting companies in Part 229 of this chapter for its annual and quarterly reports.

* * * * *

Smaller reporting company. As used in this part, the term "smaller reporting company" means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:

(1) Had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide

number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or

(2) In the case of an initial registration statement under the Securities Act for shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus the number of such shares included in the registration statement by the estimated public offering price of the shares; or

(3) In the case of an issuer whose public float as calculated under paragraph (1) or (2) of this definition was zero because the issuer had no significant public common equity outstanding or no market price for its common equity existed, had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available on the date of the filing that establishes whether or not the issuer is a smaller reporting company for any fiscal year.

(4) Determination: Whether or not an issuer is a smaller reporting company is determined for an entire fiscal year on the basis of the information in a quarterly report on Form 10-Q or an initial registration statement under the Securities Act or this Act, whichever is first to be filed during that year. Once an issuer fails to qualify for smaller reporting company status, it will remain unqualified unless it determines that its public float, as calculated in accordance with paragraph (1) of this definition was less than $50 million as of the last business day of its second fiscal quarter or, if that calculation results in zero because the issuer had no significant public equity outstanding or no market price for its equity existed, if the issuer had annual revenues of

less than $40 million during its previous fiscal year. An issuer making this determination becomes a smaller reporting company for the purpose of filings for the next fiscal year.

* * * * *

59. Amend § 240.12b-23 by revising paragraphs (a)(3)(i) and (b) to read as follows:

§ 240.12b-23 Incorporation by reference.

(a) * * *

(3) * * *

(i) A proxy or information statement incorporated by reference in response to Part III of Form 10–K (17 CFR 249.310);

* * * * *

(b) Any incorporation by reference of matter pursuant to this section shall be subject to the provisions of § 229.10(d) of this chapter restricting incorporation by reference of documents which incorporate by reference other information. Material incorporated by reference shall be clearly identified in the reference by page, paragraph, and caption or otherwise. Where only certain pages of a document are incorporated by reference and filed as an exhibit, the document from which the material is taken shall be clearly identified in the reference. An express statement that the specified matter is incorporated by reference shall be made at the particular place in the statement or report where the information is required. Matter shall not be incorporated by reference in any case where such incorporation would render the statement or report incomplete, unclear or confusing.

60. Amend § 240.12b-25 by revising the section heading and paragraphs (a) and (b)(2)(ii) to read as follows:

§ 240.12b-25 Notification of inability to timely file all or any required portion of a Form 10–K, 20–F, 11–K, N–SAR, N–CSR, 10–Q, or 10–D.

(a) If all or any required portion of an annual or transition report on Form 10–K, 20–F or 11–K (17 CFR 249.310, 249.220f or 249.311), a quarterly or transition report on Form 10–Q (17 CFR 249.308a), or a distribution report on Form 10–D (17 CFR 249.312) required to be filed pursuant to Section 13 or 15(d) of the Act (15 U.S.C. 78m or 78o(d)) and rules thereunder, or if all or any required portion of a semi-annual, annual or transition report on Form N–CSR (17 CFR 249.331; 17 CFR 274.128) or Form N–SAR (17 CFR 249.330; 17 CFR 274.101) required to be filed pursuant to Sections 13 or 15(d) of the Act or section 30 of the Investment Company Act of 1940 (15 U.S.C. 80a–29) and the rules thereunder, is not filed within the time period prescribed for such report, the registrant, no later than one business day after the due date for such report, shall file a Form 12b–25 (17 CFR 249.322) with the Commission which shall contain disclosure of its inability to file the report timely and the reasons therefor in reasonable detail.

(b) * * *

(2) * * *

(ii) The subject annual report, semi-annual report or transition report on Form 10–K, 20-F, 11–K, N–SAR, or N–CSR, or portion thereof, will be filed no later than the fifteenth calendar day following the prescribed due date; or the subject quarterly report or transition report on Form 10–Q or distribution report on Form 10–D, or portion thereof, will be filed no later than the fifth calendar day following the prescribed due date; and

* * * * *

61. Amend § 240.12h-3 by revising paragraph (e) to read as follows:

§ 240.12h-3 Suspension of duty to file reports under section 15(d).

* * * * *

(e) If the suspension provided by this section is discontinued because a class of securities does not meet the eligibility criteria of paragraph (b) of this section on the first day of an issuer's fiscal year, then the issuer shall resume periodic reporting pursuant to section 15(d) of the Act by filing an annual report on Form 10–K for its preceding fiscal year, not later than 120 days after the end of such fiscal year.

62. Amend § 240.13a-10 by revising paragraphs (c), (d)(2)(ii), (d)(2)(iii), the introductory text of paragraph (e), paragraphs (e)(1), (e)(2), (e)(4), the Note to paragraphs (c) and (e) and the introductory text of paragraph (j)(2) to read as follows:

§ 240.13a-10 Transition reports.

* * * * *

(c) If the transition period covers a period of less than six months, in lieu of the report required by paragraph (b) of this section, a report may be filed for the transition period on Form 10–Q (§ 249.308a of this chapter) not more than the number of days specified in paragraph (j) of this section after either the close of the transition period or the date of the determination to change the fiscal closing date, whichever is later. The report on Form 10–Q shall cover the period from the close of the last fiscal year end and shall indicate clearly the period covered. The financial statements filed therewith need not be audited but, if they are not audited, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period. The notes to financial statements for the transition period included in such first annual report may be integrated with the notes to financial statements for the full fiscal period. A separate audited balance sheet as of the end of the transition period shall be filed in the annual report only if the audited balance sheet as of the end of the fiscal year prior to the transition period is not filed. Schedules need not be filed in transition reports on Form 10–Q.

(d) * * *

(2) * * *

(ii) The first report required to be filed by the issuer for the newly adopted fiscal year after the date of the determination to change the fiscal year end is a quarterly report on Form 10-Q; and

(iii) Information on the transition period is included in the issuer's quarterly report on Form 10–Q for the first quarterly period (except the fourth quarter) of the newly adopted fiscal year that ends after the date of the determination to change the fiscal year. The information covering the transition period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for the transition period.

(e) Every issuer required to file quarterly reports on Form 10–Q pursuant to § 240.13a-13 of this chapter that changes its fiscal year end shall:

(1) File a quarterly report on Form 10–Q within the time period specified in General Instruction A.1. to that form for any quarterly period (except the fourth quarter) of the old fiscal year that ends before the date on which the issuer determined to change its fiscal year end, except that the issuer need not file such quarterly report if the date on which the quarterly period ends also is the date on which the transition period ends;

(2) File a quarterly report on Form 10–Q within the time specified in General Instruction A.1. to that form for each quarterly period of the old fiscal year within the transition period. In lieu of a quarterly report for any quarter of the old fiscal year within the transition period, the issuer may file a quarterly report on Form 10–Q for any period of three months within the transition period that coincides with a quarter of the newly adopted fiscal year if the quarterly report is filed within the number of days specified in paragraph (j) of this section after the end of

such three month period, provided the issuer thereafter continues filing quarterly reports on the basis of the quarters of the newly adopted fiscal year;

* * * * *

(4) Unless such information is or will be included in the transition report, or the first annual report on Form 10–K for the newly adopted fiscal year, include in the initial quarterly report on Form 10–Q for the newly adopted fiscal year information on any period beginning on the first day subsequent to the period covered by the issuer's final quarterly report on Form 10–Q or annual report on Form 10–K for the old fiscal year. The information covering such period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for such period.

<u>Note to paragraphs (c) and (e)</u>: If it is not practicable or cannot be cost-justified to furnish in a transition report on Form 10–Q or a quarterly report for the newly adopted fiscal year financial statements for corresponding periods of the prior year where required, financial statements may be furnished for the quarters of the preceding fiscal year that most nearly are comparable if the issuer furnishes an adequate discussion of seasonal and other factors that could affect the comparability of information or trends reflected, an assessment of the comparability of the data, and a representation as to the reason recasting has not been undertaken.

* * * * *

(j) * * *

(2) For transition reports to be filed on Forms 10-Q (§ 249.308a of this chapter) the number of days shall be:

* * * * *

63. Amend § 240.13a-13 by revising the section heading, paragraph (a), the introductory text of paragraph (c), and paragraph (d) to read as follows:

§ 240.13a-13 Quarterly reports on Form 10–Q (§ 249.308a of this chapter).

(a) Except as provided in paragraphs (b) and (c) of this section, every issuer that has securities registered pursuant to section 12 of the Act and is required to file annual reports pursuant to section 13 of the Act, and has filed or intends to file such reports on Form 10–K (§ 249.310 of this chapter), shall file a quarterly report on Form 10–Q (§ 249.308a of this chapter) within the period specified in General Instruction A.1. to that form for each of the first three quarters of each fiscal year of the issuer, commencing with the first fiscal quarter following the most recent fiscal year for which full financial statements were included in the registration statement, or, if the registration statement included financial statements for an interim period subsequent to the most recent fiscal year end meeting the requirements of Article 10 of Regulation S-X, for the first fiscal quarter subsequent to the quarter reported upon in the registration statement. The first quarterly report of the issuer shall be filed either within 45 days after the effective date of the registration statement or on or before the date on which such report would have been required to be filed if the issuer has been required to file reports on Form 10–Q as of its last fiscal quarter, whichever is later.

* * * * *

(c) Part I of the quarterly reports on Form 10–Q need not be filed by:

* * * * *

(d) Notwithstanding the foregoing provisions of this section, the financial information required by Part I of Form 10–Q, shall not be deemed to be "filed" for the purpose of Section 18 of the Act or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act.

64. Amend § 240.13a-14 by revising paragraph (a) to read as follows:

§ 240.13a-14 Certification of disclosure in annual and quarterly reports.

(a) Each report, including transition reports, filed on Form 10–Q, Form 10–K, Form 20–F or Form 40–F (§§ 249.308a, 249.310, 249.220f or 249.240f of this chapter) under Section 13(a) of the Act (15 U.S.C. 78m(a)), other than a report filed by an Asset-Backed Issuer (as defined in § 229.1101 of this chapter) or a report on Form 20–F filed under § 240.13a–19, must include certifications in the form specified in the applicable exhibit filing requirements of such report and such certifications must be filed as an exhibit to such report. Each principal executive and principal financial officer of the issuer, or persons performing similar functions, at the time of filing of the report must sign a certification. The principal executive and principal financial officers of an issuer may omit the portion of the introductory language in paragraph 4 as well as language in paragraph 4(b) of the certification that refers to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting for the issuer until the issuer becomes subject to the internal control over financial reporting requirements in § 240.13a–15 or 240.15d–15.

* * * * *

65. Amend § 240.13a-16 by revising paragraph (a)(3) to read as follows:

§ 240.13a-16 Reports of foreign private issuers on Form 6–K (17 CFR 249.306).

(a) * * *

(3) Issuers filing periodic reports on Forms 10–K, Form 10–Q, and Form 8–K; or

* * * * *

66. Amend § 240.13a-20 by revising the introductory text of paragraph (a) to read as follows:

§ 240.13a-20 Plain English presentation of specified information.

(a) Any information included or incorporated by reference in a report filed under section 13(a) of the Act (15 U.S.C. 78m(a)) that is required to be disclosed pursuant to Item 402, 403, 404 or 407 of Regulation S–K (§ 229.402, 229.403, 229.404 or 229.407 of this chapter) must be presented in a clear, concise and understandable manner. You must prepare the disclosure using the following standards:

* * * * *

67. Amend § 240.14a-3 by removing the Note to Small Business Issuers following the introductory text of paragraph (b), revising paragraph (b)(1) and Note 1, revising the heading "Note 2" to read "Note 2 to Paragraph (b)(i)", revising paragraphs (b)(5)(ii), (b)(10) and its Note, and (d) to read as follows:

§ 240.14a-3 Information to be furnished to security holders.

* * * * *

(b) * * *

(1) The report shall include, for the registrant and its subsidiaries, consolidated and audited balance sheets as of the end of the two most recent fiscal years and audited statements of income and cash flows for each of the three most recent fiscal years prepared in accordance with Regulation S-X (part 210 of this chapter), except that the provisions of Article 3 (other than §§210.3-03(e), 2103-04 and 210.3-20) and Article 11 shall not apply. Any financial statement schedules or exhibits or separate financial statements which may otherwise be required in filings with the Commission may be omitted. If the financial statements of the registrant and its subsidiaries consolidated in the annual report filed or to be filed with the Commission are not required to be audited, the financial statements required by this paragraph may be unaudited. A smaller reporting company may provide the information in Item 310 of Regulation S-K

(§ 229.310 of this chapter) in lieu of the financial information required by Rule 14a-3(b)(1) (§ 240.14a-3(b)(1).

Note 1 to Paragraph (b)(1): If the financial statements for a period prior to the most recently completed fiscal year have been examined by a predecessor accountant, the separate report of the predecessor accountant may be omitted in the report to security holders provided the registrant has obtained from the predecessor accountant a reissued report covering the prior period presented and the successor accountant clearly indicates in the scope paragraph of his report (a) that the financial statements of the prior period were examined by other accountants, (b) the date of their report, (c) the type of opinion expressed by the predecessor accountant and (d) the substantive reasons therefor, if it was other than unqualified. It should be noted, however, that the separate report of any predecessor accountant is required in filings with the Commission. If, for instance, the financial statements in the annual report to security holders are incorporated by reference in a Form 10–K, the separate report of a predecessor accountant shall be filed in Part II or in Part IV as a financial statement schedule.

* * * * *

(5) * * *

(ii) The report shall contain management's discussion and analysis of financial condition and results of operations required by Item 303 of Regulation S-K (§ 229.303 of this chapter).

* * * * *

(10) The registrant's proxy statement, or the report, shall contain an undertaking in bold face or otherwise reasonably prominent type to provide without charge to each person solicited upon the written request of any such person, a copy of the registrant's annual report on Form 10-K, including the financial statements and the financial statement schedules, required to be filed with the Commission pursuant to Rule 13a–1 under the Act for the registrant's most recent

fiscal year, and shall indicate the name and address (including title or department) of the person to whom such a written request is to be directed. In the discretion of management, a registrant need not undertake to furnish without charge copies of all exhibits to its Form 10–K provided that the copy of the annual report on Form 10–K furnished without charge to requesting security holders is accompanied by a list briefly describing all the exhibits not contained therein and indicating that the registrant will furnish any exhibit upon the payment of a specified reasonable fee which fee shall be limited to the registrant's reasonable expenses in furnishing such exhibit. If the registrant's annual report to security holders complies with all of the disclosure requirements of Form 10–K and is filed with the Commission in satisfaction of its Form 10–K filing requirements, such registrant need not furnish a separate Form 10–K to security holders who receive a copy of such annual report.

Note to Paragraph (b)(10): Pursuant to the undertaking required by paragraph (b)(10) of this section, a registrant shall furnish a copy of its annual report on Form 10–K (§ 249.310 of this chapter) to a beneficial owner of its securities upon receipt of a written request from such person. Each request must set forth a good faith representation that, as of the record date for the solicitation requiring the furnishing of the annual report to security holders pursuant to paragraph (b) of this section, the person making the request was a beneficial owner of securities entitled to vote.

* * * * *

(d) An annual report to security holders prepared on an integrated basis pursuant to General Instruction H to Form 10–K (§ 249.310) may also be submitted in satisfaction of this section. When filed as the annual report on Form 10–K, responses to the Items of that form are subject to section 18 of the Act notwithstanding paragraph (c) of this section.

* * * * *

68. Amend § 240.14a-5 by removing the authority citation following the section and revising paragraph (f) to read as follows:

§ 240.14a-5 Presentation of information in proxy statement.

* * * * *

(f) If the date of the next annual meeting is subsequently advanced or delayed by more than 30 calendar days from the date of the annual meeting to which the proxy statement relates, the registrant shall, in a timely manner, inform shareholders of such change, and the new dates referred to in paragraphs (e)(1) and (e)(2) of this section, by including a notice, under Item 5, in its earliest possible quarterly report on Form 10–Q (§ 249.308a of this chapter), or, in the case of investment companies, in a shareholder report under § 270.30d-1 of this chapter under the Investment Company Act of 1940, or, if impracticable, any means reasonably calculated to inform shareholders.

69. Amend § 240.14a-8, by revising paragraph (e)(1) to read as follows:

§ 240.14a-8 Shareholder proposals.

* * * * *

(e) * * *

(1) If you are submitting your proposal for the company's annual meeting, you can in most cases find the deadline in last year's proxy statement. However, if the company did not hold an annual meeting last year, or has changed the date of its meeting for this year more than 30 days from last year's meeting, you can usually find the deadline in one of the company's quarterly reports on Form 10–Q (§ 249.308a of this chapter), or in shareholder reports of investment companies under § 270.30d–1 of this chapter of the Investment Company Act of 1940. In order to avoid controversy, shareholders should submit their proposals by means, including electronic means, that permit them to prove the date of delivery.

* * * * *

70. Amend § 240.14a-101 by revising Notes C. and D.1, and the introductory text of Note E.; and removing Notes F. and G. to the cover page and revising paragraph (e)(1) of Item 9, and revising paragraph (a)(1) of Item 13 to read as follows:

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

* * * * *

Schedule 14A Information

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

* * * * *

Notes: * * *

C. Except as otherwise specifically provided, where any item calls for information for a specified period with regard to directors, executive officers, officers or other persons holding specified positions or relationships, the information shall be given with regard to any person who held any of the specified positions or relationship at any time during the period. Information, other than information required by Item 404 of Regulation S–K (§ 229.404 of this chapter), need not be included for any portion of the period during which such person did not hold any such position or relationship, provided a statement to that effect is made.

* * * * *

D. * * *

1. Any incorporation by reference of information pursuant to the provisions of this schedule shall be subject to the provisions of § 229.10(d) of this chapter restricting incorporation by reference of documents which incorporate by reference other information. A registrant incorporating any documents, or portions of documents, shall include a statement on the last page(s) of the proxy statement as to which documents, or portions of documents, are

incorporated by reference. Information shall not be incorporated by reference in any case where such incorporation would render the statement incomplete, unclear or confusing.

* * * * *

E. In Item 13 of this Schedule, the reference to "meets the requirement of Form S–3" shall refer to a registrant who meets the following requirements:

* * * * *

Item 9. Independent public accountants.

* * * * *

(e) (1) Disclose, under the caption Audit Fees, the aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements and review of financial statements included in the registrant's Form 10–Q (17 CFR 249.308a) or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years.

* * * * *

Item 13. Financial and other information. (See Notes D and E at the beginning of this Schedule.)

(a) * * *

(1) Financial statements meeting the requirements of Regulation S-X, including financial information required by Rule 3-05 and Article 11 of Regulation S-X with respect to transactions other than pursuant to which action is to be taken as described in this proxy statement (A smaller reporting company may provide the information in Item 310 of Regulation S-K (§ 229.310 of this chapter) in lieu of the financial information required by Rule 3-05 and Article 11 of Regulation S-X);

* * * * *

71. Amend § 240.14c-3 by removing the Note to Small Business Issuers following paragraph (a)(2).

72. Amend § 240.14c-101 by revising the Note that follows the cover page to read as follows:

§ 240.14c-101 Schedule 14C. Information required in information statement.

Schedule 14C Information

Information Statement Pursuant to Section 14(c) of the Securities Exchange Act of 1934

* * * * *

Note to Cover Page: Where any item, other than Item 4, calls for information with respect to any matter to be acted upon at the meeting or, if no meeting is being held, by written authorization or consent, such item need be answered only with respect to proposals to be made by the registrant. Registrants and acquirees that meet the definition of "smaller reporting company" under Rule 12b–2 of the Exchange Act (§ 240.12b–2) shall refer to the disclosure items in Regulation S-K (§§ 229.10 through 229.1123 of this chapter) and may use the scaled disclosure requirements provided therein for smaller reporting companies. A smaller reporting company may provide the information in Item 310 of Regulation S-K in lieu of any financial statements required by Item 1 of § 240.14c–101.

* * * * *

73. Amend § 240.14d-3 by removing the authority citation following the section and revising paragraph (a)(3)(i) to read as follows:

§ 240.14d-3 Filing and transmission of tender offer statement.

(a) * * *

(3) * * *

(i) To each national securities exchange where such class of the subject company's securities is registered and listed for trading (which may be based upon information contained in the subject company's most recent Annual Report on Form 10–K (§ 249.310 of this chapter) filed with the Commission unless the bidder has reason to believe that such information is not current) which telephonic notice shall be made when practicable prior to the opening of each such exchange; and

* * * * *

74. Amend § 240.15d-10 by revising paragraphs (c), (d)(2)(ii), (d)(2)(iii), the introductory text of (e), paragraphs (e)(1), (e)(2), (e)(4), the Note to paragraphs (c) and (e), paragraph (f), and the introductory text of (j)(2) to read as follows:

§ 240.15d-10 Transition reports.

* * * * *

(c) If the transition period covers a period of less than six months, in lieu of the report required by paragraph (b) of this section, a report may be filed for the transition period on Form 10–Q (§ 249.308 of this chapter) not more than the number of days specified in paragraph (j) of this section after either the close of the transition period or the date of the determination to change the fiscal closing date, whichever is later. The report on Form 10–Q shall cover the period from the close of the last fiscal year end and shall indicate clearly the period covered. The financial statements filed therewith need not be audited but, if they are not audited, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period. The notes to financial statements for the transition period included in such first annual report may be integrated with the notes to financial statements for the full fiscal period. A separate audited balance sheet as of the end of the transition period shall be filed in the annual report only if the audited balance sheet as of the end of the fiscal year prior to the transition period is not filed. Schedules need not be filed in transition reports on Form 10–Q.

(d) * * *

(2)(i) * * *

(ii) The first report required to be filed by the issuer for the newly adopted fiscal year after the date of the determination to change the fiscal year end is a quarterly report on Form 10-Q; and

(iii) Information on the transition period is included in the issuer's quarterly report on Form 10–Q for the first quarterly period (except the fourth quarter) of the newly adopted fiscal year that ends after the date of the determination to change the fiscal year. The information covering the transition period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for the transition period.

* * * * *

(e) Every issuer required to file quarterly reports on Form 10–Q pursuant to § 240.15d-13 that changes its fiscal year end shall:

(1) File a quarterly report on Form 10–Q within the time period specified in General Instruction A.1. to that form for any quarterly period (except the fourth quarter) of the old fiscal year that ends before the date on which the issuer determined to change its fiscal year end, except that the issuer need not file such quarterly report if the date on which the quarterly period ends also is the date on which the transition period ends;

(2) File a quarterly report on Form 10–Q within the time specified in General Instruction A.1 to that form for each quarterly period of the old fiscal year within the transition period. In lieu of a quarterly report for any quarter of the old fiscal year within the transition period, the

issuer may file a quarterly report on Form 10–Q for any period of three months within the transition period that coincides with a quarter of the newly adopted fiscal year if the quarterly report is filed within the number of days specified in paragraph (j) of this section after the end of such three month period, provided the issuer thereafter continues filing quarterly reports on the basis of the quarters of the newly adopted fiscal year;

* * * * *

(4) Unless such information is or will be included in the transition report, or the first annual report on Form 10–K for the newly adopted fiscal year, include in the initial quarterly report on Form 10–Q for the newly adopted fiscal year information on any period beginning on the first day subsequent to the period covered by the issuer's final quarterly report on Form 10–Q or annual report on Form 10–K for the old fiscal year. The information covering such period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for such period.

<u>Note to Paragraphs (c) and (e)</u>: If it is not practicable or cannot be cost-justified to furnish in a transition report on Form 10–Q or a quarterly report for the newly adopted fiscal year financial statements for corresponding periods of the prior year where required, financial statements may be furnished for the quarters of the preceding fiscal year that most nearly are comparable if the issuer furnishes an adequate discussion of seasonal and other factors that could affect the comparability of information or trends reflected, an assessment of the comparability of the data, and a representation as to the reason recasting has not been undertaken.

(f) Every successor issuer that has a different fiscal year from that of its predecessor(s) shall file a transition report pursuant to this section, containing the required information about each predecessor, for the transition period, if any, between the close of the fiscal year covered by the last annual report of each predecessor and the date of succession. The report shall be filed for the transition period on the form appropriate for annual reports of the issuer not more than the number of days specified in paragraph (j) of this section after the date of the succession, with financial statements in conformity with the requirements set forth in paragraph (b) of this section. If the transition period covers a period of less than six months, in lieu of a transition report on the form appropriate for the issuer's annual reports, the report may be filed for the transition period on Form 10–Q not more than the number of days specified in paragraph (j) of this section after the date of the succession, with financial statements in conformity with the requirements set forth in paragraph (c) of this section. Notwithstanding the foregoing, if the transition period covers a period of one month or less, the successor issuer need not file a separate transition report if the information is reported by the successor issuer in conformity with the requirements set forth in paragraph (d) of this section.

* * * * *

(j) * * *

(2) For transition reports to be filed on Form 10–Q (§ 249.308 of this chapter), the number of days shall be:

* * * * *

75. Amend § 240.15d-13 by revising the section heading, paragraph (a), the introductory text of (c), and paragraphs (d) and (e) to read as follows:

§ 240.15d-13 Quarterly reports on Form 10–Q (§ 249.308 of this chapter).

(a) Except as provided in paragraphs (b) and (c) of this section, every issuer that has securities registered pursuant to the Securities Act and is required to file annual reports pursuant to section 15(d) of the Act on Form 10–K (§ 249.310 of this chapter) shall file a quarterly report on Form 10–Q (§ 249.308 of this chapter) within the period specified in General Instruction A.1.

to that form for each of the first three quarters of each fiscal year of the issuer, commencing with the first fiscal quarter following the most recent fiscal year for which full financial statements were included in the registration statement, or, if the registration statement included financial statements for an interim period subsequent to the most recent fiscal year end meeting the requirements of Article 10 of Regulation S-X, for the first fiscal quarter subsequent to the quarter reported upon in the registration statement. The first quarterly report of the issuer shall be filed either within 45 days after the effective date of the registration statement or on or before the date on which such report would have been required to be filed if the issuer had been required to file reports on Form 10–Q as of its last fiscal quarter, whichever is later.

* * * * *

(c) Part I of the quarterly reports on Form 10–Q need not be filed by:

* * * * *

(d) Notwithstanding the foregoing provisions of this section, the financial information required by Part I of Form 10–Q shall not be deemed to be "filed" for the purpose of section 18 of the Act or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act.

(e) Notwithstanding the foregoing provisions of this section, the financial information required by Part I of Form 10–Q, or financial information submitted in lieu thereof pursuant to paragraph (d) of this section, shall not be deemed to be "filed" for the purpose of section 18 of the Act or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act.

76. Amend § 240.15d-14 by revising paragraph (a) to read as follows:

§ 240.15d-14 Certification of disclosure in annual and quarterly reports.

(a) Each report, including transition reports, filed on Form 10–Q, Form 10–K, Form 20–F or Form 40–F (§249.308a, 249.310, 249.220f or 249.240f of this chapter) under section 15(d) of the Act (15 U.S.C. 78o(d)), other than a report filed by an Asset-Backed Issuer (as defined in §-229.1101 of this chapter) or a report on Form 20–F filed under § 240.15d–19, must include certifications in the form specified in the applicable exhibit filing requirements of such report and such certifications must be filed as an exhibit to such report. Each principal executive and principal financial officer of the issuer, or persons performing similar functions, at the time of filing of the report must sign a certification. The principal executive and principal financial officers of an issuer may omit the portion of the introductory language in paragraph 4 as well as language in paragraph 4(b) of the certification that refers to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting for the issuer until the issuer becomes subject to the internal control over financial reporting requirements in § 240.13a–15 or 240.15d–15.

* * * * *

77. Amend § 240.15d-20 by revising the introductory text of paragraph (a) to read as follows:

§ 240.15d-20 Plain English presentation of specified information.

(a) Any information included or incorporated by reference in a report filed under section 15(d) of the Act (15 U.S.C. 78o(d)) that is required to be disclosed pursuant to Item 402, 403, 404 or 407 of Regulation S–K (§229.402, 229.403, 229.404 or 229.407 of this chapter) must be presented in a clear, concise and understandable manner. You must prepare the disclosure using the following standards:

* * * * *

78. Amend § 240.15d-21 by revising paragraph (a)(1) to read as follows:

§ 240.15d-21 Reports for employee stock purchase, savings and similar plans.

(a) * * *

(1) The issuer of the stock or other securities offered to employees through their participation in the plan files annual reports on Form 10–K (§ 249.310 of this chapter); and

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

79. The authority citations for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq., 7202, 7233, 7241, 7262, 7264, and 7265; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

80. Amend § 249.0-1 by revising paragraph (b) to read as follows:

§ 249.0-1 Availability of forms.

* * * * *

(b) Any person may obtain a copy of any form prescribed for use in this part by written request to the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Any person may inspect the forms at this address and at the Commission's regional offices. (See § 200.11 of this chapter for the addresses of SEC regional offices).

81. Amend Form 8-A (referenced in § 249.208a) by revising Item 1 before the Instruction to read as follows:

Note- The text of Form 8-A does not and this amendment will not appear in the Code of Federal Regulations.

FORM 8-A

FOR REGISTRATION OF CERTAIN CLASSES OF SECURITIES PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES ACT OF 1934

* * * * *

Item 1. Description of Registrant's Securities to be Registered.

Furnish the information required by Item 202 of Regulation S-K (§ 229.202 of this chapter), as applicable.

* * * * *

82. Amend Form 10 (referenced in § 249.210) by:

a. Adding check boxes to the cover page, above the Information Requested in Registration Statement, requesting the registrant indicate by check mark whether it is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company; and

b. Revising Item 13;

The addition and revision read as follows:

Note-The text of Form 10 does not and this amendment will not appear in the Code of Federal Regulations.

FORM 10

GENERAL FORM FOR REGISTRATION OF SECURITIES
Pursuant to Section 12(b) or (g) of The Securities Exchange Act of 1934

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

Item 13. Financial Statements and Supplementary Data.

Furnish all financial statements required by Regulation S-X and supplementary financial information required by Item 302 of Regulation S-K (§ 229.302 of this chapter). Smaller reporting companies may provide financial information required by Item 310 of Regulation S-K in lieu of the information required by Regulation S-X.

* * * * *

83. By removing and reserving § 249.210b and removing Form 10-SB.

Note- The text of Form 10-SB does not appear in the Code of Federal Regulations.

84. Amend Form 20-F (referenced in § 249.220f) by revising Item 11(e) to read as follows:

FORM 20-F

* * * * *

Part I

* * * * *

Item 11. Quantitative and Qualitative Disclosures About Market Risk.

* * * * *

(e) Smaller reporting companies. A smaller reporting company, as defined in Rule 405 (§ 230.405 of this chapter) and Rule 12b-2 (§ 240.12b-2 of this chapter), need not provide the information required by this Item 11.

* * * * *

85. Amend Form 8-K (referenced in § 249.308) by revising General Instruction B.4.; removing paragraph C.3; revising Item 2.01 paragraph (f) before the Instructions; Instructions 2 and 4 to Item 2.02; Item 2.03 paragraph (d); Item 3.02 paragraphs (a) and (b) before the Instructions and Instruction 2; Item 4.01 paragraphs (a) and (b) before the Instructions; Item 4.02 the introductory text of paragraph (a); Item 5.01 paragraphs (a)(8) and (b); Item 5.02 paragraphs (c)(2), (d)(4), (f), and Instruction 4; in Item 5.03 paragraph (b), revise the phrase "Form 10-K, Form 10-KSB, Form 10-Q or Form 10-QSB" to read "Form 10-K or Form 10-Q", and revise

Instruction 1; Item 5.05 paragraph (a); and Item 9.01 paragraphs (a)(1), (b)(1) and (d) before the Instruction

The revisions read as follows:

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

* * * * *

GENERAL INSTRUCTIONS

* * * * *

B. Events to be Reported and Time for Filing of Reports.

* * * * *

4. Copies of agreements, amendments or other documents or instruments required to be filed pursuant to Form 8-K are not required to be filed or furnished as exhibits to the Form 8-K unless specifically required to be filed or furnished by the applicable Item. This instruction does not affect the requirement to otherwise file such agreements, amendments or other documents or instruments, including as exhibits to registration statements and periodic reports pursuant to the requirements of Item 601 of Regulation S-K.

* * * * *

Item 2.01 Completion of Acquisition or Disposition of Assets.

* * * * *

(f) if the registrant was a shell company, other than a business combination related shell company, as those terms are defined in Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2), immediately before the transaction, the information that would be required if the registrant were filing a general form for registration of securities on Form 10 under the Exchange Act reflecting all classes of the registrant's securities subject to the reporting requirements of Section 13 (15

U.S.C. 78m) or Section 15(d) (15 U.S.C. 78o(d)) of such Act upon consummation of the transaction, with such information reflecting the registrant and its securities upon consummation of the transaction. Notwithstanding General Instruction B.3 to Form 8-K, if any disclosure required by this Item 2.01(f) is previously reported, as that term is defined in Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2), the registrant may identify the filing in which that disclosure is included instead of including that disclosure in this report.

* * * * *

Item 2.02 Results of Operations and Financial Condition.

* * * * *

Instructions.

* * * * *

2. The requirements of paragraph (e)(1)(i) of Item 10 of Regulation S-K (17 CFR 229.10(e)(1)(i)) shall apply to disclosures under this Item 2.02.

* * * * *

4. This Item 2.02 does not apply in the case of a disclosure that is made in a quarterly report filed with the Commission on Form 10-Q (17 CFR 249.308a) or an annual report filed with the Commission on Form 10-K (17 CFR 249.310).

Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant.

* * * * *

(d) For purposes of this Item 2.03, off-balance sheet arrangement has the meaning set forth in Item 303(a)(4)(ii) of Regulation S-K (17 CFR 229.303(a)(4)(ii)).

* * * * *

Item 3.02 Unregistered Sales of Equity Securities.

(a) If a registrant sells equity securities in a transaction that is not registered under the Securities Act, furnish the information set forth in paragraphs (a) and (c) through (e) of Item 701 of Regulation S-K (17 CFR 229.701(a) and (c) through (e)). For purposes of determining the required filing date for the Form 8-K under this Item 3.02(a), the registrant has no obligation to disclose information under this Item 3.02 until the registrant enters into an agreement enforceable against the registrant, whether or not subject to conditions, under which the equity securities are to be sold. If there is no such agreement, the registrant must provide the disclosure within four business days after the occurrence of the closing or settlement of the transaction or arrangement under which the equity securities are to be sold.

(b) No report need be filed under this Item 3.02 if the equity securities sold, in the aggregate since its last report filed under this Item 3.02 or its last periodic report, whichever is more recent, constitute less than 1% of the number of shares outstanding of the class of equity securities sold. In the case of a smaller reporting company, no report need be filed if the equity securities sold, in the aggregate since its last report filed under this Item 3.02 or its last periodic report, whichever is more recent, constitute less than 5% of the number of shares outstanding of the class of equity securities sold.

<u>Instructions.</u>

* * * * *

2. A smaller reporting company is defined under Item 10(f)(1) of Regulation S-K (17 CFR 229.10(f)(1)).

* * * * *

Item 4.01 Changes in Registrant's Certifying Accountant.

(a) If an independent accountant who was previously engaged as the principal accountant to audit the registrant's financial statements, or an independent accountant upon whom the principal accountant expressed reliance in its report regarding a significant subsidiary, resigns (or indicates that it declines to stand for re-appointment after completion of the current audit) or is dismissed, disclose the information required by Item 304(a)(1) of Regulation S-K including compliance with Item 304(a)(3) of Regulation S-K (17 CFR 229.304(a)(1)).

(b) If a new independent accountant has been engaged as either the principal accountant to audit the registrant's financial statements or as an independent accountant on whom the principal accountant is expected to express reliance in its report regarding a significant subsidiary, the registrant must disclose the information required by Item 304(a)(2) of Regulation S-K (17 CFR 229.302(a)(2)).

* * * * *

Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review.

(a) If the registrant's board of directors, a committee of the board of directors or the officer or officers of the registrant authorized to take such action if board action is not required, concludes that any previously issued financial statements, covering one or more years or interim periods for which the registrant is required to provide financial statements under Regulation S-X (17 CFR 210) or Item 310 of Regulation S-K in the case of a smaller reporting company, should no longer be relied upon because of an error in such financial statements as addressed in Accounting Principles Board Opinion No. 20, as may be modified, supplemented or succeeded, disclose the following information:

* * * * *

Item 5.01 Changes in Control of the Registrant.

(a) * * *

(8) if the registrant was a shell company, other than a business combination related shell company, as those terms are defined in Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2),

immediately before the change in control, the information that would be required if the registrant were filing a general form for registration of securities on Form 10 under the Exchange Act reflecting all classes of the registrant's securities subject to the reporting requirements of Section 13 (15 U.S.C. 78m) or Section 15(d) (15 U.S.C. 78o(d)) of such Act upon consummation of the change in control, with such information reflecting the registrant and its securities upon consummation of the transaction. Notwithstanding General Instruction B.3. to Form 8-K, if any disclosure required by this Item 5.01(a)(8) is previously reported, as that term is defined in Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2), the registrant may identify the filing in which that disclosure is included instead of including that disclosure in this report.

(b) Furnish the information required by Item 403(c) of Regulation S-K (17 CFR 229.403(c)).

Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

* * * * *

(c) * * *

(2) the information required by Items 401(b), (d), (e) and Item 404(a) of Regulation S-K (17 CFR 229.401(b), (d), (e) and 229.404(a); and

* * * * *

(d) * * *

(4) the information required by Item 404(a) of Regulation S-K (17 CFR 229.404(a)).

* * * * *

(f) If the salary or bonus of a named executive officer cannot be calculated as of the most recent practicable date and is omitted from the Summary Compensation Table as specified in Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K, disclose the appropriate information under this Item 5.02(f) when there is a payment, grant, award, decision or other occurrence as a result of which such amounts become calculable in whole or in part. Disclosure under this Item 5.02(f) shall include a new total compensation figure for the named executive officer, using the new salary or bonus information to recalculate the information that was previously provided with respect to the named executive officer in the registrant's Summary Compensation Table for which the salary and bonus information was omitted in reliance on Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K (17 CFR 229.402(c)(2)(iii) and (iv)).

Instructions to Item 5.02.

* * * * *

(4) For purposes of this Item, the term "named executive officer" shall refer to those executive officers for whom disclosure was required in the registrant's most recent filing with the Commission under the Securities Act (15 U.S.C. 77a et seq.) or Exchange Act (15 U.S.C. 78a et seq.) that required disclosure pursuant to Item 402(c) of Regulation S-K (17 CFR 229.402(c)).

Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year.

* * * * *

Instructions to Item 5.03.

1. Refer to Item 601(b)(3) of Regulation S-K (17 CFR 229.601(b)(3)) regarding the filing of exhibits to this Item 5.03.

* * * * *

Item 5.05 Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics.

(a) Briefly describe the date and nature of any amendment to a provision of the registrant's code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions and that relates to any element of the code of ethics definition enumerated in Item 406(b) of Regulation S-K (17 CFR 229.406(b)).

* * * * *

Item 9.01 Financial Statements and Exhibits.

* * * * *

(a) * * *

(1) For any business acquisition required to be described in answer to Item 2.01 of this form, financial statements of the business acquired shall be filed for the periods specified in Rule 3-05(b) of Regulation S-X (17 CFR 210.3-05(b)). A smaller reporting company may provide the information in Item 310(c) of Regulation S-K (17 CFR 229.310(c)) in lieu of any financial statements required by Item 9(a) of this Form.

* * * * *

(b) * * *

(1) For any transaction required to be described in answer to Item 2.01 of this form, furnish any pro forma financial information that would be required pursuant to Article 11 of Regulation S-X (17 CFR 210.3-14) shall be filed. A smaller reporting company may provide the information in Item 310(d) of Regulation S-K (17 CFR 229.310(d)) in lieu of any financial statements required by Item 9(b) of this Form.

* * * * *

(d) <u>Exhibits</u>. The exhibits will be deemed to be filed or furnished, depending upon the relevant item requiring such exhibit, in accordance with the provisions of Item 601 of Regulation S-K (17 CFR 229.601) and Instruction B.2 of this form.

* * * * *

86. Amend Form 10-Q (referenced in § 249.308a) by:

a. Revising the cover page of Form 10-Q to add, above Part I Financial Information, check boxes requesting the registrant to indicate whether it is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company; and

b. In Part I, revising the text of Item 1.

The revision and addition read as follows:

Note- The text of Form 10-Q does not and this amendment will not appear in the Code of Federal Regulations.

FORM 10-Q

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

Provide the information required by Rule 10-01 of Regulation S-X (17 CFR 210). A smaller reporting company, defined in Rule 12b-2 (§240.12b-2 of this chapter) may provide the information required by Item 310 of Regulation S-K (§229.310 of this chapter) in lieu of the information required by Regulation S-X.

* * * * *

87. By removing and reserving § 249.308b and removing Form 10-QSB.

Note- The text of Form 10-KSB does not appear in the Code of Federal Regulations.

88. Amend Form 10-K (referenced in § 249.310) by:

a. Revising the cover page of Form 10-K to add, above the line asking the registrant to indicate whether it is a shell company, check boxes requesting the registrant to indicate whether it is a large accelerated filer, or an accelerated filer; a non-accelerated filer, or a smaller reporting company; and

b. Revising Item 5 paragraph (a), Item 8 and Item 14 paragraph (1).

The additions and revisions read as follows:

Note- The text of Form 10-K does not and this amendment will not appear in the Code of Federal Regulations.

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FORM 10-K

* * * * *

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

* * * * *

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

(a) Furnish the information required by Item 201 of Regulation S-K (17 CFR 229.201) and Item 701 of Regulation S-K (17 CFR 229.701) as to all equity securities of the registrant sold by the registrant during the period covered by the report that were not registered under the Securities Act. If the Item 701 information previously has been included in a Quarterly Report on Form 10-Q (17 CFR 249.308a) or in a Current Report on Form 8-K (17 CFR 249.308), it need not be furnished.

* * * * *

Item 8. Financial Statements and Supplementary Data.

(a) Furnish financial statements meeting the requirements of Regulation S-X (§ 210 of this chapter), except § 210.3-05 and Article 11 thereof, and the supplementary financial information required by Item 302 of Regulation S-K (§ 229.302 of this chapter). Financial statements of the registrant and its subsidiaries consolidated (as required by Rule 14a-3(b)) shall be filed under this item. Other financial statements and schedules required under Regulation S-X may be filed as "Financial Statement Schedules" pursuant to Item 15, Exhibits, Financial Statement Schedules, and Reports on Form 8-K, of this Form.

(b) A smaller reporting company may provide the information required by Item 310 of Regulation S-K in lieu of any financial statements required by Item 8 of this Form.

* * * * *

Item 14. Principal Accounting Fees and Services.

* * * * *

(1) Disclose, under the caption <u>Audit Fees</u>, the aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements and review of financial statements included in the registrant's Form 10-Q (17 CFR 249.308a) or services that are normally provided by the

accountant in connection with statutory and regulatory filings or engagements for those fiscal years.

* * * * *

89. By removing and reserving § 249.310b and removing Form 10-KSB.

Note- The text of Form 10-QSB does not appear in the Code of Federal Regulations.

90. Amend Form 11-K (referenced in § 249.311) by revising General Instruction E(b) to read as follows:

FORM 11-K

FOR ANNUAL REPORTS OF EMPLOYEE STOCK PURCHASE, SAVINGS AND SIMILAR PLANS PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

GENERAL INSTRUCTIONS

* * * * *

E. Electronic Filers.

* * * * *

(b) Financial Data Schedules are not required to be submitted in connections with annual reports on this form. See Item 601(c)(1) of Regulation S-K (§ 229.601(c)(1)).

* * * * *

91. Amend Form SE (referenced in § 249.444) by revising General Instruction 3.C.

* * * * *

FORM SE

FORM FOR SUBMISSION OF PAPER FORMAT EXHIBITS BY EDGAR ELECTRONIC FILERS

* * * * *

FORM SE GENERAL INSTRUCTIONS

* * * * *

3. Filing of Form SE.

* * * * *

C. Identify the exhibit being filed. Attach to the Form SE the paper format exhibit and an exhibit index if required by Item 601 of Regulation S-K (§ 229.601 of this chapter).

* * * * *

PART 260--GENERAL RULE AND REGULATIONS, TRUST INDENTURE ACT OF 1939

92. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

93. Amend § 260.0-11 by revising the introductory text of paragraph (b)(1), paragraphs (b)(1)(i) and (b)(2) to read as follows:

§ 260.0-11 Liability for certain statements by issuers.

* * * * *

(b) * * *

(1) A forward-looking statement (as defined in paragraph (c) of this section) made in a document filed with the Commission, in Part I of a quarterly report on Form 10–Q, § 249.308a of this chapter, or in an annual report to share holders meeting the requirements of Rules 14a–3(b) and (c) or 14c–3(a) and (b) under the Securities Exchange Act of 1934 (§ 240.14a-3(b) and (c) or § 240.14c-3(a) and (b) of this chapter), a statement reaffirming such forward-looking statement subsequent to the date the document was filed or the annual report was made publicly available, or a forward-looking statement made prior to the date the document was filed or the date the annual report was made publicly available if such statement is reaffirmed in a filed document, in Part I of a quarterly report on Form 10–Q, or in an annual report made publicly available within a reasonable time after the making of such forward-looking statement; Provided, that:

(i) At the time such statements are made or reaffirmed, either the issuer is subject to the reporting requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and has complied with the requirements of Rule 13a–1 or 15d–1 (§ 240.13a-1 or § 240.15d-1 of this chapter) thereunder, if applicable, to file its most recent annual report on Form 10–K, Form 20–F, or Form 40–F; or if the issuer is not subject to the reporting requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, the statements are made in a registration statement filed under the Securities Act of 1933 or pursuant to section 12(b) or (g) of the Securities Exchange Act of 1934; and

* * * * *

(2) Information relating to the effects of changing prices on the business enterprise presented voluntarily or pursuant to Item 303 of Regulation S-K (§ 229.303 of this chapter) or Item 5 of Form 20–F (§ 249.220f of this chapter), "Operating and Financial Review and Prospects," or Item 302 of Regulation S-K (§ 229.302 of this chapter), "Supplementary Financial Information," or Rule 3–20(c) of Regulation S-X (§ 210.3–20(c) of this chapter), and disclosed in a document filed with the Commission, in Part I of a quarterly report on Form 10–Q, or in an annual report to shareholders meeting the requirements of Rules 14a–3(b) and (c) or 14c–3(a) and (b) (§ 240.14a-3(b) and (c) or § 240.14c-3(a) and (b)) under the Securities Exchange Act of 1934.

* * * * *

94. Amend § 260.4d-9 by revising the introductory text of § 260.4d-9 to read as follows:

§ 260.4d-9 Exemption for Canadian Trust Indentures from Specified Provisions of the Act.

Any trust indenture filed in connection with offerings on a registration statement on Form S–1, (§ 239.1 of this chapter) F–7, F–8, F–9, F–10 or F–80 (§§ 239.37 through 239.41 of this chapter) shall be exempt from the operation of sections 310(a)(3) and 310(a)(4), sections 310(b) through 316(a), and sections 316(c) through 318(a) of the Act; provided that the trust indenture is subject to:

* * * * *

95. Amend § 260.10a-5 by revising paragraph (a) to read as follows:

§ 260.10a-5 Eligibility of Canadian Trustees.

(a) Subject to paragraph (b) of this section, any trust company, acting as trustee under an indenture qualified or to be qualified under the Act and filed in connection with offerings on a registration statement on Form S–1 (§ 239.11 of this chapter) F–7, F–8, F–9, F–10 or F–80 (§§ 239.37 through 239.41 of this chapter) that is incorporated and regulated as a trust company under the laws of Canada or any of its political subdivisions and that is subject to supervision or examination pursuant to the Trust Companies Act (Canada), R.S.C. 1985, or the Canada Deposit Insurance Corporation Act, R.S.C. 1985 shall not be subject to the requirement of domicile in the United States under section 310(a) of the Act (15 U.S.C. 77jjj(a)).

* * * * *

PART 269—FORMS PRESCRIBED UNDER THE TRUST INDENTURE ACT OF 1939

96. The authority citation for Part 269 is revised to read as follows:

Authority: 15 U.S.C. 77ddd(c), 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77sss, and 78ll(d), unless otherwise noted.

97. Amend § 260.01 by revising paragraph (b) to read as follows:

§ 269.0-1 Availability of forms.

* * * * *

(b) Any person may obtain a copy of any form prescribed for use in this part by written request to the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Any person may inspect the forms at this address and at the Commission's regional offices. (See § 200.11 of this chapter for the addresses of SEC regional offices.)

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

July 5, 2007

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 27882/July 5, 2007

In the Matter of BARCLAYS GLOBAL FUND ADVISORS c/o Barclays Global Investors, N.A. 45 Fremont Street San Francisco, CA 94105 (812-13391)	:

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

Barclays Global Fund Advisors ("BGFA") filed an application on May 30, 2007, which was amended on June 26, 2007, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting applicant and any other company of which Barclays Bank PLC is or hereafter becomes an affiliated person (together with BGFA, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the United States District Court for the Southern District of New York on June 6, 2007.

On June 6, 2007, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 27851) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the conduct of BGFA has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

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Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by BGFA (File No. 812-13391), as amended, that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the United States District Court for the Southern District of New York on June 6, 2007.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

Commissioners Atkins, Campos & Nazareth Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8820 / July 6, 2007

INVESTMENT ADVISERS ACT OF 1940
Release No. 2617 / July 6, 2007

INVESTEMENT COMPANY ACT OF 1940
Release No. 27883 / July 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12678

In the Matter of **Haidar Capital Management, LLC, Haidar Capital Advisors, LLC, and Said N. Haidar,** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, IMPOSING A CEASE-AND-DESIST ORDER, AND IMPOSING REMEDIAL SANCTIONS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 203(e) AND (f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND (d) OF THE INVESTMENT COMPANY ACT OF 1940**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 203(e) and (f) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and (d) of the Investment Company Act of 1940 ("Investment Company Act") against Haidar Capital Management, LLC, Haidar Capital Advisors, LLC (collectively, Haidar Advisors), and Said N. Haidar ("Haidar").

II.

In anticipation of the institution of these proceedings, Haidar Advisors and Haidar have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a

Document 7 of 59

party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Haidar Advisors and Haidar consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings, Making Findings, Imposing a Cease-and-Desist Order, and Imposing Remedial Sanctions, Pursuant to Section 8A of the Securities Act of 1933, Sections 203(e) and (f) of the Investment Advisers Act of 1940, and Sections 9(b) and (d) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

Respondents

1. Haidar Capital Management, LLC, is a single member limited liability company formed under the laws of the State of New York. Haidar Capital Management, LLC served as the investment adviser for four private funds and is not registered with the Commission.

2. Haidar Capital Advisors, LLC, is a single member limited liability company formed under the laws of the State of New York. Haidar Capital Advisors, LLC was the administrative or managing member of three private funds and is not registered with the Commission.

3. Said N. Haidar, age 45, is a resident of New York, New York. He is the managing member and sole shareholder of Haidar Capital Management and Haidar Capital Advisors.

Facts

4. From April 2001 to September 2003 (the "relevant period"), Haidar Advisors traded an average of approximately $143 million in US mutual funds and annuities through a market timing strategy that Haidar Advisors' traders executed.[2] During the relevant period, Haidar Advisors and Haidar violated Section 17(a)(3) of the Securities Act by engaging in deceptive tactics, such as using multiple accounts, utilizing broker-dealers who used multiple registered representative numbers and purchasing variable annuities, to hide Haidar Advisors' identity from mutual funds, and otherwise

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[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] Market timing includes: (i) frequent buying and selling of shares of the same mutual fund or (ii) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares, if the market timer is exploiting pricing inefficiencies, or disrupt the management of the mutual fund's investment portfolio and can cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer.

facilitate Haidar Advisors' market timing strategies.[3] During the relevant period, Haidar Advisors earned in excess of $3.3 million in management and advisory fees from its market timing trading.

Haidar Advisors Used Multiple Trading Entities and Accounts to Hide Their Identities

5. During the relevant period, Haidar Advisors, at Haidar's direction, created eight new wholly owned subsidiaries for two parent hedge funds (collectively, the "Haidar Advisors Affiliates") to execute mutual fund trades. These wholly owned subsidiaries had unique tax identification numbers but included the same investors as the parent hedge fund and shared a bank account with the parent hedge fund. When a mutual fund family identified Haidar Advisors or the Haidar Advisors Affiliates as a market timer and blocked them from trading, Haidar Advisors continued timing the mutual fund family through another Haidar Advisors Affiliate or account, thereby concealing its identity from the mutual fund family. By September 2003, Haidar Advisors had opened in excess of 100 accounts at more than 20 broker-dealers. Through these efforts, Haidar Advisors avoided detection by the mutual funds and continue executing market timing trades in mutual funds that had imposed "block notices" to restrict their market timing activities.[4]

6. Haidar Advisors' Confidential Offering Memoranda for its various hedge funds confirm that Haidar Advisors used multiple accounts and entities and annuity contracts to execute trades in mutual funds that had previously imposed restrictions on Haidar Advisors due to market timing. In pertinent part, the Offering Memoranda, in a section entitled "Limitations on Switching Strategies," states:

> The future success of [Haidar Advisors'] trading strategy depends on several different factors. Primary among these factors is the continued availability of the free and unlimited switching option within a family of funds. [Haidar Advisors] may utilize special purpose vehicles . . . and purchase annuity contracts to maintain or increase such availability. Fund families have been slowly restricting the availability of the exchange privilege, and this trend is expected to continue. In addition, there is no assurance that [Haidar Advisors] will be able to continue to utilize special

[3] On November 30, 2001, Haidar's outside counsel provided him with a research memorandum relating to his mutual fund market timing strategy. Specifically, the memorandum addressed Haidar Advisors' use of multiple shareholder accounts under the same shareholder name and accounts for the benefit of one person but traded under separate d/b/a accounts or traded using subsidiaries. In pertinent part, Haidar Advisors' counsel concludes that its "research has not uncovered a fact pattern whereby (i) the SEC has sought to impose a penalty against an adviser or (ii) a mutual fund has sued a shareholder, in each case for market-timing activities where a person that has been precluded from trading mutual fund shares because of market-timing then sets up an account under a new name but with the same beneficial owners."

[4] Block notices restricted market timing trading by, among other things, prohibiting future trades in specific accounts, by particular registered representatives or by broker-dealer and typically included a statement concerning the mutual fund's aversion to market timing.

purpose vehicles or annuity contracts . . . to trade mutual fund shares.

7. Haidar managed the overall operations of Haidar Advisors, including the creation of the Haidar Advisors Affiliates and the opening of brokerage accounts and the transfer of funds among the Haidar Advisors-affiliated entities. Haidar personally signed all of the applications for new tax identification numbers, all account opening documents and all wire transfer letters authorizing Haidar Advisors' broker-dealers to move Haidar Advisors' money to accounts that had not yet been blocked by the mutual funds.

Use of Multiple Registered Representative Numbers to Circumvent Block Notices

8. Many mutual funds also identified market timers by tracking the number broker-dealers assigned to their registered representatives (*i.e.*, registered representative numbers). In an effort to hide their identities and circumvent block notices imposed by the mutual funds, some registered representatives at broker-dealers used by Haidar Advisors, at Haidar Advisors direction, used multiple registered representative numbers to execute Haidar Advisors' market timing trades. In setting up Haidar Advisors' accounts at various broker-dealers, Haidar Advisors' traders discussed the use of alternative registered representative numbers to evade block notices and considered the broker-dealers' ability to execute trades using multiple registered representative numbers in evaluating prospective broker-dealer relationships.

Haidar Advisors Traded In Amounts That Were More Likely To Avoid-Mutual Fund Scrutiny

9. Haidar Advisors employed structured trading strategies to further disguise its timing activities from blocking mutual funds. Specifically, Haidar Advisors divided large trades, using the Haidar Advisors Affiliates, into several smaller trades in an effort to "fly under the radar" of mutual funds that detected timers by monitoring trades with high dollar values. Haidar Advisors monitored the dollar amount that attracted attention from the mutual fund compliance personnel and traded in dollar amounts under that threshold in order to avoid mutual fund scrutiny. In each instance, no legitimate purpose required Haidar Advisors to structure the trades in that manner because the accounts and Haidar Advisors Affiliates included the same investors and employed the same trading strategy.

Haidar Advisors Used Variable Annuities to Disguise Their Identities

10. Haidar Advisors conducted market timing using variable annuity contracts.[5] Variable annuities were an attractive vehicle for Haidar Advisors to use to

[5] Variable annuities are insurance contracts which typically invest the cash premiums in mutual fund shares and which typically offer access to multiple mutual funds. Variable annuities are securities and insurance companies offer their variable annuity products through prospectuses filed with the Commission, which may describe the insurance companies' policies on market timing. As with market timing of mutual funds, market timing through variable annuities can result in increased expense to, and cause dilution in, the underlying mutual fund portfolios. Additionally, market timing through variable annuities may harm not

gain market timing capacity because issuers of variable annuities aggregate trades in their contracted fund complexes and transmit the trades on a net basis. Thus, trading through variable annuity contracts can hide the identity of timers, facilitating their timing.[6]

11. In addition to using variable annuities to conceal its identity from the mutual funds, Haidar Advisors also engaged in deceptive conduct to facilitate its variable annuity trading. Specifically, when variable annuity contracts were restricted for excessive trading, Haidar Advisors would surrender the contract and continue market timing in the same variable annuities' mutual fund sub-accounts, using a different variable annuity contract purchased in the name of a different Haidar Advisors Affiliate or using a different account number.[7]

Violations of the Federal Securities Laws

12. As a result of the conduct described above, Haidar Advisors and Haidar willfully committed violations of Section 17(a)(3) of the Securities Act, which prohibits engaging in any transaction, practice or course of business, in the offer or sale of securities, directly or indirectly, which would operate as a fraud or deceit upon the purchaser.[8]

Cooperation by Haidar Advisors and Haidar

13. In determining to accept the Offer, the Commission considered cooperation afforded the Commission staff by the Respondents.

Undertakings

Respondents have undertaken to:

14. Haidar Advisors shall, within 120 days of the date of this Order, retain an independent compliance consultant ("Independent Compliance Consultant"), not unacceptable to the staff of the Commission, to conduct a review of Haidar Advisors' policies and procedures reasonably designed to detect and prevent violations of the federal securities laws related to trading of open-end investment companies that are registered under the Investment Company Act of 1940 ("Mutual Funds"); (ii) recommend any additional policies and procedures which, on the basis of its review, the consultant

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only investors holding the same variable annuity, but also other investors in the underlying mutual funds being timed, such as investors in variable annuities issued by other insurance companies.

[6] Haidar Advisors also favored annuity trading because: (i) the annuity structure enabled Haidar Advisors to switch between fund families in a single day, and (ii) Haidar Advisors believed that the annuity fund families were contractually obligated to accept the trades.

[7] Haidar Advisors purchased multiple annuity contracts, naming its own employees as annuitants, but Haidar Advisors funded the contracts, and all profits from the trading were for Haidar Advisors' benefit.

[8] "Willfully" as used in this Order means intentionally committing the act which constitutes the violation. *Cf. Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

believes are reasonably designed to ensure that Haidar Advisors complies with federal securities laws, relating to the trading of those Mutual Funds; and (iii) submit to the Commission staff, within 30 days of the completion of the review, a report outlining the results of the Independent Compliance Consultant's review, and what recommendations, if any, the Independent Compliance Consultant made. In conjunction with the Independent Compliance Consultant's review:

(a) Haidar Advisors shall adopt the recommendations of the Independent Compliance Consultant; provided, however, that within 60 days of the completion of the review, Haidar Advisors shall in writing advise the Independent Compliance Consultant and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendations that it considers to be unnecessary or inappropriate, Haidar Advisors need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose. As to any recommendation on which Haidar Advisors and the Independent Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 90 days of the completion of the review. In the event that Haidar Advisors and the Independent Compliance Consultant are unable to agree on an alternative proposal acceptable to the staff of the Commission, Haidar Advisors will abide by the determinations of the Independent Compliance Consultant.

(b) Haidar Advisors shall, after 18 months from the date of this Order, require the Independent Compliance Consultant (i) to conduct an additional review to determine whether Haidar Advisors adopted the above recommendations and whether Haidar Advisors' policies and procedures are reasonably effective in maintaining Haidar Advisors' compliance with federal and state securities laws, and (ii) submit to the Commission's staff, within 30 days of the review, a report outlining the results of the review.

(c) The Independent Compliance Consultant's compensation and expenses shall be borne by Haidar Advisors. The Respondents shall cooperate fully with the Independent Compliance Consultant with access to their files, books, records, and personnel as reasonably requested for the reviews.

(d) Haidar Advisors shall require that the Independent Compliance Consultant, for the period of the engagement and for a period of two years from completion of the engagement, not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Haidar Advisors, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Haidar Advisors shall require that any firm with which the Independent Compliance Consultant is affiliated in performance of his or her duties under the Order not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Haidar Advisors, or any of Haidar Advisors' present or former affiliates, directors, officers, employees, or agents acting in the capacity as such for the period of the engagement and for a period of two years after the engagement.

15. Respondents shall retain, within 30 days of the entry of the Order, the services of an independent distribution consultant ("Independent Distribution Consultant") not unacceptable to the staff of the Commission. Respondents shall pay up to $50,000 of the compensation and expenses of the Independent Distribution Consultant. Such compensation and expenses shall include, without limitation, (i) the compensation of a tax administrator for the preparation of tax returns and/or for seeking any IRS rulings; (ii) the payment of taxes; and (iii) the payment of any distribution or consulting services as may be reasonably required by the Independent Distribution Consultant. Thereafter, the Independent Distribution Consultant's compensation or expenses shall be deducted from any amounts of disgorgement or penalty paid by the Respondents pursuant to this Order and any investment returns or interest earned thereon. The Respondents shall cooperate fully with the Independent Distribution Consultant, including providing access to their files, books, records, and personnel as reasonably requested for the review. Respondents shall require the Independent Distribution Consultant to develop a Distribution Plan for the distribution of the total disgorgement and penalty ordered in Paragraph IV.D. of this Order, and any interest or earnings thereon, according to a methodology developed in consultation with Respondents and acceptable to the staff of the Commission.

(a) Respondents shall require the Independent Distribution Consultant to submit to Respondents and the staff of the Commission the Distribution Plan no more than 150 days after the entry of the Order.

(b) The Distribution Plan developed by the Independent Distribution Consultant shall be binding unless, within 210 days after the date of the entry of the Order, Respondents or the staff of the Commission, advises, in writing, the Independent Distribution Consultant of any determination or calculation from the Distribution Plan that it considers to be inappropriate and states in writing the reasons for considering such determination or calculation inappropriate.

(c) With respect to any calculation with which Respondents or the staff of the Commission do not agree, such parties shall attempt in good faith to reach an agreement within 240 days of the date of the entry of the Order. In the event that Respondents and the staff of the Commission are unable to agree on an alternative determination or calculation, the determinations of the Independent Distribution Consultant shall be binding.

(d) Within 175 days of the date of entry of this Order, Respondents shall require that the Independent Distribution Consultant submit the Distribution Plan for the administration and distribution of disgorgement and penalty funds pursuant to Rule 1101 [17 C.F. R. § 201.1101] of the Commission's Rules of Practice. Following a Commission order approving a final plan of distribution, as provided in Rule 1104 [17 C.F.R. § 201.1104] of the Commission's Rules of Practice, Respondents shall require that the Independent Distribution Consultant, with Respondents, take all necessary and appropriate steps to administer the final plan for distribution of disgorgement and penalty funds.

(e) Respondents shall require that the Independent Distribution Consultant, for the period of the engagement and for a period of two years from completion of the engagement, not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Respondents shall require that any firm with which the Independent Distribution Consultant is affiliated in performance of his or her duties under the Order not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of Respondents' present or former affiliates, directors, officers, employees, or agents acting in the capacity as such for the period of the engagement and for a period of two years after the engagement.

16. Respondents undertake to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondents have undertaken:

(a) To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff;

(b) To use their best efforts to cause their employees to be interviewed by the Commission's staff at such times as the staff reasonably may direct;

(c) To use their best efforts to cause their employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff;

(d) That in connection with any testimony of Haidar Advisors to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Haidar Advisors and Haidar: (i) agrees that any such notice or subpoena for Haidar Advisors employees and officers appearance and testimony may be served by regular mail on its counsel, Ropes & Gray, LLP, attn: Richard Marshall, 1211 Avenue of the Americas, New York, NY 10036-8704; and (ii) agrees that any such notice or subpoena for Haidar Advisor appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure; and

(e) To make best efforts to produce to the Independent Distribution Consultant documents sufficient to identify all Mutual Funds (as defined in paragraph 14 above) in which Haidar Advisors executed trades in its private funds during the relevant period.

17. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Respondents' Offer.

Accordingly, it is hereby ORDERED that:

A. Respondents Haidar Capital Management and Haidar Capital Advisors are hereby censured;

B. Respondents shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act;

C. Respondents shall comply with the undertakings specified in Paragraphs 14 and 15 above; and

D. Respondents shall pay disgorgement, prejudgment interest and civil money penalties as follows:

1. Within 30 days of the entry of this Order, Respondents, jointly and severally, shall pay disgorgement of $3,300,000, prejudgment interest of $1,180,000 and a civil penalty in the amount of $100,000.

a. Such payments shall be: (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (iv) submitted under cover letter that identifies Respondents, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Katherine Addleman, Associate Regional Administrator, Securities and Exchange Commission, Burnett Plaze, Suite 1900, 801 Cherry Street, Unit 18, Fort Worth, Texas 76107.

b. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund shall be established for the funds described in Section IV.D.1 above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that they shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, further benefit by offset or reduction of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts that are the subject of the Commission's Findings in the Order.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8821 / July 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12484

In the Matter of **BEAR, STEARNS & CO. INC.,** **Respondent.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE DISQUALIFICATION PROVISION OF RULE 602(c)(3)**

Bear, Steams & Co. Inc. ("Bear Steams") has submitted a letter, dated December 15, 2006, requesting a waiver of the Rule 602(c)(3) disqualification provision of Regulation E under the Securities Act of 1933 ("Securities Act"), arising from the entry of an Order against it by the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

On November 21, 2006, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934 (the "Order") against Bear Steams. The Commission's Order found that Bear Steams violated Section 5(b) of the Securities Act in 2002 and 2003, when five of its salespersons sent customers certain electronic communications that contained sales materials concerning securities offerings during the period after a registration statement had been filed, but before the Commission had declared the registration statement effective. The Order also found that Bear Steams failed reasonably to supervise its employees with a view to preventing and detecting those violations.

The Commission ordered Bear Steams to cease and desist from committing or causing any violations or future violations of Section 5, censured Bear Steams, and directed Bear Steams to comply with the undertakings set forth in the Order. Bear Steams had executed an Offer of Settlement in which it consented to the entry of the Commission's Order without admitting or denying the findings therein.

Rule 602(c)(3) makes the Regulation E exemption from registration under the Securities Act unavailable to an issuer if, among other things, any investment adviser to

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or principal securityholder of such issuer, or underwriter for the securities to be offered, is subject to an order of the Commission entered pursuant to Section 15(b) of the Exchange Act. Rule 602(e) provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied."

Based on the representations set forth in Bear Stearns' December 15, 2006 request, the Commission has determined that, pursuant to Rule 602(e), a showing of good cause has been made and that it is not necessary under the circumstances that the exemption be denied as a result of the Commission's Order.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56028; File No. SR-NASDAQ-2007-031)

July 9, 2007

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change Relating to Three-Characters Ticker Symbols

I. Introduction

On March 29, 2007, The NASDAQ Stock Market LLC ("Nasdaq") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to allow an issuer with a three-character ticker symbol that transfers its listing to Nasdaq from another listing market to continue using its three-character ticker symbol on Nasdaq. The proposed rule change was published for comment in the Federal Register on April 4, 2007.[3]

The Commission received 24 comment letters on the proposal.[4] On May 1, 2007, Nasdaq

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 55563 (March 30, 2007), 72 FR 16391.

4 See letters from Edward J. Resch, Executive Vice President, Chief Financial Officer and Treasurer, State Stree Corporation, dated May 21, 2007 ("State Street Letter"); Larry A. Mizel, Chairman and Chief Executive Officer, M.D.C. Holdings, Inc. ("MDC Letter"), dated May 17, 2007; Jack R. Hartung, Chief Finance and Development Officer, Chipotle Mexican Grill, dated May 15, 2007 ("Chipotle Letter"); Carol R. Kaufman, Sr. Vice President Legal Affairs, The Cooper Companies, Inc., dated May 14, 2007 ("Cooper Companies Letter"); Farooq Kathwari, Chairman, President and CEO, Ethan Allen Interiors, Inc., dated May 9, 2007 ("Ethan Allen Letter"); James J. Angel, Associate Professor of Finance, McDonough School of Business, Georgetown University, dated May 9, 2007 ("Angel Letter"); Jack Sennott, Senior Vice President and Chief Financial Officer, Darwin Professional Underwriters, Inc., dated May 8, 2007 ("Darwin Letter"); Bart J. Ward, Chief Executive Officer, Ward & Company, dated May 8, 2007 ("Ward Letter"); Craig D. Mallick, Corporate Secretary, United States Steel Corporation, dated May 4, 2007 ("United States Steel Letter"); Michael Tenenbaum, Trustee, Strategic Technologies Employees Pension Fund Trust, dated May 2, 2007 ("Strategic Technologies Letter"); Carrie E. Dwyer, General Counsel and Executive Vice President Corporate Oversight, The Charles Schwab Corporation ("Schwab"), dated April 27, 2007 ("Schwab Letter"); Mary Yeager, Assistant Secretary, New York Stock Exchange LLC

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filed a response to the comment letters.[5] This order approves the proposed rule change.

II. Description of the Proposal

Historically, it has been the practice of NYSE, Amex, and the regional exchanges to list securities using three-character ticker symbols, and of Nasdaq to list securities using four- and five-character symbols.[6] Nasdaq recently submitted a proposed rule change to begin listing Delta Financial Corp., a security that transferred its listing from Amex, while retaining its three-character symbol ("DFC").[7]

("NYSE"), dated April 25, 2007 ("NYSE Letter"); Patrick J. Healy, Issuer Advisory Group, dated April 24, 2007 ("Issuer Advisory Group Letter"); Neal L. Wolkoff, Chairman and Chief Executive Officer, American Stock Exchange LLC ("Amex"), dated April 16, 2007 ("Amex Letter"); Eric W. Nodiff, Sr. V.P. and General Counsel, Cantel Medical Corp., dated April 9, 2007 ("Cantel Medical Letter"); Dave Patch, dated April 6, 2007 ("Patch Letter"); Steve S. Fishman, Chairman and Chief Executive Officer, Big Lots, Inc., dated April 4, 2007 ("Big Lots Letter"); David M. Brain, President and CEO, Entertainment Properties Trust, dated April 3, 2007 ("Entertainment Properties Trust Letter"); Cathy Burzik, President and Chief Executive Officer, Kinetic Concepts, Inc., dated March 30, 2007 ("Kinetic Concepts Letter"); Edward W. Moore, Vice President, General Counsel & Secretary, RPM International Inc., dated March 29, 2007 ("RPM Letter"); Leo Liebowitz, Chairman and Chief Executive Officer, Getty Realty Corp., dated March 29, 2007 ("Getty Realty Letter"); Timothy J. O'Donovan, Chairman of the Board and Chief Executive Officer, Wolverine World Wide, Inc., dated March 28, 2007 ("Wolverine World Wide Letter"); Jason Korstange, SVP, Director of Corporate Communications, TCF Financial Corporation, dated March 28, 2007 ("TCF Financial Letter"); and Edward F. Tancer, Vice President & General Counsel, FPL Group, Inc., dated March 28, 2007 ("FPL Group Letter").

5 See letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, to Nancy M. Morris, Secretary, Commission, dated May 1, 2007 ("Nasdaq Response Letter").

6 It has also been the practice of NYSE, Amex, and the regional exchanges to list securities using two-character ticker symbols. In addition, NYSE lists securities with one-character ticker symbols.

7 See Securities Exchange Act Release No. 55519 (March 26, 2007), 72 FR 15737 (April 2, 2007) (SR-NASDAQ-2007-025).

Nasdaq now proposes to allow any issuer with a three-character ticker symbol that transfers its listing to Nasdaq from another domestic listing market to continue using its three-character ticker symbol on Nasdaq.

III. Summary of Comments

Four commenters expressed support for Nasdaq's proposal;[8] the remaining 20 commenters, including 16 issuers listed on NYSE, objected to Nasdaq listing transferred securities with their three-character ticker symbols.[9]

The commenters objecting to the proposal generally argued that the proposal would violate the long-standing practice of allowing only NYSE-listed securities to use three-character ticker symbols,[10] cause confusion in the marketplace,[11] and circumvent the ongoing efforts of self-regulatory organizations ("SROs") to develop a national market system plan for the selection and reservation of securities ticker symbols.[12] In addition, two commenters argued that the proposal could cause a shortage of one-, two-, or three-character ticker symbols.[13]

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8 See Angel Letter, Schwab Letter, Issuer Advisory Group Letter, and Patch Letter.

9 See State Street Letter, MDC Letter, Chipotle Letter, Cooper Companies Letter, Ethan Allen Letter, Darwin Letter, Ward Letter, United States Steel Letter, Strategic Technologies Letter, NYSE Letter, Amex Letter, Cantel Medical Letter, Big Lots Letter, Entertainment Properties Trust Letter, Kinetic Concepts Letter, RPM Letter, Getty Realty Letter, Wolverine World Wide Letter, TCF Financial Letter, and FPL Group Letter.

10 Id.

11 See Ward Letter, NYSE Letter, Amex Letter, Big Lots Letter, and Wolverine World Wide Letter.

12 See Ward Letter, NYSE Letter, Amex Letter, and RPM Letter.

13 See NYSE Letter and Amex Letter. The Amex Letter, among other comment letters, expressed views on Nasdaq listing one- and two-character ticker symbols; however, this proposed rule change relates only to the transfer of three-character ticker symbol listings.

In support of the proposal, some commenters asserted that the proposal would enhance competition among markets and reduce the potential for investor confusion.[14] In its letter, Nasdaq responded to the commenters, stating that it believed that many of the commenters opposing the proposal misunderstood its proposal and the current use of symbols by the securities markets, and reiterated its belief that the proposal would reduce investor confusion and promote competition among exchanges.[15]

IV. Discussion

After a careful review of the proposed rule change, the comment letters, and the Nasdaq Response Letter, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the regulations thereunder applicable to a national securities exchange.[16] In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,[17] which requires that the rules of a national securities exchange be designed, among other things, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and Section 6(b)(8) of the Act,[18] which requires that the rules of an exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the Act.

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14 See Angel Letter, Schwab Letter, and Issuer Advisory Group Letter.

15 See Nasdaq Response Letter.

16 In approving the proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

17 15 U.S.C. 78f(b)(5).

18 15 U.S.C. 78f(b)(8).

A. Competition Among the Listing Markets

The Commission notes that national securities exchanges often allow issuers to retain the ticker symbols that identify their securities when such issuers transfer their listings to another exchange, other than Nasdaq.[19] This proposal would allow Nasdaq to participate in this existing practice, along with all other national securities exchanges, for issuers with three-character ticker symbols.[20]

Nasdaq and the commenters supporting the proposal asserted that the proposed rule change would allow publicly-listed issuers to choose their marketplace based on objective factors such as trading quality, costs, and branding, and not based on symbol portability.[21] Currently, an issuer deciding whether to transfer its listing to Nasdaq must consider, among other factors, the fact that it would need to change its ticker symbol. For example, the Schwab Letter stated that, when it considered transferring its listing to Nasdaq, the prospect of changing its symbol was a negative factor in its analysis regarding whether to transfer its listing. Schwab noted that the change in its ticker symbol, resulting from the transferring of its listing to Nasdaq, necessitated operational and systems changes at Schwab and industry-wide at other financial services firms and required the expenditure of other resources to inform its investors of that change.

The Commission notes that when an issuer is seeking to transfer its listing to an exchange other than Nasdaq, such issuer's analysis is not typically encumbered by considerations of changing its symbol and the attending administrative and other costs associated with that

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19 See, e.g., Darwin Professional Underwriters (on April 18, 2007, moved from NYSE Arca to NYSE and retaining its symbol DR) and Yamana Gold Inc. (on January 12, 2007, moved from Amex to NYSE and retaining its symbol AUY).

20 Some of the commenters expressed views on Nasdaq listing one- and two-character ticker symbols; however, these considerations are beyond the scope of this proposed rule change, which covers only the transfer of three-character ticker symbols.

21 See Issuer Advisory Group Letter and Nasdaq Response Letter.

process. The proposed rule change would eliminate the considerations associated with changing its ticker symbol from the decision by an issuer identified by a three-character symbol to transfer its listing to Nasdaq.[22] Thus, the Commission believes that the proposed rule change, by allowing issuers to retain their three-character ticker symbols upon transferring their listings to Nasdaq, would remove a burden on competition not necessary or appropriate in furtherance of the purposes of the Act and would thereby enhance competition between Nasdaq and the other exchanges in the business of providing a listing venue.

B. Investor Confusion

The Commission also believes that allowing an issuer to retain the three-character ticker symbol that identifies its security upon transferring its listing to Nasdaq does not increase, and may reduce, the potential for confusion in the marketplace by an issuer changing its ticker symbol. Commenters supporting the proposal asserted that changing an issuer's ticker symbol often results in investor confusion and costly investment mistakes.[23] In its letter, Schwab stated that its ticker symbol change required it to expend time and resources to combat the confusion that the change would have caused among its individual stockholders who had come to identify it with its three-character symbol. The Commission notes that issuers transferring their listings to exchanges other than Nasdaq typically avoid such confusion by retaining their ticker symbols.[24]

The commenters objecting to the proposal, however, asserted that the proposed rule change, for various reasons, would cause confusion in the marketplace. The majority of such commenters argued that three-character ticker symbols are a hallmark of NYSE-listed

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22 Of course, an issuer could request a new ticker symbol if it so desired.

23 See Angel Letter, Issuer Advisory Group Letter, and Schwab Letter.

24 The Nasdaq Response Letter stated that, of the 200 issuers transfers of existing three-character symbols since August 2001, all but one of those issuers have retained their symbols upon their transfer to a new exchange.

securities[25] and that, consequently, expanding the use of three-character ticker symbols to Nasdaq-listed securities would result in investor confusion.[26] The Commission notes, however, that all of the exchanges, except Nasdaq,[27] may list securities using three-character ticker symbols.[28] Unlike one-character symbols, three-character symbols are not associated by investors with any one market. The Commission also notes that the transfer of securities listings with three-character ticker symbols typically occur among other exchanges without any discernable confusion or disruption to the marketplace.[29]

Another commenter asserted that three-character symbols are exclusive indicators of securities trading on NYSE's and Amex's specialist-based markets, and that it would cause confusion if such symbols were used on Nasdaq's dealer market.[30] However, as the Commission

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25 Based on this premise, these commenters also argued that three-character ticker symbols signal NYSE's high qualitative listing standards and that allowing Nasdaq to list securities with three-character ticker symbols would blur the distinction between NYSE-listed and other exchange-listed securities and diminish the branding of NYSE-listed securities.

26 See Strategic Technologies Letter, NYSE Letter, Cantel Medical Letter, Big Lots Letter, Kinetic Concepts Letter, RPM Letter, Getty Realty Letter, Wolverine World Wide Letter, TCF Financial Letter, and FPL Group Letter.

27 With the exception of the transfer of the DFC listing, Nasdaq currently only lists securities of companies using four- or five-character symbols. See supra note 7 and accompanying text.

28 For example, as noted in the Angel Letter, the NAIC Growth Fund lists on the Chicago Stock Exchange, Inc. with the ticker symbol "GRF".

29 Nasdaq has also represented that its recent listing of DFC occurred without any trading problems. The Amex Letter tacitly agreed with this view, but argued that the lack of trading problems associated with DFC is not the best proxy for other companies that may transfer their listings to Nasdaq because it believed that DFC is a microcap company. The Nasdaq Response Letter, however, disputed this argument and the Amex Letter's labeling of DFC as a "microcap company," citing the fact that DFC has a market capitalization of over $230 million, a figure that it contends is nearly triple the $67 million market capitalization of the median Amex issuer.

30 See Amex Letter.

noted above, exchanges other than NYSE and Amex may list securities with three-character symbols.[31]

C. National Market System Plan Process

Some of the commenters have expressed concern that the proposed rule change would disrupt or circumvent ongoing efforts by the SROs to develop a national market system plan.[32] The Commission recently received two proposed national market system plans for the selection and reservation of ticker symbols submitted by two separate groups of SROs.[33] The Commission is currently considering these plans and intends to publish the proposed plans for public comment.[34] The Commission believes that its approval of the proposed rule change is independent of its consideration of these plans. The Commission under Rule 608(b)(2) may declare effective any national market system plan or plans for the selection and reservation of ticker symbols that is consistent with the requirements of the Act. Participants in any such plan would be required to comply with its requirements, which could necessitate changes to SRO rules.[35]

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31 For example, NYSE Arca lists three-character symbols. See also supra note 27.

32 See Ward Letter, NYSE Letter, Amex Letter, and RPM Letter.

33 See Proposed NMS Plan for the Selection and Reservation of Securities Symbols by the Chicago Stock Exchange, Inc., Nasdaq, National Association of Securities Dealers, Inc., National Stock Exchange, Inc. and Philadelphia Stock Exchange, Inc. (available at www.sec.gov/rules/sro/4-533revised.pdf) and Proposed NMS Plan for the Selection and Reservation of Securities Symbols by Amex, NYSE and NYSE Arca (available at www.sec.gov/rules/sro/4-534.pdf).

34 See Press Release, Commission, SEC Announces Process for Proposals on Securities 'Ticker' Symbols (April 5, 2007) (available at www.sec.gov/news/press/2007/2007-63.htm).

35 See 15 U.S.C. 78k-1(a)(3) and 17 CFR 242.608(b) and (c). The NYSE Letter referenced a "Symbol Reservation Plan," which it stated has operated to allocate and reserve symbols for over 30 years. The Commission notes, however, that no such plan has been approved by the Commission.

D. Symbol Shortage

Two commenters argued that the proposal could create a shortage of available three-character ticker symbols.[36] Nasdaq's proposal, however, would only permit it to list securities with three-character ticker symbols when such issuer transfers its listing from another exchange; the proposal would not permit Nasdaq to list new securities with three-character ticker symbols. The Commission, therefore, does not believe Nasdaq's proposal would have a negative impact on the availability of three-character ticker symbols.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[37] that the proposed rule change (SR-NASDAQ-2007-031) be, and hereby is, approved.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

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36 See NYSE Letter and Amex Letter.

37 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56037; File Nos. 4-533 and 4-534)

July 10, 2007

Joint Industry Plan; American Stock Exchange LLC, New York Stock Exchange LLC, and NYSE Arca, Inc. and Chicago Stock Exchange, Inc., The Nasdaq Stock Market, Inc., National Association of Securities Dealers, Inc., National Stock Exchange, Inc., and Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed National Market System Plans for the Selection and Reservation of Securities Symbols

I. Introduction

Securities symbols are a key element in the operation of a national market system and essential to the dissemination of trade information in a common format. Historically, securities symbols have been assigned under an informal understanding among the listing markets. It has been the practice of the New York Stock Exchange LLC ("NYSE") to list securities of companies using one-, two-, or three-character symbols. Other exchanges, including the American Stock Exchange LLC ("Amex") and regional exchanges, have also listed securities of companies using two- and three-character symbols. Until recently, The Nasdaq Stock Market, Inc. ("Nasdaq") has always listed securities of companies using four- or five-character symbols.[1] Because securities symbols are an important part of a listed company's identity and because there is a limited supply of securities symbols—particularly one-, two-, and three-character symbols—developing a formal process to reserve, select, and allocate symbols among listing markets and their companies would help promote a fair and orderly national market system and prevent investor confusion.

In 1975, Congress directed the Securities and Exchange Commission ("Commission"), through its enactment of Section 11A of the Securities Exchange Act of 1934 ("Act"),[2] to

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1 See infra note 19 and accompanying text.

2 15 U.S.C. 78k-1.

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facilitate the establishment of a national market system to link together the individual markets that trade securities. Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure fair competition among exchange markets.[3] Congress directed the Commission to authorize or require self-regulatory organizations ("SROs") to act jointly with respect to matters as to which they share authority in planning, developing, operating, or regulating a national market system.[4] Consistent with the principles of Section 11A of the Act, in February 2005, Commission staff asked the listing markets to commence joint discussions to develop a national market system plan for the process of reserving, selecting, and allocating securities ticker symbols.[5]

On March 23, 2007, pursuant to Rule 608 of Regulation NMS under the Act[6] ("Rule 608"), Amex, NYSE, and NYSE Arca filed with the Commission a proposed plan for the purpose of the selection and reservation of securities symbols ("Three-Characters Plan"). On March 23, 2007, Nasdaq, NASD, NSX, and Phlx also filed with the Commission a proposed plan for the purpose of the selection and reservation of securities symbols ("Five-Characters Plan"). On April 23, 2007, CHX, Nasdaq, NASD, NSX, and Phlx filed a supplement to the Five-Characters Plan.[7]

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3 15 U.S.C. 78k-1(a)(1)(C).

4 15 U.S.C. 78k-1(a)(3)(B).

5 See Letters from Annette L. Nazareth, then Director of the Division of Market Regulation, Commission, to Amex, Boston Stock Exchange ("BSE"), Chicago Board Options Exchange ("CBOE"), Chicago Stock Exchange ("CHX"), International Stock Exchange ("ISE"), Nasdaq, National Association of Securities Dealers, Inc. ("NASD"), National Stock Exchange, Inc. ("NSX"), NYSE, Pacific Exchange (the predecessor to NYSE Arca, Inc. ("NYSE Arca")) and Philadelphia Stock Exchange, Inc. ("Phlx"), dated February 7, 2005.

6 17 CFR 242.608.

7 In the Supplement, CHX joined as a party proposing the Five-Characters Plan. In addition, the Supplement contained a revised version of the Five-Characters Plan. The

Although the two plans are identical in many respects, they also differ on several significant matters. The primary difference between the two plans is their scope. The Three-Characters Plan would only cover one-, two-, and three-character symbols; the Five-Characters Plan would cover one-, two-, three-, four-, and five-character symbols. In addition, the plans differ with regard to the number of, and the length of time that, symbols may be reserved, the portability of symbols for issuers that move their listing from one market to another, the allocation of costs relating to the plan, and the process of withdrawing from the plan. Pursuant to Rule 608, the Commission is publishing this notice of, and soliciting comments on, both the Three-Characters Plan and the Five-Characters Plan.

Section 11A of the Act grants the Commission broad authority to authorize or require SROs, either by rule or order, to act jointly with respect to planning, developing, operating, or regulating a national market system.[8] Thus, the Commission may establish a single symbol reservation national market system plan by approving either the Three-Characters Plan or the Five-Characters Plan or may approve both the Three-Characters Plan and the Five-Characters Plan, in each case with such changes or subject to such conditions as the Commission may deem necessary or appropriate.[9] In addition, the Commission has authority to require SROs to participate in any approved national market system plan or plans, or otherwise act jointly with respect to matters related to the national market system.[10]

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parties to the Five-Characters Plan revised the plan as follows: (i) changed the definition of securities for which an SRO must maintain facilities for the quoting and trade reporting of such securities in order to be party to the plan and corresponding changes throughout the plan and (ii) deleted the statement that new parties to the plan would pay an equal share of all development costs.

8 See 15 U.S.C. 78k-1(a)(3).

9 See 17 CFR 242.608(b)(2).

10 15 U.S.C. 78k-1(a)(3)(B).

The Commission requests comment on whether all SROs that list securities should be required to join any symbol reservation national market system plan approved by the Commission. If commenters believe that SROs that list securities should not be required to join such an approved national market system plan, the Commission requests commenters to address how to preclude duplicative symbols from being selected and reserved, how to resolve disputes about symbols, or how otherwise to address concerns the plans are designed to address.

II. Background

Pursuant to Rule 601 of Regulation NMS under the Act,[11] all SROs are required to report every trade in listed equity securities[12] and Nasdaq securities[13] made through their facilities, and to make such information public. Each SRO reports every transaction to the ticker tape using the ticker symbol for that security, the volume of the trade, and the price of the trade. Currently, there are three ticker tapes: Tape A reports the stocks that are listed on NYSE, Tape B reports the stocks that are listed on Amex, as well as securities listed on any other national securities exchange (except securities also listed on NYSE and Nasdaq), and Tape C reports the stocks that are listed on Nasdaq. Tapes A and B disseminate market information pursuant to the Consolidated Tape Association Plan ("CTA Plan"), while Tape C disseminates market information pursuant to the Nasdaq Unlisted Trading Privileges Plan ("Nasdaq Plan").

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11 17 CFR 242.601.

12 17 CFR 242.600(b)(34) defines "listed equity security" as "any equity security listed and registered, or admitted to unlisted trading privileges, on a national securities exchange."

13 17 CFR 242.600(b)(41) defines "Nasdaq security" as "any registered security listed on The Nasdaq Stock Market, Inc."

The term "ticker symbol" originates from the ticker tape.[14] Instead of reporting trades using the full name of the security, a symbol was used to save time and resources when telegraph operators typed each transaction.[15] The most heavily traded stocks were assigned one-character symbols to speed up communication.[16] As noted earlier, it has been the practice of the NYSE to list companies using one-, two-, and three-character symbols. Other exchanges, including Amex and regional exchanges, have also listed companies using two- and three-character symbols. Until recently, Nasdaq, formerly a facility of the NASD, was the only market that did not list securities with one-, two-, and three-character symbols; instead, Nasdaq had always listed securities with four- and five-character symbols. In November 2005, however, Nasdaq announced its intention to begin listing companies with one-, two-, and three-character symbols.[17] Since that time, Nasdaq has made a series of announcements detailing its plans, and has worked with the industry to test trading systems to ensure the proper functionality for such symbols.[18] In March 2007, Nasdaq filed with the Commission a proposed rule change to allow

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14 The ticker tape started in 1867, when all trades made on an exchange were sent out by telegraph and printed on a piece of paper. Although the process is now automated, the securities industry participants continue to refer to the electronic reporting of information as the "tape." See Hal McIntyre, How the US Securities Industry Works, 194-95 (The Summit Group Press) (2000).

15 See, e.g., Brendan I. Koerner, How Are Ticker Symbols Allotted?, Slate, September 18, 2003, available at http://www.slate.com/id/2088587/.

16 See id.

17 See, e.g., Head Trader Alert 2005-133 (November 14, 2005), available at: http://www.nasdaqtrader.com/Trader/News/2005/headtraderalerts/hta2005-133.stm.

18 See, e.g., Head Trader Alert 2006-144 (September 29, 2006), available at: http://www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-144.stm, Head Trader Alert 2006-193 (November 16, 2006), available at: http://www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-193.stm and Head Trader Alert 2006-201 (December 6, 2006), available at: http://www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-201.stm, Head Trader Alert 2007-008 (January 25, 2007), available at: http://www.nasdaqtrader.com/Trader/News/2007/headtraderalerts/hta2007-008.stm.

companies transferring their listings to Nasdaq to retain their three-character symbols.[19]

As the securities markets have grown over the years, one-, two-, and three-character symbols, traditionally used by the exchanges, have become scarce. There are 26 combinations for one-character symbols, 676 combinations for two-character symbols, and 17,576 combinations for three-character symbols, for a total of 18,278 one-, two-, and three-character symbols. Several factors have also been increasing the demand for one-, two-, and three-character symbols. In recent years, exchanges have begun listing new and innovative products, such as exchange-traded funds, that are also now competing with listed companies for symbols. In addition, Nasdaq has expressed its intention to start using one-, two-, and three-character symbols.[20] Finally, the proliferation of standardized options has decreased the availability of three-character symbols.[21]

Concerns about constraints on symbol supply heighten the need to revisit the existing informal symbol reservation system. Currently, the process of designating securities symbols is not done pursuant to a formal national market system plan or agreement, but is conducted informally among the SROs. Each SRO keeps its own records of reserved symbols. If an SRO wishes to reserve a particular symbol, the SRO will first consult its own list of reserved symbols to confirm that the desired symbol has not been reserved by another SRO. Once the listing SRO has verified that a particular symbol is not already reserved according to its own records of

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19 See Securities Exchange Act Release No. 55563 (March 30, 2007), 72 FR 16391 (April 4, 2007) (SR-NASDAQ-2007-031). See also Securities Exchange Act Release No. 55519 (March 26, 2007), 72 FR 15737 (April 2, 2007) (SR-NASDAQ-2007-025) (allowing a single company, Delta Financial Corp., to retain its three-character symbol upon transferring its listing from Amex to Nasdaq).

20 See supra notes 17-19.

21 The options exchanges have expressed their intention to shift to a different symbology in 2009. See http://www.theocc.com/initiatives/symbology/default.jsp.

reserved symbols, the listing SRO will notify the other SROs that it wishes to reserve such symbol. If no other SRO objects, then the listing SRO has successfully reserved that symbol and each SRO would update its own records of reserved symbols accordingly.

While the existing informal reservation system has performed the function of allocating symbols among the listing markets in the past, the weakness in the current system could potentially have significant market consequences as exchanges compete more aggressively for listings and the supply of available symbols becomes more restricted over time. The absence of universal reservation records, for example, could cause confusion about the availability of certain symbols and could lead to disputes between listing markets about the availability of a symbol. Such disputes raise the potential for investor confusion and symbol duplication. Under the existing system, listing markets may reserve an excess amount of symbols indefinitely, which may exacerbate the strain on symbol supply. The fear of symbol supply constraints could even drive listing markets to reserve an excess amount of symbols, either to protect their interests in the event of needing such symbols in the future or to give themselves advantages over their competitors in securing future listings. Moreover, the existing system does not limit the potential for symbol reservations to be used for anti-competitive purposes. For example, a listing market could use the existing symbol reservation system to withhold unused symbols from their competitors, trade reserved symbols only with certain, allied exchanges, or use their power to withhold desired symbols to compel other listing markets not to trade symbols with their direct competitors. Also, the existing system does not universally permit issuers transferring their listings to a new exchange to keep their ticker symbols. For example, the exchange where an issuer listed originally could dispute the new listing exchange's right to use the issuer's ticker symbol, which could disrupt the process of transferring the listing. In addition, issuers with one-, two-, or three-character symbols currently may not transfer their listings to Nasdaq,[22] though they may do so to any other national securities exchange. These weaknesses in the existing informal symbol reservation system could potentially lead to conditions that hamper competition among the listing markets and disrupt the marketplace.

III. Description of the Plans

The two proposed plans are identical in numerous respects. A brief summary of the most significant aspects of the plans, highlighting their distinctions, is provided below. The full text of the separate plans submitted by the SROs is available on the Commission's Web site at http://www.sec.gov/rules/sro/4-534.pdf and http://www.sec.gov/rules/sro/4-533revised.pdf, respectively, at the respective SROs, and at the Commission's Public Reference Room.

A. Preambles

The preambles to the plans are nearly identical.[23] The Three-Characters Plan would establish a body composed of the signatory SROs called the International Symbols Reservation Authority. Similarly, the Five-Characters Plan would establish a body composed of the signatory SROs called the Intermarket Symbols Reservation Authority.[24]

B. Scope of Plans

Each of the proposed plans would cover only root symbols, without any suffix or special conditional identifier.[25]

- The Three-Characters Plan would be the exclusive means of allocating and using symbols of one-, two-, or three-characters in length and would not govern the use

22 See supra note 19.

23 See preambles of the proposed plans.

24 International Symbols Reservation Authority and Intermarket Symbols Reservation Authority are referred to herein as "ISRA."

25 See Section IV(a) of the proposed plans.

of four- or five-character symbols.[26] Specifically, the Three-Characters Plan would cover the allocation of all securities symbols disseminated through the CTA Plan, the Consolidated Quote Plan ("CQ Plan"), the Options Price Reporting Authority ("OPRA"), and any market data distribution network maintained by a party[27] to the plan or an affiliate of a party to the plan.

- The Five-Characters Plan would be the means of allocating and using symbols of one-, two-, three-, four-, or five-characters in length.[28] The Five-Characters Plan would cover securities that are NMS securities as currently defined in Rule 600(a)(46) of Regulation NMS[29] and any other equity securities quoted, traded and/or trade reported through an SRO facility.

The Commission requests comment on whether it would be advisable for it to approve one plan or two plans. For example, commenters views are requested on whether the Commission could approve a plan covering only one-, two-, and three-character symbols and a plan covering one-, two-, three-, four-, and five-character ticker symbols. Would there be any potential inefficiencies and inconsistencies arising from having two plans that would render that situation unworkable or undesirable? Would there be any special benefit derived from having two plans that might justify the additional burden of administering two plans? The Commission also requests comment on whether it is advisable to have a single plan covering one-, two-, three, four-, and five-character symbols. Would there be any difficulties with having a single plan for

26 See Sections I(b) and IV(a) of the Three-Characters Plan.

27 The Commission notes that under Rule 600 of Regulation NMS, SROs who are parties to a national market system plan are referred to as "participants" while the proposed plans refer to such SROs as "parties." See 17 CFR 242.600(b)(53). For purposes of this notice, the term "participants" and "parties" shall have the same meaning.

28 See Sections I(b) and IV(a) of the Five-Characters Plan.

29 17 CFR 600(a)(46).

the allocation of all symbols? What are the benefits of having only one plan? In addition, the Commission requests comment on how having either a single plan or two plans would assure fair competition among all parties and, in particular, new listing markets.

C. Parties to the Plans

The proposed plans' provisions regarding qualifications to be a party to the plan are described below:

- The Three-Characters Plan would allow an SRO to join the plan if it maintains a market for the listing and trading of securities that are identified by one-, two-, or three-character symbols and that are identified as "eligible" securities for "Network A" or "Network B" as those terms are defined in the CTA Plan.[30] A party would also have to have the actual technical and physical capability through its facilities to immediately quote and report trades in securities using one-, two-, or three-character symbols. In addition, the plan would require, as a condition to becoming a new participant, that an SRO pay a proportionate share of the aggregate development costs, with the result that each party's share of all development costs[31] is approximately the same, and sign a current copy of the plan.
- The Five-Characters Plan would allow an SRO to join the plan if it maintains a market for the listing of securities that are identified by one-, two-, three-, four-, or five-character symbols.[32] A party would also have to have the actual technical

30 See Section I(b) and (c) of the Three-Characters Plan.

31 For additional discussion regarding the plan's provision relating to costs, see discussion infra Part III(G).

32 See Section I(b) and (c) of the Five-Characters Plan.

and physical capability through its facilities to immediately quote and report trades in securities using one-, two-, or three-character symbols, if it seeks to reserve symbols of one-, two-, or three-characters in length, and using four- or five-character symbols, if it seeks to reserve symbols of four- or five-characters in length. In addition, this plan would require, as a condition to becoming a new participant, that an SRO pay a proportionate share of the aggregate development costs, based on the number of symbols it reserves, and sign a current copy of the plan.[33]

The Commission requests comment on the proposed plans' requirements for SROs to join each plan. In particular, the Commission requests comment on whether it is appropriate to limit, as the Three-Character Plan proposes, participation in the plan to SROs that maintain a market for the listing and trading of eligible securities for Network A and Network B. Would such a requirement impede fair competition? More generally, would the proposed plans' provisions on eligibility assure fair competition among all parties and, in particular, new listing markets?

D. Administration of ISRA

Section II of each of the plans sets forth the administration of the ISRA. A Policy Committee would administer the ISRA and, unless expressly provided otherwise in the plan, the Policy Committee would make all policy decisions on behalf of the ISRA in furtherance of the functions and objectives of the ISRA under the Act and the plan. Specifically, the Policy Committee would: (1) oversee the operation of the Symbol Reservation System;[34] (2) make all determinations pertaining to contracts with parties to the plan and persons who provide goods or

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33 For additional discussion regarding the plan's provision relating to costs, see discussion infra Part III(G).

34 See discussion infra Part III(F).

services to the ISRA; and (3) determine all other questions pertaining to the planning, developing, and operating of the ISRA, including those pertaining to budgetary or financial matters.

Both of the proposed plans provide that one voting member and one alternate voting member representing each party would compose the Policy Committee.[35] Each party would have one vote on all matters voted upon by the Policy Committee and actions of the ISRA under each plan would be authorized by a majority vote of the Policy Committee members, subject to Commission approval when required by applicable securities law.[36] Authorized actions under each plan would be binding upon all the parties. However, an aggrieved party may present contrary views to any regulatory body or in any other appropriate forum.[37]

Both plans also provide that a meeting of the Policy Committee would be held at least annually and that other meetings would be held as determined by the Policy Committee.[38] Each plan also specifies the notice provisions for regular and special meetings, and the organization of the meetings.

The Commission requests comment on the proposed plans' provisions relating to the administration of the ISRA by the Policy Committee. In particular, the Commission requests comment on the powers of the Policy Committee, as well as whether the committee's decision-making process by majority vote is appropriate. In addition, the Commission requests comment on the appeal procedures for an aggrieved party. Should the plans specify what is meant by the

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35 See Section II(c) of the proposed plans.

36 See Section II(d) of the proposed plans.

37 Id.

38 See Section II(e) of the proposed plans.

phrase "other appropriate forum"? Do the proposed plans provide enough clarity as to how an aggrieved party could pursue relief under the plans?

E. Performance of Functions

Section III of each of the proposed plans establishes that the ISRA would delegate the operation of the Symbol Reservation System to an independent third party (the "Processor") and would enter into contracts with the Processor relating to the operation of the Symbol Reservation System. The Processor would receive reservation requests from the parties and reserve and allocate symbols among the parties in accordance with the terms of the plan. To this end, the Processor would create and maintain a symbol reservation database.[39]

The Commission requests comment on the proposed plans' provisions related to the delegation of the operation of the Symbol Reservation System to a Processor.

F. The Symbol Reservation System

Section IV of each of the proposed plans sets forth the operating details of the Symbol Reservation System. Here, the plans diverge in key ways.

1. Reservation and Use of Symbols

a. Submission of Initial Reservation Requests

Each plan would provide that, within a specified time periods after the plan's approval, a participant in the plan may submit to the Processor requests for the initial reservation of symbols.[40] Both plans provide that a party may reserve symbols for: (i) the listing of common stock or any other security, including options; (ii) the dissemination of a securities index or other index information; or (iii) any other purpose authorized by a majority vote. In addition, the Five-Characters Plan provides that a party may reserve symbols for the trading of any over-the-

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39 See infra Part III(F)(4) for further discussion.

40 See Section IV(b)(1) of the proposed plans.

counter security. Initial reservation requests may be for perpetual or limited-time reservations, as discussed below.

(1) Perpetual Reservations

Each of the proposed plans would permit a party to reserve a limited number of symbols in perpetuity ("perpetual reservations").[41]

- The Three-Characters Plan provides that NYSE and Amex each could reserve up to 200 symbols as perpetual reservations; other parties to the plan each could reserve up to 40 symbols as perpetual reservations.
- The Five-Characters Plan provides that there would be two perpetual reservation lists—one list for one-, two-, and three-character symbols and one list for four- and five-character symbols. Each party to the plan could reserve up to 20 one-, two-, or three-character symbols as perpetual reservations, and up to 20 four- or five-character symbols as perpetual reservations.

Both proposed plans provide that a party could not add symbols to its perpetual reservation list after the initial reservation process, except when reserving a symbol for re-use.[42] In addition, both plans would provide that a party that requests perpetual reservations for more symbols than permitted would be required to place its symbols requests in priority ranking.

The Commission requests comment on the plans' proposals to include perpetual reservations lists. Should SROs be permitted to reserve symbols in perpetuity? Commenters are requested to explain why SROs should or should not be permitted to reserve symbols into perpetuity. Would there be any public benefit derived from having perpetual reservations?

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41 See Section IV(b)(1)(A) of the proposed plans.

42 See discussion infra Part III(F)(3).

What impact would allowing perpetual reservations have on competition, particularly for new markets? The Commission also requests commenters' views on the number of symbols an SRO should be permitted to reserve under any such list. Specifically, the Commission requests comment on whether all SROs should be given the same number of perpetual reservations, as proposed under the Five-Characters Plan, or whether it is reasonable to provide certain SROs a greater number of such reservations, as proposed under the Three-Characters Plan. In particular, the Commission requests comment on what basis would be appropriate for certain SROs to receive more perpetual reservations than other SROs. For example, should the primary listing markets receive a greater number of perpetual reservations?

Finally, the Commission requests commenters' views on how the proposed provisions on perpetual reservations would affect new listing markets. How would an SRO that joins the plan after the initial reservation process be able to reserve symbols? Would the existence of perpetual reservations present a significant barrier to entry by new listing markets? Would it prevent or reduce competition from new listing markets? Would conducting another initial reservation process for all plan participants upon a new market joining the plan provide a more level playing field for a new entrant? How else could the provisions on perpetual reservations be adjusted to account for new listing markets?

(2) Limited-Time Reservations

Under both plans, symbols could also be reserved for 24 months ("limited-time reservations").[43]

- The Three-Characters Plan provides that Amex and NYSE each could reserve up to 1,500 symbols as limited-time reservations and NYSE Arca could reserve up to

[43] See Section IV(b)(1)(B) of the proposed plans.

500 symbols as limited-time reservations. The Three-Characters Plan does not specify the number of limited-time reservations for other parties. Instead, this plan would need to be amended when an additional party joins the plan to specify how many limited-time reservations such party is entitled.

- The Five-Characters Plan would provide two limited-time reservation lists—one list for one-, two-, and three-character symbols and one list for four- and five-character symbols. Each party could reserve up to 1,500 symbols under the one-, two-, or three-character limited-time reservations list and up to 1,500 symbols under the four- or five-character limited-time reservations list. Moreover, under the Five-Characters Plan, a party may not make any limited-time reservations with respect to a particular symbol unless the party has a reasonable basis to utilize the symbol within the next 24 months.

As with perpetual reservation requests, under both plans, a party that requests limited-time reservations for more symbols than permitted would be required to place its symbols requests in priority ranking.

The Commission requests comment on the plans' proposals to include limited-time reservations. Should SROs be permitted to make limited-time reservations? Commenters are requested to explain why SROs should or should not be permitted to reserve symbols for a limited-time. Would there be any public benefit derived from having limited-time reservations? What impact would allowing limited-time reservations have on competition, particularly for new markets? The Commission also requests comment on the requirement for a "reasonable basis" for reserving a symbol, as articulated in the Five-Characters Plan. Specifically, should the plan be more specific as to what would be a "reasonable basis" or who would make such a determination and how?

The Commission requests comment on the number of symbols an SRO should be permitted to reserve as limited-time reservations. The Commission also requests comment on the length of time symbols may be reserved as limited-time reservations. Is 24 months an appropriate length of time—should it be shorter or longer? In addition, the Commission requests comment on whether all SROs should receive the same number of limited-time reservations, as provided under the Five-Characters Plan, or whether it is appropriate for certain SROs to receive a greater number of such reservations, as proposed under the Three-Characters Plan. In particular, the Commission requests comment on what basis would be appropriate for certain SROs to receive more limited-time reservations than other SROs. For example, should the primary listing markets receive a greater number of limited-time reservations? Finally, the Commission requests commenters' views on how the proposed provisions on limited-time reservations would affect new listing markets. How would an SRO join the plan after the initial reservation process reserve symbols? Would limited-time reservations prevent or reduce competition from new listing markets and present a significant barrier to entry by new listing markets? Would conducting a new initial reservation process for all plan participants upon a new market joining the plan provide a more level playing field for a new entrant? How else could the provisions on limited-time reservations be adjusted to account for new listing markets?

b. Processing of Initial Reservation Requests

(1) Claims to a Legacy Reservation

Both plans would permit a party to have priority over other parties in reserving a symbol that it claims was properly reserved under the current informal system ("legacy reservation"), prior to the effective date of the plan.

- Under the Three-Characters Plan, if there is only one party that claims such prior reservation of a symbol, such party would have priority over other SROs to retain its reservation of that symbol.[44] Such a symbol would be included on a party's perpetual or limited-time reservation list.
- Under the Five-Characters Plan, if there is only one party that claims such prior reservation of a symbol, such party would have priority over other SROs to retain reservation of that symbol only if the party represents that it has a reasonable basis to believe that it would utilize such symbol within the next six months.[45] Under the Five-Characters Plan, such reservation would not count towards the party's perpetual reservations or limited-time reservations, but instead be reserved as a separate, additional legacy reservation. However, if the party does not use such symbol within the allotted six-month period, it would lose the reservation unless the party requests an extension for an additional six-month period. In requesting such an extension, the party would have to have a reasonable basis to believe that it would utilize such symbol within the additional six-month period.

44 See Section IV(b)(2) of the Three-Characters Plan.

45 See Section IV(b)(2) of the Five-Characters Plan.

Both plans would provide the same process for resolving claims by more than one party to a legacy reservation.[46] This process is as follows: First, the Processor would notify all such parties of the conflicting claims. Then the parties would have five business days to reach a mutually acceptable agreement as to which party would be permitted to reserve the symbol. In the absence of an agreement, the Policy Committee would resolve the issue by a majority vote of the parties not claiming the symbol. Where there is no agreement but the Policy Committee is able to determine which party has the earliest proper claim to such symbol, the plans would require it to resolve the disagreement in favor of such party.

The Commission requests comment on the proposed plans' processes for recognizing legacy reservations. Should parties have the right to reserve, under the plans, symbols for which they claim to have a legacy reservation? Should a party only be able to retain a legacy reservation if it is able to represent that it has a reasonable basis to believe that it would utilize such symbol within the next six months, as provided under the Five-Characters Plan? If so, the Commission requests comment on the requirement to have "a reasonable basis" for retaining legacy reservations. Specifically, should the plan be more specific as to what would be a "reasonable basis" or who would make such a determination and how?

The Commission also requests comment on the proposed process for resolving claims to legacy reservations. Could the requirement of a majority vote for resolving such claims affect fair competition among the parties? How could this process be adjusted to address any competitive concerns? The Commission also requests comment on how decisions to grant extensions of legacy reservations, as proposed under the Five-Characters Plan, would be made.

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46 See Section IV(b)(2)(B) of the proposed plans.

Should the plan be more specific as to who would make a determination that a reasonable basis for an extension exists and how?

(2) Other Initial Reservations

Both plans would provide the same process for initial reservations of symbols that have not been properly reserved prior to the effective date of the plan.[47] If only one party seeks to reserve a symbol, then the Processor would reserve such symbol for that party. If multiple parties seek to reserve a symbol, the Processor would reserve the symbol based on a random ordering established by the Policy Committee. If a symbol is not available for reservation, both plans would provide that the Processor would place the requesting party on a wait list.[48] Further, both plans would provide that the Processor would process a party's symbol reservation requests by first reserving symbols up to the party's limit for its perpetual reservations list and then reserving the remaining requested symbols up to the limit for its limited-time reservations.[49]

The Commission requests comment on the proposed plans' processes for initial reservation requests. In particular, the Commission requests comment on how the proposed processes would affect new listing markets. Would the proposed processes for initial reservation requests affect competition? Should there be a special initial reservation process for a new listing market that joins the plan? Would a new listing market be adversely affected by the proposed methods of allocating initial reservation requests and its impact on the availability of symbols? How could the proposed plans assure fair competition among all parties and, in particular, new listing markets? How should the random order of priority for reserving a symbol

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47 See Section IV(b)(2)(C)-(E) of the proposed plans.

48 See discussion infra Part III(F)(2).

49 See section IV(b)(2)(F) of the proposed plans.

requested by multiple parties be designed? For example, should the order be selected anew for every symbol? Would another assignment methodology be more appropriate or fair?

c. Subsequent Reservations

Both plans contain substantially identical provisions on reserving symbols after the initial reservation process.[50] Specifically, if a party submits to the Processor a request for a limited-time reservation and the symbol is available, the Processor would reserve such symbol, provided that the party has not already reached its maximum number of allowed limited-time reservations. If it has reached its maximum number of limited-time reservations, the party could surrender a reserved symbol in order to reserve the new symbol. If a symbol requested is not available, the Processor would place the requesting party on the waiting list for such symbol.

The Commission requests comment on the proposed plans' provisions for the subsequent reservations of symbols. In particular, the Commission requests comment on whether the proposed provisions assure fair competition among all parties and, in particular, new listing markets.

d. Non-Use or Release of Symbols Within Time Period

Both plans provide that the Processor would release any limited-time reservation symbols not used within the 24-month time period.[51] A party could also voluntarily release a reserved symbol. In either case, upon the release of a symbol, the Processor would notify the parties on the waiting list, if any, of the symbol's availability. If there is no waiting list or if no party on the waiting list elects to reserve such symbol, the Processor would notify all parties to the plan of the availability of the symbol. If more than one party requests the reservation of such symbol within two business days of the notice, the Processor would assign the symbol to one party and place

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50 See Section IV(b)(3) of the proposed plans.

51 See Section IV(b)(5) of the proposed plans.

the other parties on the waiting list pursuant to a random order of priority established by the Policy Committee.

The Commission requests comment on the proposed plans' provisions for the non-use or release of symbols. How should the random order of priority for the waiting list be designed? For example, should the order be selected anew for every symbol? Would another assignment methodology be more appropriate or fair? Would the proposed plans' processes for the non-use or release of symbols affect competition?

e. Request for Release of a Symbol

Both plans would provide the same method for a party to request the release by another party of a reserved symbol.[52] Specifically, if a party has an immediate need to use a symbol that another party has reserved, the requesting party would ask the party that reserved the symbol, and any other parties on the waiting list, whether such parties would be willing to release the reserved symbol. If the parties do not agree to release the symbol, the requesting party would not obtain the reserved symbol. If the parties do agree to release the symbol, the requesting party could include such symbol as one of its limited-time reservations. If the requesting party is already at the maximum number of limited-time reservations, under the Three-Characters Plan, it would have to voluntarily surrender another reserved symbol before reserving the requested symbol. Under the Five-Characters Plan, if the requesting party is already at the maximum number of limited-time reservations, the party could either surrender or re-designate another symbol before reserving the requested symbol. If the requesting party does not use a released symbol within the 24-month period, absent the consent of all parties initially required to be

52 See Section IV(b)(6) of the proposed plans.

contacted, the reservation and waiting list priority in effect when the requesting party first made its request for the release of the symbol would again be in effect.

The Commission requests comment on the proposed plans' processes for releasing symbols. The Commission requests commenters' views on whether a requesting party that is at the maximum number of limited-time reservations should be allowed to either surrender or re-designate another symbol in order to reserve the requested symbol. The Commission notes that the Five-Characters Plan does not define or describe the process of "re-designating" a symbol. The Commission requests comment on whether it is necessary for the plan to describe the process of "re-designation." The Commission also requests comment on how a symbol could be "re-designated" if a requesting party is at its maximum number of limited-time reservations. Finally, the Commission requests comment on whether the proposed provisions on releasing symbols assure fair competition among all parties and, in particular, new listing markets.

2. Waiting List

Both plans would provide substantially identical waiting list processes.[53] Specifically, when one or more parties request to reserve a symbol that another party has reserved, the Processor would place such parties on the waiting list for that symbol. The waiting list would be based on time priority—that is, the earliest request would have precedence. However, if more than one party seeks to use a symbol already in use within either 30 days of the effective date of the plan or two business days of notice of a symbol's availability, the Policy Committee would establish a random order of such parties to determine priority on the waiting list.

When a symbol becomes available, the Processor would notify the party with priority on the waiting list. Such party would then have two business days to reserve that symbol;

[53] See Section IV(c) of the proposed plans.

otherwise, the Processor would repeat the process as necessary with all parties on the waiting list, in order of priority. The maximum number of symbols for which a party may be on the waiting list at any time would be 100 symbols.

The Commission requests comment on the proposed plans' waiting list provisions. In particular, the Commission requests comment on whether 100 symbols is an appropriate number of symbols for the waiting list. With respect to a party's request to use a symbol already in use either within 30 days of the effective date of the plan or within two business days of notice of a symbol's availability, the Commission requests comment on whether such time periods are appropriate. In addition, the Commission requests comment on whether the proposed provisions for waiting lists assure fair competition among all parties and, in particular, new listing markets. Finally, how should the random order of priority for the waiting list be designed? For example, should the order be selected anew for every symbol? Would another assignment methodology be more appropriate or fair?

3. Reuse of a Symbol and Portability of Symbols in Use

The plans propose different approaches to the reuse and portability of symbols.[54]

- The Three-Characters Plan would provide that if a party ceases to use a symbol,[55] such party automatically reserves that symbol, notwithstanding any other limits on the number of reserved symbols under the plan. The Three-Characters Plan would include within an SRO's right to automatically reserve a symbol it ceases to use the situation in which an issuer transfers its listing from one SRO to another.

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54 See Section IV(d) and (f) of the proposed plans.

55 For example, through merger or delisting of the issuer whereby the security is no longer listed.

This plan would provide that the SRO from which the issuer delisted its security would have the rights to the symbol for that security, unless it consents to the transfer of the symbol to the new SRO. If the SRO to which the issuer transferred its listing believes there is a compelling business reason why it should have the rights to the symbol (if it is a two- or three-character symbol, but not a one-character symbol), the new SRO may submit to the Processor the determination of which SRO shall have the rights in that symbol.[56] The Processor could only grant the rights in the symbol to the new SRO if the Processor determines that such SRO's business reasons for obtaining such rights substantially outweigh the business needs of the other SRO to that symbol. The Processor's decision would be final and not subject to appeal.

- The Five-Characters Plan would also provide that if a party ceases to use a symbol, such party automatically reserves that symbol, notwithstanding any other limits on the number of reserved symbols under the plan. However, this plan would provide an exception to this automatic reservation right when an issuer transfers its listing from one SRO to another. In this case, the SRO to which a listing is transferred would have the rights to that issuer's symbol.

Both plans provide that a symbol being reused pursuant to such provisions could be reserved as a perpetual reservation if the party has not yet reserved the full number of perpetual reservations available to it.[57] Otherwise, such symbol would be reserved as a limited-time

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56 The Three-Characters Plan would not permit disputes over one-character symbols to be submitted to the Processor.

57 The plans also provide that a party could move a symbol from its perpetual reservations list to its limited-time reservations list in order to place the symbol being reused on its perpetual reservations list.

reservation and the additional symbol could exceed the limit of the maximum number of limited-time reservations permitted to a party under the plan. Finally, both plans would provide that a symbol could not be reused by a party to identify a new security unless the party reasonably determines that such use would not cause investor confusion.

The Commission requests comment on the proposed plans' provisions relating to the reuse of symbols. In particular, the Commission requests comment on the proposed plans' provisions regarding the portability of a securities symbol to a new listing market when an issuer transfers its listing. When an issuer moves its listing to a new listing market, should either the former listing market or the new listing market retain the right to use the issuer's symbol? How would awarding the rights to the symbol to the former listing market affect competition? How would awarding such rights to the new listing market affect competition? Should there be a process for resolving symbol disputes between the former listing market and the new listing market or should the plans categorically award the rights to the symbol to one market or the other? If the former, the Commission requests comment on the Three-Characters Plan's proposed process for resolving such disputes.

Under the Three-Characters Plan, the new listing market may request the transferred symbol if it believes that there is a compelling business reason for the transferred symbol. The Commission requests comment on whether the plan should be more specific as to what would be a "compelling business reason" and how the Processor should assess the various business needs of the two listing markets to make the decision as to who should have the rights to the symbol. Should the business reasons of the two listing markets be the only factor in the Processor's determination? Or should other factors also be considered? If so, what other factors should be considered? Is the Three-Characters Plan's provision that the Processor's decision is final and not subject to appeal fair and reasonable? Or would it be more appropriate to provide the parties with an alternative venue for pursuing relief? Finally, the Commission requests comment on whether single-character symbols should be subject to the same portability provisions as two- and three-character symbols.

4. Database

Both plans would provide that the Processor would create and maintain a symbol reservation database.[58] Except as required by applicable law, the Processor would grant access to the database only to the parties and the Commission. The database would show all symbols currently in use and the party using such symbols.[59] In this regard, both plans would require a party to notify the Processor when the party begins using a reserved symbol. In addition, the database would show all symbols reserved on the perpetual reservations and limited-time reservations lists, including the reserving party and the expiration date for limited-time reservations. The database would also show the waiting list and the priority order of the waiting list for each symbol. The Commission requests comment on the proposed plans' provisions related to the database.

G. Financial Matters

Sections I and V of the plans set forth the manner in which the parties would share the initial development costs, as well as continuing costs. The proposed plans differ significantly in their method of cost allocation.

- Under the Three-Characters Plan, the parties would share the initial development costs equally. The Three-Characters Plan would also provide that the continuing costs and expenses of ISRA would be shared equally among the parties at the end

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58 See Section IV(e) of the proposed plans.

59 See Section IV(b)(4) of the proposed plans.

of each calendar year. The continuing costs would only be prorated for a party that had not been a party for the entire calendar year. Section I of the Three-Characters Plan would provide that any new party that joins the plan would pay to the existing parties a proportionate share of the aggregate development costs previously paid by such existing parties, with the result that each party's share of all development costs is approximately the same.

- Under the Five-Characters Plan, the parties would share the initial development costs pro-rata based on the number of symbols initially reserved by each party. Section V of the Five-Characters Plan would provide that any new party that joins the plan would also be responsible for a pro-rata portion of the initial development costs based upon the number of symbols initially reserved by such new party during the first twelve months of the new party's membership in the plan. The Five-Characters Plan would provide that the continuing costs and expenses of ISRA would be shared among the parties pro-rata based on the number of additional symbols reserved in each calendar year, estimated quarterly. In addition, under the Five-Characters Plan, the Policy Committee may develop alternative cost-allocation methodologies for special non-initial development projects.

The Commission requests comment on the proposed plans' provisions relating to financial matters. In particular, should the initial development and continuing costs be allocated by the number of parties, or by the number of reserved symbols of a party? Are there other cost allocation methodologies the Commission should consider? In addition, the Commission requests comment on the proposed plans' effects on new listing markets. Do the proposed plans' provisions on allocation of costs assure fair competition among all parties and, in particular, new listing markets? Would new listing markets be adversely affected by either formula for allocating initial development costs? The Commission also requests comment on whether the proposed plans should address the scenario of a former party who later wishes to rejoin the plan. Specifically, should such an entity be viewed as a new party who would be required to pay a share of the initial development costs according to the prescribed formula for new parties?

H. Confidentiality

Section VI of both plans would provide that the Processor would maintain all information received from the parties in strictest confidence and that the only information that the Processor would make available to the parties is the symbol reservation database. The Three-Characters Plan would also specifically provide that the Processor would make available to the parties any notices or other information specifically called for by the plan. Both plans would provide that the Processor would not make the symbol reservation database available to any person except the Commission or the parties, unless otherwise required by applicable law.

The Commission requests comment on the proposed plans' provisions with respect to the Processor's responsibility to keep information confidential.

I. Term of Plan Withdrawal – Non-transferability of Rights Under the Plan

Section VII of both plans would establish the method for a party to withdraw from the plan. Specifically, to withdraw from the plan, a party would be required to provide at least six months prior written notice to the other parties. The withdrawing party would remain liable for its proportionate share of costs and expenses during the time it was a party to the plan, but would have no further obligations after the withdrawal. The Three-Characters Plan specifically states that withdrawal by a party would not result in any rebate or adjustment in the initial development costs paid, or payable, at the time of termination.

The Commission requests comment on the proposed plans' provisions related to withdrawal. If a party withdraws from the plan, to what extent should that party be responsible for costs paid or payable at the time of its termination from the plan? Should a party that lists securities be permitted to withdraw from the plan? The Commission requests comment on whether it should require all listing markets to join any approved national market system plan for the selection and reservation of securities symbols.

In addition, under both plans, an SRO would cease to be a party to the plan when it ceases to maintain a facility for the quoting and trade reporting of securities transactions or ceases to use symbols subject to the plan.[60] An SRO could continue to be a party of the plan upon the agreement of the remaining parties. To be approved as a continuing party, the Three-Characters Plan would require the unanimous vote of the remaining parties, while the Five-Characters Plan would require a majority vote.

The Commission requests comment on whether a vote is appropriate to allow an SRO that no longer maintains a facility for quoting or trade reporting of securities transactions or ceases to use symbols subject to the plan to remain a party to the plan. If so, the Commission requests comment on whether a unanimous or majority vote is appropriate. In particular, the Commission requests comment on how the requirement of either a majority vote, as proposed by the Five-Characters Plan, or unanimous vote, as proposed by the Three-Characters Plan, would affect competition among the listing markets.

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60 See Section I(d) of the proposed plans.

Finally, both plans would provide that the right of a party to participate in the Symbol Reservation System under the plan is not transferable without the consent of the other parties.[61] However, if a party is subject to a merger, combination, or other reorganization or the sale of all or substantially all of its assets, including its registration as an SRO, both plans would provide that the surviving entity would automatically become subject to the plan and could use the Symbol Reservation System.

The Commission requests comment on the proposed plans' provisions for the transfer of a party's rights under the plans. The Three-Characters Plan would subject the transferability provision to Section I(d) of the plan. Section I(d) of the Three-Characters Plan states that an SRO that is a party to the plan would cease to be a party at such time as it ceases to maintain a facility for the quoting and trade reporting of securities or ceases to use symbols subject to the plan, unless such SRO asks to continue as a party and the other parties to the plan, by a unanimous vote, approve such SRO to continue as a party. Would the proposed plans' provisions for the transfer of a party's rights affect competition?

The Commission requests comment on this cross-reference to Section I(d), and notes that such cross-reference is not proposed in the Five-Characters Plan.

J. Amendments to the Plan

Section VIII of both plans would provide that the plan may be amended from time to time when authorized by the affirmative vote of all the parties, subject to any required approval of the Commission. The Commission notes that SROs proposing an amendment to a national market system plan must file such amendment with the Commission under Rule 608 of Regulation

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61 See Section VII of the proposed plans.

NMS.[62] The Commission requests comment on the proposed unanimity requirement for amending the plans. Would a majority or super-majority vote be more appropriate?

K. Implementation of the Plans

Both plans anticipate that the plan would be implemented upon the Commission's approval.[63]

L. Development and Implementation Phases

Parties to the Three-Characters Plan contemplate that the development and implementation phase would take place according to a timetable agreed to by the parties and the Processor. Parties to the Five-Characters Plan would determine the development and implementation phase at a later time.

The Commission requests comment on whether the plans should specify the timetable for implementation. If so, what would be an appropriate timetable? In addition, the Commission requests comment on whether the plans should address the interim period when the symbol reservation system is not yet implemented and the parties are operating under the existing informal reservation system.

M. Impact on Competition

Parties to both plans do not believe that their plan would impose any burden on competition. Parties to the Five-Characters Plan believe that the plan would promote competition among exchanges by: (1) providing all exchanges equal ability to use all symbols, (2) preserving full portability of symbols, and (3) allowing all exchanges equal ability to reserve symbols subject to equal application of reasonable time limits.

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62 The Commission may also propose amendments to any effective national market system plan. See 17 CFR 242.608(d)(2).

63 Section IV in each plan provides that each party's initial symbol reservation requests would be due to the Processor within 30 days of Commission approval.

In addition to the questions above, the Commission requests comment on whether the proposed plans have adequately addressed the impact that they might have on competition. If not, what issues have not been adequately addressed?

N. Written Understanding or Agreements Relating to Interpretation of or Participation in Plan

Parties to both plans state that they do not have any written understanding or agreement relating to the interpretation of, or participation in, their plan.

O. Operation of Facility Contemplated by the Plan

Parties to both plans state that they do not intend to operate a "facility" as that term is defined under the Act.[64]

P. Terms and Conditions of Access

Section I of each of the plans contains a provision for the admission of new participants, under which any SRO that meets the eligibility standards of the plan may become a party thereto by signing a current copy of the plan and paying to the other parties a share of the aggregate development costs previously paid by such parties to the Processor.

The Commission requests comment on the proposed plans' provision with respect to new participants. In particular, the Commission requests commenters' view on whether the provisions set forth fair terms for access for all parties and, in particular, new listing markets.

Q. Method and Frequency of Processor Evaluation

Parties to the Three-Characters Plan contemplate that they would evaluate the Processor on a periodic basis, with a formal evaluation timetable, after they have selected the Processor. Parties to the Five-Characters Plan would determine the method and frequency of the evaluation of the Processor at a later time.

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64 See 15 U.S.C. 78c(a)(2).

R. Dispute Resolution

Generally, parties to the Three-Characters Plan would seek to resolve disputes by means of negotiation and discussion among their ISRA Policy Committee representatives; parties to the Five-Characters Plan would seek to resolve disputes by communication among parties. Except in the specific instances noted below, both plans do not provide for a specific mechanism for the resolution of disputes arising under the plan but acknowledge that all parties retain the right to present their views on issues relating to the plan and their rights in the appropriate forum.

There are two instances in which the proposed plans provide mechanisms for dispute resolution. Under Section IV(b)(2)(B) of each of the plans, the Policy Committee would resolve disputes related to the initial reservation requests. Under Section IV(f) of the Three-Characters Plan, the Processor would resolve disputes with respect to which SRO would retain the rights to the symbol when an issuer moves its listing to a new SRO.

The Commission requests comment on the proposed plans' provisions on dispute resolution. Specifically, the Commission requests commenters' view whether the proposed plans should prescribe the appropriate forums that aggrieved parties may seek to present their views.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed plans are consistent with the Act. The Commission invites comments on whether the foregoing assures fair competition among all parties, including new listing markets. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Numbers 4-533 and 4-534 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Numbers 4-533 and 4-534. The file numbers should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro/nms.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed plans that are filed with the Commission, and all written communications relating to the proposed plans between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Numbers 4-533 and 4-534 and should be submitted on or before [insert date 30 days from publication in the Federal Register].

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 232, 239, 270 and 274

[Release Nos. 33-8823, IC-27884; File Number S7-05-07]

RIN 3235-AJ59

EXTENSION OF INTERACTIVE DATA VOLUNTARY REPORTING PROGRAM ON THE EDGAR SYSTEM TO INCLUDE MUTUAL FUND RISK/RETURN SUMMARY INFORMATION

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting rule amendments to extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit supplemental tagged information contained in the risk/return summary section of their prospectuses. A mutual fund choosing to tag its risk/return summary information also would continue to file this information in HTML or ASCII format, as currently required. This extension of the voluntary program is intended to help us evaluate the usefulness to investors, third-party analysts, registrants, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information.

EFFECTIVE DATE: August 20, 2007.

FOR FURTHER INFORMATION CONTACT: Alberto H. Zapata, Senior Counsel, or Brent J. Fields, Assistant Director, Office of Disclosure Regulation, Division of Investment Management, at (202) 551-6784, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720. If you have questions about the EDGAR system, contact Richard Heroux, EDGAR Program Manager, at (202) 551-8800, in the Office of Information Technology.

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SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting amendments to rules 401[1] and 402[2] of Regulation S-T[3], rule 8b-33[4] under the Investment Company Act of 1940 ("Investment Company Act"), and Form N-1A[5] under the Investment Company Act and the Securities Act of 1933 ("Securities Act").[6]

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1 17 CFR 232.401.

2 17 CFR 232.402.

3 17 CFR 232.10 et seq.

4 17 CFR 270.8b-33.

5 17 CFR 239.15A and 274.11A.

6 The Commission proposed these amendments in February 2007. Securities Act Release No. 8781 (Feb. 6, 2007) [72 FR 6676 (Feb. 12, 2007)] ("Proposing Release").

Table of Contents

I. BACKGROUND

A. Interactive Data and XBRL

For the past several years, the Commission has been evaluating the use of interactive data tagging as a tool to improve the timeliness and accessibility of the information contained in filings with the Commission under the federal securities laws.[7] Data tagging uses standard definitions (or data tags) to translate text-based information into data that is interactive, that is, data that can be retrieved, searched, and analyzed through automated means.[8]

Interactive data has enormous potential to enable investors and other market participants to analyze and compare data from different sources more efficiently and effectively and to exchange information across various platforms automatically. Through interactive data, static text-based information can be transformed into dynamic databases that can readily be searched and analyzed, facilitating the comparison of information

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7 See SEC to Rebuild Public Disclosure System to Make It 'Interactive,' Securities and Exchange Commission Press Release, Sept. 25, 2006, available at: http://www.sec.gov/news/press/2006/2006-158.htm ("September 25 Press Release"); Commission Announces Roundtable Series Giving Investors and Analysts Better Financial Data via Internet, Securities and Exchange Commission Press Release, Mar. 9, 2006, available at: http://www.sec.gov/news/press/2006-34.htm; SEC Offers Incentives for Companies to File Financial Reports with Interactive Data, Securities and Exchange Commission Press Release, Jan. 11 2006, available at: http://www.sec.gov/news/press/2006-7.htm ("January 11 Press Release"); SEC Announces Initiative to Assess Benefits of Tagged Data in Commission Filings, Securities and Exchange Commission Press Release, July 22, 2004, available at: http://www.sec.gov/news/press/2004-97.htm.

8 The Commission's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR") has allowed certain tagged data since its inception, for example, by using Standard Generalized Markup Language and Extensible Markup Language ("XML") to tag form-specific information (such as the form type, central index key, and file number) that accompanies electronic documents submitted on EDGAR. More recently, EDGAR has employed HyperText Markup Language ("HTML") to format documents and made limited use of XML related to financial and business information contained within certain EDGAR submissions.

across companies, reporting periods, and industries. Interactive data also provides a significant opportunity to automate information processing throughout the business and reporting cycle, with the potential to increase accuracy and reduce costs. By ensuring that information is classified properly at each step of the cycle, and minimizing the need for human intervention and, therefore, human error, interactive data may improve the quality of information at decreased cost.

Tags are defined in taxonomies, which are essentially data dictionaries that describe individual items of information and mathematical and definitional relationships among the items. As tagging has continued to gain prominence in recent years, there has been substantial progress in developing data tagging taxonomies related to a language for the electronic communication of business and financial data known as eXtensible Business Reporting Language ("XBRL"). XBRL was developed as an open source specification that describes a standard format for tagging financial and other information to facilitate the preparation, publication, and analysis of that information by software applications.[9] XBRL was developed and continues to be supported by XBRL International, a collaborative consortium of approximately 450 organizations representing many perspectives in the financial reporting community.[10] XBRL International and its related entities have been developing standard taxonomies that are designed to classify and define financial information in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") and Commission regulations. The Commission has contracted with

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9 "Open Source" means that the software can be used by anyone without charge and is being developed in an open and collaborative setting. For a more detailed discussion about XBRL, see "How XBRL Works" on the XBRL International Web site available at: http://www.xbrl.org/HowXBRLWorks/.

10 See "About the Organisation" page and subpages on the XBRL International Web site, available at: http://www.xbrl.org/AboutTheOrganisation/.

XBRL US, Inc., the U.S. based jurisdiction of XBRL International, to help complete the writing of XBRL taxonomies that would enable companies in all industries to file financial reports with the Commission using XBRL.[11]

B. The Voluntary Program and Tagging of Mutual Fund Information

As part of our evaluation of the potential of interactive data tagging technology, the Commission adopted rules in 2005 instituting a program that permits filers, on a voluntary basis, to submit financial information tagged in XBRL format as an exhibit to certain filings on the Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR").[12] The Commission adopted the voluntary program to help evaluate the usefulness of data tagging and XBRL to registrants, investors, the Commission, and the marketplace.[13] In 2006, the Commission initiated an interactive data test program, in which companies, including investment companies, voluntarily agree to furnish financial data in XBRL format for at least one year and provide feedback on their experiences, including the costs and benefits.[14] The data currently permitted in XBRL exhibits is limited to financial information.

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11 September 25 Press Release, supra note 7.

12 See Securities Act Release No. 8529 (Feb. 3, 2005) [70 FR 6556 (Feb. 8, 2005)] ("XBRL Adopting Release"); Securities Act Release No. 8496 (Sept. 27, 2004) [69 FR 59094 (Oct. 1, 2004)] ("XBRL Proposing Release"). See also Securities Act Release No. 8497 (Sept. 27, 2004) [69 FR 59111 (Oct. 1, 2004)] (concept release soliciting comment on data tagging).

13 XBRL Adopting Release, supra note 12, 70 FR at 6556-57.

14 January 11 Press Release, supra note 7. For more information about the Commission's interactive data initiatives, see the Commission Web page "Spotlight On: Interactive Data and XBRL Initiatives," available at: http://www.sec.gov/spotlight/xbrl.htm.

The current voluntary program extends to financial information for investment companies, including open-end management investment companies ("mutual funds").[15] In February of this year, we proposed amendments to the voluntary program that would permit mutual funds to tag the information in the risk/return summary section of their prospectuses using a taxonomy developed by the Investment Company Institute ("ICI").[16]

The risk/return summary section of the mutual fund prospectus contains important information about investment objectives and strategies, risks, and costs,[17] and tagging this information could provide powerful tools for investors. With almost half of all U.S. households owning mutual funds,[18] typically to fund their education, retirement, and other basic needs, improving the quality of mutual fund disclosure is important to millions of Americans. Tagging of key mutual fund information could help to streamline the delivery of mutual fund information and provide investors, analysts, and others with

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15 See SEC XBRL Voluntary Program Extends to Investment Companies, Securities and Exchange Commission Press Release, Aug. 8, 2005, available at: http://www.sec.gov/news/press/2005-112.htm.

16 The ICI is a national association of the American investment company industry. In March 2006, the ICI announced an initiative to create a taxonomy to cover the risk/return summary information. See Stevens Calls for Greater Use of Internet; Announces Initiative to Develop XBRL Data Tagging Technology, ICI Press Release, Mar. 20, 2006, available at: http://ici.org/statements/nr/2006/06_news_mfimc.html#TopOfPage; ICI Unveils Draft XBRL Taxonomy For Public Review, ICI Press Release, Jan. 4, 2007, available at: http://www.ici.org/statements/nr/07_news_xbrl_txnmy.html#TopOfPage.

In a letter to the Commission staff, dated May 18, 2007, the ICI advised that the risk/return summary taxonomy is ready for use and described its response to comments received regarding the taxonomy development. See Letter from Donald J. Boteler, Vice President – Operations and Continuing Education, ICI, to Andrew J. Donohue, Director, Division of Investment Management (May 18, 2007) ("Boteler Letter"), available at: http://www.sec.gov/comments/s7-05-07/s70507-21.pdf. The ICI also indicated that the schema files and reference materials for the taxonomy are available at: http://xbrl.ici.org.

17 Items 2 and 3 of Form N-1A [17 CFR 239.15A and 274.11A].

18 2007 Investment Company Fact Book, at 57-58, Investment Company Institute (2007), available at: http://www.ici.org/home/2007_factbook.pdf.

improved tools to compare funds based upon, among other things, costs, investment objectives, strategies, and risks. In addition, the risk/return summary information is largely narrative in format, and exploring the viability of tagging this information will provide us with valuable insights as we assess the potential for tagging other primarily narrative information.

The Commission received eight comment letters on the proposed rule amendments, including comments from software vendors, an accounting firm, a trade association, and several individuals.[19] These commenters generally supported the proposed rules to extend the interactive data voluntary reporting program to the risk/return summary section of mutual fund prospectuses. We are adopting the proposed amendments, with minor modifications to address commenters' recommendations. The rule amendments are intended to help us evaluate the usefulness to investors, third-party analysts, registrants, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information.

II. DISCUSSION

As part of our ongoing effort to evaluate the usefulness of data tagging, we are adopting amendments to extend the voluntary program to enable mutual funds to submit exhibits containing tagged risk/return summary information attached to EDGAR filings.[20]

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19 See comment letters of Confluence (Mar. 14, 2007); Walter S. Hamscher ("Hamscher") (Mar. 2, 2007); Charles S. Hoffman ("Hoffman") (Feb. 10, 2007); ICI (Mar. 14, 2007); NewRiver, Inc. ("NewRiver") (Mar. 14, 2007); PricewaterhouseCoopers LLP ("PWC") (Mar. 14, 2007); Rivet Software, Inc. ("Rivet") (Mar. 14, 2007); Ayal Rosenthal ("Rosenthal") (Mar. 6, 2007). The ICI contracted with PWC to design and construct the risk/return taxonomy, and Hamscher was a subcontractor to PWC. The comment letters are available on the Commission's Web site at: http://www.sec.gov/comments/s7-05-07/s70507.shtml.

20 The amendments do not alter the current voluntary program as it applies to the furnishing of XBRL information by non-investment companies.

Any mutual fund may participate, without pre-approval, merely by submitting the risk/return summary information in the required manner. As we continue to gain experience with interactive data, we will evaluate the benefits of data tagging to investors, analysts, and others. If, in the future, we consider requiring filers to tag the risk/return summary information, that would be the subject of a separate rulemaking proposal.

A. Expansion of Voluntary Program Content

Currently, the XBRL data furnished under the voluntary program must consist of at least one item from a list of enumerated mandatory content ("Mandatory Content"), including financial statements, earnings information, and, for registered management investment companies, financial highlights or condensed financial information.[21] We are adding the risk/return summary information set forth in Items 2 and 3 of Form N-1A as a new item of Mandatory Content, with two modifications to our proposal that address commenters' recommendations.

Our proposal, like the current voluntary program, would have required that Mandatory Content "consist of a complete set of information for all periods presented in the corresponding official EDGAR filing."[22] First, the adopted amendments clarify that, in the case of a Form N-1A filing that includes more than one series,[23] a filer may tag a

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21 Rule 401(b)(1) of Regulation S-T [17 CFR 232.401(b)(1)].

22 Rule 401(b)(1)(i) of Regulation S-T [17 CFR 232.401(b)(1)(i)].

23 A mutual fund may issue multiple "series" of shares, each of which is preferred over all other series in respect of assets specifically allocated to that series. Rule 18f-2 under the Investment Company Act [17 CFR 270.18f-2]. Each series is, in effect, a separate investment portfolio.

complete set of risk/return summary information for any one or more series.[24] For example, if a filing contains information about four series, a filer could tag information for one, two, three, or four series. Filers who choose to tag the information for a particular series would be required to tag all the information for that series, including the information for each class of the series.[25] Second, we have modified the proposed amendments, which would have required the information for each class to be separately identified, to clarify, as suggested by a commenter,[26] that this requirement applies only to information that does not relate to all of the classes in a series.[27] Thus, class-specific information, such as expenses and performance, would be required to be separately identified by class. Information that is not class-specific, such as investment objectives, would not be required to be separately identified by class.

Three commenters stated that if a mutual fund's official filing contains information for more than one series or class, the fund should be permitted to submit tagged risk/return summary information for one or more, but fewer than all, series or classes.[28] One of these commenters indicated that this approach would provide the broadest possible participation in the voluntary program.[29] We agree with these commenters that mutual funds volunteering to participate in the reporting program that

24 Rule 401(b)(1)(iv) of Regulation S-T [17 CFR 232.401(b)(1)(iv)].

25 A mutual fund may issue more than one class of shares that represent interests in the same portfolio of securities with each class, among other things, having a different arrangement for shareholder services or the distribution of securities, or both. Rule 18f-3 under the Investment Company Act [17 CFR 270.18f-3].

26 See letter from ICI, supra note 19.

27 Rule 8b-33 under the Investment Company Act [17 CFR 270.8b-33].

28 See letters from Hamscher, ICI, and PWC, supra note 19.

29 See letter from ICI, supra note 19.

include more than one series in an official filing should not be required to tag the information for all series in the filing. A mutual fund's series represent separate portfolios of securities, each with its own discrete investment objectives and strategies. Each series of a registered investment company is a distinct mutual fund though they are organized as part of a single legal entity. As a result, we have concluded that tagging one or more series should not require tagging all the series of a fund. Therefore, our rule amendments permit mutual funds to submit tagged risk/return summary information for one or more series in an official filing.[30] This flexibility should encourage participation in the voluntary program.[31]

We disagree, however, with commenters' recommendations[32] that volunteers be permitted to tag the risk/return summary information for less than all classes for any mutual fund or series selected. Permitting tagged submissions for less than all the classes of a fund or series would significantly impair the Commission's and users' ability to evaluate the effectiveness of the ICI's risk/return summary taxonomy in tagging class-specific information. In addition, it would limit the ability to assess the usefulness of the taxonomy in facilitating the comparison of class-specific information, such as expenses and performance, within a fund.

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30 Rule 401(b)(1)(iv).

31 We have previously indicated that rule 8b-33 would require investment companies to submit tagged XBRL documents separately for each series of an investment company registrant. See XBRL Proposing Release, supra note 12, 69 FR at 59097 n. 49. Under amended rule 8b-33, a mutual fund will not be required to submit tagged risk/return summary information in separate documents for each series or class, provided that the information is tagged in such a manner that the information may be separately identified by series and class.

32 See letters from Hamscher, ICI, and PWC, supra note 19.

As with all tagged exhibits under the voluntary program, submissions of tagged exhibits containing risk/return summary information will be supplemental and will not replace the required HTML or ASCII version of the information called for in Form N-1A. Volunteers will be required to file their complete official registration statements to ensure that all investors have access to information upon which to base their investment decisions.[33] While tagged exhibits will be required to reflect the same information contained in the risk/return summary section of the related official Form N-1A filing, we emphasize that investors and others should continue to rely on the official filing rather than the tagged exhibit.

We are adopting, as proposed, the requirement that mutual funds submitting tagged risk/return summary information must include this information as an exhibit to an amendment to a previous filing on Form N-1A.[34] Form N-1A filings, which contain mutual fund registration statements (or amendments thereto), are often subject to revision prior to effectiveness. For this reason, the rules do not permit the submission of a tagged

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33 Consistent with the current voluntary program, once received by the Commission, the official filing and the tagged risk/return summary information submitted as exhibits to the official filing will undergo technical validations. The official filing will continue to follow the normal process for receipt and acceptance. That is, it will be suspended if it fails its validation criteria. If the official filing meets its validation criteria, but any tagged risk/return summary document submitted as an exhibit to the official filing fails its own validation criteria, all tagged documents will be removed and the official filing will be accepted and disseminated without the tagged documents. The volunteer will be notified of the submission problem with the tagged documents. If the official filing fails to meet the required receipt and acceptance process and is suspended for any reason, any tagged risk/return summary information submitted with the official filing will also be suspended.

34 See Rule 401(a) of Regulation S-T [17 CFR 232.401(a)]; rule 8b-33. A mutual fund submitting tagged risk/return summary information as an exhibit to Form N-1A will be required to name each document "EX-100" as specified in the EDGAR Filer Manual. We also are adopting a technical amendment to General Instruction B.4.(b) of Form N-1A to add rule 8b-33 to the list of general provisions that apply to the filing of registration statements on Form N-1A.

exhibit that is related to a registration statement or an amendment that is not yet effective. More specifically, the rules provide that a tagged exhibit to a Form N-1A filing, whether the filing is an initial registration statement or an amendment thereto, may be submitted only as an amendment to the filing to which the tagged exhibit relates and only after the effective date of such filing.[35] An exhibit containing tagged risk/return summary information may be submitted under rule 485(b) of the Securities Act, which provides for immediate effectiveness of amendments that make non-material changes, and will only need to contain the new exhibit, a facing page, a signature page, a cover letter explaining the nature of the amendment, and a revised exhibit index.

The voluntary program requires all volunteers to use the appropriate version of a standard taxonomy, supplemented with extension taxonomies as specified by the EDGAR Filer Manual. Filers submitting tagged risk/return summary information should not include the risk/return summary taxonomy in their submissions as this taxonomy will be stored as a part of the EDGAR system. Section 5.2.4 of the EDGARLink Filer Manual (Volume II): "EDGAR Filing" will provide instructions and guidance on the preparation, submission, and validation of EDGAR-acceptable electronic filings with attached tagged risk/return summary information.[36] The EDGAR system upgrade to Release 9.7 is scheduled to become available on August 20, 2007, to, among other things,

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35 Rule 401(a); rule 8b-33.

36 Rule 301 of Regulation S-T, the regulation that governs the preparation and transmission of electronic filings on the Commission's EDGAR system, requires electronic filings to be prepared in accordance with the provisions of the EDGAR Filer Manual. The Filer Manual contains the technical formatting requirements for electronic submissions. Filers must comply with those requirements to ensure the timely receipt and acceptance of documents submitted to the Commission in an electronic format. The Commission's EDGAR Filer Manual is available at: http://www.sec.gov/info/edgar.shtml.

enable EDGAR to process tagged risk/return summary information when the expanded voluntary program becomes effective.

Similar to the current voluntary program, volunteers will be free to submit tagged risk/return summary information regularly or from time to time, and volunteers may stop and start as they choose. Participating in the voluntary program will not create a continuing obligation for a volunteer to submit tagged risk/return summary information as an exhibit to a subsequent post-effective amendment. A volunteer will, however, be required to amend any tagged risk/return summary exhibits that do not comply with the content and format requirements of rule 401, e.g., because they do not reflect the same information as the corresponding official filing.[37]

One commenter, while agreeing that participation in the voluntary program should not create a continuing obligation to submit tagged risk/return summary information as an exhibit to a subsequent post-effective amendment, noted that rendering tools may not be able to detect that tagged data is no longer current.[38] The commenter encouraged the Commission to consider whether additional safeguards, such as the option to withdraw tagged exhibits, should be made available to ensure that there is no liability to funds or harm to investors if rendering tools utilize outdated information. As we noted in response to similar comments when the voluntary program rules were initially adopted, submissions to EDGAR cannot, as a practical matter, be withdrawn after public

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37. See rule 401(c)(1) of Regulation S-T [17 CFR 232.401(c)(1)] (requires tagged exhibits to reflect the same information as corresponding official filing); XBRL Adopting Release, supra note 12, 70 FR at 6559 n. 48.

38. See letter from ICI, supra note 19.

dissemination.[39] In order to address questions of potential harm to investors and liability to mutual funds, the rules provide for cautionary disclosures[40] and liability protections.[41]

The amendments we are adopting will, as proposed, provide mutual funds with the option to submit tagged financial highlights or condensed financial information as a tagged exhibit to an amendment to the Form N-1A filing to which the information relates.[42] Mutual funds also may continue to submit this information as an exhibit to Form N-CSR, as currently permitted, whether or not they submit tagged risk/return summary information.[43] A mutual fund submitting tagged risk/return summary information may, but is not required to, submit tagged financial highlights or condensed financial information. Similarly, a mutual fund that submits tagged financial highlights or condensed financial information may, but is not required to, submit tagged risk/return summary information.

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39 XBRL Adopting Release, supra note 12, 70 FR at 6559.

40 See infra Section II.B.

41 See infra Section II.C.

42 Rule 8b-33 (permitting tagged exhibits under the voluntary program to be submitted on Form N-1A); Item 8(a) of Form N-1A (requiring mutual funds to provide financial highlights information); rule 401(a) and (b)(1)(iii) of Regulation S-T [17 CFR 232.401(a) and (b)(1)(iii)] (permitting information set forth in Item 8(a) of Form N-1A as Mandatory Content under the voluntary program).

43 Rule 401(a) and (b)(1)(iii) (permitting financial highlights or condensed financial information set forth in Item 8(a) of Form N-1A to be submitted as Mandatory Content); rule 8b-33. Mutual funds must include their financial highlights or condensed financial information in every annual and semi-annual report transmitted to shareholders. Items 22(b)(2) and (c)(2) of Form N-1A (requiring annual or semi-annual reports to include the information required by Item 8(a) of Form N-1A). Mutual funds must include a copy of their annual or semi-annual report transmitted to shareholders with their Form N-CSR filed with the Commission. Item 1 of Form N-CSR.

B. Required Disclosure

The Commission is adopting, as proposed, a requirement that the exhibit index of any Form N-1A filing that includes a tagged exhibit disclose that the purpose of submitting the tagged exhibit is to test the related format and technology and, as a result, investors should not rely on the exhibit in making investment decisions.[44] In addition, we are requiring this disclosure to appear within a tagged exhibit, as recommended by some commenters.[45]

We believe that the inclusion of the cautionary disclosure within tagged risk/return summary exhibits may help to alert investors and other users that the exhibits should not be relied on in making investment decisions. We are modifying the proposed rule to require that the disclosure be included within the exhibits as a tagged data element.[46] The ICI indicated in its comment letter that an element could be added to the risk/return summary taxonomy for the display of this disclosure and has now done so. We encourage parties that are developing rendering tools for the risk/return summary taxonomy to make use of this data tag in order to display the cautionary disclosure in rendered versions of funds' risk/return summary information.

The adopted rules, like the proposed rules and consistent with one commenter's recommendation,[47] do not require a Form N-1A filing that includes tagged exhibits

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44 Rule 401(d)(1)(ii) and (d)(2)(i) of Regulation S-T [17 CFR 232.401(d)(1)(ii) and (d)(2)(i)]. Rule 483(a) of Regulation C [17 CFR 230.483(a)] requires, among other things, that a registration statement of a registered investment company "contain an exhibit index, which should immediately precede the exhibits filed with such registration statement."

45 See letters from ICI and PWC, supra note 19.

46 Rule 401(d)(2)(i).

47 See letter from ICI, supra note 19.

containing only risk/return summary information to disclose that the information in the exhibits is "unaudited" or "unreviewed." This disclosure will be required in a Form N-1A filing with which tagged financial highlights or condensed financial information is submitted.[48]

C. Liability Issues

The two commenters who addressed liability issues supported the proposal to extend to tagged risk/return summary information limited protection from liability that is similar to the protection provided under the current voluntary program,[49] and we are adopting the liability protection as proposed. We are providing this protection because liability remains for the official filing, and because the program is experimental, it contains certain safeguards, and the program should not unnecessarily deter volunteers from participating.

Under the current voluntary program, tagged exhibits are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 ("Exchange Act")[50] or Section 34(b) of the Investment Company Act,[51] or otherwise subject to the liability of these sections.[52] In addition, the current rules also provide more general relief from liability under the securities laws, including the Securities Act, the Exchange Act, the

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48 Rule 401(d)(1)(i) of Regulation S-T [17 CFR 232.401(d)(1)(i)].

49 See letters from ICI and PWC, supra note 19.

50 15 U.S.C. 78r.

51 15 U.S.C. 80a-33(b).

52 Rule 402(a)(1) under Regulation S-T [17 CFR 232.402(a)(1)]. Further, because the tagged documents are not filed under the Exchange Act, they are not incorporated by reference into registration statements filed under the Securities Act or prospectuses they contain. These protections apply regardless of whether the documents are exhibits to a document otherwise incorporated by reference into a filing.

Trust Indenture Act of 1939, and the Investment Company Act, for information in a tagged exhibit that complies with the content and format requirements of the voluntary program to the extent that the information in the corresponding portion of the official EDGAR filing was not materially false or misleading.[53]

The amendments we are adopting, as proposed, extend the liability protection under the voluntary program to include Section 11 of the Securities Act.[54] Specifically, we are amending rule 402(a) to provide that tagged exhibits are not deemed filed for purposes of Section 11 or otherwise subject to the liabilities of that section. In addition, we are amending rule 402(a) to state explicitly that tagged exhibits are not part of any registration statement to which they relate.[55] Finally, the provision in the current rules that affords volunteers general relief from liability under the federal securities laws to the extent that the information in the corresponding portion of the official EDGAR filing was not materially false or misleading includes liability protections under the Securities Act,

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53 Rule 402(b) of Regulation S-T [17 CFR 232.402(b)].

54 In addition, the current provisions of rule 402(a) will apply to tagged risk/return summary information. In particular, a tagged exhibit on Form N-1A will not be deemed incorporated by reference into another filing, regardless of whether the tagged exhibit is an exhibit to a document otherwise incorporated by reference into another filing. Rule 402(a)(2) under Regulation S-T [17 CFR 232.402(a)(2)]. All other liability and antifraud provisions of the Securities Act, Exchange Act, and Investment Company Act will apply. Rule 402(a)(3) under Regulation S-T [17 CFR 232.402(a)(3)]. For example, material misstatements or omissions in a tagged submission will continue to be subject to liability under Section 10(b) [15 U.S.C. 78j(b)] and rule 10b-5 [17 CFR 240.10b-5] under the Exchange Act.

55 Section 11 of the Securities Act applies to "any part of the registration statement, when such part became effective." The Commission takes a similar approach with unofficial PDF copies contained in electronic submissions. See Rule 104(d) of Regulation S-T [17 CFR 232.104(d)]. Similar to the other protections in the voluntary program, Section 11 liability relief will not extend to the information that the official filing contains.

and it will apply to tagged documents submitted as exhibits on Form N-1A.[56] We will continue to caution users on the Commission's Web site that documents submitted under the voluntary program should not be relied upon for making investment decisions, and users should continue to rely on the company's official filing.[57]

D. The Risk/Return Summary Taxonomy and Software Tools

The taxonomy for tagging the risk/return summary information was developed by the ICI. Mutual funds will be permitted to submit documents containing risk/return summary information that is tagged using the ICI's taxonomy commencing on the effective date of the rules that we are adopting. In January 2007, the ICI released a draft risk/return summary taxonomy for public review and comment.[58] The final taxonomy was submitted for acknowledgement by the ICI to XBRL International on May 16, 2007,[59] in accordance with XBRL International procedures.[60] The taxonomy received

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56 Rule 402(b). We are adopting technical amendments to rule 402(b) to replace each reference to "Item 401" with "Rule 401."

57 See "XBRL Data Submitted in the XBRL Voluntary Program on EDGAR" page on the Commission Web site, available at: http://www.sec.gov/Archives/edgar/xbrl.html.

58 See ICI Unveils Draft XBRL Taxonomy For Public Review, Investment Company Institute Press Release, Jan. 4, 2007, available at: http://www.ici.org/statements/nr/07_news_xbrl_txnmy.html#TopOfPage. See also Statements of SEC Chairman Christopher Cox and Division of Investment Management Director Andrew Donohue Regarding the Investment Company Institute's Mutual Fund Interactive Data Taxonomy, Securities and Exchange Commission Press Release, Jan. 4, 2007, available at: http://www.sec.gov/news/press/2007/2007-2.htm.

59 See Boteler Letter, supra note 16.

60 XBRL US, Inc., represents the United States to XBRL International. XBRL US, Inc., is responsible for organizing and sponsoring taxonomies from the United States, including the main accounting standards for United States business reporting. There are two levels of XBRL taxonomy recognition: (1) "acknowledgement" is formal recognition that a taxonomy complies with XBRL specifications, including testing by a defined set of validation tools; and (2) "approval" is a formal recognition requiring more detailed quality assurance and testing, including compliance with official XBRL guidelines for the type of taxonomy under review, creation of a number of instance documents, and an open review period after acknowledgement. For more information regarding the XBRL

acknowledgement in June 2007.[61] The ICI also intends to seek approval of the taxonomy in accordance with the procedures of XBRL International, but has indicated that requiring the taxonomy to be approved prior to use in the voluntary program could introduce delay, the length of which is unpredictable.[62]

We have concluded that the ICI's taxonomy is sufficiently developed to permit its use in the voluntary program. Three commenters involved in the taxonomy development process stated that the risk/return summary taxonomy is sufficiently developed for use in the voluntary program, noting that the taxonomy was developed through the use of a broad working group that was given the opportunity to review and comment on the taxonomy as it was developed and that the taxonomy was subjected to a public review and comment period.[63] While some commenters suggested changes to the taxonomy, such as reducing the number of elements in the taxonomy[64] or avoiding the use of complex structures,[65] these commenters did not suggest that the voluntary program should be delayed unless the taxonomy is modified. The ICI has considered the comments it received on the taxonomy, as well as the comments on the taxonomy submitted to the Commission, and has submitted a letter to the Commission's staff

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taxonomy recognition process, see "Taxonomy Recognition Process" on the XBRL International Web site available at: http://www.xbrl.org/TaxonomyRecognition/.

61 The taxonomy is available on XBRL International's Web site at: http://www.xbrl.org/Taxonomy/ici/ici-rr-summarydocument-20070516-acknowledged.htm.

62 See letter from ICI, supra note 19. See also letter from Hamscher, supra note 19.

63 See letters from Hamscher, ICI, and PWC, supra note 19.

64 See letter from NewRiver, supra note 19.

65 See letter from Rivet, supra note 19.

summarizing its response to the commenters and the taxonomy changes that were made.[66] In its letter, the ICI asserts that the taxonomy is ready for use with the Commission's interactive data voluntary reporting program. In light of the ICI's consideration of comments related to the taxonomy, and the comments that we received favoring the expansion of the voluntary program to the risk/return summary,[67] we have concluded that it is appropriate to permit use of the taxonomy in its present state of development. Further, the purpose of the voluntary program is to test and evaluate tagging technology, and, as a result, we agree with commenters' recommendations that it is not necessary for approval of the taxonomy to be obtained before permitting volunteers to submit tagged documents.

As in the current voluntary program, filers will be permitted to use extensions to the risk/return summary taxonomy, which are additional tags created by a particular user that further refine the tags contained in a standard taxonomy. Some commenters supported permitting the use of at least some extensions with the risk/return summary taxonomy,[68] but one commenter opposed the use of extensions to the risk/return summary taxonomy, stating that the extensions would introduce complexity.[69] While we recognize that permitting the use of extensions to the risk/return summary taxonomy may affect the ability to compare or render tagged submissions, we believe that it will be helpful to permit extensions on an unrestricted basis at this time. Experimentation with extensions

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66 See Boteler Letter, supra note 16.

67 See letters from Confluence, Hamscher, Hoffman, ICI, NewRiver, PWC, and Rosenthal, supra note 19.

68 See letters from ICI, PWC, and Rivet, supra note 19.

69 See letter from Confluence, supra note 19.

will permit the Commission, filers, and users of tagged filings to better assess the need for extensions to the risk/return summary taxonomy and the impact that extensions may have on tagged documents.

One commenter recommended that the Commission impose validity testing on tagged risk/return summary exhibits in addition to the tests currently performed under the voluntary program, but we have determined not to impose additional testing at this time.[70] The commenter stated that additional validity testing would improve the quality of tagged exhibits submitted. Currently, under the voluntary program, validity testing of tagged exhibits consists of testing for: (1) content validation (i.e., validating for invalid ASCII characters); (2) document-type validation (e.g., ensuring that EX-100.INS documents have .xml extensions and "<XBRL tags>"); and (3) XBRL validation (e.g., ensuring that exhibits follow appropriate XBRL standards and are structured according to the taxonomy). We agree that increased validity testing of tagged submissions might improve their quality. The purpose of the voluntary program, however, is to test the technology and the taxonomy. We, therefore, believe that it is premature to impose additional validity testing upon tagged risk/return summary documents.

The Commission's Web site currently provides access to a prototype XBRL Web application that converts tagged financial information submitted in the voluntary program into a rendered, or human readable, format.[71] At present, our Web site does not provide access to any rendering or analytical tools for use with tagged risk/return summary information. Some commenters favored a tool on the Commission's Web site that would

70 See comment letter from Hoffman, supra note 19.

71 See "Interactive Financial Report Viewer — Preview Release" Web page on the Commission Web site, available at: http://www.sec.gov/spotlight/xbrl/xbrlwebapp.htm.

render tagged risk/return summary documents.[72] One commenter noted that such a tool could help both investors and mutual funds to better understand and explore the benefits of tagging and could stimulate the development of other, more sophisticated tools for rendering tagged data.[73] We agree that the availability of rendering and analysis tools will help investors and mutual funds, as well as third party users, to evaluate the benefits of tagged risk/return summary data.

We will continue to analyze rendering and other capabilities specifically developed for the risk/return summary taxonomy, and we may add these features to our Web site in the future. The Commission also encourages funds and third parties to develop these tools. Users of EDGAR data on the Commission's Web site will be able to download the tagged risk/return summary information to perform their own analysis if they have appropriate software. Users will continue to be able to view the official filing in ASCII or HTML format, as they can today.

E. Effective Date

The effective date of these amendments is August 20, 2007, in order to provide sufficient time to implement EDGAR system changes necessary to provide for risk/return summary functionality.

III. PAPERWORK REDUCTION ACT

The rule and form amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[74] Provision of information under the amendments would be voluntary and would not be kept

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72 See letters from Hamscher, ICI, and PWC, supra note 19.

73 See letter from ICI, supra note 19.

74 44 U.S.C. 3501 et seq.

confidential. An agency may not conduct or sponsor, and a person is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget ("OMB") control number.

The title for the collection of information is "Voluntary XBRL-Related Documents" (OMB Control No. 3235-0611). The rule and form amendments expand the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings. We published notice soliciting comments on the collection of information requirements in the release proposing the amendments and submitted the proposed collection of information to OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.[75] OMB pre-approved these collection requirements. We received no comments on the collection of information requirements.

The Voluntary Program

The amendments, which will expand the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings, will increase the burden associated with the existing collection of information for Voluntary XBRL-Related Documents. The expansion of the voluntary program will be open to any mutual fund choosing to participate. We estimate that 10% of the approximately 545 fund complexes that have mutual funds, or 55 fund complexes, will each submit documents containing tagged risk/return summary information for one

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[75] See Proposing Release, supra note 6, 72 FR at 6682-83.

mutual fund.[76] This estimate is higher than the number of mutual funds participating in the current voluntary program. However, we believe that additional mutual funds will participate in the expanded voluntary program.[77]

Submission of tagged risk/return summary information will not directly affect the burden of preparing the mutual funds' registration statements or the registrants' official EDGAR filings. In order to provide tagged risk/return summary information, a participating mutual fund will have to tag the risk/return summary section of its prospectus using the risk/return summary taxonomy and potentially develop taxonomy extensions and will submit an exhibit to its filing. Based on our previous estimates and our experience with registrants who have submitted tagged financial information in the current voluntary program, we estimate that the initial creation of tagged documents containing risk/return summary information will require, on average, approximately 110

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76 In the case of a mutual fund with multiple series, our estimate treats each series as a separate mutual fund.

77 The ICI is undertaking an educational effort to encourage mutual funds to use the risk/return summary taxonomy to tag the information in their EDGAR filings. ICI Details Project to Extend XBRL to Key Investor Information, Investment Company Institute Press Release, June 12, 2006, available at: http://www.ici.org/statements/nr/2006/06_news_xbrl.html#TopOfPage.

One commenter suggested that the Commission offer incentives to encourage volunteers to participate in the expanded voluntary program. See letter from ICI, supra note 19. Specifically, the commenter suggested that the Commission: (1) offer expedited review of mutual fund exemptive applications; or (2) offer expedited review of an initial registration statement on Form N-1A or an amendment to a registration statement to add a new fund or series. Id. The Commission did not initially offer incentives for volunteers to submit tagged information as part of the current voluntary program. The Commission subsequently offered expedited review of registration statements and annual reports to volunteers agreeing to participate in a test group. See January 11 Press Release, supra note 7. Volunteers that participate in the test group agree to furnish financial data contained in their periodic and investment company reports in XBRL format for at least one year and provide feedback on their experiences. Id. At this time, we are not offering specific incentives to encourage volunteers to participate in the expanded voluntary program, however, we will continue to assess the need for incentives going forward.

burden hours per mutual fund,[78] and the creation of such tagged documents in subsequent years will require an average 10 burden hours per mutual fund.[79] Because the PRA estimates represent the average burden over a three-year period, we estimate the average hour burden for the submission of tagged documents containing risk/return summary information for one mutual fund to be approximately 43 hours.[80]

Based on the estimates of 55 participants submitting tagged documents containing risk/return summary information for one mutual fund per year and incurring 43 hours per submission, we estimate that, in the aggregate, the industry will incur an additional 2,365

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78 In the current voluntary program, we estimated that an initial set of submissions would require an average of 130 burden hours, 75% of which (or 97.5 hours) represents the internal burden hour estimate. See XBRL Adopting Release, supra note 12, 70 FR at 6563; XBRL Proposing Release, supra note 12, 69 FR at 59101. Based upon our experience with filers who have submitted tagged financial information in the current voluntary program, we believe that this burden estimate for submitting an initial set of submissions may have been too high. See, e.g., Indra K. Nooyi, Chief Executive Officer, PepsiCo, Inc., Webcast Archive of October 3 Interactive Data Roundtable, Oct. 3, 2006, available at: http://www.connectlive.com/events/secinteractivedata100306/ (initial submission in voluntary program required approximately 60 to 80 total labor hours); John Stantial, Director of Financial Reporting, United Technologies Corporation, Transcript of June 12 Interactive Data Roundtable, June 12, 2006, available at: http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf, at 160 (initial submission in voluntary program required about 80 hours of effort). We, therefore, estimate that the initial creation of tagged documents containing risk/return summary information will require, on average, approximately 110 burden hours per mutual fund, 75% of which (or 82.5 hours) represents the internal burden hour estimate. These estimates more closely approximate the experience of filers in the current voluntary program.

79 In the current voluntary program, we estimated that each set of submissions, after the initial set, would take 10 burden hours. See XBRL Adopting Release, supra note 12, 70 FR at 6563; XBRL Proposing Release, supra note 12, 69 FR at 59101. We continue to believe that this estimate is appropriate.

80 (110 hours in the first year + 10 hours in the second year + 10 hours in the third year) ÷ 3 years = 43 hours. While the PRA requires an estimate based on a hypothetical three years of participation, a registrant, as noted earlier, could participate in the expanded voluntary program by submitting tagged risk/return summary information over a shorter period or even just once as the registrant chooses.

burden hours associated with the amendments.[81] We further estimate that 75% of this burden increase, or approximately 1,774 hours, will be borne internally by the mutual fund complex. We estimate that this internal burden increase converted to dollars will amount to approximately $393,828.[82]

We also estimate that 25% of the burden, or approximately 591 hours, will be outsourced to external professionals and consultants retained by the mutual fund complex at an average cost of $256.00 per hour for a total annual increase of approximately $151,296.[83] In addition, it is our understanding that many participants will also have annual software licensing costs. We estimate that the cost of licensing software will be

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81 55 documents per year x 43 hours per submission = 2,365 hours.

82 This cost increase is estimated by multiplying the increase in annual internal hour burden (1,774) by the estimated hourly wage rate of $222.00. The estimated wage figure is based on published rates for compliance attorneys and programmer analysts, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding effective hourly rates of $261 and $209, respectively. See Securities Industry Association, Report on Management & Professional Earnings in the Securities Industry 2006 (Sept. 2006) ("SIA Report"). The estimated wage rate is further based on the estimate that compliance attorneys would account for one quarter of the hours worked and programmer analysts would account for the remaining three quarters, resulting in a weighted wage rate of $222.00 (($261 x .25) + ($209 x .75)). The wage rates used in the Proposing Release were based upon the Securities Industry Association, Report on Management & Professional Earnings in the Securities Industry 2005 (Sept. 2005), and the total internal and external burden increases converted to dollars differs from the estimates in the Proposing Release due to changes in wage rates in the 2006 SIA Report.

83 591 hours x $256.00 per hour = $151,296. The estimated wage figure is based on published rates for attorneys and senior programmers, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding effective hourly rates of $292 and $244, respectively. See SIA Report, supra note 82. The estimated wage rate is further based on the estimate that attorneys will account for one quarter of the hours worked and senior programmers will account for the remaining three quarters, resulting in a weighted wage rate of $256.00 (($292 x .25) + ($244 x .75)).

$333 per participant per year, for a total annual increase of $18,315.[84] Altogether, the total annual increase in external costs related to the amendments will be $169,611.[85]

Our cost estimates are intended to reflect both initial and ongoing costs over a three-year period. In calculating these costs, we have tried to take into account, among other things, the current state of reporting process automation, automation that likely will be introduced in connection with the initial cost incurred, and the efficiencies that likely will be realized over the course of three years.

Regulation S-T

Regulation S-T (OMB Control No. 3235-0424) specifies the requirements that govern the electronic submission of documents. The amendments will revise rules under Regulation S-T, but the associated increase in burden is reflected in the "Voluntary XBRL-Related Documents" collection of information as described above.

IV. COST/BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. The goal of the voluntary program is to increase EDGAR's efficiency and utility and to enhance the usefulness to investors of the information collected through EDGAR. In

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84 $333 per participant x 55 participants = $18,315. The estimated annual cost of the software comes from our previous PRA estimate for the current voluntary program. See XBRL Adopting Release, supra note 12, 70 FR at 6563 and n. 113. That estimate was based on our discussions with software providers and others familiar with XBRL. We estimated that the cost of licensing software will range from $200 to $3,000 each year, with the majority of companies licensing less complex software in the $200 to $500 range. We set our software cost estimate at $500, which is the highest cost for the simpler XBRL software license, and we assumed that the first year license fee will be waived (based upon our understanding that software providers indicated that they will provide these products for free in the initial stages of the voluntary program). Because the PRA estimates represent the average burden over a three-year period, we estimated the average burden for software license costs to be $333 per year. Id.

85 This annual total consists of $151,296 in outside professional costs plus $18,315 in software costs.

order to evaluate data tagging further, we are adopting amendments to extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings.

A. Benefits

We believe that tagged information may allow more efficient and effective retrieval, research, and analysis of company information through automated means. The expansion of the voluntary program will assist us in assessing whether using interactive data tags enhances users' ability to analyze and compare mutual fund risk/return summary information included in mutual funds' filings with the Commission. The expansion of the voluntary program to include narrative, non-financial information, such as that contained in the risk/return summary, also will facilitate our ability to assess further the technical requirements of processing tagged documents using EDGAR.

Currently, a number of companies use computers and data entry staff to mine risk/return summary information provided by mutual funds on EDGAR in order to populate databases that are used to package information for sale to analysts, funds, investors, and others. Permitting funds to tag risk/return summary information in Commission filings will aid this data-mining process in that it will identify points of data at the source, which could reduce the cost to populate databases and improve the accuracy of that data. Additionally, the expanded voluntary program may benefit funds and the public by permitting experimentation with data tagged using the risk/return summary taxonomy.

In the future, the availability of potentially more accurate tagged information about mutual funds could also reduce the cost of research and analysis and create new opportunities for companies that compile, provide, and analyze data to produce more value added services. Enhanced access to tagged information also has the potential to allow retail investors (or financial advisers assisting such investors) to perform more personalized and sophisticated analyses and comparisons of mutual funds, which could result in investors making better informed investment decisions, and therefore in a more efficient distribution of assets by investors among different funds. This may, in turn, also contribute to increased competition among mutual funds and result in a more efficient allocation of resources among competing investment products. Although it is not possible to quantify precisely the beneficial effects of more efficient allocation of investors' assets and increased competition, they may be significant, given the size of the mutual fund industry.

In the Proposing Release, we sought comments on our cost-benefit analysis,[86] and several commenters discussed the potential benefits resulting from the expansion of the interactive data voluntary reporting program and from interactive data in general. Two commenters stated that interactive data will increase the accuracy of information.[87] One commenter also noted the potential for increased timeliness of critical data that investors require to make informed investment decisions.[88] Another commenter stated that a prospectus tagged using the risk/return summary taxonomy will allow automated,

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[86] See Proposing Release, supra note 6, 72 FR at 6684.

[87] See letters from Confluence and Hamscher, supra note 19.

[88] See letter from PWC, supra note 19.

instantaneous extraction of every fact disclosed in the risk/return summary.[89] Further, commenters stated that allowing funds to file tagged risk/return summary information would serve the objective of providing investors with more user-friendly access to key fund information.[90] Commenters also noted potential cost savings of interactive data which would benefit investors.[91] Finally, one commenter noted that the investment analysis process would become more efficient and effective through the increased use of automation and reduced human intervention that would result from the use of interactive data.[92]

B. Costs

The expansion of the voluntary program will lead to some additional costs for funds choosing to submit tagged documents containing risk/return summary information as exhibits to their Form N-1A filings. For purposes of the PRA, we estimated that the increase in annual internal burden hours to the industry will be 1,774 hours, which will amount to approximately $393,828 and that the increase in annual external costs will amount to approximately $169,611 for a total estimated increase of $563,439 on an annual basis.[93]

We based these cost estimates upon, among other things, experience with filers who have submitted tagged financial information in the current voluntary program.[94]

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89 See letter from Hamscher, supra note 19.

90 See letters from ICI and PWC, supra note 19.

91 See letters from Confluence and PWC, supra note 19.

92 See letter from PWC, supra note 19.

93 See supra Section III.

94 See supra note 78.

Due to the ongoing nature of the project to develop the risk/return summary taxonomy, however, we have limited data to quantify the cost of implementing the use of interactive data tags applied to risk/return summary information. In the Proposing Release, we sought comments and supporting data on our cost estimates with regard to the proposed amendments.[95] We did not receive any comments or supporting data specific to our cost estimates.[96]

In the future, there may be additional costs to current users of EDGAR data. For example, companies that currently provide tagging and dissemination of EDGAR data may experience decreased demand for their services. These entities have developed certain products and services based on data in EDGAR; many entities disseminate, repackage, analyze, and sell the information. Allowing mutual funds to submit tagged risk/return summary information, even voluntarily, may have an impact on entities providing EDGAR-based services and products. Because the Commission does not regulate all these entities, it is currently not feasible to accurately estimate the number or size of these potentially affected entities. The limited, voluntary nature of the program will help the Commission assess the effect, if any, on these entities. In addition, the availability of mutual fund tagged data on EDGAR may provide these companies with alternative business opportunities.

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95 See Proposing Release, supra note 6, 72 FR at 6684.

96 One commenter noted that it is difficult to estimate the likely cost of participation in the voluntary program at this time but noted that it may wish to provide cost data to the Commission in the future. See letter from ICI, supra note 19.

V. PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 2(c) of the Investment Company Act[97] and section 2(b) of the Securities Act[98] require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The amendments will extend the interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings. The expansion of the voluntary program is intended to help us evaluate the usefulness to investors, third-party analysts, mutual funds, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information. Because compliance with the amendments will be voluntary, the Commission estimates that the impact of the amendments will be limited. However, because the tagging of risk/return summary information has the potential to facilitate analysis of that information, we believe that the amendments could promote efficiency by allowing us and others to gain experience with tagged mutual fund information in Commission filings.

Further, tagging of the risk/return summary information has the potential to help streamline the delivery of mutual fund information, and provide investors and others with improved tools to compare funds based upon, among other things, costs, investment objectives, strategies, and risks. We believe that the potential to streamline the delivery

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97 15 U.S.C. 80a-2(c).

98 15 U.S.C. 77b(b).

of mutual fund information and to provide investors and others with improved mutual fund comparison tools could promote efficiency and competition through more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. In the future, companies that currently provide tagging and dissemination of EDGAR data may experience decreased demand for their services. The availability of mutual fund tagged data on EDGAR, however, may provide these companies with alternative business opportunities. We do not anticipate that the amendments will have a significant impact on capital formation. Finally, because the amendments are designed to permit mutual funds to provide information in a format that we believe will be more useful to investors, we believe that the amendments are appropriate in the public interest and for the protection of investors.

We requested comment on whether the proposed amendments would promote efficiency, competition, and capital formation. We received no comment on this issue.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 and relates to the amendments we are adopting that will expand the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings. An Initial Regulatory Flexibility Analysis ("IRFA"), which was prepared in accordance with the 5 U.S.C. 603, was published in the release proposing the amendments.

A. Need for the Amendments

The purpose of the amendments is to help us evaluate the usefulness to investors, third-party analysts, mutual funds, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information. We believe that the expanded voluntary program will enable us to study further the extent to which interactive data tags enhance the comparability of that data, the usefulness of data tags for dissemination, and our staff's ability to review and assess the accuracy and adequacy of that data. The expanded voluntary program will also help us assess the effect of interactive data tags on the quality and transparency of risk/return summary information, as well as the compatibility of data tagging with the Commission's disclosure requirements.

More specifically, we believe that the expanded voluntary program will better enable us to study the extent to which interactive data enhances the:

- search capability of the EDGAR database to allow more efficient and effective extraction and analysis of specific data,
- capability to perform comparisons among mutual funds, and
- ability to perform analyses of mutual fund data and whether it would reduce the resources needed for data analysis.

In addition, we believe that the expanded voluntary program will enhance our ability to evaluate the:

- impact on the staff's ability to review filings on a more timely and efficient basis,
- use of tagged data for risk assessment and surveillance procedures, and
- compatibility of interactive data with reporting quality, transparency, and other Commission reporting requirements.

B. Significant Issues Raised by Public Comment

In the IRFA for the proposed amendments, we requested comment on the number of small entities that would be affected by the proposed amendments, the existence or nature of the potential effect of the proposals on small entities, how to quantify the effect of the proposals, how different procedures could be provided for small entities, and we asked commenters to provide any empirical data supporting the extent of the impact. We received no comment letters specifically addressing the IRFA in the Proposing Release; however, one commenter suggested that the Commission could lower the barrier for participation for small funds by providing a "literal" or structured form using some commonly used software applications.[99]

C. Small Entities Subject to the Rules

The expansion of the voluntary program may have an effect on mutual fund participants in the voluntary program. Under Rule 0-10 under the Investment Company Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[100] We estimate that there are approximately 131 mutual funds that meet this definition. A smaller subset of those issuers may voluntarily submit tagged risk/return summary information under the voluntary program, but, because submitting risk/return summary information will be voluntary, we anticipate that only complexes with sufficient resources will elect to

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[99] See letter from Hamscher, supra note 19.

[100] 17 CFR 270.0-10.

participate. To date, no small entity mutual funds have elected to participate in the current voluntary program.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The voluntary program is designed to assist us in assessing the feasibility of using interactive data on a broader basis. Experience with the current voluntary program indicates that the cost of participating in the expanded program, the associated burden on the EDGAR system, and the possible effect of the expanded voluntary program on those entities that use the EDGAR data will be minimal. Nevertheless, the impact of the amendments remains somewhat speculative at this point.

No registrant will be required to submit tagged documents under the expansion of the voluntary program. The submission of tagged risk/return summary information will require a participating mutual fund to tag the risk/return summary section of its prospectus using the risk/return summary taxonomy and potentially develop extensions and to submit exhibits to its filing. Volunteers may also need to purchase software or retain a consultant to assist in tagging data. For purposes of the PRA, we estimated that each volunteer, including small entities, would incur approximately 43 burden hours and $333 in software costs annually.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. The purpose of the amendments is to help us evaluate the usefulness to investors, third-party analysts, mutual funds, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information. Submitting documents containing tagged risk/return summary information is entirely voluntary. We have considered different or simpler procedures for small entities, including:

- The establishment of different compliance or reporting requirements or timetables;
- The clarification, consolidation, or simplification of the proposed requirements;
- The use of performance rather than design standards; and
- Exemption from coverage.

For tagged data to provide benefits such as ready comparability, however, the data tagging system cannot have alternative procedures. Similarly, in order to achieve the benefits of interactive data tagging, use of a single data tagging technology is necessary. Additionally, providing structured input forms, as suggested by one commenter,[101] is not appropriate at this time given the cost of deploying and maintaining such forms and the difficulty of permitting extensions to be used with a structured input form. If we determine to require data tagging in the future, we will look to the results of the voluntary program, including those of the expansion of the program to risk/return summary information, in considering alternatives to minimize any burden on small entities.

VII. STATUTORY AUTHORITY

The Commission is adopting the rule amendments outlined above under Sections 5, 6, 7, 10, 19(a), and 28 of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, 77s(a), and 77z-3] and Sections 6(c), 8, 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-8, 80a-24(a), 80a-29, and 80a-37].

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101 See supra note 99.

List of Subjects in 17 CFR Parts 232 and 239

Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Parts 270 and 274

Investment Companies, Reporting and recordkeeping requirements, Securities.

TEXT OF RULE AND FORM AMENDMENTS

For the reasons set forth above, the Commission amends title 17, Chapter II of the Code of Federal Regulations as follows:

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

1. The general authority citation for Part 232 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

2. Amend § 232.401 by:

a. Revising the first sentence of paragraph (a);

b. Removing the word "or" at the end of paragraph (b)(1)(ii);

c. Removing the phrase "(§ 239.15A and § 274.11A of this chapter)" in paragraph (b)(1)(iii);

d. Removing the period at the end of paragraph (b)(1)(iii) and adding in its place "; or";

e. Adding new paragraph (b)(1)(iv); and

f. Revising paragraphs (d)(1)(i) and (d)(2)(i).

The addition and revisions read as follows:

§ 232.401 XBRL-Related Document Submissions.

(a) An electronic filer that participates in the voluntary XBRL (eXtensible Business Reporting Language) program may submit XBRL-Related Documents (§ 232.11) in electronic format as an exhibit to: the filing (other than a Form N-1A (§ 239.15A and § 274.11A of this chapter) filing) to which the XBRL-Related Documents relate; an amendment to such filing, but, in the case of a Form N-1A filing, an amendment made only after the effective date of the Form N-1A filing to which the XBRL-Related Documents relate; or if the electronic filer is eligible to file a Form 8-K (§ 249.308 of this chapter) or a Form 6-K (§ 249.306 of this chapter), a Form 8-K or a Form 6-K, as applicable, that references the filing to which the XBRL-Related Documents relate if such Form 8-K or Form 6-K is submitted no earlier than the date of that filing. * * *

(b) * * *

(1) * * *

(iv) The risk/return summary information set forth in Items 2 and 3 of Form N-1A provided that, in the case of a Form N-1A filing that includes more than one series (as that term is used in rule 18f-2(a) under the Investment Company Act (§ 270.18f-2(a) of this chapter), a filer may include in mandatory content complete risk/return summary information for any one or more of those series.

* * * * *

(d) * * *

(1) * * *

(i) That the financial information contained in the XBRL-Related Documents is "unaudited" or "unreviewed," as applicable (but only if the mandatory content contained in the XBRL-Related Documents contains information other than risk/return summary information submitted under paragraph (b)(1)(iv) of this section);

* * * * *

(2) * * *

(i) The exhibit index of a Form 10-K (§ 249.310 of this chapter), 10-Q (§ 249.308a of this chapter), 10 (§ 249.210 of this chapter), 10-SB (§ 249.210b of this chapter), 10-KSB (§ 249.310b of this chapter), 10-QSB (§ 249.308b of this chapter), 20-F or N-1A and, in the case of risk/return summary information submitted under paragraph (b)(1)(iv) of this section, within the XBRL-Related Documents as a tagged data element;

* * * * *

3. Revise § 232.402(a)(1) to read as set forth below and amend § 232.402(b) by removing each reference to "Item 401" and adding in its place "Rule 401".

§ 232.402 Liability for XBRL-Related Documents.

(a) * * *

(1) Are not deemed filed for purposes of section 11 of the Securities Act (15 U.S.C 77k), section 18 of the Exchange Act (15 U.S.C. 78r), or section 34(b) of the Investment Company Act (15 U.S.C. 80a-33(b)), or otherwise subject to the liabilities of these sections, and are not part of any registration statement to which they relate;

* * * * *

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

4. The general authority citation for Part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

PART 270 – GENERAL RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

5. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

* * * * *

6. Revise § 270.8b-33 to read as follows:

§ 270.8b-33 XBRL-Related Documents.

A registrant that participates in the voluntary XBRL (eXtensible Business Reporting Language) program may submit, in electronic format as an exhibit to a filing on Form N-1A (§§ 239.15A and 274.11A of this chapter), Form N–CSR (§§ 249.331 and 274.128 of this chapter), or Form N–Q (§§ 249.332 and 274.130 of this chapter) to which they relate, XBRL-Related Documents (§ 232.11 of this chapter). A registrant that submits XBRL-Related Documents as an exhibit to a form must name each XBRL-Related Document "EX 100" as specified in the EDGAR Filer Manual and submit the XBRL-Related Documents in such a manner that will permit the information for each series and, for any information that does not relate to all of the classes in a filing, each class of an investment company registrant and each contract of an insurance company separate account to be separately identified. A registrant may submit such exhibit with, or in an amendment to, the Form N-CSR or Form N-Q filing to which it relates, or in an amendment to the Form N-1A filing to which it relates, in accordance with rule 401 of Regulation S-T (§ 232.401).

PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

7. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

8. Amend General Instruction B.4.(b) of Form N-1A (referenced in §§ 239.15A and 274.11A) by revising "8b-32 [17 CFR 270.8b-1 – 270.8b-32]" to read "8b-33 [17 CFR 270.8b-1 – 270.8b-33]".

Note: The text of Form N-1A will not appear in the Code of Federal Regulations.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

July 11, 2007

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 8824 / July 11, 2007

CORRECTED

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 56045 / July 11, 2007

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2618 / July 11, 2007

Admin. Proc. File No. 3-12288

In the Matter of

DAVID HENRY DISRAELI
and
LIFEPLAN ASSOCIATES, INC.

ORDER DENYING MOTION FOR LEAVE TO TAKE ADDITIONAL EVIDENCE

On June 13, 2007, Respondents David Henry Disraeli and Lifeplan Associates, Inc. ("Respondents") filed a "Motion for Leave to Take Additional Evidence" in which they "request[ed] that the Commission order joint depositions" of an attorney in the Division of Enforcement and a staff accountant in the Office of Compliance, Inspections, and Examinations. 1/ For the reasons discussed below, we deny the motion.

Rule of Practice 233 prescribes the standards for taking depositions in our administrative proceedings. 2/ Rule 233 is part of the Rule 200 series of our Rules of Practice governing the initiation of proceedings and prehearing rules. The Rule requires the filing of a written motion to obtain permission to take a deposition and specifies the particular, limited circumstances in which

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1/ Respondents appear before the Commission pro se. Respondents state that they move for the submission of additional evidence "pursuant to Rule 201.42." Although our Rules of Practice contain no such rule, we nonetheless consider Respondents' motion.

2/ 17 C.F.R. § 201.233.

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a party may obtain testimony from a witness by deposition in lieu of at the hearing. 3/ These circumstances include the likelihood that the prospective witness will give testimony material to the proceeding, that the prospective witness, who is then in the United States, will be unable to attend or testify at the hearing due to age, sickness, infirmity, imprisonment, other disability, or absence from the United States, and that the taking of the deposition will serve the interests of justice. 4/ The comment to Rule 233 states that depositions should be used "only to preserve testimony of a witness who would be unlikely to be able to attend the hearing." 5/ The placement of the Rule among those governing prehearing proceedings, the procedural requirements for obtaining permission to take a deposition and the limitations on its availability, and the comment's reference to witnesses "unlikely to be able to attend the hearing" evince our intention that any depositions will be taken prior to a hearing, in lieu of, rather than in addition to, testimony given at the hearing, and will be the exception to the usual rule that witnesses will provide testimonial evidence at the hearing. Depositions are not intended to be used as a means of adducing additional evidence after a hearing. The depositions sought by Respondents cannot be scheduled prior to the hearing because the hearing has already been concluded.

Rule of Practice 452 provides that a party may file a motion to adduce additional evidence after the conclusion of a hearing. 6/ However, any such motion must show "that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." 7/ Respondents have not demonstrated either materiality or reasonable grounds for failing to adduce the evidence previously. 8/ Respondents acknowledge that the enforcement attorney was on both parties' witness lists and that Respondents did not call her due to a dispute between Respondents and their counsel. Respondents claim that the attorney's testimony will show that the investigation was not objective. The potential materiality of this testimony is unclear. The initial decision was not based on the investigation but on the evidence adduced at the hearing. Respondents also make no argument that any issue of age, sickness, infirmity,

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3/ Id. § 201.233(a)-(b).

4/ Id. § 201.233(b).

5/ Rules of Practice, Exchange Act Rel. No. 35833 (June 9, 1995), 59 SEC Docket 1546, 1573.

6/ 17 C.F.R. § 201.452.

7/ Id.

8/ Cf. Thomas F. White, 51 S.E.C. 1194, 1197 n.6 (1994) (granting respondent's request under the predecessor to Rule 452 to adduce as additional evidence a witness's sworn deposition testimony where the evidence was material and respondent had shown reasonable grounds for the failure to adduce the evidence before the law judge because the witness "was out of the country during the hearings before the law judge").

imprisonment, other disability, or absence from the United States provided a basis for the enforcement attorney's non-appearance at the hearing. 9/

Respondents also acknowledge that the staff accountant testified at the hearing on August 15, 2006. She therefore was available for cross-examination. Thus, Respondents' request is for testimony in addition to that given at the hearing. 10/ Respondents' reasons for requesting depositions do not satisfy the standards set forth in our Rules of Practice, and we deny Respondents' motion for leave to take additional evidence. 11/

Accordingly, IT IS ORDERED that the "Motion for Leave to Take Additional Evidence" of David Henry Disraeli and Lifeplan Associates, Inc., be, and it hereby is, denied.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

9/ Respondents blame counsel who represented Respondents at the hearing for committing "grave errors" by failing to "call certain witnesses to testify against the protests of Respondents" and for failing to bring the staff accountant's alleged failures "to the court's attention." We reject this argument as a basis for ordering post-hearing depositions. Cf. William A. Calvo, III, Order on Motion for Supplemental Hearings and/or Briefs and for Reconsideration of Motion to Admit Additional Evidence, Admin. Proc. Rulings Rel. No. 342 (Aug. 29, 1989), 1989 WL 376620, at *1 (order of administrative law judge)(denying respondent's request to admit additional evidence that respondent contended was "'crucial to a 'complete evaluation of the matter under consideration'" where respondent's "only slightly veiled effort to blame counsel for not offering the materials in a timely fashion [was] without substance" because respondent "had a full opportunity to present evidence and argument" and there was "no reason why he should be permitted to start over again").

10/ Respondents claim that the accountant's testimony will demonstrate that her analysis of their financial records did not comport with generally accepted accounting principles.

11/ We also deny Respondents' request that we "grant an extension to Respondents in order to include the additional evidence obtained in the depositions requested."

Commissioners Campos & Casey Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 12, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12684

In the Matter of **NATURE'S SUNSHINE PRODUCTS, INC.** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission's ("Commission") public official files disclose that Nature's Sunshine Products, Inc. ("Nature's Sunshine" or "Respondent"), a Utah corporation headquartered in Provo, Utah, manufactures and markets nutritional and personal care products to consumers worldwide through a system of independent direct sales distributors. Nature's Sunshine shares are registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and the company files its annual and quarterly reports on Forms 10-K and 10-Q.

II.

After an investigation, the Division of Enforcement alleges that Nature's Sunshine has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder by: (1) failing to file an Annual Report on Form 10-K since March 16, 2005, when it filed its Annual Report on Form 10-K for the year ended December 31, 2004; and (2) failing to file a Quarterly Report on Form 10-Q containing financial statements which had been reviewed by a registered independent public accountant for any fiscal period subsequent to its fiscal quarter ended June 30, 2005.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted pursuant to Section 12(j) of the Exchange Act to determine:

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A. Whether the allegations contained in Section II. above are true and, in connection therewith, afford Respondent an opportunity to establish any defenses to such allegations; and

B. Whether the registration pursuant to Section 12(g) of the Exchange Act of each class of the securities of Nature's Sunshine, identified in Section I., should be suspended for a period not exceeding twelve months, or revoked, pursuant to Section 12(j) of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III. above be held at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56066 / July 13, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2634 / July 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-9331

In the Matter of B.J. Thomas	: ORDER GRANTING APPLICATION FOR : REINSTATEMENT TO APPEAR AND PRACTICE : BEFORE THE COMMISSION AS AN ACCOUNTANT : RESPONSIBLE FOR THE PREPARATION OR : REVIEW OF FINANCIAL STATEMENTS REQUIRED : TO BE FILED WITH THE COMMISSION

On June 10, 1997, B.J. Thomas ("Thomas") was suspended from appearing or practicing as an accountant before the Commission as a result of public administrative proceedings instituted by the Commission against Thomas pursuant to Rule 102(e)(3) of the Commission's Rules of Practice.[1] The suspension stemmed from Thomas's consent to the entry of a final judgment against him on March 11, 1997 in an action brought by the Commission in federal district court. The final judgment permanently enjoined him from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

The Commission's complaint in federal district court alleged that Thomas served as the chief financial officer of Technology International, Ltd. ("TIL") from at least March 1993 until February 1994. TIL's Form 10-Q for the quarter ended June 30, 1993 materially misstated its financial condition. TIL reported ownership of approximately $2.1 million of rental properties when, in fact, as of the end of the quarter, TIL had not consummated the purchase of those properties and could not, consistent with GAAP, report them as assets. TIL also improperly capitalized $828,744 of "Pre Operating and Deferred Costs," including consulting fees, officers' salaries, the cost of running the Shareholders Relations Department and interest costs. Finally, TIL failed, contrary to the requirements of Regulation S-X, to disclose that it had made a prior period adjustment to capitalize costs that had previously been expensed. Thomas prepared TIL's

[1] *See* Accounting and Auditing Enforcement Release No. 922, dated June 10, 1997. Thomas was temporarily suspended from appearing or practicing before the Commission. This suspension became permanent, pursuant to Rule 102(e)(3)(ii) after 30 days from the date of the release.

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June 30, 1993 financial statements and was responsible for all of TIL's accounting policies and practices during that time period.

This order is issued in response to Thomas's application for reinstatement to practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

In his capacity as a preparer or reviewer, or a person responsible for the preparation or review of financial statements required to be filed with the Commission, Thomas attests that he will have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Thomas is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to resume appearing and practicing before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original suspension order in this regard. Therefore, Thomas's suspension from practice before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original suspension order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."[2] This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Thomas, it appears that he has complied with the terms of the June 10, 1997 order suspending him from practice before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Thomas, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

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[2] Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that B.J. Thomas is hereby reinstated to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56062 / July 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12687

In the Matter of **Sports Arenas, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Sports Arenas, Inc. ("Sports Arenas" or "Respondent").

II.

In anticipation of the institution of these proceedings, Sports Arenas, has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Sports Arenas consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

On the basis of this Order and the Respondent's Offer, the Commission finds:

1. Sports Arenas (CIK No. 93003) is a Delaware corporation located in San Diego, California. At all times relevant to this proceeding, the common stock of Sports Arenas was registered with the Commission under Exchange Act Section 12(g). As of October 25, 2006, the common stock of Sports Arenas (symbol "SPAI") was quoted on the Pink Sheets,

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had six market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

2. Sports Arenas has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended December 31, 2004.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission deems that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Sports Arenas's, securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56061 / July 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12686

In the Matter of **Sonex Research, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Sonex Research, Inc. ("Sonex" or Respondent).

II.

In anticipation of the institution of these proceedings, Sonex has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Sonex consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

On the basis of this Order and the Respondent's Offer, the Commission finds:

1. Sonex (CIK No. 723312) is a Maryland corporation located in Annapolis, Maryland. At all times relevant to this proceeding, the common stock of Sonex has been registered with the Commission under Exchange Act Section 12(g). As of February 2, 2007, the common stock of Sonex (symbol "SONX") was quoted on the Pink Sheets.

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2. Sonex has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2004.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Sonex's, securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56060 / July 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12685

In the Matter of **Rigid Airship USA, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Rigid Airship USA, Inc. ("Rigid Airship" or "Respondent").

II.

In anticipation of the institution of these proceedings, Rigid Airship has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Rigid Airship consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

On the basis of this Order and the Respondent's Offer, the Commission finds:

1. Rigid Airship (CIK No. 1075245) is a revoked Nevada corporation located in Stone Harbor, New Jersey. At all times relevant to this proceeding, the common stock of Rigid Airship was registered with the Commission under

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Exchange Act Section 12(g). As of October 12, 2006, the company's common stock (symbol "RGDA") is no longer publicly quoted or traded.

2. Rigid Airship has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2000.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission deems it necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Rigid Airship's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56063 / July 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12688

In the Matter of TCPI, Inc., Respondent.	ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against TCPI, Inc. ("TCPI" or Respondent).

II.

In anticipation of the institution of these proceedings, TCPI, has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, TCPI consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

On the basis of this Order and the Respondent's Offer, the Commission finds:

1. TCPI (CIK No. 924921) is an inactive Florida corporation located in Pompano Beach, Florida. At all times relevant to this

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proceeding, the common stock of TCPI was registered with the Commission under Exchange Act Section 12(g). As of March 20, 2007, TCPI's common stock was quoted on the Pink Sheets (symbol "PKGH"), had twelve market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3). TCPI filed a Chapter 11 bankruptcy proceeding on July 3, 2001, that was later converted to a Chapter 7 proceeding and was still pending as of March 20, 2007.

2. TCPI has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended June 30, 2001.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission deems it necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of TCPI's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8520A/ July 13, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 50910A/ July 13, 2007

ADMINISTRATIVE PROCEEDING
FILE NO. 3-11780

In the Matter of Edward D. Jones & Co., L.P., Respondent.	AMENDED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Edward D. Jones & Co., L.P. ("Edward Jones" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Amended Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A

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of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Respondent

1. Edward Jones is a Missouri limited partnership that has been registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act since 1941. It is also a member of the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE"). Edward Jones' principal offices are located in St. Louis, Missouri. It has more than 8,000 branch offices staffed primarily by one or two registered Investment Representatives ("IRs") that provide retail brokerage services throughout the United States, Canada and the United Kingdom. Edward Jones is the principal operating subsidiary of the Jones Financial Companies, L.L.L.P. ("Jones Financial"), a Missouri limited partnership whose limited partnership interests are registered under Section 12(g) of the Exchange Act. Jones Financial holds all of Edward Jones' partnership equity. Jones Financial is comprised of approximately 275 general partners, 5,021 limited partners and 146 subordinated limited partners.

Overview

2. Edward Jones is one of the largest sellers of brokerage-sold mutual funds in the United States. Half of all of Edward Jones' customers' assets are invested in mutual funds held in brokerage accounts and college savings plans established under Section 529 of the Internal Revenue Code ("529 plans"). Edward Jones' customers hold onto their investments for a lengthier period of time than customers at other broker-dealers. Edward Jones has selling agreements with approximately 240 mutual fund families which permit its IRs to sell at least 1,930 different mutual funds.

3. Prior to the late 1980s, Edward Jones had internally designated certain of the mutual fund families with which it had selling agreements as "recommended." In the late 1980s, Edward Jones approached certain of those mutual fund families ("Preferred Families") with which it had long-standing relationships and sought to obtain revenue sharing from them. Edward Jones set an internal revenue sharing target of 25% of the advisory fees earned by those mutual fund families on the mutual fund assets purchased or held by Edward Jones' customers, plus in most instances sought an equity interest in their advisers or distributors.

The Preferred Mutual Fund Family Program

4. By the early 1990s, six mutual fund families had agreed to make revenue sharing payments to Edward Jones. Between 1993 and 1996, Edward Jones removed one of

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

these fund families and added two new fund families to the list of Preferred Families, raising the total number of Preferred Families to seven.

5. Each of these fund families agreed to make revenue sharing payments to Edward Jones in varying amounts up to and in several cases meeting Edward Jones' target of 25% of the advisory fees for assets purchased or held by Edward Jones' customers. These fees were calculated in various ways and by various measures, including: a flat fee determined by the fund family based on the total fund assets held by Edward Jones' customers; 7.5 to 10 basis points of average fund assets held by Edward Jones' customers in a given year; 12.5 basis points on the gross sales of a Preferred Families' mutual funds made by Edward Jones to its customers in a given year; or 25% of the advisory fee attributable to the average assets of certain Preferred Families' mutual funds held by Edward Jones' customers in a given year. One of the Preferred Families also agreed to provide Edward Jones an equity interest of at least 5% in the distributor of its mutual funds if Edward Jones reached a certain threshold of sales of its mutual funds, this was later changed to profit participation.

6. Revenue sharing was a material factor, among others, in the selection of at least two of the Preferred Families. Revenue sharing was also a material factor, among others, with respect to the retention of fund families as Preferred Families. Edward Jones periodically sought to negotiate additional revenue sharing payments from its Preferred Families.

7. Edward Jones' revenue sharing agreements with the Preferred Families are and have been highly profitable to Edward Jones. Between 1999 and the present, the firm has collected tens of millions of dollars in revenue sharing payments from the Preferred Families each year. Most of these payments have been paid directly to Edward Jones from the assets of the advisers or distributors associated with the Preferred Families. However, for a portion of this time period, Edward Jones also accepted millions of dollars in directed brokerage commissions or "step-outs" from three of the Preferred Families for distribution of mutual fund shares. In these instances, the advisers of these Preferred Families instructed the brokerage firm executing portfolio transactions for their mutual funds to "step out" of the transactions and direct a portion of the commissions for the transactions to Edward Jones. These directed brokerage payments ceased in 2003.

8. Edward Jones' distributed 11% to 12% of its net income, which includes net revenue sharing, to its limited partners and 10% to 12% of its net income to its subordinated limited partners each year and the residual is distributed to the general partners. Thus, the majority of any revenue sharing received by Edward Jones, after operating expenses, was distributed to the firm's general partners, some of whom make decisions regarding which mutual fund families become "Preferred Families" and others of whom are Edward Jones IRs who recommend the Preferred Families to their customers. During 2003 alone, the revenue sharing received by Edward Jones was equivalent to 33% of the net income of Edward Jones' parent holding company, Jones Financial.

9. Out of the approximately 240 mutual fund families with which Edward Jones has selling agreements, only the seven Preferred Families make revenue sharing payments to Edward Jones. These payments are in addition to standard sales loads, commissions, Rule 12b-1 fees, expense reimbursements and sub-transfer-agent fees for maintaining customer account information. Edward Jones does not receive any revenue sharing payments from any non-preferred mutual fund families. Historically, 95% to 98% of Edward Jones' sales of mutual fund shares have been sales of the Preferred Families.

10. Edward Jones and its partners have a financial incentive to internally promote the sales of mutual funds from the Preferred Families over other mutual funds that its IRs can sell. Edward Jones promoted to IRs the existence of revenue sharing by the Preferred Families and encouraged IRs on a case-by-case basis to consider revenue sharing in making recommendations to their customers to purchase certain mutual funds.

11. For example, during the relevant time period, Edward Jones' Director of Mutual Fund Marketing described his "greatest contribution to the Firm's bottom line" as "the Department's ability to continue the focus on selling preferred fund families and the subsequent leverage this gives us to negotiate revenue sharing programs with vendors." He also represented to the IRs that Edward Jones directly passes the revenue sharing income along to the "IRs who did the work to get the money in the first place."

12. During the "rollouts" of the two newest Preferred Families, a general partner of the firm also made broadcast presentations to IRs throughout the country further extolling the benefits the IRs receive from the revenue sharing agreements negotiated with these Preferred Families.

13. At least one newsletter distributed by an Edward Jones regional leader conveyed this message by describing how "[r]evenue sharing can contribute large benefits to the firm in terms of profit and bonus." In a January 2000 regional newsletter, a regional leader further promoted the sales of mutual funds from Preferred Families that provide revenue sharing payments over those that do not provide revenue sharing by describing how, over a ten year period, an IR would receive an additional $256,369 in profit from the sales of such mutual funds. During regional and other meetings, another of Edward Jones' regional leaders, who was also a general partner, encouraged IRs in his region to sell the mutual funds of one Preferred Family over the funds of another Preferred Family that paid less revenue sharing.

14. Edward Jones' IRs receive credits for the amount of revenue sharing that Edward Jones receives from the IRs' proportionate sales and customer holdings of funds from the Preferred Families. These credits were not directly paid to IRs, but were applied as a separate line item to the profit and loss statements ("P&Ls") prepared for each IR's office. These P&Ls are distributed monthly to the IRs and track their profitability to the firm. An IR's profitability to the firm determines whether the IR is successful at Edward Jones and is used as a factor in determining whether the IR will be considered for status as a limited partner. In addition, three times per year, Edward Jones' IRs are eligible to receive bonuses based, in part, on their overall profitability which is impacted by their

revenue sharing credits. For an IR to receive a bonus in any of Edward Jones' three annual bonus periods, both the firm and the particular IR's office must be profitable during the period. In addition, if an IR has worked for Edward Jones for more than 30 months, the IR also needs to make at least $4,000 in profits to become eligible for a bonus. Edward Jones' top-producing IRs have received as much as an additional $5,000 per bonus period as the part of their bonuses based directly on revenue sharing payments attributable to the IRs' sales and customer holdings of funds from the Preferred Families to their retail customers.

15. Edward Jones further offers "diversification contest" trips to its IRs two times each year. During these contests, the IRs can qualify for a trip by earning points based on, among other things, their sales of mutual funds. Once an IR earns a specific number of points, the IR "wins" a trip. Although the IRs generally can earn contest points for selling any mutual funds or other investment product, for a ninety-day period in the fall of 2002, Edward Jones only gave mutual fund contest points for the sale of a subset of mutual funds from the Preferred Families. One or more of the Preferred Families always participate in the sponsorship of the diversification trips and make one short training presentation for the IRs during each trip. Sponsorship of these trips and other meetings provide the Preferred Families with exclusive access to and visibility with the IRs.

16. The Preferred Families receive certain benefits not otherwise available to non-preferred families. First, Edward Jones exclusively promotes the seven Preferred Families on its public website and exclusively provides links to the Preferred Families' websites on Edward Jones' internal computer system accessible only to its IRs. Second, Edward Jones exclusively lists the Preferred Families in sales literature and newsletters provided to its customers. Third, Edward Jones provides its IRs with research on only the seven Preferred Families and maintains a "Preferred Funds List" containing the names of approximately 110 mutual funds within the Preferred Families that Edward Jones' Product Review department recommends for sale to Edward Jones' retail customers. Only funds from the seven Preferred Families are considered for inclusion on this list. The Product Review department does not review any mutual funds from fund families that are not Preferred Families for this "Preferred Funds List." Fourth, Edward Jones uses only the Preferred Families as examples in its internal training sessions for new IRs and only invites representatives from the Preferred Families to make presentations at these training sessions. Finally, Edward Jones facilitates exclusive direct access for the Preferred Families to its IRs for the dissemination of marketing materials and to answer IRs' questions regarding the funds offered by the Preferred Families.

Edward Jones Did Not Disclose Its Financial Incentives To Sell Mutual Funds From The Preferred Families

17. The mutual fund section of Edward Jones' public website lists only the seven Preferred Families and provides links to only the Preferred Families' websites. In addition, since approximately 1997, Edward Jones has claimed on its public website that it focuses on the seven Preferred Families because: "With nearly 11,000 mutual funds available, it can be difficult to know which fund(s) to pick. That's why at Edward Jones,

24. Edward Jones currently has selling agreements with 14 mutual fund companies to sell their 529 plans. However, Edward Jones promotes only the 529 plans of the Preferred Families that offer 529 plans, two of which pay additional revenue sharing to Edward Jones for sales of 529 plans. Edward Jones expressly encourages its IRs to sell only the 529 plans of the Preferred Families. In internal notices to its IRs announcing the availability of 529 plans from non-preferred families, Edward Jones explicitly states: "Edward Jones will continue to promote only our preferred vendors' 529 plans . . . Although we have a selling agreement with [another 529 plan], they are not one of our preferred vendors. However, if one of your clients feel [*sic*] the advantages of [another 529 plan] are important factors in their decision, you can sell it." In addition, Edward Jones has made it easier for its IRs to sell and service the Preferred Families' 529 plans versus non-preferred 529 plans.

25. At the same time, Edward Jones has failed to disclose on its website or in any other written documents prepared by Edward Jones, including confirmations of 529 plan sales, the material financial incentives to Edward Jones, its partners and its IRs to sell 529 plans from certain of the Preferred Families over other 529 plans that Edward Jones could sell.

26. Based on the conduct described above, Edward Jones willfully violated:

a. Section 17(a)(2) of the Securities Act, which provides that it is "unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;"

b. Rule 10b-10 under the Exchange Act, which provides in pertinent part that it is "unlawful for any broker or dealer to effect for or with an account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security . . . unless such broker or dealer, at or before completion of such transaction, gives or sends to such customer written notification disclosing . . . the source and amount of any other remuneration received or to be received by the broker in connection with the transaction;" and

c. Section 15B(c)(1) of the Exchange Act, which provides that "[n]o broker, dealer, or municipal securities dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in contravention of any rule of the [Municipal Securities Rulemaking] Board."

27. By virtue of its sales of 529 college savings plans, as described above, Edward Jones also contravened the dictates of Municipal Securities Rulemaking Board ("MSRB") Rule G-15, which requires a broker or dealer to send or give a written confirmation to its customer, at or before the completion of a municipal securities

transaction, that discloses, among other things, either: "(A) the source and amount of any remuneration received or to be received . . . by the broker [or] dealer . . . in connection with the transaction from any person other than the customer, or (B) a statement indicating whether any such remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of the customer."

Undertakings

28. Edward Jones undertakes the following:

a. Edward Jones shall place and maintain on the mutual fund portion of its public website within 15 days of the date of entry of this Order disclosures regarding its Preferred Mutual Fund Family program ("program") to include: (i) the existence of the program; (ii) the mutual fund families participating in the program; (iii) the amount of revenue sharing payments that Edward Jones receives from each of the Preferred Families based on a reasonable estimate from historical experience, expressed in basis points or dollars ; (iv) the total amount of revenue sharing payments (expressed in dollars) that Edward Jones receives annually, starting with the amount received in 2004 as of the date of this Order and updated each year thereafter; (v) the source of such payments (fund assets, adviser, distributor, underwriter, etc.); (vi) that its IRs and the equity owners of the firm may benefit financially from the revenue sharing payments Edward Jones receives; and (vii) that Edward Jones does not receive revenue sharing payments from any non-preferred mutual fund families.

b. Edward Jones shall place and maintain on the college savings program portion of its public website within 15 days of the date of entry of this Order disclosures regarding its Preferred Mutual Fund Family program to include: (i) the existence of the program; (ii) an identification of the Preferred Families that pay Edward Jones revenue sharing for sales of 529 plans; (iii) the amount of revenue sharing payments that Edward Jones receives from each of these Preferred Families based on a reasonable estimate from historical experience, expressed in basis points or dollars; (iv) the total amount of revenue sharing payments (expressed in dollars) that Edward Jones receives annually, starting with the amount received in 2004 as of the date of this Order and updated each year thereafter; (v) the source of such payments (fund assets, adviser, distributor, underwriter, etc.); (vi) that its IRs and the equity owners of the firm may benefit financially from the revenue sharing payments Edward Jones receives; and (vii) that Edward Jones does not receive revenue sharing payments from any non-preferred mutual fund families.

c. Edward Jones shall send the information contained in paragraphs a. and b. above: (i) to its current customers within 60 days following the date of entry of this Order and annually thereafter; (ii) to new customers upon the opening of an account; and (iii) in those cases where confirmations are sent out directly by

Edward Jones, to all customers at or before the completion of each transaction involving customer purchases of mutual fund shares or interests in 529 plans, except that Edward Jones may send the information quarterly to customers purchasing mutual funds pursuant to a periodic plan in compliance with Exchange Act Rule 10b-10 and to customers purchasing 529 plans pursuant to a periodic municipal security plan in compliance with MSRB Rule G-15.

d. Edward Jones shall devise and implement within 60 days of the date of entry of this Order a policy and set of procedures to ensure that Edward Jones is complying with its disclosure obligations under this Order, the federal securities laws and the MSRB rules. The policy and procedures shall also ensure that all statements made on Edward Jones' public website comply with this Order, the federal securities laws and the MSRB rules and are otherwise not misleading.

e. Edward Jones shall devise and implement within 60 days of the date of entry of this Order a policy and set of procedures to conduct comprehensive reviews of all prospectuses and SAIs issued by the Preferred Families on a regular basis to ensure that Edward Jones is in compliance with this Order, the federal securities laws and the MSRB rules.

f. Edward Jones shall devise and implement within 60 days of the date of entry of this Order a policy and set of procedures to document the basis for its decisions to add or remove mutual fund families from its list of Preferred Families.

g. Edward Jones shall devise and implement within 60 days of the date of entry of this Order a policy and set of procedures for training its IRs regarding the disclosure of financial incentives that Edward Jones, its IRs, general partners and limited partners receive from each of the Preferred Families.

h. Edward Jones shall retain, within 60 days of the date of entry of this Order, the services of an Independent Consultant not unacceptable to the Commission's Staff. Edward Jones shall exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. Edward Jones shall retain the Independent Consultant to conduct a comprehensive review of: (i) the adequacy of the policies and procedures that Edward Jones is required to devise and implement under this Order; and (ii) whether Edward Jones' receipt and disclosure of revenue sharing payments is in compliance with this Order, the federal securities laws and the MSRB rules.

i. Edward Jones shall further retain the Independent Consultant to, at the conclusion of the review, which in no event shall be more than 120 days after the date of entry of this Order, submit to Edward Jones and to the Commission's Staff an Initial Report. The Initial Report shall address, at a minimum: (i) the adequacy of the policies and procedures that Edward Jones is required to devise and implement under this Order; and (ii) whether Edward Jones' receipt and disclosure of revenue sharing payments is in compliance with this Order, the federal securities laws and the MSRB rules. The Initial Report must include a description of the review performed, the conclusions reached, and the Independent Consultant's recommendations for modifications and additions to the policies and procedures devised and implemented by Edward Jones.

j. Within 150 days from the date of the entry of the Order, Edward Jones shall in writing advise the Independent Consultant and the Commission's Staff of the recommendations from the initial report that it is adopting and the recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Edward Jones considers unnecessary or inappropriate, Edward Jones shall explain why the objective or purpose of such recommendation is unnecessary or inappropriate and provide in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose.

k. With respect to any recommendation with which Edward Jones and the Independent Consultant do not agree, Edward Jones shall attempt in good faith to reach an agreement with the Independent Consultant within 180 days from the date of the entry of the Order. In the event that the Independent Consultant and Edward Jones are unable to agree on an alternative proposal, Edward Jones and the Independent Consultant shall jointly confer with the Commission's Staff to resolve the matter.

l. Edward Jones shall further retain the Independent Consultant to conduct a follow up review and submit a written Final Report to Edward Jones and to the Commission's Staff no later than one year after the date of entry of this Order. In the Final Report, the Independent Consultant shall address Edward Jones' compliance with this Order, its implementation of the policies and procedures adopted under this Order and make any further recommendations he or she deems necessary. Within 30 days of its receipt of the Independent Consultant's Final Report, Edward Jones shall adopt the recommendations contained in the Final Report.

m. Within 60 days of the date of the entry of this Order, Edward Jones shall submit to the Independent Consultant for review (and simultaneously to the Commission staff) a plan ("Distribution Plan") pursuant to which the Independent Consultant shall administer and distribute the monetary sums ordered to be paid pursuant to Section IV.C below. The Distribution Plan shall address how such monetary sums shall be distributed to benefit customers who purchased through Edward Jones mutual funds of the Preferred Families between January 1, 1999 and the date of the entry of this Order. The Distribution Plan shall not be unacceptable to the Independent Consultant. If the Independent Consultant finds that the Distribution Plan is unacceptable, Edward Jones shall attempt in good faith to reach an agreement with the Independent Consultant within 90 days of the entry of this Order. In the event that Edward Jones and the Independent Consultant are unable to agree on an alternative proposal, Edward Jones shall abide by the recommendation of the Independent Consultant. The final Distribution Plan shall be submitted, and must be acceptable, to the Commission Staff.

n. Edward Jones shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to Edward Jones' files, books, records and personnel as reasonably requested by the Independent Consultant.

o. For good cause shown, and upon receipt of a timely application from the Independent Consultant or Edward Jones, the Commission's Staff may extend any of the procedural dates set forth above

p. To ensure the independence of the Independent Consultant, Edward Jones: (i) shall not have the authority to terminate the Independent Consultant, without the prior written approval of the Commission's Staff; (ii) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; (iii) shall not be in and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports, or documents to the Commission or the Commission's Staff.

q. To further ensure the independence of the Independent Consultant, Edward Jones shall require the Independent Consultant to enter into an agreement that provides that for the period of the engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Edward Jones, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. Any firm with which the Independent Consultant is affiliated in performance of his or her duties under this Order shall not, without prior written consent of the Commission's Staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Edward Jones, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

In determining whether to accept the Offer, the Commission has considered this undertaking:

r. Edward Jones shall not seek or accept, directly or indirectly, reimbursement or indemnification from any source including, but not limited to, payment made pursuant to any insurance policy, with regard to any penalty amounts that Edward Jones shall pay pursuant to this Order, regardless of whether such penalty amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors. Edward Jones shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state or local tax for any penalty amounts that Edward Jones shall pay pursuant to this Order, regardless of whether such penalty amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Edward Jones' Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Edward Jones is censured.

B. Edward Jones shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act, Section 15B(c)(1) of the Exchange Act and Rule 10b-10 thereunder and MSRB Rule G-15.

C. IT IS FURTHER ORDERED that:

1. Edward Jones shall pay disgorgement plus prejudgment interest in the total amount of $37.5 million ("Disgorgement") and a civil monetary penalty in the amount of $37.5 million ("Penalties"), for a total payment of $75 million.

2. There shall be, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund established for the funds described in Section C.1. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Edward Jones agrees that it shall not, after offset or reduction in any Related Investor Action based on Edward Jones' payment of disgorgement in this action, further benefit by offset or reduction of any part of Edward Jones' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Edward Jones agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Edward Jones

by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

3. Pursuant to an escrow agreement not unacceptable to the staff of the Commission, Edward Jones shall, within 90 days of the entry of this Order, pay the Disgorgement and Penalties into an escrow account. The escrow agreement shall, among other things: (1) require that all funds in escrow be invested as soon as reasonably possible and to the extent practicable in short-term U.S. Treasury securities with maturities not to exceed six months; (2) name an escrow agent who shall be appropriately bonded; and (3) provide that escrowed funds be disbursed only pursuant to an order of the Commission. Edward Jones shall be responsible for all costs associated with the escrow agreement and the Fair Fund distribution.

D. Edward Jones shall comply with the undertakings enumerated in Section III.28(a) through (q).

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56074 / July 13, 2007

ACCOUNTING AND AUDIT ENFORCEMENT
Release No. 2635 / July 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12689

In the Matter of Paul Kearney, Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Paul Kearney ("Kearney" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Respondent

1. Paul Kearney, age 33, is an Irish citizen and a resident of Hollywood, Ireland. Kearney was the financial accountant of Zomax Limited's Operations Facility in Clondalkin, Ireland from April 2000 until January 2005, when he voluntarily resigned.

Relevant Entities

2. Zomax, Inc. ("Zomax") was a Minnesota corporation founded in February 1996 with its headquarters in Plymouth, Minnesota. Zomax was a manufacturer of CDs and DVDs, and provided software and related services to computer manufacturers and other producers of multimedia products. Zomax operated eleven facilities across the United States, Canada, Mexico, and Ireland. Zomax's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was listed on the Nasdaq National Market. For the period ended December 31, 2004 the Company's revenue was $199 million with operating losses of $15.3 million and net losses of $8.4 million.

3. Zomax Limited ("Zomax Ireland") was an Irish limited liability company and the Irish subsidiary of Zomax. Zomax Ireland was comprised of two distinct divisions: the Marketing Service Group located in Santry, Ireland and the Operations Facility located in Clondalkin, Ireland ("Operations Facility"). The Marketing Service Group was a customer contact center, and the Operations Facility was engaged in replication, print management, printing, packaging, warehousing, and distribution activities. For the period ended December 31, 2004, Zomax Ireland's revenue was approximately $35 million, which represented approximately 17.5 percent of Zomax's total revenues. For the period ended December 31, 2004, Zomax Ireland's operating losses were $3.4 million with net losses of $3.3 million.

Background

4. From the end of 2003 through 2004, the former general manager of Zomax Ireland ("General Manager"), the former financial controller of the Operations Facility ("Controller"), and Kearney were the Zomax Ireland employees primarily responsible for reporting Zomax Ireland's financial results to Zomax. The General Manager was the top executive officer of Zomax Ireland and the Controller was the top financial officer of Zomax Ireland's Operations Facility. As the financial accountant for the Operations Facility, Kearney reported directly to the Controller and he also took direction from the General Manager. Kearney's duties included making journal entries for the operations facility and sending Zomax Ireland's monthly financial documents to Zomax.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. Zomax Ireland's performance started to decline in late 2003, due to increased manufacturing costs, decreased demand, and a corresponding drop in prices to attempt to address the falling demand. These problems were caused by a substantial increase in the cost of raw materials, specifically petroleum based materials, which drastically increased Zomax Ireland's costs. Also, many of Zomax Ireland's customers started moving to competitors with production plants located in Eastern Europe and other parts of the world with lower labor costs. Finally, Zomax Ireland's machinery was aging, making it more difficult to produce CDs and DVDs in a cost effective manner. These problems led to significant declines in Zomax Ireland's operating performance beginning in late 2003 and continuing throughout 2004.

6. From the end of 2003 through 2004, the General Manager, the Controller, and Kearney engaged in a fraudulent scheme to inflate the financial results of Zomax Ireland by manipulating certain accounts to hide the declining performance of Zomax Ireland during 2004. Specifically, the General Manager and the Controller directed Kearney to conceal Zomax Ireland's losses by making false journal entries to overstate the sales accrual account, to capitalize spare machine parts that should have been expensed, to understate accruals for employee holiday pay, and then to conceal the fraudulent conduct by sending false Zomax Ireland financial information to Zomax.

7. The General Manager, the Controller, and Kearney's fraudulent scheme to manipulate the sales accrual account throughout 2004 resulted in this account being substantially overstated by $367,424, $573,804, and $392,266 during the first three quarters of 2004. These sales accrual overstatements, in turn, resulted in revenue being overstated for the first three quarters of 2004. The General Manager, the Controller, and Kearney also inappropriately capitalized $136,470 and $79,129 of spare machine parts in the second and third quarters of 2004, respectively. The inappropriate capitalization of spare machine parts resulted in the corresponding understatement of Zomax Ireland's expenses and overstatement of its earnings in the second and third quarters of 2004. Lastly, their understatement of accruals for employee holiday pay during the third and fourth quarters of 2004 understated expenses by $54,896 during these quarters.

8. Throughout 2004, the General Manager and the Controller hid this fraudulent scheme by continually misrepresenting Zomax Ireland's true financial status to Zomax. At the direction of the General Manager and the Controller, Kearney submitted fraudulent monthly financial packages to Zomax. Then the General Manger and the Controller reaffirmed the false financial information contained in the fraudulent monthly financial packages during telephone meetings with Zomax senior officers. In addition, the General Manager and the Controller each signed and submitted to Zomax false certifications for Zomax Ireland's quarterly financial statements. In turn, Zomax's senior officers relied on these false certifications in connection with their certifications to the Commission as required by Sections 302 and 906 of the Sarbanes-Oxley Act for Zomax's Forms 10-Q for the first three quarters of 2004.

9. Zomax unknowingly incorporated Zomax Ireland's false financial information in its Forms 10-Q for the first three quarters of 2004. The General Manager, the Controller, and Kearney's fraudulent scheme to inflate the financial results of Zomax Ireland had a material effect on Zomax's consolidated quarterly financial statements during 2004. On March 31, 2005, Zomax

filed its Form 10-K for 2004, which restated the financial statements for 2003 and the first three quarters of 2004. This restatement, caused primarily by the General Manager, the Controller, and Kearney's fraudulent scheme, negatively impacted the previously reported quarterly results for 2004. For the first quarter of 2004, Zomax previously reported a net loss of $981,000; the restatement increased this net loss by $565,000 to $1,546,000, which represents a 58% increase in net loss. For the second quarter of 2004, Zomax previously reported net income of $1,252,000; the restatement decreased net income for this period by $718,000 to $534,000, which represents a 57% decrease in net income. Finally, for the third quarter of 2004, Zomax previously reported a net loss of $5,497,000; the restatement increased this net loss by $540,000 to $6,037,000, which represents a 10% increase in net loss.

10. The General Manager, the Controller, and Kearney, as part of their fraudulent scheme, knowingly circumvented a system of internal accounting controls, knowingly falsified books, records or accounts, and directly or indirectly falsified or caused to be falsified any book, record, or account.

11. The General Manager, the Controller, and Kearney's fraudulent scheme caused Zomax to fail to make and keep its books, records, and accounts in reasonable detail to accurately and fairly reflect its transactions and dispositions of assets.

12. The General Manager, the Controller, and Kearney's fraudulent scheme caused Zomax to file with the Commission Forms 10-Q for the first three quarters of 2004 that contained false statements of material fact and omitted to state material facts necessary to add such further material information as was necessary, in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

13. As a result of the conduct described above, Kearney violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

14. Also, as a result of the conduct described above, Kearney violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, which prohibit persons from knowingly circumventing a system of internal accounting controls, knowingly falsifying any book, record or account, and directly or indirectly falsifying or causing to be falsified any book, record, or account.

15. Also, as a result of the conduct described above, Kearney caused Zomax's violations of Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

16. Lastly, as a result of the conduct described above, Kearney caused Zomax's violations of Sections 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

17. In determining to accept the Offer, the Commission considered the cooperation that Respondent afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Kearney's Offer.

Accordingly, it is hereby ORDERED that Paul Kearney cease and desist from committing or causing any violations and any future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder

By the Commission.

Nancy M. Morris
Secretary
J. Lynn Taylor

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 56075 / July 13, 2007

Admin. Proc. File No. 3-12398

In the Matter of JOHN M. LUCARELLI	ORDER DISMISSING ADMINISTRATIVE PROCEEDING

On July 28, 2006, a jury returned a guilty verdict against John M. Lucarelli on one count of conspiracy to commit mail fraud and one count of securities fraud before the United States District Court for the District of Connecticut. 1/ The counts of the criminal indictment as to which the jury found Lucarelli guilty alleged, among other things, that Lucarelli and others engaged in a scheme to obtain certain stock illegally in connection with the conversion of a mutual savings bank into a capital stock savings bank. 2/

On August 25, 2006, the Commission instituted an administrative proceeding against Lucarelli pursuant to Section 15(b) of the Securities Exchange Act of 1934 based on the criminal conviction. 3/ On September 5, 2006, Lucarelli filed an answer. On September 20, 2006, upon motion by the United States Attorney's Office for the District of Connecticut (the "USAO"), the administrative law judge entered an order staying this proceeding pending the entry of a "judgment and commitment" by the District Court in the underlying criminal proceeding against Lucarelli.

1/ United States v. Vought, Case No. 3:05cr268 (JBA), 2006 U.S. Dist. LEXIS 39664 (D. Conn. June 15, 2006).

2/ The allegations in the criminal indictment are substantially similar to the allegations in the Commission's complaint in the civil injunctive action that it filed against four individuals, including Lucarelli, on June 28, 2005. See SEC v. Ross, Civil Action No. 3:05cv01036 (CFD) (D. Conn.). The Commission's civil action is pending as to Lucarelli.

3/ 15 U.S.C. § 78*o*(b); see also Order Instituting Administrative Proceedings, Securities Exchange Act Rel. No. 54361 (Aug. 25, 2006), 88 SEC Docket 2650.

On March 22, 2007, the District Court entered a judgment of acquittal in the underlying criminal proceeding, notwithstanding the jury's guilty verdict. The District Court's order set aside the jury's verdict. 4/ On March 26, 2007, the USAO filed a motion for reconsideration of the judgment of acquittal, seeking reconsideration of the District Court's decision not to order a new trial. Lucarelli opposed the motion. The USAO's motion remains pending.

The parties agree that it is appropriate to dismiss this administrative proceeding, but disagree as to whether the dismissal should be granted "with prejudice" or "without prejudice." On April 19, 2007, the Division of Enforcement (the "Division") filed with the Commission a motion to dismiss this administrative proceeding "without prejudice." In support of its motion, the Division argues that this proceeding was instituted properly because it is based on the jury's guilty verdict. The Division states that the USAO has moved for reconsideration of the District Court's judgment of acquittal. In addition, the Division contends that the entry of an injunction against Lucarelli in the pending Commission civil action, 5/ or his alleged willful violations, "could provide an independent basis for re-institution of these proceedings at a later date." 6/

Lucarelli opposes the Division's motion and requests that the Commission dismiss this administrative proceeding "with prejudice." Lucarelli asserts that "a judgment of conviction has never been entered in [the criminal] matter, only a judgment of acquittal." Lucarelli contends that he has been prejudiced by being forced to defend a proceeding that "should never have been commenced."

The Commission's Rules of Practice do not distinguish between dismissing proceedings with or without prejudice. Lucarelli seeks to preclude the Division from taking action against him in the future. However, given the state of the proceeding before the Commission, we can determine only that, as a result of the District Court's order setting aside the jury's guilty verdict, there is currently no basis for instituting or continuing a proceeding against Lucarelli pursuant to

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4/ United States v. Lucarelli, Case No. 3:05cr268, 2007 U.S. Dist. LEXIS 17067 (D. Conn. Mar. 8, 2007).

5/ See supra note 2.

6/ The Division postulates three scenarios under which this proceeding could be re-instituted: (1) a subsequent conviction in the criminal proceeding, if the District Court orders a new trial or the USAO files an appeal and the United States Court of Appeals for the Second Circuit reverses the District Court's acquittal decision and orders a new trial; (2) the entry of an injunction by the District Court in the civil injunctive action; or (3) allegations that willful violations were committed by Lucarelli.

Exchange Act Section 15(b) on the record before us. We conclude that it is appropriate to dismiss the proceeding. 7/

Accordingly, IT IS ORDERED that the motion of the Division of Enforcement to dismiss the administrative proceeding instituted on August 25, 2006 against John M. Lucarelli be, and it hereby is, granted.

By the Commission.

Nancy M. Morris
Secretary

7/ See, e.g., Richard J. Adams, 55 S.E.C. 85, 88 (2001) (citing Warren G. Trepp, 54 S.E.C. 364 (1999)); see also Global Crown Capital, LLC, Exchange Act Rel. No. 55318 (Feb. 20, 2007), 90 SEC Docket 58 (dismissal order). We do not intend to suggest any view regarding the institution of any subsequent proceedings against Lucarelli arising from these or any other facts.

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56080 / July 16, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2638 / July 16, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12692

In the Matter of **Richard R. Hylland, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Richard R. Hylland ("Respondent" or "Hylland") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.C. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Hylland, age 47, is and has been a certified public accountant holding an inactive license to practice in the State of South Dakota. Hylland served as president, chief operating officer, and a member of the board of directors of NorthWestern Corporation ("NorthWestern") from May 1998 until April 2003. Hylland also served as vice-chairman of the board of directors of Expanets, Inc. ("Expanets") from December 1997 until April 2003.

B. NorthWestern was, at all relevant times, a Delaware corporation with its principal place of business in Sioux Falls, South Dakota. NorthWestern operates a regulated utility business in South Dakota, Nebraska and Montana. During the period of conduct described herein, NorthWestern consolidated the financial results of two significant non-utility entities, Expanets, and Blue Dot Services, Inc. ("Blue Dot"). At all relevant times, NorthWestern's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

C. On July 9, 2007 a final judgment was entered against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Richard R. Hylland, Civil Action Number 07-4058 in the United States District Court for the District of South Dakota.

D. The Commission's Complaint alleged, among other things, that during 2002, Respondent misled investors about the operating results and financial condition of NorthWestern and its operating segments. First, the Complaint alleged that Respondent misled investors about the functionality of Expanets' new computer system, which materially impacted Expanets' billing and collection functions. The Commission's Complaint further alleged that Respondent knew that Expanets' improperly accounted for accounts receivable and adjustments to customers' bills, causing overstatements of NorthWestern's reported income from continuing operations of 90%

and 109% in the second and third quarters of 2002, respectively. Second, the Commission's Complaint alleged that Respondent misled investors about the nature of NorthWestern's and Expanets' reported income by misrepresenting or failing to disclose the magnitude of Expanets' reserve reductions or its receipt of unusual non-compete payments. Third, the Commission's Complaint alleged that Respondent misled investors about other issues critical to NorthWestern's liquidity, including NorthWestern's transfer of large amounts of cash in continued support of Expanets and Blue Dot, and NorthWestern's inability to collect $97 million it had publicly anticipated from the sale of certain utility assets. Finally, the Commission's Complaint alleged that Respondent's false and misleading statements facilitated more than $800 million in securities offerings by NorthWestern in September and October 2002, including an $87.5 million equity offering that raised badly needed operating capital for the company.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision.

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56078 / July 16, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2636 / July 16, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12690

In the Matter of **Kipp D. Orme, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Kipp D. Orme ("Respondent" or "Orme") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.C. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Orme, age 48, is and has been a certified public accountant holding an inactive license to practice in the State of Kansas. Orme served as chief financial officer of NorthWestern Corporation ("NorthWestern") from approximately February 2001 through September 2003.

B. NorthWestern was at all relevant times a Delaware corporation with its principal place of business in Sioux Falls, South Dakota. NorthWestern operates a regulated utility business in South Dakota, Nebraska and Montana. During the period of conduct described herein, NorthWestern consolidated the financial results of two significant non-utility entities, Expanets, Inc. ("Expanets") and Blue Dot Services, Inc. ("Blue Dot"). At all relevant times, NorthWestern's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

C. On July 9, 2007 a final judgment was entered against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, and Section 10(b) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Kipp D. Orme, Civil Action Number 07-4060 in the United States District Court for the District of South Dakota.

D. The Commission's Complaint alleged, among other things, that during 2002, Respondent misled investors about the operating results and financial condition of NorthWestern and its operating segments. First, the Complaint alleged that Respondent misled investors about the functionality of Expanets' new computer system, which materially impacted Expanets' billing and collection functions. The Commission's Complaint alleged that, as a result of these problems, Expanets improperly accounted for its accounts receivable and adjustments to customers' bills, causing material overstatements of NorthWestern's reported income from continuing operations in the second and third quarters of 2002, respectively. Second, the Commission's Complaint alleged that Respondent misled investors about the nature of NorthWestern's and Expanets' reported income by misrepresenting or failing to disclose the magnitude of Expanets' reserve reductions or its receipt of unusual non-compete payments. Third, the Commission's Complaint alleged that Respondent misrepresented or failed to disclose facts relating to other issues critical to NorthWestern's liquidity, including NorthWestern's transfer of cash in continued support of its subsidiaries. Finally, the Commission's Complaint alleged that Respondent's false and misleading statements facilitated NorthWestern's registration of more than $800 million in securities offerings in September and October 2002, including an $87.5 million equity offering that raised operating capital for the company.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision.

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56079 / July 16, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2637 / July 16, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12691

In the Matter of **Kurt D. Whitesel, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Kurt D. Whitesel ("Respondent" or "Whitesel") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.C. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Whitesel, age 45 is and has been a certified public accountant holding an inactive license to practice in the State of Ohio. Whitesel served as vice-president, controller and treasurer of NorthWestern Corporation ("NorthWestern") from approximately August 2001 until August 2003.

B. NorthWestern was, at all relevant times, a Delaware corporation with its principal place of business in Sioux Falls, South Dakota. NorthWestern operates a regulated utility business in South Dakota, Nebraska and Montana. During the period of conduct described herein, NorthWestern consolidated the financial results of two significant non-utility entities, Expanets, Inc. ("Expanets") and Blue Dot Services, Inc. ("Blue Dot"). At all relevant times, NorthWestern's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

C. On July 9, 2007 a final judgment was entered against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Kurt D. Whitesel, Civil Action Number 07-4059 in the United States District Court for the District of South Dakota.

D. The Commission's Complaint alleged, among other things, that during 2002, Respondent misled investors about the operating results and financial condition of NorthWestern and its operating segments. First, the Complaint alleged that Respondent failed to disclose serious problems with the functionality of Expanets' new computer system, which materially impacted Expanets' billing and collection functions. The Commission's Complaint further alleged that Respondent knew or was reckless in not knowing that Expanets' improperly accounted for accounts receivable and adjustments to customers' bills, causing overstatements of NorthWestern's reported income from continuing operations of 90% and 109% in the second and third quarters of 2002, respectively. Second, the Commission's Complaint alleged that Respondent misled investors as to the nature of NorthWestern's and Expanets' reported income by failing to disclose the magnitude of Expanets' reserve reductions or its receipt of unusual non-compete payments. Third, the Commission's Complaint alleged that Respondent failed to disclose facts relating to other issues critical to NorthWestern's liquidity, including NorthWestern's transfer of large amounts of cash in continued support of Expanets and Blue Dot, and NorthWestern's inability to collect $97 million it had publicly anticipated from the sale of certain utility assets. The Complaint further alleged that Respondent withheld material facts from NorthWestern's outside auditor regarding Expanets' improper accounting. Finally, the Commission's Complaint alleged that Respondent's false and misleading statements facilitated more than $800 million in securities offerings by NorthWestern in September and October 2002, including an $87.5 million equity offering that raised badly needed operating capital for the company.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision.

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56087 / July 17, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2640 / July 17, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12698

In the Matter of **Jay D. Bolding (CPA),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Jay D. Bolding ("Bolding" or "Respondent") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Bolding has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3. below, which are admitted, Bolding consents to the entry of this

[1] Rule 102(e)(3)(i) provides, in relevant part, that: "The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder."

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Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Bolding, age 47, is a resident of Omaha, Nebraska. He was licensed as a certified public accountant in Kansas and Tennessee; however, both licenses have lapsed. He worked for approximately 14 years in public accounting as an auditor, including as a Senior Manager. From January 1997 to the beginning of ConAgra's fourth quarter of fiscal year 1999 (March 1999), he was the head of ConAgra Food, Inc.'s ("ConAgra") Internal Audit department. From March 1999 until approximately April 2004, he served as ConAgra's Corporate Controller. Until his resignation on June 1, 2006, he held the position of Senior Vice President for Capital and Market Investment Effectiveness at ConAgra.

2. ConAgra, a Delaware corporation with headquarters in Omaha, Nebraska, is a diversified international food company. ConAgra's common stock is registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and trades on the New York Stock Exchange. ConAgra's fiscal year ends on the last Sunday in May of each year.

3. On June 29, 2007, the Commission filed a complaint against Bolding in SEC v. James P. O'Donnell, et al. (Civil Action No. 07-cv-01373-RPM). On July 6, 2007, the court entered a final judgment against Bolding which permanently enjoined Bolding, by consent, from future violations of Exchange Act Rule 13b2-1, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1 and 13a-13. Bolding was also ordered to disgorge (a) $345,790, plus prejudgment interest of $129,816, and (b) $117,207, representing the market value, determined as of the date the Commission accepts Bolding's settlement offer, of 4,341 shares of ConAgra common stock; and to pay a $125,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Bolding directed ConAgra's improper accounting for excess reserves in fiscal year 2000, that he did not ensure that ConAgra properly accounted for its income tax expense in fiscal year 1999 and that he should have known that the ConAgra's disclosure in note 14 to the financial statements regarding the reduction of its income tax expense in its Form 10-K for fiscal year 1999 was inaccurate. The complaint also alleged that Bolding knew, or should have known, about ConAgra's improper accounting for excess reserves in fiscal year 2001. Further, the complaint alleged that Bolding was aware about improper accounting practices at United Agri Products ("UAP"), a subsidiary of ConAgra, involving the improper recognition of revenue and the failure to record adequate bad debt expense in fiscal year 2000. According to the allegations in the complaint, as a result of the improper accounting, which was not in accordance with Generally Accepted Accounting Principles ("GAAP"), certain of ConAgra's filings with the Commission between fiscal year 1999 and the third quarter of fiscal year 2001 were materially false and misleading because they overstated ConAgra's reported income before income taxes, net income and earnings per share. In addition,

ConAgra's registration statement related to its proposed merger with International Home Foods, Inc. ("IHF") filed on Forms S-4 and S-4/A in June and July of 2000, respectively, were materially false and misleading. Additionally, the complaint alleged that Bolding violated, and aided and abetted ConAgra's violations of, the provisions of the federal securities laws as noted in Section III.3. above.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Bolding's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Bolding is suspended from appearing or practicing before the Commission as an accountant.

B. After one (1) year from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependant on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934 **CORRECTED**
Release No. 56083 / July 17, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2645 / July 17, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12696

In the Matter of **Ronald Renjilian,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against Ronald Renjilian ("Renjilian") pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act").

II.

In anticipation of the institution of these proceedings, Renjilian has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Renjilian consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

FACTS

On the basis of this Order and Renjilian's Offer, the Commission finds[1] that:

A. Respondent

Renjilian, age 47, resides in Lafayette, Colorado. He was Head of Emerging Market Sales at Quovadx from November 2002 until April 2004. Renjilian is currently self-employed.

B. Related Party

Quovadx, Inc. ("Quovadx"), a Delaware corporation based in Englewood, Colorado, is a software company that sells software licenses and related services to the health care industry. Quovadx's stock was registered with the Commission under Section 12(g) of the Exchange Act during the relevant period and traded on the NASDAQ National Market. During 2002 and 2003, Quovadx derived about one-third of its reported revenue from sales of software licenses, with the rest coming from maintenance and service contracts. Quovadx separately reported its software licensing revenue, which included sales of both software and licenses.[2]

C. Summary

Between 2002 and 2003, Quovadx improperly recognized over $12 million in revenue from software licensing deals with four of its customers and materially overstated its software licensing revenues in its filings with the Commission. As a result of these transactions, Quovadx violated the reporting provisions of the Exchange Act. Renjilian was involved in the negotiations for Quovadx in connection with the transactions involving two of the four customers, Sourceworks and Infotech, and knew or should have known that Quovadx could not have recognized revenue from these transactions. Accordingly, Renjilian was a cause of Quovadx's reporting violations.

On March 15, 2004, when it could not collect payment from Infotech for transactions it had previously booked as revenue, Quovadx announced that it would restate its prior results to decrease revenue by approximately $11 million. Quovadx's stock price fell 29%, and dropped further after Quovadx announced on May 13, 2004, that it was reviewing two additional contracts. By August 16, 2004, when Quovadx restated its results for the second time to correct for additional transactions, including Sourceworks, Quovadx's stock was trading at $1.65 per share.

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1 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

2 Throughout this Order, "software sales" and "software license sales" are used interchangeably.

D. Applicable Accounting Principles for Software Sales

As a public company, Quovadx was required to file quarterly and annual reports with the Commission that presented its financial results in conformity with Generally Accepted Accounting Principles ("GAAP"). AICPA Statement of Position 97-2, *Software Revenue Recognition* ("SOP 97-2") governs the recognition of revenue for sales of software and software licenses.

Under SOP 97-2, a company may not recognize revenue from a software license sale unless and until there is: persuasive evidence of an arrangement; delivery of the software; a fixed or determinable seller's fee; and a reasonable probability of collecting the accounts receivable. Further, if payment is substantially contingent on the buyer's success in distributing the product to the end user, either due to the terms of the deal or because the buyer is so undercapitalized that it cannot pay until it sells the product, the seller may not recognize the software license revenue at the time of sale.

Between 2002 and 2003, in a series of transactions with four different customers, Quovadx recognized revenue that was not in conformity with SOP 97-2 and that materially overstated the company's financial results.

E. The Sourceworks Transaction

In early 2003, Renjilian solicited the Veterans' Administration ("VA") to buy licenses for Quovadx's Insurenet software, a product for processing patient medical insurance information. The VA refused to buy the licenses, but expressed an interest in using the software and periodically paying Quovadx a fee based on the number of insurance transactions that it processed. Quovadx was not interested in this proposal. Renjilian therefore suggested a plan, approved by members of Quovadx's then senior management, whereby Quovadx would sell the licenses to a third-party, which would then enter into a contract with the VA to offer the software on a per-use basis.

Renjilian then contacted a Colorado-based venture capital firm and proposed that the firm buy the Insurenet licenses from Quovadx. Renjilian told the venture capital firm that, in return, Quovadx would negotiate a contract for the venture capital firm to license the software on a per-use basis to the VA. As the end of the second quarter of 2003 approached, the venture capital firm agreed in principle to this proposal. However, because it was not a software reseller, the firm repeatedly said that it would not pay for the Insurenet licenses unless and until Quovadx obtained the promised user contract. Renjilian expressed confidence that Quovadx would obtain the contract with the VA early in the third quarter. With that understanding, the venture capital firm created a company, Sourceworks USA LLC, in late June 2003 to buy the Insurenet licenses from Quovadx and enter into the user contract with the VA. On June 30, 2003, Quovadx and Sourceworks executed a contract requiring Sourceworks to pay Quovadx $600,000 for the Insurenet licenses. The contract, which gave Sourceworks six months to pay Quovadx, did not indicate that Sourceworks' payment to Quovadx was contingent upon Quovadx successfully negotiating a VA deal for Sourceworks.

Despite the fact that Sourceworks presented financial statements to Quovadx that showed it could not pay for the Insurenet licenses unless the venture capital firm provided the funds, which in turn depended upon securing the VA contract, Quovadx recognized the entire $600,000 in the second quarter, based upon the June 30, 2003 contract. It issued a press release on July 23, 2003, touting the company's second quarter financial results, which included the Sourceworks revenue. For the next eight months, Quovadx attempted to secure a contract for Sourceworks. However, these negotiations ultimately failed. As a result, other than one $30,000 payment in August 2003, Sourceworks did not pay Quovadx for the Insurenet licenses.[3] Because Sourceworks did not pay the remaining $570,000, Quovadx's new senior management and auditor reviewed the Sourceworks transaction in the Spring of 2004 and reversed the revenue as part of the company's second restatement.

As a result of its improper recognition of the Sourceworks revenue, Quovadx overstated its software licensing revenues by $570,000, or approximately 9%, in the second quarter of 2003.[4]

F. The Infotech Transactions

In the third and fourth quarters of 2003, Quovadx improperly recognized a total of $11.1 million in software licensing revenue from a series of transactions with Infotech Network Group ("Infotech"), a company based in India.[5] Because each of these transactions had material contingencies and the collection of payment was not probable, Quovadx was precluded from recognizing this revenue. Moreover, even after Infotech did not pay for its third quarter 2003 purchases, Quovadx shipped additional software to Infotech and recognized revenue on those sales in the fourth quarter of 2003. Renjilian was involved in negotiating these deals with Infotech and knew or should have known about the material contingencies and the improbability of collecting payment from Infotech.

1. The Third Quarter Transactions

In early September 2003, Quovadx and Infotech executed two related agreements. Under the first ("the distributor agreement"), Infotech agreed to buy $5 million of software licenses from Quovadx and to be the exclusive distributor of Quovadx products in India. Under the second agreement ("the outsourcing agreement"), Quovadx agreed to pay Infotech to perform certain services and conduct various research and development projects, pursuant to Statements of Work that would be subsequently negotiated. The agreements required both parties to fund letters-of-credit to guarantee the payment of their respective obligations. The

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3 Sourceworks has since demanded that Quovadx return the $30,000; Quovadx has not done so. Sourceworks, in turn, has rejected Quovadx's demand for payment of the $570,000 balance due on the purchase of the licenses.

4 Quovadx overstated its software licensing revenue in its July 23, 2003, Form 8-K, which incorporated its preliminary earnings results, its quarterly report for the second quarter of 2003, and its annual report for 2003.

5 Infotech Network Group represented itself to Quovadx as a consortium of major Indian companies that sought outsourced research and development projects from U.S. software companies.

distributor agreement required that Infotech fund a $5.46 million letter-of-credit before Quovadx shipped any software to it.

As required by the outsourcing agreement, Quovadx immediately funded a letter-of-credit for $2.46 million to pay Infotech as it rendered outsourcing services. By mid-September, Infotech had not funded its letter-of-credit. Quovadx nevertheless shipped the $5 million of software licenses to Infotech. In an attempt to meet Quovadx's quarterly revenue goals, Renjilian was directed to solicit Infotech to buy more software licenses before the end of the third quarter. Infotech agreed to do so, on the condition that Quovadx guarantee pre-payment of outsourcing funds. On September 30, 2003, the parties signed supplemental contracts under which Infotech was to buy $2.1 million of software licenses and Quovadx was to pre-pay Infotech over $1 million for unspecified outsourcing work. Quovadx shipped the additional $2.1 million in software to Infotech on the last day of the quarter. Quovadx, with the concurrence of its outside auditor, offset the revenue from these two purported sales by its estimated outsourcing obligation to Infotech and recognized approximately $4.6 million in revenue for the quarter. Quovadx planned to recognize the remaining revenue as Infotech performed outsourcing services.

In early October 2003, before Quovadx filed its quarterly report for the third quarter, Infotech told Renjilian and others at Quovadx that it did not have enough money to fund its required letters-of-credit. Quovadx agreed to wire $410,000 to assist Infotech in making a margin payment to an Indian bank, purportedly to establish and fund the required letters-of-credit.[6] In return, Infotech gave Quovadx a letter from the Indian bank expressing confidence that Infotech's letter of credit would be opened (not funded) by October 21, 2003. Quovadx relied on this letter as support for Infotech's supposed ability to pay and recognized revenue on the third quarter Infotech transactions.

On October 22, 2003, Quovadx issued both a press release announcing the distribution and software development agreement with Infotech and a preliminary earnings release touting a 183% increase in software licensing revenue over the third quarter of 2002. The Infotech transaction accounted for approximately 60% of Quovadx's reported third quarter software licensing revenue. Quovadx's share price increased over 25% on the news of the third quarter results.

2. <u>The Fourth Quarter Transactions</u>

By mid-December 2003, although it appeared to Quovadx that Infotech had established one letter-of-credit, Infotech still had not funded the required letters-of-credit and had not paid for either of its third quarter purchases. Infotech told Renjilian that the software had still not been released from customs in India, which Infotech claimed was necessary before it could fund its letter-of-credit. Despite these significant issues, Quovadx, hoping to meet Wall Street expectations, asked Infotech to make another software purchase. Infotech told Renjilian that it was unwilling to agree to another software purchase unless Quovadx immediately wired

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6 In fact, unbeknownst to Quovadx, Infotech never used the money to establish and fund a letter-of-credit.

$500,000 to it as part of the outsourcing prepayment to which Quovadx had committed at the end of the third quarter. Quovadx made this payment, even though Infotech had not met the conditions for prepayment under the outsourcing agreement for $440,000 of this amount. To preserve its legal remedies, Quovadx also sent Infotech a default letter for failing to pay for its third quarter purchases. Thus, by mid-December Quovadx had sent $910,000 to Infotech, yet Infotech had not paid for any of the software licenses that it had bought from Quovadx.[7]

On December 31, 2003, Infotech signed a contract, to buy $6.5 million of software licenses from Quovadx. Quovadx simultaneously signed a supplemental agreement to pay Infotech up to $1.94 million for any outsourcing work that Infotech actually performed through August 2004. Renjilian negotiated both contracts on behalf of Quovadx. Quovadx also provided Infotech assurances that it would increase Quovadx's outsourcing to Infotech significantly over the coming year.

On February 11, 2004, Quovadx issued its preliminary fourth quarter earnings release (attached to a Form 8-K filed the same day), which included the $6.5 million in Infotech revenue. Quovadx issued this release even though Infotech had not paid for the third quarter purchases and Infotech's ability to pay for the fourth quarter purchases depended on its ability to resell the software licenses. The earnings release claimed that Quovadx's total annual revenue for 2003 had increased about 30% and that its year-over-year software licensing revenue had grown about 173%. The Infotech transactions accounted for virtually the entire increase in Quovadx's software licensing revenue. After this announcement, Quovadx's stock price increased by about 10%, closing at $6.66 per share on February 12.

At the time of Quovadx's year-end audit in mid-February 2004, Infotech still had not funded a letter-of-credit or made any payments for either the third or fourth quarter software purchases. In early March 2004, Quovadx's auditor advised it that the company would have to reverse the Infotech revenue from both the third and fourth quarters unless Infotech made a substantial payment before Quovadx's annual report was due to be filed. On March 8, 2004, therefore, Quovadx, following negotiations in which Renjilian participated, authorized Infotech to draw down the $1.94 million balance on Quovadx's outsourcing letter-of-credit, with the understanding that Infotech would use these funds to arrange bank financing to pay Quovadx for the software purchases. Immediately after receiving the $1.94 million, Infotech told Quovadx that it believed it was entitled to this money under the outsourcing agreement and would not use it to pay Quovadx for the software. When Quovadx requested that Infotech return the money, Infotech refused. Infotech never returned the money or paid for the software.

On March 15, 2004, Quovadx announced that it would reverse all revenue on sales to Infotech in the third and fourth quarters of 2003. On March 18, Quovadx filed its annual report for 2003 which restated its financial results for the third and fourth quarters of 2003 and removed $11.1 million in revenue from transactions with Infotech. In response to these events, the Quovadx board of directors commenced an investigation into the Infotech relationship which

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[7] During the fourth quarter, Quovadx provided Infotech with about $10,000 in outsourcing work, and trained some Infotech subcontractors on the use of Quovadx software. Infotech eventually performed outsourcing work for Quovadx worth about $500,000 based on the December 2003 prepayments.

subsequently encompassed two other transactions, including Sourceworks. Shortly thereafter, Quovadx's chief executive officer and chief financial officer resigned. On May 14, 2004, Quovadx filed a Form 8-K in which it indicated that, as a result of its internal investigation, Quovadx had discontinued any further severance payments to its former chief executive officer and chief financial officer and demanded the return of severance payments already paid and prior compensation, including bonuses. Quovadx also indicated that it had terminated its executive vice president of sales.

IV.

LEGAL CONCLUSIONS

Reporting Violations

Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder require that issuers with securities registered under Section 12 of the Exchange Act, such as Quovadx, file annual and quarterly reports with the Commission and keep this information current. These reports must be complete and accurate in all material respects. *United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Rule 12b-20 of the Exchange Act requires that an issuer's periodic reports include any additional information "necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." The issuer's legal obligation "extends not only to accurate quantitative reporting of the required items in its financial statements, but also to other information, qualitative as well as quantitative, needed to enable investors to make informed decisions." *In re Sony Corp. and Sumio Sano*, 67 SEC Docket 1609, 1998 WL 439898 at *4 (Aug. 5, 1998).

Quovadx improperly recognized revenue from the transactions with Sourceworks and Infotech. As a result, Quovadx's annual report for 2003, quarterly reports for the second and third quarters of 2003, and earning releases for the second, third, and fourth quarters of 2003 contained materially false and misleading statements concerning Quovadx's software licensing revenue. Accordingly, Quovadx violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

Because he was involved in negotiating the transaction with Sourceworks, Renjilian knew or should have known that Sourceworks could not and would not pay for the Insurenet software license unless and until Quovadx negotiated a contract between Sourceworks and the VA for the use of the software. Similarly, Renjilian was involved in negotiating the deals between Quovadx and Infotech in third and fourth quarters of 2003. Renjilian was also aware that Infotech had not funded the required letters-of-credit for these purchases and, accordingly, knew or should have known that Quovadx was not reasonably likely to collect payment from Infotech. Accordingly, Renjilian was a cause of Quovadx's violations of Sections 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

V.

FINDINGS

Based on the foregoing, the Commission finds that Renjilian was a cause of Quovadx's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

VI.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Renjilian's Offer.

Accordingly, **IT IS HEREBY ORDERED** that:

Pursuant to Section 21C of the Exchange Act, Renjilian cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56084 / July 17, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2639 / July 17, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12697

In the Matter of **Paul Anthony Davis,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against Paul Anthony Davis ("Davis") pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act").

II.

In anticipation of the institution of these proceedings, Davis has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Davis consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

FACTS

On the basis of this Order and Davis' Offer, the Commission finds[1] that:

A. Respondent

Davis, age 41, resides in Lafayette, Colorado. Davis is a founding partner of a venture capital firm located in Boulder, Colorado. In June 2003, Davis facilitated the creation of a company, Sourceworks USA LLC ("Sourceworks"), to enter into a software license transaction with Quovadx, Inc.

B. Related Party

Quovadx, Inc. ("Quovadx"), a Delaware corporation based in Englewood, Colorado, is a software company that sells software licenses and related services to the health care industry. Quovadx's stock was registered with the Commission under Section 12(g) of the Exchange Act during the relevant time and traded on the NASDAQ National Market. During 2002 and 2003, Quovadx derived about one-third of its reported revenue from sales of software licenses, with the rest coming from maintenance and service contracts. Quovadx separately reported its software licensing revenue, which included sales of both software and licenses.[2]

C. Summary

In the second quarter of 2003, Quovadx improperly recognized approximately $570,000 in software licensing revenue from the purported sale of software licenses to Sourceworks. Sourcework's payment for that software was contingent upon Quovadx securing a contract for Sourceworks with the anticipated end-user of the software. As a result of this transaction, Quovadx materially overstated its software licensing revenue by over 9% for the second quarter of 2003 and violated the reporting provisions of the Exchange Act. On August 16, 2004, Quovadx restated its financial results to correct for the Sourceworks transaction, among others. Davis negotiated with Quovadx on behalf of Sourceworks and knew or should have known that Quovadx could not have recognized revenue from this transaction. Accordingly, Davis was a cause of Quovadx's reporting violations.

D. Applicable Accounting Principles for Software Sales

As a public company, Quovadx was required to file quarterly and annual reports with the Commission that presented its financial results in conformity with Generally Accepted Accounting Principles ("GAAP"). AICPA Statement of Position 97-2, *Software Revenue Recognition* ("SOP 97-2") governs the recognition of revenue for sales of software and software licenses.

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1 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

2 Throughout this Order, "software sales" and "software license sales" are used interchangeably.

Under SOP 97-2, a company may not recognize revenue from a software license sale unless and until there is: persuasive evidence of an arrangement; delivery of the software; a fixed or determinable seller's fee; and a reasonable probability of collecting the accounts receivable. Further, if payment is substantially contingent on the buyer's success in distributing the product to the end user, either due to the terms of the deal or because the buyer is so undercapitalized that it cannot pay until it sells the product, the seller may not recognize the software license revenue at the time of sale.

In the second quarter of 2003, Quovadx recognized revenue from a transaction with Sourceworks that did not conform to SOP 97-2 and that materially overstated the company's financial results.

E. The Sourceworks Transaction

In early 2003, a senior salesperson at Quovadx solicited the Veterans' Administration ("VA") to buy licenses for Quovadx's Insurenet software, a product for processing patient medical insurance information. The VA refused to buy the licenses, but expressed an interest in using the software and periodically paying Quovadx a fee based on the number of insurance transactions that it processed. Quovadx was not interested in this proposal. The Quovadx salesperson therefore suggested a plan, approved by members of Quovadx's then senior management, whereby Quovadx would sell the licenses to a third-party, which would then enter into a contract with the VA to offer the software on a per-use basis.

The Quovadx salesperson then contacted Davis, a partner of a Colorado-based venture capital firm, and proposed that Davis' firm buy the Insurenet licenses from Quovadx. The Quovadx salesperson told Davis that, in return, Quovadx would negotiate a contract for the firm to license the software on a per-use basis to the VA. As the end of the second quarter of 2003 approached, Davis agreed in principle to this proposal. However, because the venture capital firm was not a software reseller, Davis said that the firm would not pay for the Insurenet licenses unless and until Quovadx obtained the promised user contract. The Quovadx salesperson expressed confidence that Quovadx would obtain the contract with the VA early in the third quarter. With that understanding, Davis facilitated the creation of a company, Sourceworks USA LLC, in late June 2003 to buy the Insurenet licenses from Quovadx and enter into the user contract with the VA. On June 30, 2003, Quovadx and Sourceworks executed a contract requiring Sourceworks to pay Quovadx $600,000 for the Insurenet licenses. The contract, which gave Sourceworks six months to pay Quovadx, did not indicate that Sourceworks' payment to Quovadx was contingent upon Quovadx successfully negotiating a VA deal for Sourceworks.

Despite the material contingency to the Sourceworks transaction, Quovadx recognized the entire $600,000 in the second quarter, based upon the June 30, 2003 contract. It issued a press release on July 23, 2003, touting the company's second quarter financial results, which included the Sourceworks revenue. For the next eight months, Quovadx attempted to secure a contract for Sourceworks. However, these negotiations ultimately failed. As a result, other than one $30,000 payment in August 2003, Sourceworks did not pay Quovadx for the Insurenet licenses.[3] Because Sourceworks did not pay the remaining $570,000, Quovadx's new senior management and auditor reviewed the Sourceworks transaction in the Spring of 2004 and reversed the revenue as part of a restatement on August 14, 2004.

As a result of its improper recognition of the Sourceworks revenue, Quovadx overstated its software licensing revenues by $570,000, or approximately 9%, in the second quarter of 2003.[4]

IV.

LEGAL CONCLUSIONS

Reporting Violations

Section 13(a) of the Exchange Act and Rules 13a-11, and 13a-13 thereunder require that issuers with securities registered under Section 12 of the Exchange Act, such as Quovadx, file quarterly reports with the Commission and keep this information current. These reports must be complete and accurate in all material respects. *United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Rule 12b-20 of the Exchange Act requires that an issuer's periodic reports include any additional information "necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." The issuer's legal obligation "extends not only to accurate quantitative reporting of the required items in its financial statements, but also to other information, qualitative as well as quantitative, needed to enable investors to make informed decisions." *In re Sony Corp. and Sumio Sano*, 67 SEC Docket 1609, 1998 WL 439898 at *4 (Aug. 5, 1998).

Quovadx improperly recognized revenue from the transaction with Sourceworks. As a result, Quovadx's quarterly report for the second quarter of 2003 and its earnings release for the second quarter of 2003 (attached to the Form 8-K that Quovadx filed with the Commission on July 24, 2003) contained materially false and misleading statements concerning Quovadx's software licensing revenue. Accordingly, Quovadx violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

Because he was involved in negotiating the Sourceworks transaction with Quovadx, Davis knew or should have known that the Sourceworks contract did not reflect the material contingency that existed in the deal – namely, that Sourceworks could not and would not pay for the Insurenet software license unless and until Quovadx negotiated the VA contract. Accordingly, Davis was a cause of Quovadx's violations of Sections 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

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[3] Sourceworks has since demanded that Quovadx return the $30,000; Quovadx has not done so. Sourceworks, in turn, has rejected Quovadx's demand for payment of the $570,000 balance due on the purchase of the licenses.

[4] Owing to the Sourceworks transaction, Quovadx overstated its software licensing revenue in its July 23, 2003, Form 8-K, which incorporated its preliminary earnings results and its quarterly report for the second quarter of 2003 filed with the Commission on August 5, 2003.

V.

FINDINGS

Based on the foregoing, the Commission finds that Davis was a cause of Quovadx's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

VI.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Davis' Offer.

Accordingly, **IT IS HEREBY ORDERED** that:

Pursuant to Section 21C of the Exchange Act, Davis cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8825 / July 17, 2007

CORRECTED

SECURITIES EXCHANGE ACT OF 1934
Release No. 56082 / July 17, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2644 / July 17, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12695

In the Matter of **QUOVADX, INC.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against Quovadx, Inc. ("Quovadx") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act").

II.

In anticipation of the institution of these proceedings, Quovadx has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings which are admitted, Quovadx consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

FACTS

On the basis of this Order and Quovadx's Offer, the Commission finds[1] that:

A. Respondent

Quovadx, a Delaware corporation based in Englewood, Colorado, is a software company that licenses software and sells related services to the healthcare industry. Quovadx's stock was registered with the Commission under Section 12(g) of the Exchange Act during the relevant time and traded on the NASDAQ National Market. During 2002 and 2003, Quovadx derived about one-third of its reported revenue from software licensing fees, with the rest coming from software maintenance and service contracts. Quovadx separately reported its software licensing revenue, which included sales of both software and licenses.[2] During the relevant period, Quovadx had a continuously effective offering of securities pursuant to Form S-8. It also registered an offer of securities pursuant to Form S-4 in the fourth quarter of 2003.

B. Summary

Between 2002 and 2003, Quovadx improperly recognized over $12 million in revenue from software licensing deals with four of its customers in an attempt to meet aggressive revenue and sales goals set by the company. In transactions with three customers - Sourceworks, Microstar, and Infotech - Quovadx's recognition of revenue was fraudulent. In each of these transactions, one or more members of Quovadx's then senior management knowingly or recklessly engaged in the improper revenue recognition and other conduct described herein.[3] In the fourth transaction, Quovadx improperly accelerated recognition of the revenue. As a result, Quovadx materially overstated its software licensing revenues in its quarterly reports by amounts ranging from 10% in the third quarter of 2002 to nearly 180% by the third and fourth quarters of 2003.

On March 15, 2004, when it could not collect payment from Infotech for transactions it had previously booked as revenue, Quovadx announced that it would restate its prior results to decrease revenue by approximately $11 million. Quovadx's stock price fell 29%, and dropped further after Quovadx announced on May 13, 2004, that it was reviewing two additional contracts. By August 16, 2004, when Quovadx restated its results for the second time to correct for the transactions with Sourceworks, MicroStar, and the fourth customer, Quovadx's stock was trading at $1.65 per share.

C. Applicable Accounting Principles for Software Sales

As a public company, Quovadx was required to file quarterly and annual reports with the Commission that presented its financial results in conformity with Generally Accepted

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] Throughout this Order, "software sales" and "software license sales" are used interchangeably.

[3] References below to Quovadx's "management" refer to the former management that departed Quovadx in Spring 2004.

Accounting Principles ("GAAP"). The American Institute of Certified Public Accountants' Statement of Position 97-2, *Software Revenue Recognition* ("SOP 97-2") and related interpretations are the principal GAAP provisions governing the recognition of revenue for sales of software and software licenses. Under SOP 97-2, a company may not recognize revenue from a software license sale unless and until there is: persuasive evidence of an arrangement; delivery of the software; a fixed or determinable seller's fee; and a reasonable probability of collecting the accounts receivable. Further, if payment is substantially contingent on the buyer's success in distributing the product to the customer, either due to the terms of the deal or because the buyer is so undercapitalized that it cannot pay until it sells the product, the seller may not recognize the software license revenue at the time of sale.

In its financial reports filed with the Commission, Quovadx claimed that it had recognized revenue in accordance with GAAP. Between 2002 and 2003, in a series of transactions with four different customers, however, Quovadx recognized revenue that was not in conformity with SOP 97-2 and that materially overstated the company's financial results.

D. The Sourceworks Transaction

In early 2003, Quovadx solicited the Veterans' Administration ("VA") to buy licenses for Quovadx's Insurenet software, a product for processing patient medical insurance information. The VA refused to buy the licenses, but expressed an interest in using the software and periodically paying Quovadx a fee based on the number of insurance transactions that it processed. Quovadx was not interested in this proposal because it did not want to license software on a per-use basis. Quovadx therefore developed a plan whereby Quovadx would sell the licenses to a third party, which would then enter into a contract with the VA to offer the software on a per-use basis.

A Quovadx employee contacted a Colorado-based venture capital firm and proposed that the firm buy the Insurenet licenses from Quovadx. In return, Quovadx would negotiate a contract for the venture capital firm to license the software on a per-use basis to the VA. As the end of the second quarter of 2003 approached, the venture capital firm agreed in principle to Quovadx's proposal. However, because it was not a software reseller, the firm repeatedly said that it would not pay for the Insurenet licenses unless and until Quovadx obtained the promised user contract with the VA. The Quovadx employee expressed confidence that it would obtain the contract with the VA early in the third quarter. With that understanding, the venture capital firm created a shell company, Sourceworks USA LLC, in late June 2003 to buy the Insurenet licenses from Quovadx and enter into the user contract with the VA. On June 30, 2003, Quovadx and Sourceworks executed a contract requiring Sourceworks to pay Quovadx $600,000 for the Insurenet licenses. The contract, which gave Sourceworks six months to pay Quovadx, did not indicate that Sourceworks' ability to pay Quovadx was contingent upon Quovadx successfully negotiating a VA deal for Sourceworks.

Quovadx knew or was reckless in not knowing that Sourceworks could not pay for the licenses unless the venture capital firm provided the funds or the VA contract was secured.[4] Nevertheless, Quovadx recognized the entire $600,000 in the second quarter, based upon the

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4 Sourceworks USA LLC was formed as a subsidiary of Sourceworks Consulting, a Canadian firm. Sourceworks Consulting supplied incomplete and unaudited financial statements to Quovadx that did not support a conclusion that either the parent or the subsidiary Sourceworks could pay for the Insurenet licenses.

June 30, 2003 contract. It issued a press release on July 23, 2003, touting the company's second quarter financial results, which included the Sourceworks revenue. For the next eight months, Quovadx attempted to secure a contract between Sourceworks and the VA. However, these negotiations ultimately failed. As a result, other than one $30,000 payment in August 2003, Sourceworks did not pay Quovadx for the Insurenet licenses.[5] Because Sourceworks did not pay the remaining $570,000, Quovadx's new senior management and auditor reviewed the Sourceworks transaction in the Spring of 2004 and reversed the revenue as part of the company's second restatement.

As a result of its fraudulent recognition of the Sourceworks revenue, Quovadx overstated its software licensing revenues by $570,000, or approximately 9%, in the second quarter of 2003.[6]

E. <u>The MicroStar Transactions</u>

In the third quarter of 2003, Quovadx fraudulently recognized $380,000 in software licensing revenue from three purported sales of licenses to MicroStar, Inc. ("MicroStar"), an Ohio company that sells software licenses and maintenance services to the healthcare industry. The sales were, in fact, part of a parking arrangement designed to accelerate revenue recognition from other transactions that Quovadx was in the process of negotiating, but had been unable to finalize before the end of the quarter. Quovadx carried out this arrangement in an attempt to meet its third quarter sales targets. Quovadx knew or recklessly disregarded that MicroStar was merely holding the licenses in its inventory so that Quovadx could recognize revenue on their "sale." MicroStar had no ability or intent to pay for the licenses unless Quovadx found customers to which MicroStar could resell the licenses. Therefore, Quovadx should not have recorded the transactions as revenue.

In late September 2003, shortly before the close of the third quarter, MicroStar and Quovadx signed three separate software license purchase contracts with a total value of about $380,000. Quovadx and MicroStar simultaneously reached a side-agreement that MicroStar did not have to pay Quovadx for the licenses until Quovadx finalized sales of those licenses to three anticipated customers with whom Quovadx had already been negotiating. Under the side-agreement, Quovadx gave MicroStar a discount on the license price in exchange for holding the licenses in MicroStar's inventory. Certain senior management at Quovadx became aware of this arrangement with MicroStar before the end of the third quarter. Nevertheless, Quovadx treated the MicroStar contracts as bona fide sales agreements and recorded $380,000 of revenue in the third quarter. Quovadx issued a preliminary earnings release and a quarterly report for the third quarter of 2003 that included the revenue from the arrangement with MicroStar.

In fact, MicroStar was unwilling or unable to pay for the licenses unless and until it was able to resell them to the customers with whom Quovadx had been negotiating. Shortly after Quovadx filed its quarterly report, the company learned that MicroStar had not paid for any of the software licenses because the anticipated customers had declined to buy the licenses from

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5 Sourceworks has since demanded that Quovadx return the $30,000; Quovadx has not done so. Sourceworks, in turn, has rejected Quovadx's demand for payment of the $570,000 balance due on the purchase of the licenses.

6 Quovadx overstated its software licensing revenue in its July 23, 2003, Form 8-K, which incorporated its preliminary earnings results, its quarterly report for the second quarter of 2003, and its annual report for 2003.

MicroStar. Quovadx did not reverse the MicroStar revenue, but instead Quovadx's sales staff attempted to find alternative customers to buy the software licenses from MicroStar. Quovadx's sales staff was unable to find other buyers.

In December 2003, one of the three anticipated customers purchased different software licenses for approximately $257,000 from a Quovadx subsidiary in the United Kingdom. In February 2004, when the customer made payment, the U.K. subsidiary, at Quovadx's direction, reversed the transaction from its books and sent the approximately $257,000 to Quovadx's U.S. offices. Quovadx then wired this money to MicroStar with the instruction that MicroStar would wire it back to Quovadx, less $10,000 as payment to MicroStar. MicroStar wired the money less its payment. By channeling the payment through MicroStar, Quovadx created the false appearance that MicroStar had paid a significant portion of what it owed. Quovadx's employees also continued unsuccessfully to search for additional opportunities to channel software license sales through MicroStar to eliminate the remaining balance. In August 2004, Quovadx reversed all three software license sales to MicroStar as part of its second restatement.[7]

F. **The Infotech Transactions**

In the third and fourth quarters of 2003, Quovadx fraudulently recognized a total of $11.1 million in software licensing revenue from a series of transactions with Infotech Network Group ("Infotech"), a company based in India.[8] Because each of these transactions had material contingencies and the collection of payment was not probable, Quovadx was precluded from recognizing this revenue. Moreover, even after Infotech did not pay for its third quarter 2003 purchases, Quovadx shipped additional software to Infotech and recognized revenue on those sales in the fourth quarter of 2003.

1. **The Third Quarter Transactions**

In early September 2003, Quovadx and Infotech executed two related agreements. Under the first ("the distributor agreement"), Infotech agreed to buy $5 million of software licenses from Quovadx and to be the exclusive distributor of Quovadx products in India. Under the second agreement ("the outsourcing agreement"), Quovadx agreed to pay Infotech to perform certain services and conduct various research and development projects, pursuant to Statements of Work that would be subsequently negotiated. The agreements required both parties to fund letters-of-credit to guarantee the payment of their respective obligations. The distributor agreement required that Infotech fund a $5.46 million letter-of-credit before Quovadx shipped any software to it.

As required by the outsourcing agreement, Quovadx immediately funded a letter-of-credit for $2.46 million to pay Infotech as it rendered outsourcing services. By mid-September, however, Infotech had not funded its letter-of-credit. Quovadx nevertheless shipped the $5 million of software licenses to Infotech. In an attempt to meet its third quarter revenue goals, Quovadx also asked Infotech to buy more software. Infotech agreed, on the condition that

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7 Quovadx overstated its software licensing revenue by $380,000 in its October 22, 2003, Form 8-K incorporating its preliminary earnings results, its quarterly report for the third quarter of 2003, and its annual report for 2003.

8 Infotech Network Group represented itself to Quovadx as a consortium of major Indian companies that sought outsourced research and development projects from U.S. software companies.

Quovadx guarantee pre-payment of outsourcing funds. On September 30, 2003, the parties signed supplemental contracts under which Infotech was to buy $2.1 million of software licenses and Quovadx was to pre-pay Infotech approximately $1 million for unspecified outsourcing work. Quovadx shipped the additional $2.1 million in software to Infotech on the last day of the quarter. Quovadx, with the concurrence of its outside auditor, offset the revenue from these two purported sales by its estimated outsourcing obligation to Infotech and recognized approximately $4.6 million in revenue for the quarter. Quovadx planned to recognize the remaining revenue as Infotech performed outsourcing services.

In early October 2003, before Quovadx filed its quarterly report for the third quarter, Infotech told Quovadx that it did not have enough money to fund its required letters-of-credit. Quovadx agreed to wire $410,000 to assist Infotech in making a margin payment to an Indian bank, purportedly to establish and fund the required letters of credit.[9] In return, Infotech gave Quovadx a letter from the Indian bank expressing confidence that Infotech's letter-of-credit would be opened (not funded) by October 21, 2003. Quovadx relied on this letter as support for Infotech's supposed ability to pay and recognized revenue on the third quarter Infotech transactions. Quovadx falsely entered the $410,000 payment to Infotech in its books and records as a prepayment under the outsourcing agreements, when in fact Infotech had not satisfied the conditions for prepayment.

On October 22, 2003, Quovadx issued both a press release announcing the distribution and software development agreement with Infotech and a preliminary earnings release touting a 183% increase in software licensing revenue over the third quarter of 2002. The Infotech transaction accounted for approximately 60% of Quovadx's reported third quarter software licensing revenue. Quovadx's share price increased over 25% on the news of the third quarter results.

2. The Fourth Quarter Transactions

By mid-December 2003, although it appeared to Quovadx that Infotech had established one letter-of-credit, Infotech still had not funded this letter-of-credit and had not paid for either of its third quarter purchases. Infotech told Quovadx that the software had still not been released from customs in India, which Infotech claimed was necessary before it could fund its letter-of-credit. Despite these significant issues, Quovadx, hoping to meet Wall Street expectations, asked Infotech to make another software purchase. Infotech was unwilling to agree unless Quovadx immediately wired $500,000 to it as part of the outsourcing prepayment to which Quovadx had committed at the end of the third quarter. Quovadx made this payment, even though Infotech had not met the conditions for prepayment under the outsourcing agreement for $440,000 of this amount. To preserve its legal remedies, Quovadx also sent Infotech a default letter for failing to pay for its third quarter purchases. Thus, by mid-December, Quovadx had sent $910,000 to Infotech, yet Infotech had not paid for any of the software licenses that it had bought from Quovadx.[10]

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9 In fact, unbeknownst to Quovadx, Infotech never used the money to establish and fund a letter-of-credit.

10 During the fourth quarter, Quovadx provided Infotech with about $10,000 in outsourcing work, and trained some Infotech subcontractors on the use of Quovadx software. Infotech eventually performed outsourcing work for Quovadx worth about $500,000 based on the December 2003 prepayments.

On December 31, 2003, Quovadx signed a contract to sell $6.5 million of software licenses to Infotech. Quovadx simultaneously signed a supplemental agreement to pay Infotech up to $1.94 million for any outsourcing work that Infotech actually performed through August 2004. Quovadx also provided Infotech assurances that it would increase Quovadx's outsourcing to Infotech significantly over the coming year.

On February 11, 2004, Quovadx issued its preliminary fourth quarter earnings release (attached to a Form 8-K filed the same day), which included the $6.5 million in Infotech revenue. Quovadx issued this release even though Infotech had not paid for the third quarter purchases and Infotech's ability to pay for the fourth quarter purchases depended on its ability to resell the software licenses. The earnings release claimed that Quovadx's total annual revenue for 2003 had increased about 30% and that its year-over-year software licensing revenue had grown about 173%. The Infotech transactions accounted for virtually the entire increase in Quovadx's software licensing revenue. After this announcement, Quovadx's stock price increased by about 10%, closing at $6.66 per share on February 12.

At the time of Quovadx's year-end audit in mid-February 2004, Infotech still had not funded a letter-of-credit or made any payments for either the third or fourth quarter software purchases. In early March 2004, Quovadx's auditor advised it that the company would have to reverse the Infotech revenue from both the third and fourth quarters unless Infotech made a substantial payment before Quovadx's annual report was due to be filed. On March 8, 2004, therefore, Quovadx authorized Infotech to draw down the $1.94 million balance on Quovadx's outsourcing letter-of-credit, with the understanding that Infotech would use these funds to arrange bank financing to pay Quovadx for the software purchases. Immediately after receiving the $1.94 million, Infotech told Quovadx that it believed it was entitled to this money under the outsourcing agreement and would not use it to pay Quovadx for the software. When Quovadx requested that Infotech return the money, Infotech refused. Infotech never returned the money or paid for the software.

On March 15, 2004, Quovadx announced that it would reverse all revenue on sales to Infotech in the third and fourth quarters of 2003. On March 18, Quovadx filed its annual report for 2003 which restated its financial results for the third and fourth quarters of 2003 and removed $11.1 million in revenue from transactions with Infotech. In response to these events, the Quovadx board of directors commenced an investigation into the Infotech relationship which subsequently encompassed the Sourceworks and MicroStar transactions. Shortly thereafter, Quovadx's chief executive officer and chief financial officer resigned. On May 14, 2004, Quovadx filed a Form 8-K in which it indicated that, as a result of its internal investigation, Quovadx had discontinued any further severance payments to its former chief executive officer and chief financial officer and demanded the return of severance payments already paid and prior compensation, including bonuses. Quovadx also indicated that it had terminated its executive vice president of sales.

G. Quovadx Prematurely Recognized $250,000 in Revenue in the Third Quarter of 2002

In addition to the software licensing revenue that Quovadx fraudulently recognized in 2003, Quovadx prematurely recognized $250,000 in the third quarter of 2002. In May 2002, Quovadx announced the release of QuickTrials 1.0, a software product designed to help automate the management of clinical drug trials. The following month, Quovadx entered into negotiations to sell QuickTrials for $250,000 to a company that managed clinical trials in the pharmaceutical industry. Because the existing version of QuickTrials did not meet all of the customer's specifications, Quovadx and the customer discussed developing an acceptable version of QuickTrials, to be called QuickTrials 2.0. In early September 2002, Quovadx proposed that the customer pay $250,000 for the platform software needed to run QuickTrials, and that they enter into a partnership to develop QuickTrials 2.0. Quovadx told the customer that it would deliver the platform software in September and the first development (or beta) version of QuickTrials 2.0 in October 2002.

On September 30, 2002, the last day of the third quarter, Quovadx and the customer executed a contract under which Quovadx would provide the company beta versions of QuickTrials 2.0 and a commercial version of that software, if and when released. Further, at the request of the customer, Quovadx extended the payment over eight months, which roughly corresponded to the anticipated completion of the development of QuickTrials 2.0. Despite this extended payment plan and promise to deliver QuickTrials 2.0 in the future if and when Quovadx released it, Quovadx recognized the full $250,000 in revenue in the third quarter of 2002.

In substance, the value of the transaction for the customer lay in obtaining the beta versions of QuickTrials 2.0, not the platform programs delivered in the third quarter.[11] Therefore, Quovadx should not have recognized the revenue from the transaction with the customer until at least the fourth quarter of 2002. By prematurely recognizing this revenue, Quovadx overstated its software revenues for the third quarter of 2002 by approximately 10%. As part of its second restatement, Quovadx reversed the $250,000 in revenue from the third quarter of 2002 and recognized that amount for the fourth quarter of 2002.

IV.

LEGAL CONCLUSIONS

A. Violations of the Antifraud Provisions

Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit a variety of fraudulent practices in connection with the offer, purchase or sale of securities. An issuer violates these provisions when it makes material misstatements or omissions in annual or quarterly reports filed with the Commission, or in earning releases or other public statements. *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998). "Moreover, half-truths are as violative ... as outright falsehoods." *SEC v. Schiffer*, S.D.N.Y. 1998 Fed. Sec. L. Rep. ¶ 90,247, 1998 WL 307375, at *2 (S.D.N.Y.). A fact is material if there is a substantial likelihood that a reasonable investor would consider the information to be important. *Basic v. Levinson*, 485 U.S. 224, 231-32 (1988). Information concerning a company's financial condition and profitability is material information. *See, e.g., SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980). "[E]arnings reports are among the pieces of data that investors find most relevant to their investment decisions." *Ganino v. Citizens Util. Co.*, 228 F.3d 154, 164 (2d Cir. 2000) (citation omitted).

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11 SOP 97-2 provides in pertinent part that: "When-and-if-available deliverables should be considered in determining whether an arrangement includes multiple elements.... If an arrangement includes multiple elements, the fee should be allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated within the contract for each element."

Section 10(b) and Rule 10b-5 of the Exchange Act and Section 17(a)(l) of the Securities Act require that a defendant act with scienter, which has been defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Aaron v. SEC*, 446 U.S. 680, 701-02 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n. 12 (1976). Scienter can be satisfied by showing that a defendant acted recklessly. *See. e.g., ITT v. Cornfeld*, 619 F.2d 909, 923 (2d Cir. 1980); *Schiffer*, 1998 WL 307375, at *3. For the purposes of establishing scienter on the part of a company, the mental state of the company's officers is imputed to the company. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

Quovadx fraudulently recognized revenue on the Sourceworks, MicroStar, and Infotech transactions. In each of those transactions, one or more members of Quovadx's senior management knew, or recklessly disregarded that those transactions either had material contingencies or were not true sales, and collection from the customers was not reasonably probable. Sourceworks could not and would not pay for software licenses unless and until Quovadx secured a contract between Sourceworks and the VA. The arrangement with MicroStar to hold software licenses in MicroStar's inventory had no legitimate business purpose and MicroStar had no intent or ability to pay for the software licenses unless it could resell them to customers identified by Quovadx. Quovadx attempted to disguise this arrangement by funneling an unrelated payment through MicroStar to make it appear that MicroStar had partially paid for the licenses. Finally, Quovadx recognized more than $11 million in revenue on software sales to Infotech, even after the company knew or was reckless in not knowing that it was not reasonably probable that Infotech would pay for the software. Indeed, Quovadx advanced Infotech nearly $1 million as an inducement for Infotech to buy some of the software, even though Infotech had not funded its required letters-of-credit. Further, fearing that its auditor would require it to reverse the Infotech revenue, Quovadx gave Infotech nearly another $2 million in the vain hope that Infotech would use that money to pay some of its debt.

As a result of its improper recognition of revenue from these transactions, Quovadx fraudulently overstated its software licensing revenue by $600,000 in the second quarter of 2003, by almost $5 million in the third quarter of 2003, and by $6.5 million in the fourth quarter of 2003. Moreover, although Quovadx had reversed the Infotech overstatement by the time the company filed its annual report for 2003, that annual report still included the revenue from the Sourceworks and MicroStar transactions. Quovadx also issued false and misleading press releases during the period that materially misrepresented the company's financial results and were attached to the Forms 8-K that Quovadx filed with the Commission in the second, third and fourth quarters of 2003.

As a result of this conduct, Quovadx violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Because Quovadx had a continuously effective offering of securities pursuant to Forms S-8 and S-4 during the period, the company also violated Section 17(a) of the Securities Act.[12]

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[12] In May 2002, Quovadx filed a Form S-8 that became effective to offer stock in connection with the company's employee stock purchase plan (the Form S-8 was incorporated into Quovadx's subsequent annual and quarterly reports). In addition, Quovadx filed a Form S-4 on November 12, 2003, and Amended Forms S-4 on December 4 and December 10, 2003, registering an offer of securities in connection with Quovadx's acquisition of RogueWave Software.

B. Reporting Violations

Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder require that issuers with securities registered under Section 12 of the Exchange Act, such as Quovadx, file annual and quarterly reports with the Commission and keep this information current. These reports must be complete and accurate in all material respects. *United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Rule 12b-20 of the Exchange Act requires that an issuer's periodic reports include any additional information "necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." The issuer's legal obligation "extends not only to accurate quantitative reporting of the required items in its financial statements, but also to other information, qualitative as well as quantitative, needed to enable investors to make informed decisions." *In re Sony Corp. and Sumio Sano*, 67 SEC Docket 1609, 1998 WL 439898 at *4 (Aug. 5, 1998).

Quovadx filed a quarterly report on Form 10-Q for the third quarter of 2002 that overstated the company's software licensing revenue by 10% as a result of the company's premature recognition of revenue from the transaction with the clinical trials manager. Recognition of the $250,000 in revenue in the third quarter did not conform to SOP 97-2, and Quovadx should have deferred recognizing this revenue until a subsequent quarter.

Quovadx entered into transactions with Sourceworks, MicroStar, and Infotech in which Quovadx knew or was reckless in not knowing that revenue should not be recognized. By doing so, Quovadx fraudulently recognized revenue on transactions that were not actual sales. As a result, Quovadx's annual report for 2003, quarterly reports for the second and third quarters of 2003, and earning releases for the second, third, and fourth quarters of 2003 contained materially false and misleading statements concerning Quovadx's software licensing revenue. Accordingly, Quovadx violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

C. Record-Keeping and Internal Controls Violations

Section 13(b)(2)(A) of the Exchange Act requires that issuers make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company. Section 13(b)(2)(B) of the Exchange Act requires reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain accountability of assets.

As discussed above, Quovadx improperly recognized revenue in the third quarter of 2002 from the transaction with the clinical trials manager and, in the second, third and fourth quarters of 2003, from the transactions with Sourceworks, MicroStar, and Infotech. As a result, Quovadx's books and records were materially inaccurate because they overstated software licensing revenue and did not accurately or fairly reflect the transactions of the company. Quovadx also failed to maintain internal controls sufficient to ensure that revenue recognition would occur properly and that its financial statements would be prepared in conformity with GAAP. Therefore, Quovadx violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

V.

FINDINGS

Based on the foregoing, the Commission finds that Quovadx violated Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

VI.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Quovadx's offer.

Accordingly, **IT IS HEREBY ORDERED** that:

Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Quovadx cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant S...

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56081 / July 17, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12694

In the Matter of **Starlite Acquisition Corp.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Starlite Acquisition Corp. ("Starlite" or "Respondent").

II.

In anticipation of the institution of these proceedings, Starlite, has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Starlite consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

On the basis of this Order and the Respondent's Offer, the Commission finds:

1. Starlite (CIK No. 1135786) is a forfeited Delaware corporation located in Dix Hills, New York. At all times relevant to this proceeding, the common stock of Starlite was registered with the Commission under Exchange Act Section 12(g). The company's stock does not publicly trade.

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2. Starlite has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2003.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission deems that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Starlite's, securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Chairman Cox and Commissioner Campos Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56097 / July 18, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2646 / July 18, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12701

In the Matter of **JEFFREY McMAHON, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Jeffrey McMahon ("Respondent" or "McMahon") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Jeffrey McMahon, age 46, is a certified public accountant licensed to practice in the State of Texas. He served as Treasurer of Enron Corp. (Enron), from April 1998 until May 2000, as Chief Financial Officer from October 2001 until February 2002, and as Chief Operating Officer from February 2002 until June 2002, when he voluntarily resigned from Enron.

2. Enron was, at all relevant times, an Oregon corporation with its principal place of business in Houston, Texas. Until its bankruptcy filing in December 2001, Enron was the seventh largest corporation in the United States based on reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. The Company also created and traded financial products. At all relevant times, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Securities and Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange.

3. On July 6, 2007, a final judgment was entered against McMahon, permanently enjoining him from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5 and 13b2-1, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Jeffrey McMahon, Civil Action Number H-07-2051, in the United States District Court for the Southern District of Texas. McMahon also was ordered to pay disgorgement of $109,275, prejudgment interest of $40,725, and a civil money penalty of $150,000.

4. The Commission's complaint alleged, among other things, that McMahon participated in a fraudulent asset parking arrangement that allowed Enron to improperly record $12 million in earnings in the fourth quarter of 1999. The complaint also alleged that McMahon, while serving as Enron's Treasurer from April 1998 until May 2000, made several false and misleading statements and omissions to the national credit rating agencies regarding the stability, predictability, and sources of Enron's cash flows. In addition, the Complaint alleges that McMahon made similar false and misleading statements to the rating agencies while serving as Enron's Chief Financial Officer during the crisis period prior to Enron's bankruptcy filing, October – December 2001.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent McMahon's's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. McMahon is suspended from appearing or practicing before the Commission as an accountant.

B. After three years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependant on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

/

Commissioner Campos Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 18, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12700

In the Matter of

GALAXY MINERALS, INC.,

Respondent.

ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Galaxy Minerals, Inc. ("Galaxy" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

1. Galaxy Minerals, Inc. (CIK No. 1102217), is a Florida corporation with offices in Lake Villa, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Galaxy is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-QSB for the period ended September 30, 2005.

2. The Respondent is delinquent in its periodic filings with the Commission, having repeatedly failed to meet its obligations to file timely periodic reports, and failed to heed a notice sent to it by the Division of Enforcement notifying it of its failure.

3. The following periodic filings are delinquent.

Form	Period Ended	Due on or about
10-KSB	12/31/2005	03/31/2006
10-QSB	03/31/2006	05/15/2006
10-QSB	06/30/2006	08/14/2006
10-QSB	09/30/2006	11/14/2006
10-KSB	12/31/2006	03/31/2007
10-QSB	03/31/2007	05/15/2007

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4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

5. As a result of the foregoing, Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or to revoke the registration of each class of securities of the Respondent identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Cox
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8826 / July 18, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 56089 / July 18, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2643 / July 18, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12699

In the Matter of

OM GROUP, INC.

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against OM Group, Inc. ("OM Group" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. RESPONDENT

OM Group is a Delaware corporation headquartered in Cleveland, Ohio. OM Group is engaged in the production and marketing of value-added, metal-based specialty chemicals and related materials, primarily from cobalt and nickel. At all relevant times and continuing through today, OM Group's common stock has been registered with the Commission pursuant to Section 12(b) of the Exchange Act, and is listed on the New York Stock Exchange under the ticker symbol "OMG." Its fiscal year end is December 31 of each year and its independent auditor is Ernst & Young LLP.

B. SUMMARY

This matter involves a pattern of accounting fraud by OM Group and certain of its senior officers in 2001, 2002, and years prior. OM Group is a metal-based specialty chemicals company that is based in Cleveland, Ohio and has operations globally. At the end of each quarter and each fiscal year, OM Group consolidated the financial statements of its various operating entities and subsidiaries into one consolidated statement. OM Group's former Chief Financial Officer ("CFO") and former Corporate Controller ("Controller") were responsible for the entire consolidation process. OMG Americas was one of OM Group's wholly owned subsidiaries, and was comprised of manufacturing and other facilities at five North American locations. The former Controller of OMG Americas oversaw the consolidation process for OMG Americas. OM Group, through its CFO and Controller, engaged in accounting fraud by recording and directing numerous adjustments to the consolidated financials ("top-side adjustments"), which were wholly unsupported and often duplicative of entries already recorded at the operating unit level. The Controller of OMG Americas recorded erroneous and unsupported accounting entries at the direction of the CFO and Controller to OMG Americas' books and records. Many of the improper accounting practices were done with the intent to manage earnings and to achieve financial results that were closer to OM Group's annual plan.

These practices materially increased OM Group's annual and quarterly net income in a departure from generally accepted accounting principles ("GAAP"). During the relevant period, OM Group did not have an adequate system of internal controls that would detect and prevent this type of conduct. In addition, certain information was concealed from OM Group's independent outside auditor, Ernst & Young LLP ("E & Y"). As a result of the conduct, OM Group filed materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal years ended December 31, 2001 and December 31, 2002, and in the company's quarterly reports on Form 10-Q for the first three quarters of 2002, and the fourth quarter results

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

filed on Form 10-K, and the first three quarters of 2003 filed on Form 10-Q. In March 2005, after conducting an internal investigation into the accounting improprieties, OM Group issued a restatement reducing its retained earnings for the relevant period by $64 million as a result of the fraudulent conduct.

C. BACKGROUD

1. <u>OM Group History and Growth</u>

OM Group is a producer and marketer of metal-based specialty chemicals and related materials primarily from cobalt and nickel. OM Group was formed in 1991 and was the parent company of three operating subsidiaries, Mooney Chemicals, Kokkola Chemicals in Finland, and Vasset S.A. in France. It became a public company in September of 1993. OM Group experienced tremendous growth from 1992 through 2001, acquiring a number of entities in the United States and internationally. In 2000, OM Group acquired a nickel refinery in Harjavalta, Finland, which increased OM Group's sales revenue from approximately $500 million to nearly $1 billion. The most significant acquisition occurred in August 2001, when OM Group completed the acquisition of Degussa Metals Catalysts Cerdec ("dmc^2"), which consisted of multiple operating entities. After the dmc^2 acquisition, OM Group had over $2 billion in sales revenue.[2] OM Group also experienced earnings growth during the 1999 through 2001 period and reported positive net income that increased each year during that period.[3] Although OM Group grew through acquisitions, the accounting staff at corporate did not grow at the same rate and the accounting staff at the operating unit level was thin.

At the end of each quarter and each fiscal year, OM Group consolidated the financial statements of its various operating entities and subsidiaries into one consolidated financial statement, which was reported on OM Group's Forms 10-K and 10-Q. During the relevant period, the CFO and Controller were responsible for the entire consolidation process, which took place at their Cleveland headquarters. In practice, each operating unit submitted to the Controller electronically its monthly financial statement, which the Controller consolidated into one corporate financial statement. During the close process, both the Controller and CFO made numerous top-side adjustments to OM Group's consolidated financial statement. In some instances, either the Controller or CFO directed the individual controllers of the operating units to make adjustments at the local level and resubmit the financials. The Controller of OMG Americas made numerous entries at the direction of the Controller and CFO of OM Group. OM Group did not have an

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[2] The Harjavalta acquisition was financed with about $200 million in bank borrowing. dmc^2 was financed with debt (a bridge loan), equity, and the sale of assets. In conjunction with the dmc^2 acquisition, OM Group sold certain assets to repay a portion of the bridge loan. Shortly thereafter, in December 2001, the company completed a $400 million bond offering and used the proceeds to repay the remainder of the bridge loan. In January 2002, the company completed a $225.7 million equity offering and used the proceeds to repay other debts. OM Group filed registration statements for both the equity and bond offerings, which contained financial statements covering the 1999 through 2000, and 1999 through 2001 periods, respectively.

[3] OM Group's net income for the 1999 through 2001 period was as follows: 1999--$55.8 million; 2000--$71.5 million; 2001--$75.6 million: Q1 2002--$23.3 million (up from $19.6 million in Q1 2001); Q2 2002--$25.5 million (up from $20.1 million in Q2 2001).

internal audit group during the relevant period. Thus, there was no review of the work being performed by the Controller or the CFO other than the audits performed by E & Y.

2. The Shareholder Litigation, Audit Committee Investigation, and $64 Million Restatement

The CFO retired from OM Group in May 2002. In the third quarter of 2002, under the direction of a new CFO, OM Group announced a lower of cost or market adjustment to inventory of $108 million, after changing its outlook for the price of cobalt and determining that it had to lower production levels of cobalt and sell off inventory to raise cash. OM Group's trend of obtaining positive net income ceased when OM Group's third quarter of 2002 reflected a net loss of $71.2 million for the three month period, and $22.3 million for the nine month period. In response to this announcement, OM Group's stock price dropped 71% from $30.90 to $8.95, and shareholders filed a class action lawsuit on November 1, 2002 and a shareholder derivative suit on December 12, 2002. During the discovery phase of the shareholder lawsuit in mid-2003, OM Group's attorneys found e-mails that raised questions about whether there was adequate support for adjustments that were made to OM Group's inventory balances. In November 2003, OM Group's audit committee hired outside counsel and forensic accountants to conduct an independent investigation. At the conclusion of its internal investigation, OM Group reported its findings to the Commission staff in August 2004. The company also underwent a restatement audit.[4] The internal investigation and restatement audit by E & Y concluded that there were numerous unsupported top-side adjustments and other accounting entries to OM Group's financial statements. On March 31, 2005, as a result of the investigation, OM Group restated its financials for fiscal years ended December 31, 2002 and 2001, quarters ended September 30, 2003, June 30, 2003, March 31, 2003, and all four quarters of 2002. The restatement also affected periods prior to 2001.

The restatement adjustments reduced previously reported retained earnings as of September 30, 2003 by $64.0 million. A summary of the impact of the restatement follows (in millions):

Increase in net income for the nine months Ended September 30, 2003	$111.3
Increase in 2002 net income	125.1
Decrease in 2001 net income	(123.5)
Decrease in net income for years prior to 2001	(176.9)
Cumulative net decrease in previously reported Retained earnings at September 30, 2003	$(64.0)

4 OM Group also undertook steps to improve its internal controls and compliance program, including implementing a formal financial statement "close process" and creating an internal audit function.

The materiality of the adjustments is demonstrated below:

(in millions)	9 months ended 9-30-03	Year ended 12-31-02	Year ended 12-31-01	Years prior to 1-1-01	Total
Net income (loss) as originally reported	57.6	(327.9)	75.7		
Adjustments	111.3	125.1	(123.5)	(176.9)	(64.0)
Net income (loss) as restated*	168.9	(202.8)	(47.8)		
Percent overstated (understated)	(66%)	(62%)	258%		

* Before OM Group's change from the LIFO to FIFO method of valuing inventory.

D. IMPROPER ACCOUNTING PRACTICES AND FRAUDULENT CONDUCT

1. Corporate Level Top-Side Adjustments

OM Group, through its CFO and Controller, made more than 700 top-side adjustments to OM Group's financials. The adjustments were made across the divisions of OM Group and appeared to have no pattern. The support for the adjustments was either inadequate or did not exist. In addition, there were numerous e-mails and other documents that showed the adjustments were made with the intent to manage earnings and to achieve financial results that were closer to OM Group's annual plan. There are also e-mails and other documents that show a concerted effort to conceal the conduct from E & Y. The improper top-side adjustments are discussed below.

a. Over Capitalizing Overhead Costs

During the 1999 through 2002 period, the CFO and Controller made top-side adjustments to capitalize additional overhead costs related to certain of its operating units. These adjustments were wrong because they were duplicative of amounts already recorded at the operating unit level. Thus, their top-side adjustments to OM Group's consolidated financial statements contributed to an overstatement of OM Group's income.

b. Cobalt Inventory Recovery Yields

OM Group had to extract their raw materials, like cobalt, from slag piles. Although OM Group estimated the yields for the piles, extraction was a very inexact process and resulted in inconsistent yields from month to month. When the yields were below what the CFO and Controller predicted -- for example, if they expected the operating unit to extract 10% cobalt but it only extracted 8% -- the CFO and/or Controller made a top-side adjustment for the remaining expected yield. OM Group's contention was that the remaining 2% was still in the pile or somewhere in the manufacturing process. However, there was no process for extracting the remaining 2%, nor was there any analysis done to determine whether it was cost effective to attempt to recover any remaining content. This accounting practice was not consistent with GAAP.[5] Thus, these inappropriate top-side adjustments allowed OM Group to increase income.

c. Supplier Receivables

Prior to 2001, OM Group was in a contractual dispute with three cobalt raw material suppliers concerning the metal content of raw materials that OM Group bought from the suppliers. In connection with this dispute, the CFO recorded three receivables totaling $26.9 million that were treated as prepaid inventory representing advance payments for future inventory shipments. It was determined that OM Group waived its claim to these recoverable amounts in its dispute negotiations with the suppliers, or otherwise did not adequately document its position to support recording these assets. The top-side adjustments resulted in an overstatement of OM Group's assets.

d. Interest Receivables

OM Group advanced $27.6 million to its joint venture partners during construction of a smelter in years prior to 2001. OM Group recorded a receivable for such amount. Although there was no agreement between OM Group and the joint venture partners providing for interest on the advance, OM Group recorded interest income on the advances in 2001 and years prior of $5.5 million and $9.9 million, respectively. In 2002, OM Group established a reserve of $12.0 million against the interest receivable of $15.4 million. In 2003, OM Group finalized a written agreement with one of the partners, which provided for $6.8 million in interest income. The original interest recorded represented a contingent asset that should not have been recorded until a written agreement was finalized.[6] Thus, the interest receivable and the 2002 reserve should not have been recorded.

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5 The term inventory embraces goods awaiting sale, goods in the course of production (work-in-process), and goods to be consumed directly or indirectly in production (raw materials and supplies). ARB 43, chapter 4, paragraph 3.

6 Without a written agreement, OM Group's recordation of the interest receivable and corresponding interest income constituted a contingent gain. SFAS No. 5, "Accounting for Contingencies." Paragraph 17 prohibits the reflection of gain contingencies in financial statements, since to do so might be to recognize revenue prior to its realization.

e. Duplicating Entries Already Made at the Operating Unit Level

OM Group purchased nickel raw material that was off-specification and incurred incremental costs to process this material to a usable form, which was recorded as a receivable from the supplier by the CFO and Controller. However, the raw material contract included provisions for financial remedy for off-specification raw material, and the remedy properly was accounted for at the operating unit level. The CFO and Controller made numerous other top-side adjustments to capitalize costs that were expensed at the operating unit level for certain fixed asset projects, software implementation projects, and miscellaneous other assets. The adjustments were not appropriate because the operating units appropriately accounted for the expenses.

f. Other Erroneous and Unsupported Accounting Entries

There were numerous other top-side adjustments and errors that were restated, including inappropriate adjustments to fixed asset construction projects, certain accounts payable and cost of sales related to raw material contracts, inventory numbers, incorrect entries related to purchase accounting for the Harjavalta acquisition, errors in foreign currency remeasurement and intercompany profit elimination, improper derivative accounting, and expenses charged in a period that should have been taken in an earlier period. All of these top-side adjustments were wholly inaccurate and unsupported.

2. Inaccurate Estimates to OMG Americas' Books and Records Made by the Controller of OMG Americas at the Direction of the CFO and Controller of OM Group

The Controller of OMG Americas was responsible for consolidating OMG Americas' financial results and submitting them to OM Group's Controller. The OMG Americas Controller used inaccurate estimates to record inventory amounts at OMG Americas. During the relevant period, OMG Americas did not have an inventory tracking system that could account for inventory that was "work-in-process" i.e., raw materials that had entered into the manufacturing process but not yet into finished goods. As a result, work-in-process was estimated by the OMG Americas Controller at the direction and review of the Controller and CFO of OM Group. Similarly, estimates were used to record amounts of finished goods inventory in-transit to company warehouses from the Franklin facility based on the theory that the system could not account for inventory that was in-transit to a distribution center. Estimates were also used to record inventory balances for containers, packaging, and certain lab inventory at the Franklin facility. Finally, entries were made to record the valuation of inventory full absorption costing.

These estimates were inaccurate and unsupported. At the end of each year, the Franklin plant slowed down production in anticipation of a holiday shutdown. By December 31st, little or no work-in-process existed because the manufacturing process was completed by that time, and the materials were turned into finished goods and shipped out. Thus, the OMG Americas Controller's estimates for work-in-process were wholly inaccurate and unsupported. It was determined that in-transit inventory was fully accounted for on OMG America's books. Thus, there was no need for the Controller of OMG Americas to record additional amounts or estimates to record in-transit inventory. OM Group sold materials to customers in totes, to which OM Group retained ownership. The Controller of OMG Americas estimated the number of totes in inventory; however, he could not describe a mechanism that was in place to retrieve the totes from the customer, nor could he specifically describe how the totes were tracked when they were sent out to customers. Thus, there was no reasonable basis for his inventory estimates. In addition, there was no supporting documentation for his valuation of inventory full absorption at the Franklin facility. The Controller of OMG Americas submitted all of his estimates to the CFO and the Controller of OM Group for review. More often than not, the OMG Americas Controller's estimates increased following feedback from these two more senior officers.

The Controller of OMG Americas also recorded inaccurate journal entries concerning certain litigation. In 2000, the Controller of OMG Americas recorded $4.5 million for anticipated recovery of contributions previously made by the company to a settlement trust and related legal fees for product liability litigation. The asset was reduced to $2.5 million in 2001 and was written off in December 2002. Despite having an adverse judgment entered against the company's position and other unfavorable facts and circumstances, OM Group kept the receivable on its books. The Controller of OMG Americas established the receivable pursuant to discussions with the CFO and Controller of OM Group based upon their expectation that when the claimants had settled the matter, the funds in the trust would be redistributed to the contributors. However, the Controller of OMG Americas did not recall learning from the CFO or Controller of OM Group that an adverse judgment had been rendered against the company.

3. <u>Evidence that the Accounting Improprieties Amounted to Fraud</u>

There are numerous e-mails and documents that clearly demonstrate that OM Group through its CFO and Controller engaged in fraudulent accounting practices, and that the Controller of OMG Americas was a participant. The e-mails evidence the intent to adjust numbers to meet earnings targets or to enhance OM Group's performance in a particular quarter or year end. The e-mails also show that there was a concerted effort by the CFO, the Controller, and the Controller of OMG Americas to hide information from E & Y. One e-mail from the Controller of OMG Americas to the CFO and Controller of OM Group states: "My concern about inventory is that going too heavy in WIP [work-in-process] or others will trigger even greater scrutiny. Truth is, we have a fresh set of auditors, and I have no idea how much conversational auditing this group will take." Another e-mail discusses making "small undetectable changes to inventory" in documents that would be submitted to E & Y, and then further states that "I can't change them by much, it would not be a prudent move." The e-mails and other documents also show that the CFO and Controller of OM Group were aware that the accounting entries made to OM Group's financial statements were not supportable and that OM Group's financial statements were potentially materially misstated during the relevant period. There are also e-mails that show the Controller of OMG Americas raised red flags to the CFO and Controller that certain of the journal entries made to OMG Americas' financial statements were not supportable. For example, the Controller of OMG Americas wrote to the Controller of OM Group that "I do believe that we were too aggressive in our estimation of an SGA [sales general administrative expenses] adjustment. I believe that we can substantiate one-fourth that number, the rest is tight."

The documents also reflect a pattern of recording almost random round numbers to journal entries to try to manage OM Group's earnings, and to look for "other candidates," i.e., other accounting categories in which to make more adjustments. There is also evidence that certain journal entries were made at locations that E & Y would not likely visit during audits.

E. LEGAL ANALYSIS

1. Violations of the Antifraud Provisions: Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

Section 17(a) of the Securities Act prohibits fraud in the offer or sale of securities. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit securities fraud in connection with the purchase or sale of securities. To establish a violation of these antifraud provisions, the Commission must generally prove that the defendant made materially false or misleading representations or omissions in connection with the offer, purchase or sale of securities, with *scienter*. Aaron v. SEC, 446 U.S. 680, 697 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976); SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999); SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1466-67 (2d Cir. 1996). "Recklessness" satisfies the *scienter* standard. Press v. Chemical Investment Svcs. Corp., 166 F. 3d 529, 527-38 (2d Cir. 1999).

A statement or omission is material if "there is a substantial likelihood that a reasonable shareholder would consider it important" or, in other words, "there [is] a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable shareholder as having significantly altered the 'total mix' of information available." Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988) (adopting standard of TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). Precipitous movement in stock price can be an indication of materiality. United States v. Bilzerian, 926 F.2d 1285, 1298 (2d Cir. 1991). The "in connection with" requirement is satisfied by showing that false financial information was disseminated into the market place in a manner reasonably calculated to influence the investing public. Ames Department Stores, Inc. Stock Litig., 991 F.2d 953, 962, 966 (2d Cir. 1993) ("in connection with" requirement satisfied by allegations that corporation disseminated false financial information into marketplace through press releases, annual reports, Form 10-K and two Forms 10-Q).

OM Group violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as a result of the conduct described above. OM Group included in its offering documents, periodic filings, and press releases financial information that senior management knew, or was reckless in not knowing, was materially false and misleading. The top-side adjustments and other improper accounting entries caused OM Group's financial statements to be materially misstated. OM Group's $64 million retained earnings restatement is evidence of the materiality of the accounting improprieties. The materially false financial statements were included in OM Group's annual and quarterly reports during fiscal years 2001 and 2002 and in the

Form S-1, effective January 16, 2002,[7] that was issued in OM Group's $225.7 million equity offering. The materially incorrect financial information was also disseminated to the public through earnings releases. The level of *scienter* was high. The CFO and Controller concealed from the company's auditor the fact that many of their top-side adjustments lacked support and were done with the intent to manage earnings. The CFO's and the Controller's *scienter* is imputed to OM Group.

2. **Violations of the Reporting Provisions: Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder**

Section 13(a) of the Exchange Act requires all issuers of securities registered under Section 12 of the Exchange Act to file reports with the Commission containing such information as the Commission's rules and regulations prescribe. 15 U.S.C. § 78m(a) (2006). Rules 13a-1, 13a-11 and 13a-13 thereunder require issuers to file annual, current, and quarterly reports, respectively. The reports must contain financial statements prepared in conformity with GAAP and not contain any materially false or misleading information. *See Ponce v. SEC*, 345 F.3d 722, 734-37 (9th Cir. 2003). Additionally, Rule 12b-20 requires that in addition to the information required in a report, further material information should be added as necessary to make the required statements, in light of the circumstances under which they were made, not misleading. Information regarding the financial condition of a company is presumptively material. SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985). No showing of scienter is required to establish a violation of Section 13 of the Exchange Act. SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998).

OM Group violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder as a result of the conduct described above. OM Group filed reports with the Commission that misrepresented OM Group's financial results for fiscal years ended December 31, 2001 and December 31, 2002 on Form 10-K, and in the company's quarterly reports on Form 10-Q for the first three quarters of 2002 and the fourth quarter results filed on Form 10-K, and the first three quarters of 2003 filed on Form 10-Q. Some of the misrepresented financials were included in Forms 8-K.

3. **Violations of the Books and Records and Internal Controls Provisions: Sections 13(b)(2)(A) and 13(b)(2(B) of the Exchange Act**

a. Books and Records Violations

Section 13(b)(2)(A) of the Exchange Act requires issuers to make and keep books and records which in reasonable detail fairly and accurately reflect the transactions and disposition of the assets of the issuer. 15 U.S.C. § 78m (b)(2)(A) (2006). OM Group violated Section 13(b)(2)(A) of the Exchange Act as a result of the conduct described above. OM group failed to make and keep books and records in accordance with GAAP.

[7] OM Group filed an S-1 on December 5, 2001 that became effective on January 16, 2002 that contained financial statements for the fiscal year ended December 31, 2000 and the nine months ended September 30, 2001.

b. Internal Controls Violations

Section 13(b)(2)(B) of the Exchange Act requires issuers to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that ... transactions are recorded as necessary to (I) permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (II) to maintain accountability for assets." 15 U.S.C. § 78m(b)(2)(B) (2006). OM Group violated Section 13(b)(2)(B) of the Exchange Act by failing to implement a system of internal accounting controls that would detect and prevent the improper accounting practices engaged in by its CFO, Controller, and Controller of OMG Americas.

F. REMEDIAL EFFORTS

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by OM Group and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

Respondent OM Group cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
JUL 1 9 2007

IN THE MATTER OF **Bentley Commerce Corp.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Bentley Commerce Corp. because it has not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in Bentley Commerce Corp. is suspended for the period from 9:30 a.m. EDT on July 19, 2007, through 11:59 p.m. EDT on August 1, 2007.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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Chairman Cox
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 56100 / July 19, 2007

Admin. Proc. File No. 3-12461

In the Matter of the Application of

GREGG HEINZE
c/o Paul R. Grand, Esq.
Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, P.C.
565 Fifth Avenue
New York, NY 10017

For Review of Disciplinary Action Taken by the

New York Stock Exchange, Inc.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE -- REVIEW OF DISCIPLINARY PROCEEDING

Failure to Provide Requested Testimony

Former associated person of member firm and member of national securities exchange asserted the privilege against self-incrimination in response to association's request for testimony. Held, the proceeding is remanded for further consideration.

APPEARANCES:

Paul R. Grand and Andrew J. Schell, of Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, P.C., for Gregg Heinze.

Susan Light, Virginia J. Harnsich, Allen D. Boyer, and Kwame Anthony for the New York Stock Exchange, Inc.

Appeal filed: October 23, 2006
Last brief received: January 30, 2007

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I.

Gregg Heinze, a former specialist with New York Stock Exchange, Inc. ("NYSE" or the "Exchange") member firm Bear Wagner Specialists LLC ("Bear Wagner"), 1/ appeals from NYSE disciplinary action. The Exchange found that Heinze failed to comply with requests by the NYSE that Heinze provide testimony in connection with an NYSE investigation concerning matters that occurred while he was a specialist at Bear Wagner, in violation of NYSE Rule 476, and that Heinze was, therefore, subject to discipline pursuant to NYSE Rules 476(a) and 477. 2/ The NYSE censured Heinze and permanently barred him from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization. For the reasons given below, we have determined to remand the proceeding to the Exchange for further consideration consistent with this opinion. To the extent we make findings, we base them on an independent review of the record.

II.

On November 2, 2004, our Division of Enforcement (the "Division") issued a subpoena to Heinze, requesting information and testimony in connection with the Division's investigation of NYSE specialists. 3/ Shortly thereafter, on November 19, 2004, the NYSE Division of Enforcement ("NYSE Enforcement") requested documents from Heinze as part of its investigation of "allegations of improper trading by specialists on the Floor of the Exchange that resulted in violations of Exchange Rules and Federal Securities Laws." In a letter dated December 3, 2004, Heinze responded to NYSE Enforcement's document request, stating, "As we discussed during our telephone conference earlier this week, Gregg Heinze does not have any documents responsive to your November 19, 2004 letter."

1/ Heinze voluntarily resigned from Bear Wagner on December 23, 2004.

2/ NYSE Rule 476(a) provides that NYSE members and employees of NYSE members who violate any provision of any NYSE rule are subject to the imposition of disciplinary sanctions, including a censure and bar, by the Exchange. NYSE Rule 477 states that NYSE members, or employees of NYSE members, who do not comply with an NYSE request to provide testimony, while they are a member or an employee of an NYSE member and during the one-year period after the termination of membership or employment by an NYSE member, are subject to the imposition of disciplinary sanctions, including a bar.

3/ The subpoena is not in the record. However, the record does include the cover letter, dated November 2, 2004, accompanying the subpoena, sent by a Division attorney to Heinze's counsel. The subject line of the letter is "*In the Matter of Certain Specialist Trading - New York Stock Exchange*." The letter does not otherwise detail the scope of the Division's investigation.

On January 12, 2005, Heinze responded to the Division's subpoena by a written, sworn declaration, in which he asserted the Fifth Amendment privilege against self-incrimination as to all questions posed by the Division. 4/ Also on January 12, 2005, NYSE Enforcement requested that Heinze appear on February 3, 2005, for testimony in connection with NYSE Enforcement's investigation of "allegations that during [Heinze's] employment as a registered specialist with Bear Wagner Specialists LLC, he may have violated Exchange rules and federal securities laws in connection with his trading of Exchange listed securities." Subsequently, Heinze informed the NYSE that he would not appear for testimony as requested. 5/

On February 28, 2005, as a result of Heinze's failure to comply with the Exchange's request for testimony, NYSE Enforcement charged that Heinze "violated Exchange Rule 476 in that he failed to comply with requests by the Exchange that he provide testimony concerning matters which occurred prior to the termination of his employment with a member organization, and he is, therefore, subject to discipline pursuant to Exchange Rule 476(a) and 477." The parties submitted briefs and, before the NYSE Hearing Panel, NYSE Enforcement requested summary judgment on the question of whether Heinze had committed the violations the Exchange charged. The Hearing Panel granted NYSE Enforcement's request for summary judgment and found Heinze guilty of violating NYSE Rule 476 and then heard arguments regarding sanctions. The NYSE Hearing Panel later issued its decision censuring and barring Heinze. 6/

4/ The Fifth Amendment to the United States Constitution provides that no person "shall be compelled in any criminal case to be a witness against himself." U.S. Const. amend. V. The record indicates that the declaration, dated January 7, 2005, was hand-delivered to the Commission staff on January 12, 2005.

5/ The way in which Heinze informed the NYSE that he would not testify as requested and the substance of what he told the Exchange are unclear. However, in Heinze's April 15, 2005, response to the NYSE's charge memorandum, Heinze's counsel stated, "We received the Exchange's request calling for Mr. Heinze's testimony only after the commencement of both an investigation by the United States Attorney's Office and an investigation by the Securities and Exchange Commission . . . . At the time we received the Exchange's request for our client's testimony, we had already received a subpoena from the S.E.C. and had explained to the S.E.C. that, because of the pendency of the criminal investigation and of the S.E.C.'s refusal to identify the transactions they were accusing our client of having engaged in, we had advised Mr. Heinze to rely on his constitutional right not to be a witness against himself."

6/ Under the Hearing Panel decision, Heinze received a thirty-day period to testify before his bar would become permanent. Heinze continued to decline to testify during this thirty-day period.

On March 24, 2006, subsequent to Heinze's hearing, we issued our opinion in Frank P. Quattrone, in which we observed that a self-regulatory organization ("SRO"), such as the Exchange, although generally not a "state actor," can become subject to the Fifth Amendment under certain circumstances when, through its significant involvement with a government investigation, it can be deemed to have engaged in "state action." 7/ Following our decision in Quattrone, Heinze requested that the NYSE Hearing Panel set aside its decision and re-open the record to permit Heinze to introduce evidence to support his claim that "the Exchange and the S.E.C., by their own admission, conducted a joint investigation into the conduct of various specialist firms and individual specialists such as Mr. Heinze." Among other things, Heinze noted that there was significant regulatory interest in the trading activities of NYSE specialists at Bear Wagner and other firms during this time period. 8/ The NYSE Hearing Panel, however, denied Heinze's request to re-open the hearing, finding that the "information submitted on behalf of Mr. Heinze does not rise to the level of specific facts required to re-open the record. They constitute mere conclusory allegations or speculation insufficient to re-open this matter."

On July 3, 2006, Heinze requested review of the Hearing Panel decision by the NYSE Board of Directors. The NYSE Board set oral argument for Heinze's appeal on October 3, 2006. By letter dated September 29, 2006, however, Heinze informed NYSE Enforcement that he was then willing to testify in connection with the Exchange's underlying investigation and requested

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7/ Securities Exchange Act Rel. No. 53,547, 87 SEC Docket 2155 (Mar. 24, 2006). Before the NYSE Hearing Panel, NYSE Enforcement had cited NASD's decision barring Quattrone (before the Commission set it aside) to support its argument that "the Fifth Amendment did not apply in the disciplinary proceeding."

8/ On April 12, 2005, a press release was issued announcing the settlement of a Commission enforcement action against the Exchange, "finding that the NYSE, over the course of nearly four years, failed to police specialists, who engaged in widespread and unlawful proprietary trading on the floor of the NYSE." On April 12, 2005, the Commission instituted proceedings against several NYSE specialists, including two Bear Wagner specialists, but not Heinze, charging the specialists with violations of the antifraud provisions of the securities laws by inter-positioning orders in their firms' proprietary accounts between customer orders and by trading ahead of customer orders using their firms' proprietary accounts. Also on April 12, 2005, the Exchange announced the issuance of charges resulting from its investigation of other NYSE specialists, including two Bear Wagner specialists, but not including Heinze. On April 15, 2005, the United States Attorney for the Southern District of New York brought criminal charges relating to improper trading in proprietary accounts against fifteen NYSE specialists, including two Bear Wagner specialists, but not Heinze.

that, accordingly, oral argument before the NYSE Board be postponed. 9/ On October 2, 2006, the NYSE denied Heinze's request that the oral argument be postponed. 10/ On October 4, 2006, following oral argument, the NYSE Board issued a one-sentence decision affirming the decision of the NYSE Hearing Panel in all respects. This appeal followed.

III.

Heinze acknowledges that he failed to appear for testimony, as found by the Exchange. Such a failure establishes a prima facie violation of NYSE Rules 476 and 477. 11/ Heinze argues, however, that he could not be forced to testify before the NYSE because he was entitled to invoke the Fifth Amendment's right against self-incrimination. Heinze argues that the right against self-incrimination applied to the NYSE because of evidence that "show[ed]," according to Heinze, "that NYSE Enforcement had been working jointly with the SEC when it sought Mr. Heinze's testimony and thus had engaged in state action." On appeal, Heinze requests that his case be remanded to the NYSE "for further fact-finding on the issue of whether NYSE Enforcement engaged in state action in its investigation of Mr. Heinze." 12/

9/ Heinze's counsel stated, "I am writing to inform you that recent developments in the specialists investigation – including two acquittals and a declination of prosecution – have led me to re-assess my previous advice to Gregg Heinze that he not testify before the Exchange. Based on my re-assessment, Mr. Heinze has decided that he may now follow through on his long-standing desire to provide the Exchange with testimony."

10/ Despite Heinze's offer to testify, which remains outstanding, Heinze has never provided testimony to NYSE Enforcement.

11/ See, e.g., Louis F. Albanese, 53 S.E.C. 294, 297-98 (1997) (sustaining NYSE disciplinary action for violation of NYSE Rule 477 where respondent failed to cooperate immediately with NYSE investigation); Wallace E. Lin, 50 S.E.C. 196 (1990) (sustaining NYSE findings of violation of Rule 477 where respondent refused to testify in Exchange investigation); cf. Justin F. Ficken, Exchange Act Rel. No. 54,699, 89 SEC Docket 685, 690-91 (Nov. 3, 2006) ("The failure to respond to NASD's requests for testimony demonstrates a prima facie violation of [analogous NASD Rule].").

12/ Alternatively, Heinze asks that we order the NYSE to terminate Heinze's permanent bar within thirty days. Heinze argues, "In our opening brief, we asked for an order that the permanent bar on Mr. Heinze's membership be lifted once he testifies. However, out of a concern that such an order may result in a de facto permanent bar simply because NYSE Enforcement never asks for Mr. Heinze's testimony, we ask for an order lifting the bar within 30 days of the issuance of the Commission's order. This will provide NYSE Enforcement with ample time to take Mr. Heinze's testimony, but will ensure that the bar is lifted even if NYSE Enforcement chooses not to take the testimony."

Heinze supports his claim of state action by pointing to comments he claims were made by NYSE Enforcement staff during their investigation of him. According to Heinze, during a conversation regarding "what misconduct [Heinze] had engaged in," Heinze's lawyer "was told by a [NYSE] staff attorney that the Stock Exchange was, the words were, conducting a joint investigation with the SEC and that the SEC was taking the lead on certain aspects. And if it weren't a joint investigation, he could tell me more about what the accusations were against my client." Heinze claims that this alleged statement by an NYSE attorney "impl[ies] that the SEC was forcing NYSE Enforcement to restrict the flow of information."

Heinze also asserts that, on January 12, 2005, the same day that Heinze asserted his Fifth Amendment privilege in connection with the Commission investigation, "In a telephone conversation with [Heinze's counsel], one or more NYSE attorneys revealed that he/they knew Heinze had informed the SEC he would assert his privilege and decline to testify." According to Heinze, his decision to assert his Fifth Amendment privilege before the Commission was "information that [NYSE Enforcement] could only have learned from the SEC." Heinze argues, "The fact that NYSE Enforcement, upon learning this information, immediately requested Mr. Heinze's testimony indicates that the request was the result of joint planning with the SEC, or caused by coercion, or at the very least, strong encouragement, from the SEC." In addition to these assertions, Heinze cites a March 30, 2004, Commission press release announcing the settlement of enforcement actions against five NYSE specialist firms, including Bear Wagner, for violations involving "executing orders for their dealer accounts ahead of executable public customer or 'agency' orders," which described the action as the product of a "joint investigation" and stated, "The NYSE and SEC will continue to coordinate in the investigation of individual responsibility for the violative conduct that is the subject of the enforcement actions announced today." 13/

The Exchange contends that the evidence Heinze presented is insufficient to establish state action. At most, the NYSE asserts, the evidence suggests regulatory coordination between Commission staff and NYSE Enforcement which, according to the Exchange, "clearly does not establish state action." In particular, the NYSE disputes the veracity of Heinze's claim that an NYSE attorney told Heinze's counsel that the NYSE had been instructed by the Commission not to provide Heinze with additional information about the NYSE investigation, arguing that, "if it were true, Heinze's counsel clearly would have raised the issue at his hearing in July 2005, which he did not." The NYSE also characterizes as "merely erroneous speculation" Heinze's claim that the NYSE's knowledge of Heinze's assertion of the Fifth Amendment before the Commission shows significant cooperation and "strong encouragement" between the Commission and the NYSE.

13/ Although, as noted above, the record contains limited information about the Division's underlying investigation of Heinze, the investigation of Heinze appears to be related to the same subject matter as the enforcement actions discussed in the March 30, 2004, press release.

IV.

In three recent opinions, we have addressed the question of whether an SRO, although not generally a state actor subject to the Fifth Amendment, can, under certain circumstances, engage in "state action" such that it becomes subject to the right against self-incrimination. In Quattrone, we set aside on procedural grounds NASD action barring an associated person who had refused to testify in an NASD investigation because he was then subject to criminal prosecution. 14/ We observed in Quattrone that "[a]pplicable law indicates that cooperation between the Commission and NASD will rarely render NASD a state actor, and the mere fact of such collaboration is generally insufficient, standing alone, to demonstrate state action." 15/ However, we also noted there that precedent indicates that a private entity such as an SRO may, under certain circumstances, engage in state action, observing that the Fifth Amendment restricts only governmental conduct and will constrain a private entity only insofar as its actions are found to be "fairly attributable" to the government. 16/ We also noted in Quattrone that the Supreme Court has held that private parties' actions may constitute state action if there is such a "close nexus between the State and the challenged action" that the seemingly private behavior "may be fairly treated as that of the State itself." 17/

14/ In Quattrone, we concluded that NASD's grant of summary disposition on the issue of liability against Quattrone was inappropriate and not in accordance with its rules. Quattrone, 87 SEC Docket at 2166.

15/ 87 SEC Docket at 2165 (citing Scher v. NASD, 386 F. Supp. 2d 402, 408 (S.D.N.Y. 2005)). As the Second Circuit has held, in articulating a standard that would apply equally to other SROs, including the Exchange, "The NASD is a private actor, not a state actor. It is a private corporation that receives no federal or state funding. Its creation was not mandated by statute, nor does the government appoint its members or serve on any NASD board or committee." D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc., 279 F.3d 155, 162 (2d Cir. 2002)(citing Desiderio v. National Ass'n of Secs. Dealers, Inc., 191 F.3d 198, 206 (2d Cir. 1999), cert. denied, 531 U.S. 1069 (2001)).

16/ 87 SEC Docket at 2163 n.22 (citing D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc., 279 F.3d 155, 161 (2d Cir. 2002) (citing Lugar v. Edmondson Oil Co., 457 U.S. 922, 937 (1982)).

17/ Id. (citing Brentwood Acad. v. Tennessee Secondary Sch. Ath. Ass'n, 531 U.S. 288, 296 (2001)).

In Justin F. Ficken, where NASD had also barred an associated person who had refused to testify in an NASD investigation because he was the subject of both a Commission investigation and a criminal investigation of the same subject matter, we determined to remand the case to NASD for further development of the record because, among other things, the applicant had been limited in his ability to introduce evidence on the question of whether NASD had engaged in state action. 18/ In remanding Ficken, we noted that the case had been considered by NASD prior to the issuance of our decision in Quattrone. As part of our discussion of the relevant legal precedent, we observed in Ficken that the Supreme Court has identified certain facts "that can bear on the fairness of such an attribution [that a private entity engaged in state action]," such as whether a challenged activity "results from the State's exercise of its 'coercive power'"; whether "the State provides 'significant encouragement, either overt or covert'"; or whether "a private actor operates as a 'willful participant in the joint activity with the State or its agents.'" 19/

More recently, in Warren E. Turk, 20/ the applicant, like Heinze the subject of Commission and, potentially, criminal investigations, had been barred based on his failure to testify before the NYSE. Like Heinze, Turk sought unsuccessfully to develop a record before the Exchange regarding possible state action by the NYSE Enforcement staff. As in Ficken, we determined to remand the proceeding. We found that the evidence Turk had presented in support of his state action claim did not meet the burden of "demonstrating joint activities sufficient to render an SRO a state actor." 21/ "Nevertheless," we held there that, "while the evidence Turk

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18/ Exchange Act Rel. No. 54,699 (Nov. 3, 2006), 89 SEC Docket 695, 696.

19/ 89 SEC Docket at 692 (citing Brentwood, 531 U.S. at 296). Some courts have described this last fact pattern as the "joint action" test, and have focused on inquiries such as whether "the state has so far insinuated itself into a position of interdependence with the private entity that it must be recognized as a joint participant in the challenged activity" or whether "the particular actions challenged are inextricably intertwined with those of the government." See, e.g., Kirtley v. Rainey, 326 F.3d 1088, 1093, 1094 (9th Cir. 2003) (stating that "joint action" test and "government compulsion" test are separate tests for establishing state action and under the former considering whether "the state has so far insinuated itself into a position of interdependence with the private entity that it must be recognized as a joint participant in the challenged activity" and under the latter considering whether "the coercive influence or significant encouragement of the state effectively converts the private action into a government action").

20/ Exchange Act Rel. No. 55,942, __ SEC Docket __ (June 22, 2007).

21/ __ SEC Docket at __.

identifies is insufficient to establish state action, he should have a further opportunity to develop and present his state action claim." 22/

We have similarly determined here that Heinze should have a further opportunity to develop and present his state action claim. The evidence Heinze has presented raises questions about whether the Exchange's coordination with Commission staff made the Exchange a state actor in its investigation of Heinze. The assertions made by Heinze -- (1) that his counsel was told by an NYSE attorney that the Division had instructed the NYSE to limit the amount of information about his investigation that the Exchange provided to Heinze and (2) that NYSE attorneys told Heinze's counsel that they were aware of Heinze's assertion of his Fifth Amendment privilege before the Commission on the same day he so informed the Commission -- appear to warrant further development of the record in order to assess their credibility. If Heinze's assertions were found to be credible, they would suggest the possibility that the Division exercised significant control and influence over the NYSE's investigation of Heinze, which would be relevant to a state action inquiry. 23/

Although, as noted in Turk, the burden of demonstrating joint activities sufficient to render an SRO a state actor is high, and that burden falls on the party asserting state action, 24/ we believe that Heinze has identified specific evidence that warrants a further opportunity to develop and present his state action claim. Under the circumstances and because the NYSE considered Heinze's case without the full benefit of all of our recent decisions on this issue, 25/

22/ Id. In Turk, we found that, on the record that had been developed, we were not able to make each of the findings required by Section 19(e) of the Securities Exchange Act of 1934 to sustain disciplinary action by an SRO. See Exchange Act Section 19(e)(1), 15 U.S.C. § 78s(e)(1). We also are unable to make such findings here, as discussed below.

23/ See, e.g., Brentwood, 531 U.S. at 295-96 (citing, among the factors that contribute to a determination of when a private actor engages in state action, whether a challenged activity "results from the State's exercise of its 'coercive power'" and whether "the State provides 'significant encouragement, either overt or covert'").

24/ See Turk, __ SEC Docket at __ (citing Ficken, 89 SEC Docket at 695).

25/ As noted in Turk, we expect that, in the future, parties will seek to introduce any evidence related to the state action issue during the initial evidentiary hearing, so that the record is fully developed in the first instance when the case is before the SRO.

we believe it is appropriate to remand this proceeding for full consideration of this evidence. 26/ We do not intend to suggest any view on the outcome of this remand.

An appropriate order will issue. 27/

By the Commission (Commissioners ATKINS, CAMPOS, NAZARETH, and CASEY); Chairman COX not participating.

Nancy M. Morris
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

26/ On remand, the Exchange should carefully consider whether Heinze should be given a new hearing to present additional evidence regarding his state action claim. It appears, as indicated, that such a hearing will be necessary, at a minimum, to assess the credibility of Heinze's assertions about what his lawyers were told regarding the level of coordination between the NYSE Enforcement and Division staff in their investigations of Heinze. Nevertheless, in seeking such a hearing, Heinze will be required to state "the precise manner in which [the facts he does possess] support[] his claims," explain "why he needs additional discovery," "state with some precision the materials he hope[s] to obtain with further discovery," and explain "exactly how" the further information would support his claims. See Ficken, 89 SEC Docket at 695-96 n.37 (citing Krim v. BancTexas Group, Inc., 989 F.2d 1435, 1442-1443 (5th Cir. 1993)). To the extent that Heinze meets this burden, the NYSE will be expected to give due consideration to any requests Heinze makes for additional discovery. See id., 89 SEC Docket at 696.

27/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 56100 / July 19, 2007

Admin. Proc. File No. 3-12461

In the Matter of the Application of

GREGG HEINZE
c/o Paul R. Grand, Esq.
Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, P.C.
565 Fifth Avenue
New York, NY 10017

For Review of Disciplinary Action Taken by the

the New York Stock Exchange, Inc.

ORDER REMANDING DISCIPLINARY PROCEEDING TO NATIONAL SECURITIES EXCHANGE

On the basis of the Commission's opinion issued this day, it is

ORDERED that this disciplinary proceeding with respect to Gregg Heinze be, and it hereby is, remanded to the New York Stock Exchange, Inc. for further consideration.

By the Commission.

Nancy M. Morris
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 56104 / July 19, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
RELEASE NO. 2647 / July 19, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12703

In the Matter of ERNST & YOUNG CHARTERED ACCOUNTANTS, and DENIS O'HOGAN, FCA. Respondents.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Ernst & Young Chartered Accountants ("EYCA") and Denis O'Hogan ("O'Hogan") (collectively the "Respondents"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)].[1]

II.

In anticipation of the institution of these proceedings, each Respondent has submitted an Offer of Settlement ("Offers") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the

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1 Rule 102(e)(1)(ii) provides, in relevant part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it ... to any person who is found ... to have engaged in ... improper professional conduct.

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Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and over the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Proceedings pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and the Respondents' Offers, the Commission finds[2] that:

A. SUMMARY

This matter concerns improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice by the Respondents in connection with the reviews and audits of SmartForce PLC ("SmartForce" or the "Company") financial statements for the years ended December 31, 1999, 2000, and 2001 and quarterly reviews for the quarters ended in March 31 and June 30, 2002 (the "Restatement Period"). EYCA received approximately $725,000 in fees for performing audit and review services.

SmartForce's securities traded publicly on NASDAQ beginning in April 1995. SmartForce's financial statements, which the Company included in its annual and quarterly reports during the Restatement Period, were materially false and misleading in that they overstated net income and revenue in some periods and understated net income and revenue in other periods by failing to comply with United States generally accepted accounting principles ("GAAP"). SmartForce prepared these financial statements by, among other things, recognizing revenue improperly from multi-element arrangements, reciprocal transactions, and reseller agreements. Several registration statements incorporated by reference SmartForce's financial statements for the restated periods.

The Respondents reasonably should have known that SmartForce's financial statements had not been prepared in conformity with GAAP. EYCA nonetheless issued unqualified audit reports on SmartForce's annual financial statements that opined that the Company's financial statements presented fairly the consolidated financial position and results of operations of SmartForce in conformity with GAAP and stated that the auditor had conducted the audits in accordance with United States generally accepted auditing standards ("GAAS"). The audit reports were included in SmartForce's 1999, 2000, and 2001 Forms 10-K, which were

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2 The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

incorporated by reference in various Forms S-3, S-4, and S-8 registration statements. EYCA issued consent letters agreeing to the incorporation by reference of its audit reports in these registration statements.

O'Hogan did not comply with GAAS in the conduct of the audits and the reviews, and thus engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice through repeated instances of unreasonable conduct.

B. RESPONDENTS

1. EYCA is located in Ireland and is a member firm of Ernst & Young Global ("E&Y Global"). EYCA employs over 800 people and holds itself out as one of the leading firms of auditors and business advisors in Ireland. EYCA served as SmartForce's independent accountant from 1994 until its merger with SkillSoft Corporation ("SkillSoft Corp.") in September 2002. EYCA issued unqualified audit reports on SmartForce's December 31, 1999, 2000 and 2001 consolidated financial statements. In those unqualified audit reports, EYCA represented, among other things, (i) that it had conducted its audits of SmartForce's financial statements in accordance with GAAS; and (ii) that in its opinion, based on its audits, the SmartForce financial statements presented fairly, in all material respects, the consolidated financial position and results of operations of SmartForce in conformity with GAAP.

2. Denis O'Hogan, age 57, is an Irish citizen. O'Hogan became a member of the Institute of Chartered Accountants in Ireland ("ICAI") in 1975, which is similar to being a certified public accountant in the United States.[3] Chartered Accountants are accounting professionals, some of whom are authorized to provide audit and assurance services within Ireland. O'Hogan has been employed by or a partner of EYCA or its predecessor since 1978. O'Hogan became a member of the SmartForce engagement team around 1994 in connection with the Company's preparation of the registration statement for its initial public offering ("IPO"). After the IPO, O'Hogan served as the concurring partner on the account until 1999, when he became the engagement partner. O'Hogan remained as the engagement partner until the Company engaged in a merger in September 2002, after which Ernst & Young LLP ("E&Y LLP") served as the Company's auditor. As of June 3, 2005, O'Hogan ceased working on engagements involving SEC registrants pending the outcome of these proceedings.

C. THE COMPANY

On September 6, 2002, SmartForce, a public limited company organized under the laws of the Republic of Ireland, merged with SkillSoft Corporation (which was a corporation organized under the laws of Delaware) and changed its name to SkillSoft PLC ("SkillSoft"). Although SmartForce emerged as the surviving entity, SkillSoft Corp. was deemed the acquirer

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3 Members of the ICAI use the designatory letters ACA for Associate Chartered Accountant of the Institute and FCA for Fellow Chartered Accountant of the Institute.

for accounting purposes and the former SkillSoft Corp. management took over management of the acquiring company. SkillSoft maintains its principal executive offices in New Hampshire. SkillSoft provides an Internet-based management and technology platform for training courseware, seminars, and reference materials geared toward business and IT professionals. SkillSoft's securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act and trade on NASDAQ.

D. FACTS

1. The Merger Announcement Between SmartForce and SkillSoft Corporation and Subsequent S-4 Registration Statements

On June 10, 2002, SkillSoft Corp. and SmartForce issued a press release announcing that the two companies had signed a definitive agreement to merge in a stock-for-stock transaction. Shortly thereafter, SmartForce filed a registration statement on Form S-4 regarding the merger in which SmartForce's financial statements for the year ended December 31, 2001 were incorporated by reference and included an unqualified audit report by EYCA dated January 16, 2002. The registration statement became effective on July 31, 2002.

2. SkillSoft Detects the Improper Accounting Practices by SmartForce

Before the markets opened on November 19, 2002, SkillSoft announced that in the process of preparing SmartForce's closing balance sheet, SkillSoft identified several accounting irregularities that would require SkillSoft to restate SmartForce's historical financial statements for the three-year period ended December 31, 2001, and for the six months ended June 30, 2002. Although the precise amount of the restatement was unknown at the time, SkillSoft estimated that SmartForce had prematurely recognized approximately $35 million to $40 million in revenue. The Company also announced that it was exiting certain business lines and that renewals from its corporate customers had slowed. After the announcement, SmartForce's stock price fell from $4.63 per share to $3.07 per share, a drop of 33.7 percent.

On September 22, 2003, SkillSoft filed with the Commission a Form 8-K/A, restating SmartForce's historical financial statements for the three-year period ended December 31, 2001, and for the six months ended June 30, 2002. Due to the nature and severity of the accounting errors and irregularities, E&Y LLP, SkillSoft's auditors, re-audited the annual financial statements pertaining to the Restatement Period. In the restatement, SkillSoft corrected multiple accounting irregularities consisting primarily of misapplication of certain revenue recognition principles by SmartForce, which had resulted in an overstatement of revenue by $113.6 million and net income by approximately $127 million during the Restatement Period.

3. Accounting for Software Sales

GAAP requires that revenue from the sale or license of software be recognized consistent with AICPA Statement of Position 97-2, Software Revenue Recognition ("SOP 97-2"). SOP 97-2 specifies the circumstances in which a company may recognize software license revenue upon delivery, and when a company must defer immediate revenue recognition. Software license revenue is generally recognizable upon delivery under SOP 97-2 if no significant production, customization or modification of software is required, if the remaining undelivered elements of the parties' arrangement are not essential to the functionality of the software, and if the following four basic criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) the vendor's fee is fixed or determinable; and (iv) collectibility is probable. Paragraph 28 of SOP 97-2 provides, among other things, that "if payment of a significant portion of the software licensing fee is not due until after the expiration of the license or more than twelve months after delivery, the licensing fee should be presumed not to be fixed or determinable." Moreover, when an arrangement involves multiple elements (e.g., software, upgrades, and consulting services), Paragraph 10 of SOP 97-2 requires that the fee be "allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated within the contract for each element. Vendor-specific objective evidence of fair value is limited to the following:

- The price charged when the same element is sold separately;
- For an element not yet being sold separately, the price established by management having the relevant authority; it must be probable that the price, once established, will not change before the separate introduction of the element into the marketplace."

Appendix B to SOP 97-2 states that the AICPA Accounting Standards Executive Committee (AcSEC) believes that the price for an element as included in a price list does not necessarily represent vendor-specific objective evidence of fair value ("VSOE") for that element.

4. Accounting for Non-Monetary Transactions

Under GAAP, accounting for non-monetary transactions should be based on the fair value of the assets or services involved, if it can be determined within reasonable limits. See Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions ("APB 29"). Paragraph 25 of APB 29 states, among other things, that fair value of a non-monetary asset "should be determined by referring to estimated realizable values in cash transactions of the same or similar assets, quoted market prices, independent appraisals, estimated fair values of assets or services received in exchange, and other available evidence." If neither the fair value of a non-monetary asset transferred nor the fair value of a non-monetary asset received in exchange is determinable within reasonable limits, the recorded amount of the non-monetary asset transferred from the enterprise may be the only available measure of the transaction. APB 29, para. 26.

5. Improper Accounting Practices by SmartForce

During the Restatement Period, SmartForce engaged in various improper accounting practices, including premature recognition of revenue from multi-element arrangements, improper recognition of revenue from reciprocal transactions, and premature recognition of revenue from reseller agreements. As a result of these improper accounting practices, SmartForce overstated its revenue by $113.6 million and net income by approximately $127 million.

The majority of the overstated revenue related to misapplication of the accounting guidance regarding VSOE and extended payment terms. More specifically, upon partial delivery, SmartForce recognized revenue prematurely despite not having VSOE for any of the elements sold. Similarly, SmartForce recognized revenue upon delivery from sales agreements that contained payment terms extending beyond 12 months even though the Company had an insufficient history of collecting on similar agreements without making concessions. The principal consequence of these practices was that SmartForce recognized revenue sooner than it otherwise should have.

In addition, during 2001, SmartForce also entered into several reciprocal non-monetary transactions with its customers, whereby the Company both sold and purchased goods or services without sufficient evidence to support the fair value of the goods or services exchanged. SmartForce recognized license revenue upon delivery of the software sold to its customer and recorded the acquisition from the customer as if it had been a separate, unrelated transaction. Instead, SmartForce should have recorded the sale and purchase as an exchange pursuant to APB 29, such that there would have been a gain only to the extent of any net cash received where the fair value of the assets or services involved could not be determined. Most of the reciprocal deals also included multi-elements and had extended payment terms. Revenue recognition from these transactions was also improper because the Company failed to meet the requirements under provisions of SOP 97-2 pertaining to VSOE and extended payment terms.

SmartForce also recognized revenue prematurely from reseller transactions, some of which were non-binding agreements and some of which contained termination clauses that allowed the customer to terminate the agreement prior to its expiration. For example, during the second and fourth quarters of 2001, SmartForce improperly recognized an aggregate of $5.5 million of revenue from two non-binding agreements with a reseller.

Consequently, SmartForce's financial statements, which were included in the Company's annual and quarterly reports during the Restatement Period, were materially false and misleading in that they overstated net income and revenue by failing to comply with GAAP. Several registration statements incorporated by reference various SmartForce financial statements for the restated periods.

6. The Respondents' Improper Conduct

EYCA performed the reviews and audits of SmartForce's financial statements during the Restatement Period. The auditors were responsible for reporting on whether SmartForces's annual financial statements complied with GAAP and for conducting the audits and reviews in accordance with GAAS. The auditors, however, failed to adequately audit SmartForce's financial statements, which allowed the Company's overstatement of its revenue and earnings during the Restatement Period to go undetected.

The members of the SmartForce engagement team did not possess adequate technical training and proficiency, as required under GAAS, to audit the Company's financial statements. Except for O'Hogan, the SmartForce engagement team had little or no training or experience with software revenue recognition prior to being assigned to the SmartForce engagement. After joining the SmartForce engagement team, they received limited training on GAAP. O'Hogan, the audit engagement partner during the Restatement Period, was considered by EYCA knowledgeable with regard to software revenue recognition. O'Hogan conducted a training course for EYCA's staff on the subject of SOP 97-2 and made presentations to software companies that were clients of EYCA. As discussed below, however, O'Hogan failed to take exception to SmartForce's misapplication of key provisions of SOP 97-2.

a. Failure to Adequately Audit Multi-Element Arrangements

On numerous multi-element arrangements, the auditors improperly accepted management's conclusion that SmartForce had VSOE for each element of the multi-element arrangements and concurred with the Company's up-front revenue recognition for the delivered elements. Had the auditors adequately tested SmartForce's determination that it had VSOE for each element of the multi-element arrangements, they would have discovered that such conclusion did not conform with GAAP.

SmartForce did not have VSOE for each element of its multi-element arrangements because (1) the elements were not sold separately, and (2) the list price was not representative of fair value, as the Company offered its customers significant discounts from the list price. The discount percentage varied from customer to customer. The auditors did not assess whether each element had been sold separately and whether such sales were sufficient to support the fair value of those elements. In addition, the auditors failed to analyze properly how the size and variability of the discounts offered by SmartForce affected the suitability of the price list as a basis for VSOE.

b. Failure to Adequately Audit Agreements with Extended Payment Terms

In connection with numerous agreements with extended payment terms, the auditors improperly accepted management's conclusions that the fees were fixed or determinable. In doing so, the auditors simply accepted management's representation that the Company had a history of entering into such agreements and had successfully collected on them without granting concessions. Had the auditors adequately tested SmartForce's collection history for agreements with extended payment terms, they would have discovered that the Company did not have a sufficient history of collecting on such agreements without making concessions.

c. Failure to Adequately Audit Reciprocal Non-Monetary Transactions

The auditors failed to adequately audit reciprocal non-monetary transactions between SmartForce and its customers. During 2001, SmartForce engaged in several reciprocal non-monetary transactions with certain customers. In these transactions SmartForce simultaneously sold and purchased products or services from the same customer, or the Company and the customer agreed to sell each other's products. SmartForce recognized the total amount from such sales as revenue.

Had the auditors adequately audited the non-monetary transactions, they would have discovered that SmartForce did not determine the fair value for such transactions, and accordingly, that the Company had improperly recognized revenue on those transactions. On some occasions, the auditors also failed to identify that the transaction was part of a reciprocal arrangement and thus failed to consider the applicability of APB 29.

d. Failure to Adequately Audit Non-Binding Agreements

During late June 2001, Smartforce entered into a letter agreement with a reseller, whereby the reseller agreed to "endeavor" to sell $2 million of Smartforce courseware. More specifically, the letter agreement provided that the reseller would endeavor to bundle a minimum of 400,000 units of Smartforce training courses with other software. The reseller would pay SmartForce $5.00 per each bundle shipped. SmartForce factored the receivable for this agreement, but was liable for any amounts unpaid by the reseller. SmartForce recognized the $2 million as revenue for the quarter ended June 30, 2001.

In December 2001, Smartforce entered into another letter agreement with the same reseller, whereby the reseller again agreed to endeavor to sell $3.5 million of Smartforce courseware. SmartForce factored the December endeavor receivable and again remained liable for any amounts unpaid by the reseller. SmartForce included the $3.5 million as revenue in its Form 10-K for fiscal 2001.

SmartForce should not have recognized up-front the $5.5 million as revenue because the reseller did not make a firm commitment.

While reviewing the work papers for the fourth quarter 2001 transactions, O'Hogan became concerned that the December transaction was not a firm commitment, and therefore the fee was not fixed or determinable. Based on the audit manager's explanation that the transaction was like the June endeavor agreement, for which SmartForce had received payment, and based on a purported representation from management that the endeavor agreement constituted a binding commitment, O'Hogan failed to take exception to the Company's improper revenue recognition on this transaction. Reliance on any such purported representation, however, was unwarranted in light of the fact that the endeavor agreement on its face provided that the reseller would merely make an effort to bundle SmartForce's products.

e. Failure to Adequately Audit a Multi-Element Arrangement

In mid-June 2001, SmartForce executed a three-year multi-element arrangement with a customer. The arrangement entitled the customer to use (i) SmartForce's platform and generic courseware, and (ii) third party content that SmartForce would customize. The third party content consisted of software developed by a private company. The total price charged by SmartForce for the arrangement was $5 million, of which $800,000 was applied toward the license for the SmartForce platform and generic courseware, while the remaining $4.2 million was earmarked for the third party content. The agreement obligated the customer to make two payments of $2.5 million to SmartForce, on July 6, 2001, and October 5, 2001.

During the quarter ended September 30, 2001, Smartforce recognized revenue on this multi-element arrangement ratably. Contrary to GAAP, in its fourth quarter 2001, however, SmartForce reversed most of the deferred revenue balances and recognized a sum of approximately $3.9 million in revenue. Accordingly, for fiscal 2001, SmartForce recognized $4.3 million on this arrangement and improperly included that revenue in the Company's Form 10-K for the year ended December 31, 2001.

In January, 2002, the audit manager reviewed and initialed a deferred revenue listing that clearly reflected that $3.9 million of the deferred revenue from the transaction with the customer had been taken into revenue. Notwithstanding this red flag, the audit manager failed to follow up on the matter and the auditors failed to discover that SmartForce had improperly recognized revenue from the arrangement.

f. Other Aspects of Respondents' Inadequate Audit

The Respondents' audit work was inadequate in other ways as well. For example, the auditors failed to take exception to revenue recognition from agreements that had effective dates but which did not indicate the date of execution, as well as to recognition of $2.4 million in revenue from an agreement that allowed either party to terminate the obligation without cause. Such termination clause rendered the fee not fixed or determinable.

The auditors also failed to document alleged representations made by SmartForce's management and certain procedures purportedly performed during the audits. For example, notwithstanding O'Hogan's purported reliance on management's representation that the endeavor phrase constituted a binding agreement in reaching his conclusion that the Company had properly recognized revenue on the re-seller transaction, he did not document that representation in the work papers. On several occasions, the auditors failed to document how they concluded that delivery had occurred and that the fee was fixed or determinable in light of the extended payment terms.

E. LEGAL DISCUSSION

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." Rule 102(e)(1)(iv)(B)(2). As stated below, O'Hogan acted unreasonably in failing to detect SmartForce's failure to comply with GAAP and in failing to comply with GAAS during EYCA's audits and reviews of the Company's financial statements during the Restatement Period.

1. Training and Proficiency of an Auditor

Regulation S-X, 17 CFR § 210 et seq., prescribes the qualifications of accountants and the contents of the accountants' reports that must be submitted with corporate financial statements. In particular, 17 CFR § 210.1-02(d) requires that the financial statements of a public corporation must be audited by an accountant in accordance with GAAS. GAAS requires that the audit be performed by "a person or persons having adequate technical training and proficiency as an auditor." AU § 210.01. GAAS requires that auditors be assigned "to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining." AU § 230.06.

2. Professional Care and Skepticism, Evidential Matter and Management Representations

GAAS provides that "[d]ue professional care is to be exercised in the planning and performance of the audit and the preparation of the report." AU § 230.01. Among other things, due professional care requires that an auditor exercise professional skepticism, defined as "an attitude that includes a questioning mind and a critical assessment of audit evidence." AU § 230.07. "Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence." AU § 230.08. "In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." AU § 230.09.

GAAS also requires that "[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 326.01. "To be competent, evidence, regardless of its form, must be both valid and relevant." AU § 326.21. In addition, the auditor should "recognize the possibility that the financial statements may not be fairly presented in conformity with generally accepted accounting principles . . ." and should "consider relevant evidential matter regardless of whether it appears to corroborate or contradict the assertions in the financial statements." AU § 326.25. Management representations "are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 333.02.

3. Audit Working Papers

GAAS also provided that "the auditor should prepare and maintain working papers . . ." and that "[t]he information contained in working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters." AU § 339.01. Working papers ordinarily should include documentation showing that, among other things, "[t]he audit evidence obtained, the auditing procedures applied, and the testing performed have provided sufficient competent evidential matter to afford a reasonable basis for an opinion . . ." AU § 339.05.[4]

4. Deficiencies

a. EYCA

During the three-and-one-half years of the Restatement Period, EYCA failed to ensure that the engagement was adequately staffed, and that the auditors had the training and qualifications appropriate for the specific engagement and level of responsibilities assigned. As a result, EYCA failed to assign auditors with the requisite technical training and proficiency in auditing software companies to the SmartForce engagement. In addition, the audit staff assigned was neither adequately trained in the applicable accounting requirements for software companies nor properly supervised during the engagement. Hence, the engagement team reached erroneous conclusions during its reviews and audits of the SmartForce financial statements.

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4 The content of AU § 339 was replaced in or about January 2002 (effective for audits begun on or after May 15, 2002).

b. O'Hogan

O'Hogan placed undue reliance on management's representations and failed to, among other things, obtain sufficient competent evidential matter to ensure that the Company (i) had a history of collecting on contracts with extended payment terms without making concessions; (ii) had documented verifiable VSOE for each element of the multi-element arrangements; and (iii) could establish fair value for the reciprocal transactions. Moreover, O'Hogan failed to document an alleged management representation upon which he placed reliance to support an opinion that revenue was properly recognized.

Accordingly, O'Hogan failed to comply with GAAS. He failed to exercise due professional care in violation of AU § 230.01; failed to maintain an attitude of professional skepticism in violation of AU § 230.07; failed to obtain sufficient competent evidential matter in violation of AU § 326.01; and failed to document evidence obtained in violation of AU § 339.05; the audit manager also lacked adequate technical training and proficiency and was not supervised properly by O'Hogan in violation of AU § 210.01 and § 230.06.

F. FINDINGS

Based on the foregoing, the Commission finds that EYCA and O'Hogan engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice. Specifically, EYCA and O'Hogan engaged in repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

G. REMEDIAL STEPS TAKEN BY EYCA SINCE ITS AUDITS OF SMARTFORCE

Since its audits of SmartForce, EYCA has undertaken remedial steps regarding risk management, audit procedures, staffing of engagements, and training of its staff.

H. UNDERTAKINGS BY RESPONDENTS

1. *Ongoing Cooperation:* Respondents shall cooperate fully and reasonably with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondents have undertaken:

   a. To produce, on reasonable notice, without service of a notice or subpoena, any and all relevant documents and other information reasonably requested by the Commission's staff;

   b. EYCA shall use its best efforts to cause its employees to be interviewed by the Commission's staff at such times as the staff reasonably may direct;

c. EYCA shall use its best efforts to cause its employees to appear and testify truthfully and completely, on reasonable notice, without service of a notice or subpoena in such investigations, depositions, hearings or trials as may reasonably be requested by the Commission's staff; and

d. If requested by the Commission's staff, Respondent O'Hogan shall agree to be interviewed by the Commission's staff at such times as the staff reasonably may direct, and to appear and testify truthfully and completely, on reasonable notice, without service of a notice or subpoena in such investigations, depositions, hearings or trials.

I. ADDITIONAL UNDERTAKINGS BY EYCA

1. Within 10 days of the issuance of this Order, EYCA undertakes to pay $725,000 to the United States Treasury, which represents the amount of EYCA's fees for reviewing and auditing SmartForce's financial statements between 1999 and June 2002. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies EYCA as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Carlos Costa-Rodrigues, Boston District Office, Securities and Exchange Commission, 33 Arch Street, Twenty Third Floor, Boston, MA 02110.

2. *Training in Generally Accepted Accounting Principles and PCAOB Standards*: EYCA shall ensure that training is provided to its audit professionals prior to assignment to SEC registrant engagements, in the requirements of GAAP and GAAS – including SOP 97-2 and APB 29, and PCAOB Standards – that is consistent and appropriate in light of the roles and expectations for that audit professional on each specific engagement.

3. *Fraud Detection Training*: EYCA shall ensure that its audit professionals assigned to SEC registrant engagements undergo fraud detection training conducted by the Association of Certified Fraud Examiners or another comparable organization. Such training must be completed within 12 months from the date of the Order. The training will include techniques in detecting and responding to possible fraud by audit clients or by employees, officers or directors of audit clients.

4. *Personnel Assignments to SEC Registrant Engagements*: EYCA shall improve implementation of its written policies and procedures to provide reasonable assurance that personnel assigned to audits and SAS 100 interim reviews of SEC registrant engagements will have the skills, training and competencies necessary to fulfill the roles and responsibilities

expected of them on the particular engagement. Assignment considerations will include such factors as: engagement size and complexity; specialized experience and expertise required; personnel availability and the involvement of supervisory personnel; timing of the work to be performed; and continuity and rotation of personnel.

5. *Professional Development Program*: EYCA shall maintain a professional development program designed to provide reasonable assurances that personnel assigned to audits and reviews of SEC registrants participate in professional development activities in accordance with firm guidelines and in subjects that are relevant to their responsibilities.

6. *Qualifications of SEC Registrant Engagement Personnel*: EYCA shall adopt and implement written policies and procedures for documenting the qualifications, training and current responsibilities of senior engagement personnel assigned to each SEC registrant audit engagement. EYCA shall adopt written policies and procedures to ensure that the engagement team on SEC registrant engagements includes members who have the requisite skills, training and experience in light of the characteristics of the registrant and risk involved.

7. *Documentation of Significant Consultation:* EYCA shall adopt and implement written policies and procedures designed to provide reasonable assurance that work papers prepared in connection with the audits of the financial statements of SEC registrants include documentation of significant consultations with the filing reviewers, firm specialists or others within or without the firm, as required by PCAOB rules. The documentation of such consultations should be in accordance with PCAOB rules.

8. *Distribution of Order*: EYCA shall distribute a copy of this Order to all of its audit professionals within 10 business days after entry of the Order.

9. *Certification of Compliance with the Undertakings*: At the end of one year from the entry of this Order, EYCA shall certify in writing to the Commission staff that it is in compliance with the undertakings set forth herein.

In determining whether to accept the Respondents' Offers, the Commission has considered these undertakings and the remedial acts already undertaken by EYCA.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents' Offers.

Accordingly, it is hereby ORDERED, effective immediately, that:

a. EYCA is censured pursuant to Rule 102(e)(1)(ii).

b. O'Hogan is denied the privilege of appearing or practicing before the Commission as an accountant.

c. After two (2) years from the date of this Order, O'Hogan may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that O'Hogan's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that: (a) O'Hogan, or the public accounting firm with which he is associated, is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective; (b) O'Hogan, or the registered public accounting firm with which he is associated, has been inspected by the PCAOB or equivalent Irish organization and that inspection did not identify any criticisms of or potential defects in O'Hogan's or the firm's quality control system that would indicate that O'Hogan will not receive appropriate supervision or, if the PCAOB has not conducted an inspection, has received an unqualified report relating to his, or the firm's, most recent peer review conducted in accordance with the guidelines adopted by the former SEC Practice Section of the American Institute of Certified Public Accountants Division for CPA Firms or an organization providing equivalent oversight and quality control functions; (c) O'Hogan has resolved any disciplinary issues with the PCAOB or equivalent Irish organization, and has complied with all terms and conditions of any sanctions imposed (other than reinstatement by the Commission); and (d) O'Hogan acknowledges his responsibility, as long as O'Hogan appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

d. The Commission will consider an application by O'Hogan to resume appearing or practicing before the Commission provided that his chartered accountant license is current and he has resolved any disciplinary issues with the applicable Irish Institute of Chartered Accountants. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to O'Hogan's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 19, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12702

In the Matter of **Bentley Commerce Corp.,** **ECO2, Inc.,** **Guideline Capital, Inc.,** **Lapitos Acquisition Corp.,** **Para Mas Internet, Inc.,** **Prentice Capital, Inc., and** **Spa Faucet, Inc.,** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Bentley Commerce Corp. ("Bentley Commerce") (CIK No. 1091964) is a Florida corporation located in Beverly Hills, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Bentley Commerce is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $601,389 for the prior three months. As of July 17, 2007, the company's common stock (symbol "BLYO") was quoted on the Pink Sheets, had nineteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

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2. ECO2, Inc. ("ECO2") (CIK No. 889418) is a void Delaware corporation located in Tampa, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). ECO2 is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 1997, which reported a net loss of $987,513 for the prior three months. As of July 17, 2007, the company's common stock (symbol "ECOI") was quoted on the Pink Sheets.

3. Guideline Capital, Inc. ("Guideline Capital") (CIK No. 1129930) is a revoked Nevada corporation located in Portland, Oregon with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Guideline Capital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2004, which reported a net loss of $11,707 for the prior six months.

4. Lapitos Acquisition Corp. ("Lapitos") (CIK No. 1091966) is a void Delaware corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Lapitos is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2000. Lapitos was a "blank check" company which was acquired through a reorganization agreement with Para Mas Internet, Inc. ("Para Mas"). Upon effectiveness of the reorganization agreement, pursuant to Rule 12(g)-3(a) of the Exchange Act, Para Mas became the successor issuer to Lapitos for reporting purposes under the Exchange Act and elected to report effective April 17, 2000. Para Mas has failed to file a Form 15 for Lapitos to terminate Lapitos's reporting obligation.

5. Para Mas (CIK No. 1103145) is a revoked Nevada corporation located in Surrey, British Columbia, Canada. Para Mas is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2005, which reported a net loss of $176,814 for the prior six months. As of July 17, 2007, the company's common stock (symbol "PMIJ") was quoted on the Pink Sheets.

6. Prentice Capital, Inc. ("Prentice Capital") (CIK No. 870256) is a void Delaware corporation located in Boca Raton, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Prentice Capital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1997, which reported a net loss of $45,793 for the prior three months.

7. Spa Faucet, Inc. ("Spa Faucet") (CIK No. 1026495) is an expired Utah corporation located in Chatsworth, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Spa Faucet is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB on February 12, 1998. As of July 17, 2007, the company's common stock (symbol "DRIP") was quoted on the Pink Sheets.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified or Express Mail, or by other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Chart of Delinquent Filings by
Bentley Commerce Corp., et al.

Company Name	Form Type	Period Ended	Due Date	Date Rec'd	Months Delinquent (rounded up)
Bentley Commerce Corp.					
	10-KSB	06/30/05	09/28/05	Not filed	22
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-QSB	12/31/05	02/14/06	Not filed	17
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-KSB	06/30/06	09/28/06	Not filed	10
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-QSB	12/31/06	02/14/07	Not filed	5
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	8				
ECO2, Inc.					
	10-QSB	06/30/97	08/14/97	Not filed	119
	10-KSB	09/30/97	12/29/97	Not filed	115
	10-QSB	12/31/97	02/17/98	Not filed	113
	10-QSB	03/31/98	05/15/98	Not filed	110
	10-QSB	06/30/98	08/14/98	Not filed	107
	10-KSB	09/30/98	12/29/98	Not filed	103
	10-QSB	12/31/98	02/16/99	Not filed	101
	10-QSB	03/31/99	05/17/99	Not filed	98
	10-QSB	06/30/99	08/16/99	Not filed	95
	10-KSB	09/30/99	12/29/99	Not filed	91
	10-QSB	12/31/99	02/14/00	Not filed	89
	10-QSB	03/31/00	05/15/00	Not filed	86
	10-QSB	06/30/00	08/14/00	Not filed	83
	10-KSB	09/30/00	12/29/00	Not filed	79
	10-QSB	12/31/00	02/14/01	Not filed	77
	10-QSB	03/31/01	05/15/01	Not filed	74
	10-QSB	06/30/01	08/14/01	Not filed	71
	10-KSB	09/30/01	12/31/01	Not filed	67
	10-QSB	12/31/01	02/14/02	Not filed	65
	10-QSB	03/31/02	05/15/02	Not filed	62

Company Name	Form Type	Period Ended	Due Date	Date Rec'd	Months Delinquent (rounded up)
ECO2, Inc.					
	10-QSB	06/30/02	08/14/02	Not filed	59
	10-KSB	09/30/02	12/30/02	Not filed	55
	10-QSB	12/31/02	02/14/03	Not filed	53
	10-QSB	03/31/03	05/15/03	Not filed	50
	10-QSB	06/30/03	08/14/03	Not filed	47
	10-KSB	09/30/03	12/29/03	Not filed	43
	10-QSB	12/31/03	02/17/04	Not filed	41
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-KSB	09/30/04	12/29/04	Not filed	31
	10-QSB	12/31/04	02/14/05	Not filed	29
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-KSB	09/30/05	12/29/05	Not filed	19
	10-QSB	12/31/05	02/14/06	Not filed	17
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-KSB	09/30/06	12/29/06	Not filed	7
	10-QSB	12/31/06	02/14/07	Not filed	5
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	40				
Guideline Capital, Inc.					
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	11				

Company Name	Form Type	Period Ended	Due Date	Date Rec'd	Months Delinquent (rounded up)
Lapitos Acquisition Corp.					
	10-QSB	06/30/00	08/14/00	Not filed	83
	10-QSB	09/30/00	11/14/00	Not filed	80
	10-KSB	12/31/00	04/01/01	Not filed	75
	10-QSB	03/31/01	05/15/01	Not filed	74
	10-QSB	06/30/01	08/14/01	Not filed	71
	10-QSB	09/30/01	11/14/01	Not filed	68
	10-KSB	12/31/01	04/01/02	Not filed	63
	10-QSB	03/31/02	05/15/02	Not filed	62
	10-QSB	06/30/02	08/14/02	Not filed	59
	10-QSB	09/30/02	11/14/02	Not filed	56
	10-KSB	12/31/02	03/31/03	Not filed	52
	10-QSB	03/31/03	05/15/03	Not filed	50
	10-QSB	06/30/03	08/14/03	Not filed	47
	10-QSB	09/30/03	11/14/03	Not filed	44
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/30/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	03/31/07	Not filed	4
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	31				
Para Mas Internet, Inc.					
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3

Company Name	Form Type	Period Ended	Due Date	Date Rec'd	Months Delinquent (rounded up)
Para Mas Internet, Inc.					
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	7				
Prentice Capital, Inc.					
	10-KSB	12/31/97	03/31/98	Not filed	112
	10-QSB	03/31/98	05/15/98	Not filed	110
	10-QSB	06/30/98	08/14/98	Not filed	107
	10-QSB	09/30/98	11/16/98	Not filed	104
	10-KSB	12/31/98	03/31/99	Not filed	100
	10-QSB	03/31/99	05/17/99	Not filed	98
	10-QSB	06/30/99	08/16/99	Not filed	95
	10-QSB	09/30/99	11/15/99	Not filed	92
	10-KSB	12/31/99	03/30/00	Not filed	88
	10-QSB	03/31/00	05/15/00	Not filed	86
	10-QSB	06/30/00	08/14/00	Not filed	83
	10-QSB	09/30/00	11/14/00	Not filed	80
	10-KSB	12/31/00	04/02/01	Not filed	75
	10-QSB	03/31/01	05/15/01	Not filed	74
	10-QSB	06/30/01	08/14/01	Not filed	71
	10-QSB	09/30/01	11/14/01	Not filed	68
	10-KSB	12/31/01	04/01/02	Not filed	63
	10-QSB	03/31/02	05/15/02	Not filed	62
	10-QSB	06/30/02	08/14/02	Not filed	59
	10-QSB	09/30/02	11/14/02	Not filed	56
	10-KSB	12/31/02	03/31/03	Not filed	52
	10-QSB	03/31/03	05/15/03	Not filed	50
	10-QSB	06/30/03	08/14/03	Not filed	47
	10-QSB	09/30/03	11/14/03	Not filed	44
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23

Company Name	Form Type	Period Ended	Due Date	Date Rec'd	Months Delinquent (rounded up)
Prentice Capital, Inc.					
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	3/31/07	05/15/07	Not filed	2
Total Filings Delinquent	38				
Spa Faucet, Inc.					
	10-QSB	08/31/97	10/15/97	Not filed	117
	10-QSB	11/30/97	01/14/98	Not filed	114
	10-QSB	02/28/98	04/14/98	Not filed	111
	10-KSB	05/31/98	08/31/98	Not filed	107
	10-QSB	08/31/98	10/15/98	Not filed	105
	10-QSB	11/30/98	01/14/99	Not filed	102
	10-QSB	02/28/99	04/14/99	Not filed	99
	10-KSB	05/31/99	08/30/99	Not filed	95
	10-QSB	08/31/99	10/15/99	Not filed	93
	10-QSB	11/30/99	01/14/00	Not filed	90
	10-QSB	02/29/00	04/14/00	Not filed	87
	10-KSB	05/31/00	08/29/00	Not filed	83
	10-QSB	08/31/00	10/16/00	Not filed	81
	10-QSB	11/30/00	01/16/01	Not filed	78
	10-QSB	02/28/01	04/16/01	Not filed	75
	10-KSB	05/31/01	08/29/01	Not filed	71
	10-QSB	08/31/01	10/15/01	Not filed	69
	10-QSB	11/30/01	01/14/02	Not filed	66
	10-QSB	02/28/02	04/15/02	Not filed	63
	10-KSB	05/31/02	08/29/02	Not filed	59
	10-QSB	08/31/02	10/15/02	Not filed	57
	10-QSB	11/30/02	01/14/03	Not filed	54
	10-QSB	02/28/03	04/14/03	Not filed	51
	10-KSB	05/31/03	08/29/03	Not filed	47
	10-QSB	08/31/03	10/15/03	Not filed	45
	10-QSB	11/30/03	01/14/04	Not filed	42

Company Name	Form Type	Period Ended	Due Date	Date Rec'd	Months Delinquent (rounded up)
Spa Faucet, Inc.					
	10-QSB	02/28/04	04/13/04	Not filed	39
	10-KSB	05/31/04	08/30/04	Not filed	35
	10-QSB	08/31/04	10/15/04	Not filed	33
	10-QSB	11/30/04	01/14/05	Not filed	30
	10-QSB	02/28/05	04/14/05	Not filed	27
	10-KSB	05/31/05	08/29/05	Not filed	23
	10-QSB	08/31/05	10/17/05	Not filed	21
	10-QSB	11/30/05	01/17/06	Not filed	18
	10-QSB	02/28/06	04/14/06	Not filed	15
	10-KSB	05/31/06	08/29/06	Not filed	11
	10-QSB	08/31/06	10/17/06	Not filed	9
	10-QSB	11/30/06	01/16/07	Not filed	6
	10-QSB	02/28/07	04/16/07	Not filed	3

Total Filings Delinquent 39

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 56105 / July 19, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
RELEASE NO. 2648 / July 19, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12704

In the Matter of DAVID C. DRUMMOND, JOHN P. HAYES, FCA, and PATRICK E. MURPHY, FCA, Respondents.	ORDER INSTITUTING CEASE-AND-DESIST AND PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE MAKING FINDINGS, IMPOSING A CEASE -AND-DESIST ORDER, REMEDIAL SANCTIONS, AND OTHER RELIEF

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against David C. Drummond ("Drummond"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and that cease-and-desist and public administrative proceedings be, and hereby are, instituted against John P. Hayes ("Hayes") and Patrick E. Murphy ("Murphy") pursuant to Section 21C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)].[1]

[1] Rule 102(e)(1)(iii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it ... to any person who is found ... to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

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II.

In anticipation of the institution of these proceedings, each Respondent has submitted an Offer of Settlement ("Offers") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and over the subject matter of these proceedings, which are admitted, the Respondents each consent to the entry of this Order Instituting Cease-And-Desist and Public Administrative Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, Imposing a Cease-And-Desist Order, Remedial Sanctions, and Other Relief ("Order"), as set forth below.

III.

On the basis of this Order and the Respondents' Offers, the Commission finds[2] that:

A. RESPONDENTS

1. Drummond, age 43, is a resident of San Jose, California. Drummond was the Chief Financial Officer ("CFO") of SmartForce PLC ("SmartForce" or the "Company"), now known as SkillSoft PLC ("SkillSoft"), from July 1999 to February 2002, when he left the Company to become General Counsel and Vice President ("VP") for Corporate Development of another now public company. Prior to joining SmartForce as the CFO, Drummond was a partner at a major law firm and his professional training is as a lawyer. Drummond has no formal training in accounting and has never been a certified public accountant.

2. Murphy, age 56, is an Irish citizen. Murphy is a chartered accountant and has been a member of the Institute of Chartered Accountants ("ICA") in Ireland since 1989, which is similar to being a certified public accountant in the United States.[3] Murphy joined SmartForce in January 1996 as a group controller and reported to Hayes. As a group controller, Murphy worked primarily on consolidation of the North America and Australia accounts. Murphy was promoted to VP of Finance-North America in January 1998 and then to VP of Global Finance in

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2 The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

3 Members of the ICA use the designatory letters ACA for associate chartered accountant andFCA for fellow chartered accountant.

September 2001. In February 2002, Murphy became the acting CFO, a position he held until the merger. Prior to joining SmartForce, Murphy worked for Ernst & Young Chartered Accountants in Dublin ("EYCA") where he performed work on the account of CBT Systems Limited (predecessor to SmartForce) at the company's California headquarters during 1995.

3. Hayes, age 53, is an Irish citizen. Hayes is a chartered accountant and has been a member of the ICA in Ireland since 1983. In 1986, Hayes joined SmartForce (then CBT Systems Limited, which at the time was privately-held) as the controller. Around the time that CBT Systems went public in 1995, Hayes became the chief accounting officer and was responsible for making all accounting decisions at the company. After Murphy joined the Company, he and Hayes divided the accounting responsibilities: Murphy became responsible for the accounts in the Americas and Australia while Hayes remained responsible for the European and South African accounts. Hayes retained the title of VP of Finance for the European Division from January 1998 until September 2001, when he retired from the Company.

B. RELATED PARTY

SkillSoft is a public limited company organized under the laws of the Republic of Ireland. SkillSoft maintains its principal executive offices in New Hampshire. SkillSoft is the product of a September 6, 2002 merger between the SkillSoft Corporation ("SkillSoft Corp.") and SmartForce, a company organized under the laws of the Republic of Ireland that began trading on NASDAQ in April 1995. Although SmartForce emerged as the surviving entity, SkillSoft Corp. was deemed to be the acquirer for accounting purposes. Following the merger, SmartForce changed its name to SkillSoft PLC. In this order "SmartForce" refers to SmartForce PLC prior to the merger with SkillSoft Corp. SkillSoft provides an Internet-based management and technology platform for training courseware, seminars, and reference materials geared toward business and IT professionals. SkillSoft's securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act and trade on NASDAQ.

C. FACTS

1. The Merger Between SmartForce and SkillSoft

On June 10, 2002, SkillSoft Corp. and SmartForce issued a press release announcing that the two companies had signed a definitive agreement to merge in a stock-for-stock transaction. A couple of weeks later, SmartForce filed a registration statement on Form S-4, regarding the merger, in which SmartForce's financial statements, including an unqualified audit report by EYCA dated January 16, 2002, were incorporated by reference.

2. The Restatement

Before the markets opened on November 19, 2002, SkillSoft announced that in the process of preparing SmartForce's closing balance sheet, SkillSoft identified several accounting issues concerning generally accepted accounting principles in the United States ("GAAP") that would require SkillSoft to restate SmartForce's historical financial statements for the three-year period ended December 31, 2001 and for the six months ended June 30, 2002 (the "Restatement Period"). Although the precise amount of the restatement was unknown at the time, SkillSoft estimated that SmartForce had prematurely recognized approximately $35 million to $40 million in revenue. SkillSoft also announced, along with the accounting restatement, that SkillSoft would be exiting three service lines of business with an approximately $30 million annual reduction in revenue, and that SkillSoft had been experiencing materially lower renewal rates. The day after the announcement, SkillSoft's stock price fell from $4.63 per share to $3.07 per share, a drop of 33.7 percent.

On September 22, 2003, SkillSoft filed with the Commission a Form 8-K/A, restating SmartForce's historical financial statements for the three-year period ended December 31, 2001 and for the six months ended June 30, 2002. Due to the nature and severity of the accounting issues identified, Ernst & Young LLP in the United States, SkillSoft's auditors, re-audited the financial statements pertaining to the entire Restatement Period and made over 300 adjustments to correct the previously issued financial statements. In the restatement, SkillSoft corrected multiple inaccurate accounting entries - primarily misapplication of certain revenue recognition principles by SmartForce, which had resulted in an overstatement of revenue by $113.6 million and net income by approximately $127 million during the Restatement Period.

3. Accounting for Software Sales

GAAP requires that revenue from the sale or license of software be recognized consistent with AICPA Statement of Position 97-2, as amended, ("SOP 97-2"). SOP 97-2 specifies the circumstances in which a company may recognize software license revenue upon delivery, and when a company must defer revenue recognition. Software license revenue is generally recognizable upon delivery under SOP 97-2 if no significant production, customization or modification of software is required, if the remaining undelivered elements of the parties' arrangement are not essential to the functionality of the software, and if the following four basic criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) the vendor's fee is fixed or determinable; and (iv) collectibility is probable. Paragraph 28 of SOP 97-2 provides, among other things, that "if payment of a significant portion of the software licensing fee is not due until after the expiration of the license or more than twelve months after delivery, the licensing fee should be presumed not to be fixed or determinable." Moreover, when an arrangement involves multiple elements (e.g., software, upgrades, or consulting services), Paragraph 10 of SOP 97-2 requires that the fee be:

> allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated within the contract for each element. Vendor-specific objective evidence of fair value is limited to the following:
>
> - The price charged when the same element is sold separately;

- For an element not yet being sold separately, the price established by management having the relevant authority; it must be probable that the price, once established, will not change before the separate introduction of the element into the marketplace.

SOP 97-2 makes clear that the price for an element as included in a price list does not necessarily represent vendor-specific objective evidence of fair value ("VSOE") for that element.

4. Accounting for Non-Monetary Transactions

Under GAAP, accounting for non-monetary transactions should be based on the fair value of the assets or services involved, if it can be determined within reasonable limits. See Accounting Principles Board Opinion No. 29, "Accounting for Nonmonetary Transactions" ("APB 29"). Paragraph 25 of APB 29 states, among other things, that fair value of an asset "should be determined by referring to estimated realizable values in cash transactions of the same or similar assets, quoted market prices, independent appraisals, estimated fair values of assets or services received in exchange, and other available evidence." If neither the fair value of a non-monetary asset transferred nor the fair value of a non-monetary asset received in exchange is determinable within reasonable limits, the recorded amount of the non-monetary asset transferred from the enterprise may be the only available measure of the transaction. APB 29, para. 26.

5. Accounting Practices by SmartForce

During the Restatement Period, SmartForce engaged in various improper accounting practices, including premature recognition of revenue from multi-element arrangements, improper recognition of revenue from reciprocal transactions, and premature recognition of revenue from reseller agreements. As a result of these accounting practices, SmartForce overstated its revenue by $113.6 million and net income by approximately $127 million.

The vast majority of the overstated revenue related to misapplication of the accounting guidance regarding VSOE and extended payment terms. More specifically, SmartForce recognized revenue upon delivery from multi-element arrangements despite not having VSOE for each undelivered element as required under GAAP. Similarly, SmartForce recognized revenue upon delivery from sales agreements that contained payment terms extending beyond 12 months even though the Company had no history of collecting on similar agreements without making concessions.

In addition, during 2001, SmartForce also entered into several reciprocal non-monetary transactions with its customers, whereby the Company both sold and purchased goods or services without sufficient evidence to support the fair value of the goods or services exchanged.

SmartForce recognized license revenue upon delivery of the software sold to its customers and recorded the purchases from its customers as if they had been separate, unrelated transactions. Instead, SmartForce should have recorded the sales and purchases as exchanges pursuant to APB 29, such that there would have been a gain only to the extent of any net cash received. Most of the reciprocal deals also included multiple elements and had extended payment terms. Revenue recognition from these transactions was also improper because the Company failed to meet the requirements under provisions of SOP 97-2 pertaining to VSOE and extended payment terms.

SmartForce also recognized revenue prematurely from reseller transactions, some of which were non-binding agreements and some of which contained termination clauses that allowed the customer to terminate the agreement prior to its expiration. For example, during the second and fourth quarters of 2001, SmartForce improperly recognized $5.5 million of revenue from two non-binding agreements with a reseller.

Consequently, SmartForce's financial statements, which were included in the Company's annual and quarterly reports during the Restatement Period, were materially false and misleading in that they overstated net income and revenue by failing to comply with GAAP. Several registration statements incorporated by reference various SmartForce financial statements for the restated periods. This Order relates only to the financial statements of SmartForce for the restated periods prior to the merger between SmartForce and SkillSoft Corp.

6. The Conduct of Respondents Murphy and Hayes

Murphy and Hayes shared the primary responsibility for the accounting decisions at SmartForce and for making sure that such accounting complied with GAAP. Murphy was responsible for the accounts from the Americas and Australia, which constituted 70 percent of SmartForce's business, while Hayes was responsible for the European and South African accounts, which represented the other 30 percent of SmartForce's business.

On several multi-element arrangements, Murphy and Hayes improperly concluded that SmartForce had VSOE for each element of the arrangement and determined that the Company could recognize revenue up-front for the delivered elements. SmartForce, however, did not have VSOE for each element of its multi-element arrangements because (i) the elements were not sold separately, and (ii) the list price was not representative of fair value, as the Company offered its customers significant discounts from the list price. The discount percentage varied from customer to customer. However, SmartForce performed no analysis to determine which elements were sold separately and whether there was an adequate amount of separate sales to support the fair value of the elements, nor did it perform an analysis to assess how the discounts affected its price list. Accordingly, the determination that SmartForce had VSOE for each element of the multi-element arrangements did not conform with GAAP.

Moreover, despite the extended payment terms in the arrangements, Murphy and Hayes incorrectly concluded that the fees being charged by SmartForce were fixed or determinable. In doing so, Murphy and Hayes concluded that the Company had a history of entering into such agreements and had successfully collected on them without granting concessions. SmartForce, however, did not have an adequate history of successful payment collections without concessions.

During 2001, SmartForce engaged in several reciprocal non-monetary arrangements with certain customers. In these arrangements SmartForce simultaneously sold and purchased products or services from the same customer, or the Company and the customer agreed to sell each other's products. Murphy and Hayes allowed SmartForce to recognize the total amount from such sales as revenue. The Company, however, should have recorded a gain only to the extent of any net cash received.

For example, in mid-June 2001, SmartForce and a customer executed a three-year multi-element arrangement. The arrangement entitled the customer to use (i) SmartForce's platform and generic courseware, and (ii) third party content. The third party content consisted of software developed by a private software company.

The total price SmartForce charged the customer for the arrangement was $5 million, of which $800,000 was applied toward the license for the SmartForce platform and generic courseware, while the remaining $4.2 million was earmarked for the software company's content. The agreement obligated the customer to make two payments of $2.5 million to SmartForce, on July 6, 2001 and October 5, 2001. Even though SmartForce did not determine fair value for either the courses it was selling to the customer or the software it was purchasing from the private software company, at Murphy's direction, the Company recorded $4.3 million as revenue from this arrangement. Such accounting did not comport with GAAP.

During the relevant period, Murphy and Hayes sold shares of SmartForce at prices that were inflated because of the accounting issues.

7. Respondent Drummond's Conduct

Drummond was hired as CFO of SmartForce in July 1999. Drummond is a lawyer who had been a partner at a major law firm and who had no formal accounting training or background. Accordingly, the accounting function was handled primarily by Hayes and Murphy although Drummond, in his capacity as CFO, ultimately had responsibility for SmartForce's financial statements.

During late June 2001, SmartForce entered into a letter agreement with a reseller whereby the reseller agreed to "endeavor" to sell $2 million of SmartForce courseware. More specifically, the letter agreement provided that the reseller would endeavor to bundle a minimum of 400,000 units of SmartForce training courses with other software, and would pay

SmartForce $5.00 per each bundle shipped. Drummond learned of this non-binding agreement before the end of the second quarter 2001, and knew or should have known that it would have been improper for SmartForce to recognize revenue from such agreement. Nonetheless, Drummond did not take any steps to determine whether SmartForce was recognizing revenue from the agreement or whether the accounting for the agreement complied with GAAP. SmartForce incorrectly recognized the $2 million as revenue and included the revenue in its Form 10-Q for the second quarter of 2001.

Moreover, prior to the end of the second quarter 2001, Drummond became aware of the arrangement among SmartForce, the private software company, and the customer described above, as he was consulted by the SmartForce salespeople negotiating the arrangement with the customer and actively participated in negotiating the transaction. Drummond knew that the customer dictated the price that SmartForce paid for the third party content described above. Because Drummond relied on Murphy to account for this three-way arrangement, Drummond should have communicated such information to Murphy. Drummond, however, failed to do so. Furthermore, Drummond did not take any steps to determine whether the accounting for the arrangement complied with GAAP. Consequently, for fiscal 2001, SmartForce recognized $4.3 million on this arrangement and included that revenue in the Company's Form 10-K for the year ended December 31, 2001.

During the relevant period, Drummond sold shares of SmartForce at prices that were inflated because of the accounting issues.

8. Federal Securities Laws Violations and Findings

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Exchange Act Rule 12b-20 further requires the inclusion of any additional material information that is necessary to make required statements, in light of the circumstances under which they were made, not misleading. Information regarding the financial condition of a company is presumptively material. *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985). As a result of the conduct described above, Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets. As a result of the conduct described above, Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Section 13(b)(2)(A) of the Exchange Act.

Section 13(b)(2)(B) of the Exchange Act requires Section 12 registrants to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (i) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (ii) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences." Section 13(b)(5) of the Exchange Act provides that "no person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account" described in Section 13(b)(2)(B). As a result of the conduct described above, Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Section 13(b)(2)(B) of the Exchange Act. Moreover, as a result of the conduct described above, Drummond violated, and Murphy and Hayes willfully violated, Section 13(b)(5) of the Exchange Act.

Based on the foregoing, the Commission finds that (a) Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 promulgated thereunder; and (b) Drummond violated, and Murphy and Hayes willfully violated, Section 13(b)(5) of the Exchange Act.

Based on the foregoing, the Commission finds that Murphy and Hayes willfully violated and willfully aided and abetted violations of the federal securities laws and rules thereunder within the meaning of Rule 102(e)(1)(iii) of the Commission's Rules of Practice and as accountants are subject to sanctions under the Rule.

D. UNDERTAKINGS BY RESPONDENTS

1. Respondents each undertake and agree to cooperate fully with the Commission in any and all Commission investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondents have undertaken:

a. To produce, without service of a notice or subpoena, any and all relevant and non-privileged documents and other information requested by the Commission's staff;

b. If requested by the Commission's staff, Respondents Drummond, Murphy, and Hayes shall agree to be interviewed by the Commission's staff at such times as the staff reasonably may direct, and appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials;

2. In determining to accept the Respondents' Offers of Settlement, the Commission has considered the undertakings set forth in this Section.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in each Respondent's Offer of Settlement.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondents Drummond, Murphy, and Hayes shall cease and desist from committing or causing any violations and any future violations of Section 13(b)(5) of the Exchange Act; and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

B. Respondents Murphy and Hayes are denied the privilege of appearing or practicing before the Commission as accountants.

C. After two (2) years from the date of this order Murphy may request that the Commission consider his reinstatement. After two (2) years from the date of this order Hayes may request that the Commission consider his reinstatement. Each Respondent shall make any such request by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that the Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board or equivalent Irish organization and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board or equivalent Irish organization, and has complied with all terms and conditions of any sanctions imposed (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as the Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by either Respondent to resume appearing or practicing before the Commission provided that his chartered accountant license is current and he has resolved all other regulatory or disciplinary issues, if any, with the applicable Irish institute of chartered accountants. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent Drummond shall, within 10 days of the entry of this Order, pay disgorgement of $454,105 and prejudgment interest of $119,874 to the United States Treasury.

F. Respondent Murphy shall, within 10 days of the entry of this Order, pay disgorgement of $449,269 and prejudgment interest of $118,597 to the United States Treasury.

G. Respondent Hayes shall, within 10 days of the entry of this Order, pay disgorgement of $673,882 and prejudgment interest of $188,513 to the United States Treasury.

H. Such payments shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies the particular Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Carlos Costa-Rodrigues, Boston District Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 20, 2007

IN THE MATTER OF **American Pad & Paper Co.,** **The CattleSale Co.,** **CHS Electronics, Inc.,** **Cypost Corp.,** **Gen-ID Lab Services, Inc.,** **Global Business Information Directory, Inc.,** **Golf Communities of America, Inc.,** **GSL Holdings, Inc.,** **Industrial Rubber Innovations, Inc.,** **Instapay Systems, Inc.,** **Midland, Inc.,** **Orbit Brands Corp.,** **Signal Apparel Co., Inc., and** **United Specialties, Inc.,** **(n/k/a WaterColor Holdings, Inc.)** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of American Pad & Paper Co. because it has not filed any periodic reports since the period ended March 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of The CattleSale Co. because it has not filed any periodic reports since the period ended September 30, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of CHS Electronics, Inc. because it has not filed any periodic reports since the period ended September 30, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cypost Corp. because it has not filed any periodic reports since the period ended March 31, 2003.

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Gen-ID Lab Services, Inc. because it has not filed any periodic reports since the period ended September 30, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Global Business Information Directory, Inc. because it has not filed any periodic reports since September 9, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Golf Communities of America, Inc. because it has not filed any periodic reports since the period ended March 31, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of GSL Holdings, Inc. because it has not filed any periodic reports since the period ended June 30, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Industrial Rubber Innovations, Inc. because it has not filed any periodic reports since the period ended October 31, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Instapay Systems, Inc. because it has not filed any periodic reports since the period ended September 30, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Orbit Brands Corp. because it has not filed any periodic reports since December 31, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Midland, Inc. because it has not filed any periodic reports since the period ended September 30, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Signal Apparel Co., Inc. because it has not filed any periodic reports since the period ended June 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of United Specialties, Inc. (n/k/a WaterColor Holdings, Inc.) because it has not filed any periodic reports since the period ended September 30, 2003.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed companies, including trading in the debt securities of CHS Electronics, Inc. and Midland, Inc., is suspended for the period from 9:30 a.m. EDT on July 20, 2007, through 11:59 p.m. EDT on August 2, 2007.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 20, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12706

In the Matter of **The CattleSale Co.,** **Gen-ID Lab Services, Inc.,** **Global Business Information Directory, Inc.** **GSL Holdings, Inc.,** **Industrial Rubber Innovations, Inc.,** **Instapay Systems, Inc., and** **Orbit Brands Corp.,** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The CattleSale Co. ("CattleSale") (CIK No. 205239) is a void Delaware corporation located in San Antonio, Texas with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). CattleSale is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2004, which reported a net loss from operations of $687,000 for the prior three quarters. As of July 12, 2007, the company's common stock (symbol "CTLE") was quoted on the Pink Sheets, had nine market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

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2. Gen-ID Lab Services, Inc. (CIK No. 1042669) is a Minnesota corporation located in Fontana, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Gen-ID is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1998, which reported a net loss of $348,506 for the quarter. As of July 12, 2007, the company's common stock (symbol "GDLB") was quoted on the Pink Sheets, had eighteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

3. Global Business Information Directory, Inc. ("Global") (CIK No. 1071475) is a dissolved Colorado corporation located in Seattle, Washington with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Global is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on September 9, 1999, which reported no revenues and a net loss of $389,973. As of July 12, 2007, the company's common stock (symbol "GBDI") was traded on the Pink Sheets, had five market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

4. GSL Holdings, Inc. (CIK No. 1075082) is a purported British Virgin Islands corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). GSL is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2004. As of July 12, 2007, the company's common stock (symbol "GSLHF") was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

5. Industrial Rubber Innovations, Inc. (CIK No. 1091882) is a dissolved Florida corporation located in Bakersfield, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Industrial Rubber is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended October 31, 1999, which reported a net loss of $1.29 million. As of July 12, 2007, the company's common stock (symbol "IRBB") was quoted on the Pink Sheets, had four market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

6. Instapay Systems, Inc. (CIK No. 846494) is an expired Utah corporation located in Chula Vista, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Instapay is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2004, which reported a net loss since inception of $3.1 million. As of July 12, 2007, the company's common stock (symbol "IPYS") was quoted on the Pink Sheets, had fourteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

7. Orbit Brands Corp. (CIK No. 916184) is a void Delaware corporation located in Sherman Oaks, California with a class of equity securities registered with the

Commission pursuant to Exchange Act Section 12(g). Orbit is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ending December 31, 2004, which reported a net operating loss of $31.4 million for the prior year. As of July 12, 2007, the company's common stock (symbol "OBBCQ") was quoted on the Pink Sheets, had nineteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K, 10-KSB, or 20-F), and Rule 13a-13 requires domestic issuers to file quarterly reports (Forms 10-Q or 10-QSB). Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1, 13a-13, and/or 13a-16 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Attachment

Appendix 1

Chart of Delinquent Filings
In the Matter of The CattleSale Co., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
The CattleSale Co.					
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-KSB	03/31/05	04/04/05	Not filed	27
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	10				
Gen-ID Lab Services, Inc.					
	10-KSB	12/31/98	03/31/99	Not filed	100
	10-QSB	03/31/99	05/17/99	Not filed	98
	10-QSB	06/30/99	08/16/99	Not filed	95
	10-QSB	09/30/99	11/15/99	Not filed	92
	10-KSB	12/31/99	03/30/00	Not filed	88
	10-QSB	03/31/00	05/15/00	Not filed	86
	10-QSB	06/30/00	08/14/00	Not filed	83
	10-QSB	09/30/00	11/14/00	Not filed	80
	10-KSB	12/31/00	04/02/01	Not filed	75
	10-QSB	03/31/01	05/15/01	Not filed	74
	10-QSB	06/30/01	08/14/01	Not filed	71
	10-QSB	09/30/01	11/14/01	Not filed	68
	10-KSB	12/31/01	04/01/02	Not filed	63
	10-QSB	03/31/02	05/15/02	Not filed	62
	10-QSB	06/30/02	08/14/02	Not filed	59
	10-QSB	09/30/02	11/14/02	Not filed	56
	10-KSB	12/31/02	03/31/03	Not filed	52
	10-QSB	03/31/03	05/15/03	Not filed	50

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Gen-ID Lab Services, Inc.	*10-QSB*	06/30/03	08/14/03	Not filed	47
(continued)	*10-QSB*	09/30/03	11/14/03	Not filed	44
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	34				
Global Business Information Directory, Inc.					
	10-QSB	07/31/99	09/14/99	Not filed	94
	10-KSB	10/31/99	01/31/00	Not filed	90
	10-QSB	01/31/00	03/16/00	Not filed	88
	10-QSB	04/30/00	06/14/00	Not filed	85
	10-QSB	07/31/00	09/14/00	Not filed	82
	10-KSB	10/31/00	01/29/01	Not filed	78
	10-QSB	01/31/01	03/19/01	Not filed	76
	10-QSB	04/30/01	06/14/01	Not filed	73
	10-QSB	07/31/01	09/14/01	Not filed	70
	10-KSB	10/31/01	01/29/02	Not filed	66
	10-QSB	01/31/02	03/18/02	Not filed	64
	10-QSB	04/30/02	06/14/02	Not filed	61
	10-QSB	07/31/02	09/16/02	Not filed	58
	10-KSB	10/31/02	01/29/03	Not filed	54
	10-QSB	01/31/03	03/17/03	Not filed	52
	10-QSB	04/30/03	06/16/03	Not filed	49
	10-QSB	07/31/03	09/15/03	Not filed	46

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Global Business Information Directory, Inc.	*10-KSB*	10/31/03	01/29/04	Not filed	42
(continued)	*10-QSB*	01/31/04	03/16/04	Not filed	40
	10-QSB	04/30/04	06/14/04	Not filed	37
	10-QSB	07/31/04	09/14/04	Not filed	34
	10-KSB	10/31/04	01/31/05	Not filed	30
	10-QSB	01/31/05	03/17/05	Not filed	28
	10-QSB	04/30/05	06/14/05	Not filed	25
	10-QSB	07/31/05	09/14/05	Not filed	22
	10-KSB	10/31/05	01/30/06	Not filed	18
	10-QSB	01/31/06	03/17/06	Not filed	16
	10-QSB	04/30/06	06/14/06	Not filed	13
	10-QSB	07/31/06	09/14/06	Not filed	10
	10-KSB	10/31/06	01/29/07	Not filed	6
	10-QSB	01/31/07	03/19/07	Not filed	4
	10-QSB	04/30/07	06/14/07	Not filed	1
Total Filings Delinquent	32				
GSL Holdings, Inc.					
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	11				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Industrial Rubber Innovations, Inc.					
	10-QSB	01/31/00	03/16/00	Not filed	88
	10-QSB	04/30/00	06/14/00	Not filed	85
	10-QSB	07/31/00	09/14/00	Not filed	82
	10-QSB	10/31/00	01/29/01	Not filed	78
	10-QSB	01/31/01	03/19/01	Not filed	76
	10-QSB	04/30/01	06/14/01	Not filed	73
	10-QSB	07/31/01	09/14/01	Not filed	70
	10-QSB	10/31/01	01/29/02	Not filed	66
	10-QSB	01/31/02	03/18/02	Not filed	64
	10-QSB	04/30/02	06/14/02	Not filed	61
	10-QSB	07/31/02	09/16/02	Not filed	58
	10-QSB	10/31/02	01/29/03	Not filed	54
	10-QSB	01/31/03	03/17/03	Not filed	52
	10-QSB	04/30/03	06/16/03	Not filed	49
	10-QSB	07/31/03	09/15/03	Not filed	46
	10-QSB	10/31/03	01/29/04	Not filed	42
	10-QSB	01/31/04	03/16/04	Not filed	40
	10-QSB	04/30/04	06/14/04	Not filed	37
	10-QSB	07/31/04	09/14/04	Not filed	34
	10-QSB	10/31/04	01/31/05	Not filed	30
	10-QSB	01/31/05	03/17/05	Not filed	28
	10-QSB	04/30/05	06/14/05	Not filed	25
	10-QSB	07/31/05	09/14/05	Not filed	22
	10-QSB	10/31/05	01/30/06	Not filed	18
	10-QSB	01/31/06	03/17/06	Not filed	16
	10-QSB	04/30/06	06/14/06	Not filed	13
	10-QSB	07/31/06	09/14/06	Not filed	10
	10-QSB	10/31/06	01/29/07	Not filed	6
	10-QSB	01/31/07	03/19/07	Not filed	4
	10-QSB	04/30/07	06/14/07	Not filed	1

Total Filings Delinquent 30

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Instapay Systems, Inc.					
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	12				
Orbit Brands Corp.					
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	9				

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 20, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12705

In the Matter of **American Pad & Paper Co.,** **CHS Electronics, Inc.,** **Cypost Corp.,** **Golf Communities of America, Inc.,** **Midland, Inc.,** **Signal Apparel Co., Inc., and** **United Specialties, Inc.,** **(n/k/a Water-Color Holdings, Inc.)** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. American Pad & Paper Co. ("American") (CIK No. 5588) is a Delaware corporation located in Dallas, Texas with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). American is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2000, which reported a $28 million net loss for that quarter. On January 10, 2000, an involuntary Chapter 11 bankruptcy petition was filed against the company in the U.S. Bankruptcy Court for the District of Delaware which was converted to a Chapter 7 proceeding on December 12, 2001, which is still pending. As of July 12, 2007, the company's common stock (symbol "APPPQ") was quoted on the Pink Sheets, had five market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

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2. CHS Electronics, Inc. (CIK No. 924374) is a Florida corporation located in Miami, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). CHS is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1999, which reported a net loss of $225 million. On April 4, 2000, the company filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the Southern District of Florida, and was discharged from bankruptcy on July 26, 2000. As of July 12, 2007 , the company's common stock (symbol "CHSWQ") was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

3. Cypost Corp. (CIK No. 1090659) is a forfeited Delaware corporation located in Vancouver, British Columbia, Canada with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Cypost is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2003, which reported a net loss since inception of $16.2 million, and a doubt about the company's ability to continue as a going concern. On August 1, 2003, the company filed a Chapter 11 bankruptcy proceeding in the Western District of Washington that was converted to a Chapter 7 proceeding on June 29, 2005, which is still pending. As of July 12, 2007, the company's common stock (symbol "CYPO") was quoted on the Pink Sheets, had ten market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

4. Golf Communities of America, Inc. (CIK No. 833864) is an expired Utah corporation located in Orlando, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Golf Communities is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 1999, which reported a net loss of $5.6 million. On July 13, 1999, the company filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the Middle District of Florida, and its reorganization plan was confirmed on September 19, 2000. As of July 12, 2007, the company's common stock (symbol "GFCM") was quoted on the Pink Sheets, had three market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

5. Midland, Inc. (CIK No. 830746) is a Colorado corporation located in Stone Mountain, Georgia with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Midland is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1999, which reported a net loss from operations of $19,942 for the prior three quarters.

6. Signal Apparel Co., Inc. (CIK No. 105107) is a dissolved Indiana corporation located in Avenel, New Jersey with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Signal is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2000, which reported a net loss from operations of $15 million for the prior six months. On September 22, 2000, the company filed a

Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the Southern District of New York, and that proceeding was terminated on April 4, 2002. As of July 12, 2007, the company's common stock (symbol "SIAYQ") was quoted on the Pink Sheets, had two market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

7. United Specialties, Inc. (n/k/a WaterColor Holdings, Inc.) (CIK No. 1041771) is a Colorado corporation located in Long Island City, New York with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). United Specialties is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2003, which reported a net loss from operations of $3 million for the prior three quarters. As of July 12, 2007, the company's common stock (symbol "WCHG") was quoted on the Pink Sheets, had fifteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Attachment

Appendix 1

Chart of Delinquent Filings
In the Matter of American Pad & Paper Co., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
American Pad & Paper Co.					
	10-Q	06/30/00	08/14/00	Not filed	83
	10-Q	09/30/00	11/14/00	Not filed	80
	10-K	12/31/00	04/02/01	Not filed	75
	10-Q	03/31/01	05/15/01	Not filed	74
	10-Q	06/30/01	08/14/01	Not filed	71
	10-Q	09/30/01	11/14/01	Not filed	68
	10-K	12/31/01	04/01/02	Not filed	63
	10-Q	03/31/02	05/15/02	Not filed	62
	10-Q	06/30/02	08/14/02	Not filed	59
	10-Q	09/30/02	11/14/02	Not filed	56
	10-K	12/31/02	03/31/03	Not filed	52
	10-Q	03/31/03	05/15/03	Not filed	50
	10-Q	06/30/03	08/14/03	Not filed	47
	10-Q	09/30/03	11/14/03	Not filed	44
	10-K	12/31/03	03/30/04	Not filed	40
	10-Q	03/31/04	05/17/04	Not filed	38
	10-Q	06/30/04	08/16/04	Not filed	35
	10-Q	09/30/04	11/15/04	Not filed	32
	10-K	12/31/04	03/31/05	Not filed	28
	10-Q	03/31/05	05/16/05	Not filed	26
	10-Q	06/30/05	08/15/05	Not filed	23
	10-Q	09/30/05	11/14/05	Not filed	20
	10-K	12/31/05	03/31/06	Not filed	16
	10-Q	03/31/06	05/15/06	Not filed	14
	10-Q	06/30/06	08/14/06	Not filed	11
	10-Q	09/30/06	11/14/06	Not filed	8
	10-K	12/31/06	04/02/07	Not filed	3
	10-Q	03/31/07	05/15/07	Not filed	2

Total Filings Delinquent 28

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
CHS Electronics, Inc.					
	10-K	12/31/99	03/30/00	Not filed	88
	10-Q	03/31/00	05/15/00	Not filed	86
	10-Q	06/30/00	08/14/00	Not filed	83
	10-Q	09/30/00	11/14/00	Not filed	80
	10-K	12/31/00	04/02/01	Not filed	75
	10-Q	03/31/01	05/15/01	Not filed	74
	10-Q	06/30/01	08/14/01	Not filed	71
	10-Q	09/30/01	11/14/01	Not filed	68
	10-K	12/31/01	04/01/02	Not filed	63
	10-Q	03/31/02	05/15/02	Not filed	62
	10-Q	06/30/02	08/14/02	Not filed	59
	10-Q	09/30/02	11/14/02	Not filed	56
	10-K	12/31/02	03/31/03	Not filed	52
	10-Q	03/31/03	05/15/03	Not filed	50
	10-Q	06/30/03	08/14/03	Not filed	47
	10-Q	09/30/03	11/14/03	Not filed	44
	10-K	12/31/03	03/30/04	Not filed	40
	10-Q	03/31/04	05/17/04	Not filed	38
	10-Q	06/30/04	08/16/04	Not filed	35
	10-Q	09/30/04	11/15/04	Not filed	32
	10-K	12/31/04	03/31/05	Not filed	28
	10-Q	03/31/05	05/16/05	Not filed	26
	10-Q	06/30/05	08/15/05	Not filed	23
	10-Q	09/30/05	11/14/05	Not filed	20
	10-K	12/31/05	03/31/06	Not filed	16
	10-Q	03/31/06	05/15/06	Not filed	14
	10-Q	06/30/06	08/14/06	Not filed	11
	10-Q	09/30/06	11/14/06	Not filed	8
	10-K	12/31/06	04/02/07	Not filed	3
	10-Q	03/31/07	05/15/07	Not filed	2

Total Filings Delinquent 30

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Cypost Corp.					
	10-QSB	06/30/03	08/14/03	Not filed	47
	10-QSB	09/30/03	11/14/03	Not filed	44
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	16				
Golf Communities of America, Inc.					
	10-QSB	06/30/99	08/16/99	Not filed	95
	10-QSB	09/30/99	11/15/99	Not filed	92
	10-KSB	12/31/99	03/30/00	Not filed	88
	10-QSB	03/31/00	05/15/00	Not filed	86
	10-QSB	06/30/00	08/14/00	Not filed	83
	10-QSB	09/30/00	11/14/00	Not filed	80
	10-KSB	12/31/00	04/02/01	Not filed	75
	10-QSB	03/31/01	05/15/01	Not filed	74
	10-QSB	06/30/01	08/14/01	Not filed	71
	10-QSB	09/30/01	11/14/01	Not filed	68
	10-KSB	12/31/01	04/01/02	Not filed	63
	10-QSB	03/31/02	05/15/02	Not filed	62
	10-QSB	06/30/02	08/14/02	Not filed	59
	10-QSB	09/30/02	11/14/02	Not filed	56
	10-KSB	12/31/02	03/31/03	Not filed	52
	10-QSB	03/31/03	05/15/03	Not filed	50
	10-QSB	06/30/03	08/14/03	Not filed	47

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Golf Communities of America, Inc. *(continued)*	*10-QSB*	09/30/03	11/14/03	Not filed	44
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	32				
Midland, Inc.					
	10-QSB	06/30/02	08/14/02	Not filed	59
	10-QSB	09/30/02	11/14/02	Not filed	56
	10-KSB	12/31/02	03/31/03	Not filed	52
	10-QSB	03/31/03	05/15/03	Not filed	50
	10-QSB	06/30/03	08/14/03	Not filed	47
	10-QSB	09/30/03	11/14/03	Not filed	44
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Midland, Inc.	*10-QSB*	06/30/06	08/14/06	Not filed	11
(continued)	*10-QSB*	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	20				
Signal Apparel Co., Inc.					
	10-Q	09/30/00	11/14/00	Not filed	80
	10-K	12/31/00	04/02/01	Not filed	75
	10-Q	03/31/01	05/15/01	Not filed	74
	10-Q	06/30/01	08/14/01	Not filed	71
	10-Q	09/30/01	11/14/01	Not filed	68
	10-K	12/31/01	04/01/02	Not filed	63
	10-Q	03/31/02	05/15/02	Not filed	62
	10-Q	06/30/02	08/14/02	Not filed	59
	10-Q	09/30/02	11/14/02	Not filed	56
	10-K	12/31/02	03/31/03	Not filed	52
	10-Q	03/31/03	05/15/03	Not filed	50
	10-Q	06/30/03	08/14/03	Not filed	47
	10-Q	09/30/03	11/14/03	Not filed	44
	10-K	12/31/03	03/30/04	Not filed	40
	10-Q	03/31/04	05/17/04	Not filed	38
	10-Q	06/30/04	08/16/04	Not filed	35
	10-Q	09/30/04	11/15/04	Not filed	32
	10-Q	12/31/04	03/31/05	Not filed	28
	10-Q	03/31/05	05/16/05	Not filed	26
	10-Q	06/30/05	08/15/05	Not filed	23
	10-Q	09/30/05	11/14/05	Not filed	20
	10-Q	12/31/05	03/31/06	Not filed	16
	10-Q	03/31/06	05/15/06	Not filed	14
	10-Q	06/30/06	08/14/06	Not filed	11
	10-Q	09/30/06	11/14/06	Not filed	8
	10-Q	12/31/06	04/02/07	Not filed	3
	10-Q	03/31/07	05/15/07	Not filed	2
Total Filings Delinquent	27				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
United Specialties, Inc.					
	10-KSB	12/31/03	03/30/04	Not filed	40
	10-QSB	03/31/04	05/17/04	Not filed	38
	10-QSB	06/30/04	08/16/04	Not filed	35
	10-QSB	09/30/04	11/15/04	Not filed	32
	10-KSB	12/31/04	03/31/05	Not filed	28
	10-QSB	03/31/05	05/16/05	Not filed	26
	10-QSB	06/30/05	08/15/05	Not filed	23
	10-QSB	09/30/05	11/14/05	Not filed	20
	10-KSB	12/31/05	03/31/06	Not filed	16
	10-QSB	03/31/06	05/15/06	Not filed	14
	10-QSB	06/30/06	08/14/06	Not filed	11
	10-QSB	09/30/06	11/14/06	Not filed	8
	10-KSB	12/31/06	04/02/07	Not filed	3
	10-QSB	03/31/07	05/15/07	Not filed	2

Total Filings Delinquent 14

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56123 / July 24, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2651 / July 24, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12708

In the Matter of **AYAL ROSENTHAL, CPA,** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Ayal Rosenthal pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Rosenthal is a certified public accountant licensed in New York and New Jersey.

2. On June 13, 2007, a judgment of conviction was entered against Rosenthal in *United States v. Ayal Rosenthal*, No. 07-CR-98-01 (JG), in the United States District Court for the Eastern District of New York, finding him guilty of one count of conspiracy to commit securities fraud.

3. As a result of this conviction, Rosenthal was sentenced to two months'

[1] Rule 102(e)(2) provides in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

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imprisonment in a federal penitentiary and ordered to pay a fine of $5,000.

III.

In view of the foregoing, the Commission finds that Rosenthal has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Ayal Rosenthal is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2621 / July 25, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12709

In the Matter of **VINCENT MONTAGNA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Vincent Montagna ("Montagna" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.B below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Since 1997, Montagna has been president and chief executive officer of Quantus Holdings Company Inc. ("Quantus"), an entity through which he managed Tiburon Asset Management LLC ("Tiburon Asset"), a purported domestic hedge fund. Since 2000, Montagna has also been president and chief executive officer of Tiburon Investment Management, Ltd. ("Tiburon Management"), an entity through which he managed Tiburon Partners, Ltd. ("Tiburon Partners"), a purported offshore hedge fund. Montagna, age 34, is a resident of Pennsylvania. From at least October 2000 through February 2004, acting through Quantus and Tiburon Management, Montagna was acting as an investment adviser as defined by Section 202(a)(11) of the Advisers Act, 15 United States Code Section 80b-2(a)(11).

B. On February 9, 2007, Montagna pleaded guilty to one count of wire fraud in violation of Title 18 United States Code Sections 1343 and 2 before the United States District Court for the Southern District of New York, in United States v. Vincent Montagna, Crim. Indictment No. 1:05-CR-0457.[1]

C. The count of the criminal indictment to which Montagna pleaded guilty alleged, inter alia, that, while acting as an investment adviser, Montagna caused a wire transfer to occur on January 22, 2003, for the purpose of executing a scheme and artifice to defraud, which scheme and artifice involved Montagna's failure to disclose to investors in Tiburon Asset and Tiburon Partners side agreements into which he entered with certain companies in which Tiburon Asset and Tiburon Partners had invested, and pursuant to which these companies either issued stock to him or for his benefit or paid for certain of his personal expenses.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Montagna's Offer.

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1 On September 22, 2006, the Commission issued an Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions against Montagna, Vincent Montagna, Advisers Act Release No. 2551 (Sept. 22, 2006). That proceeding was based on a guilty plea by Montagna that was subsequently withdrawn. By separate order issued today in that proceeding (Administrative Proceeding File No. 3-12424), the Commission has vacated the Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions against Montagna issued on September 22, 2006.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Montagna be, and hereby is, barred from association with any investment adviser.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2620 / July 25, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12424

In the Matter of **VINCENT MONTAGNA,** **Respondent.**	**ORDER VACATING ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

On September 22, 2006, the Commission issued an Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions against Vincent Montagna ("Montagna"). Montagna consented to the issuance of the order without admitting or denying the findings therein, except as to the Commission's jurisdiction over him and the subject matter of the proceedings and the findings concerning his guilty plea, which he admitted. That order was based upon Montagna's guilty plea to two counts of fraud upon investment advisory clients in violation of Title 15 United States Code Section 80b-6 and Title 18 United States Code Section 2, before the United States District Court for the Southern District of New York, in United States v. Vincent Montagna, Crim. Indictment No. 1:05-CR-0457.

On February 9, 2007, Montagna withdrew his guilty plea to the Advisers Act fraud counts.[1]

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[1] Montagna has pleaded guilty to another count of the indictment against him. Accordingly, on the date of this order, the Commission is also issuing an Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions against Montagna based on that guilty plea. Montagna consented to the issuance of the order

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Accordingly, it is hereby ORDERED that:

The Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions against Montagna issued on September 22, 2006 is hereby vacated.

By the Commission.

Nancy M. Morris
Secretary

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without admitting or denying the findings therein, except as to the Commission's jurisdiction over him and the subject matter of the proceedings, and the findings concerning his guilty plea, which he admitted.

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[RELEASE NOS. 34-56135; IC-27911; File No. S7-03-07]

RIN 3235-AJ79

SHAREHOLDER CHOICE REGARDING PROXY MATERIALS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the proxy rules under the Securities Exchange Act of 1934 to provide shareholders with the ability to choose the means by which they access proxy materials. Under the amendments, issuers and other soliciting persons will be required to post their proxy materials on an Internet Web site and provide shareholders with a notice of the Internet availability of the materials. The issuer or other soliciting person may choose to furnish paper copies of the proxy materials along with the notice. If the issuer or other soliciting person chooses not to furnish a paper copy of the proxy materials along with the notice, a shareholder may request delivery of a copy at no charge to the shareholder.

DATES: Effective Date: January 1, 2008, except §240.14a-16(d)(3) and §240.14a-16(j)(3) are effective [insert date that is 60 days after publication in the Federal Register].

Compliance Dates: "Large accelerated filers," as that term is defined in Rule 12b-2 under the Securities Exchange Act of 1934, not including registered investment companies, must comply with the amendments regarding proxy solicitations commencing on or after January 1, 2008. Registered investment companies, persons other than issuers, and issuers that are not large accelerated filers conducting proxy solicitations

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(1) may comply with the amendments regarding proxy solicitations commencing on or after January 1, 2008 and (2) must comply with the amendments regarding proxy solicitations commencing on or after January 1, 2009.

FOR FURTHER INFORMATION CONTACT: Raymond A. Be, Special Counsel, Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: The Commission is adopting amendments to Rules 14a-3,[1] 14a-7,[2] 14a-16,[3] 14a-101,[4] 14b-1,[5] 14b-2,[6] 14c-2,[7] and 14c-3[8] under the Securities Exchange Act of 1934.[9]

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[1] 17 CFR 240.14a-3.

[2] 17 CFR 240.14a-7.

[3] 17 CFR 240.14a-16.

[4] 17 CFR 240.14a-101.

[5] 17 CFR 240.14b-1.

[6] 17 CFR 240.14b-2.

[7] 17 CFR 240.14c-2.

[8] 17 CFR 240.14c-3.

[9] 15 U.S.C. 78a et seq.

I. Introduction

On January 22, 2007, we proposed amendments to the proxy rules that would require all issuers and other soliciting persons to furnish proxy materials to shareholders by posting them on an Internet Web site and providing shareholders with notice of the electronic availability of the proxy materials.[10] Under the proposal, issuers and other soliciting persons would be permitted to deliver paper or e-mail copies of their proxy materials to shareholders along with the notice. The proposal was intended to provide all shareholders with the ability to choose the means by which they access proxy materials, including via paper, e-mail or the Internet, while still affording issuers and other soliciting persons flexibility in determining how to furnish their proxy materials to shareholders.[11] In a companion release issued on the same date, we adopted the "notice and access" model that issuers and other soliciting persons may comply with on a voluntary basis for proxy solicitations commencing on or after July 1, 2007.[12]

We received 23 comment letters on the proposal. The vast majority of commenters generally supported our goal of increasing reliance on technology to improve proxy distribution.[13] However, many of the commenters thought that the

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10 See Release No. 34-55147 (Jan. 22, 2007) [72 FR 4176].

11 For purposes of this release, the term "proxy materials" includes proxy statements on Schedule 14A [17 CFR 240.14a-101], proxy cards, information statements on Schedule 14C [17 CFR 240.14c-101], annual reports to security holders required by Rules 14a-3 [17 CFR 240.14a-3] and 14c-3 [17 CFR 240.14c-3] of the Exchange Act, notices of shareholder meetings, additional soliciting materials, and any amendments to such materials. For purposes of this release, the term does not include materials filed under Rule 14a-12 [17 CFR 240.14a-12].

12 Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148].

13 See letters from AARP, American Business Conference (ABC), Automatic Data Processing Brokerage Services Group, now known as Broadridge Financial Solutions, Inc. (ADP), Bank of New York (BONY), U.S. Chamber of Commerce (Chamber of Commerce), Council of Institutional Investors (CII), Commerce Finance Printers Corp. (Commerce Finance Printers), Computershare, Dechert LLP (Dechert), Kathryn Elmore and Michael Allen (Elmore & Allen), Investment Company Institute (ICI), Infosys Technologies Limited (Infosys), MailExpress, Reed Smith LLP (Reed Smith), Registrar and Transfer Company (Registrar and Transfer), Karl W.

Commission's timetable for adopting the proposed amendments was too aggressive.[14] They suggested that we postpone adoption of the proposal until we gain experience from operation of the voluntary rule.

Although we acknowledge the timing concerns raised by the commenters, we think that it is appropriate to adopt the proposal at this time because the model that we are adopting will provide shareholders with enhanced choices without changing significantly the obligations of an issuer or other soliciting person. The only new obligations that the revised notice and access model will impose on issuers and other soliciting persons compared to the voluntary rule is that an issuer or other person soliciting proxies who wishes to initially furnish a full set of proxy materials in paper to shareholders will be required to: (1) post those proxy materials on an Internet Web site; and (2) include a Notice of Internet Availability of Proxy Materials (Notice) with the full set or incorporate the Notice information into its proxy statement and proxy card.[15]

Furthermore, under the phase-in schedule that we are establishing for expanding the notice and access model to all issuers and other soliciting persons, the largest public companies will become subject to the model a year before any other companies become subject to the model. Most of these companies already appear to post their proxy

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Reimers (Reimers), Ayal Rosenthal (Rosenthal), Society of Corporate Secretaries and Governance Professionals (SCSGP), Securities Industry and Financial Markets Association (SIFMA), Mark Snyder (Snyder), Shareholder Services Association (SSA), and Securities Transfer Association, Inc. (STA).

14 See letters from AARP, ABC, ADP, BONY, Chamber of Commerce, CII, Computershare, ICI, Reed Smith, Registrar and Transfer, SCSGP, SIFMA, SSA, and STA.

15 The effective result of the rules is that an intermediary must prepare Notices (or incorporate Notice information in its request for voting instructions) and create Web sites for all issuers for which securities are held by the intermediary's customers, rather than only for issuers who elect to follow the notice and access model under the voluntary system.

materials and Exchange Act reports on an Internet Web site.[16] A large accelerated filer (not including registered investment companies) will have to comply with the notice and access model for solicitations beginning on or after January 1, 2008.[17] All other issuers (including registered investment companies) and soliciting persons other than issuers will have to comply with the model for solicitations beginning on or after January 1, 2009. This tiered system of implementation addresses the commenters' timing concerns by providing the Commission with a significant test group of large accelerated filers from which to obtain operating data and more than a full year to study the effects of the notice and access model and make any necessary revisions to the rules before they apply to other entities.

In addition, several commenters were concerned that the proposals would have required all issuers to establish Internet voting platforms[18] or to prepare their proxy materials at least 40 days prior to the shareholder meeting,[19] and therefore would impose significant costs on issuers. As discussed in detail below, the final rules do not require, and the proposals would not have required, an issuer or other soliciting person to

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16 Based on a random sampling of 150 large accelerated filers, approximately 80% of such filers already post their proxy materials on a non-EDGAR Web site, while almost all of the rest provide a link on their Web site to the Commission's EDGAR system. Only a small handful of such filers do not post their proxy materials on their Web site at all. We note, however, that currently there is no requirement that such Web sites preserve the anonymity of persons accessing the Web site. See Section II.A.1.f of this release for a description of this requirement.

17 A large accelerated filer, as defined in Exchange Act Rule 12b-2 [17 CFR 240.12b-2], is an issuer that, as of the end of its fiscal year, has an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as measured on the last business day of the issuer's most recently completed second fiscal quarter; has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and is not eligible to use Forms 10-KSB and 10-QSB for its annual and quarterly reports.

18 See letters from ABC, BONY, and Registrar and Transfer.

19 See, for example, letters from Chamber of Commerce, CII, Commerce Financial Printers, Elmore & Allen, ICI, and STA.

establish an Internet voting platform. Similarly, the rules do not require an issuer or other soliciting person that sends a full set of proxy materials to shareholders to prepare its proxy materials at least 40 days prior to the meeting.

II. Description of the Amendments

Under the amendments, an issuer that is required to furnish proxy materials to shareholders under the Commission's proxy rules must post its proxy materials on a specified, publicly-accessible Internet Web site (other than the Commission's EDGAR Web site) and provide record holders with a notice informing them that the materials are available and explaining how to access those materials.[20] Intermediaries also must follow the notice and access model to furnish an issuer's proxy materials to beneficial owners. Persons other than the issuer conducting their own proxy solicitations must comply with the notice and access model as well. By requiring Internet availability of proxy materials, the amendments are designed to enhance the ability of investors to make informed voting decisions and to expand use of the Internet to ultimately lower the costs of proxy solicitations.

A. Notice and Access Model for Issuers: Two Options for Making Proxy Materials Available to Shareholders

The notice and access model allows an issuer to select either of the following two options to provide proxy materials to shareholders: (1) the "notice only option" and (2) the "full set delivery option." Under the notice only option, an issuer will comply with the same requirements that we adopted in connection with the voluntary notice and

[20] See revised Rule 14a-3(a). The notice and access model does not apply to a proxy solicitation related to a business combination transaction. See Rule 14a-16(m) [17 CFR 240.14a-16(m)]. Also, as with the voluntary model, the notice and access model does not apply if the law of the issuer's state of incorporation would prohibit them from furnishing proxy materials in that manner. See Rule 14a-3(a)(3)(ii).

access model. Under these requirements, the issuer must post its proxy materials on an Internet Web site and send a Notice to shareholders to inform them of the electronic availability of the proxy materials at least 40 days before the shareholders meeting. If an issuer follows this option, it must respond to shareholder requests for copies, including a shareholder's permanent request for paper or e-mail copies of proxy materials for all shareholder meetings.

Under the full set delivery option, an issuer can deliver a full set of proxy materials to shareholders, along with the Notice. An issuer need not prepare and deliver a separate Notice if it incorporates all of the information required to appear in the Notice into its proxy statement and proxy card,[21] and it need not respond to requests for copies as required under the notice only option.

An issuer does not have to choose one option or the other as the exclusive means for providing proxy materials to shareholders. Rather, an issuer may use the notice only option to provide proxy materials to some shareholders and the full set delivery option to provide proxy materials to other shareholders. We describe both options in greater detail below.

1. The Notice Only Option: Sending a Notice Without a Full Set of Proxy Materials

We are adopting the notice only option substantially as proposed. Under the notice only option, an issuer will follow the same procedures that we have established under the existing notice and access model that issuers may choose to comply with on a voluntary basis for proxy solicitations commencing on or after July 1, 2007.[22] Under

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21 If not soliciting proxies, an issuer may incorporate the Notice information into its information statement.

22 See Rule 14a-16 [17 CFR 240.14a-16].

these procedures, the issuer must send a Notice to shareholders at least 40 calendar days before the shareholder meeting date, or if no meeting is to be held, at least 40 calendar days before the date that votes, consents, or authorizations may be used to effect a corporate action, indicating that the issuer's proxy materials are available on a specified Internet Web site and explaining how to access those proxy materials.[23] Issuers may household the Notice pursuant to Rule 14a-3(e).[24]

a. Contents of the Notice of Internet Availability of Proxy Materials

The Notice must contain the following information:[25]

- A prominent legend in bold-face type that states:

  "Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].

  - **This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.**

  - **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**

  - **If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery."**

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23 Rule 14a-16(a)(1) [17 CFR 240.14a-16(a)(1)].

24 17 CFR 240.14a-3(e).

25 Rule 14a-16(d) [17 CFR 240.14a-16(d)]. Appropriate changes must be made if the issuer is providing an information statement pursuant to Regulation 14C, seeking to effect a corporate action by written consent, or is a legal entity other than a corporation.

- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on, and the issuer's recommendations, if any, regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- (1) A toll-free telephone number; (2) an e-mail address; and (3) an Internet Web site address where the shareholder can request a copy of the proxy materials, for all meetings and for the particular meeting to which the Notice relates;
- Any control/identification numbers that the shareholder needs to access his or her proxy card;
- Instructions on how to access the proxy card, provided that such instructions do not enable a shareholder to execute a proxy without having access to the proxy statement; and
- Information about attending the shareholder meeting and voting in person.

The Notice must be written in plain English.[26] The Notice may contain only the information specified by the rules and any other information required by state law, if the issuer chooses to combine the Notice with any shareholder meeting notice that state law may require.[27] However, the Notice may contain a protective warning to shareholders,

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26 Rule 14a-16(g) [17 CFR 240.14a-16(g)].

27 Rule 14a-16(e) [17 CFR 240.14a-16(e)].

advising them that no personal information other than the identification or control number is necessary to execute a proxy.[28] In addition, a registered investment company may send its prospectus and/or report to shareholders together with the Notice.[29] The issuer must file its Notice with the Commission pursuant to Rule 14a-6(b)[30] no later than the date that it first sends the Notice to shareholders.[31]

b. Design of the specified publicly-accessible Web site

An issuer must make all proxy materials identified in the Notice publicly accessible, free of charge, at the Web site address specified in the Notice on or before the date that the Notice is sent to the shareholder.[32] The specified Web site may not be the Commission's EDGAR system.[33] The issuer also must post any subsequent additional soliciting materials on the Web site no later than the date on which such materials are first sent to shareholders or made public.[34] The materials must be presented on the Web site in a format, or formats, convenient for both reading online and printing on paper.[35]

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28 Rule 14a-16(e)(2)(ii) [17 CFR 240.14a-16(e)(2)(ii)].

29 See new Rule 14a-16(f)(2)(iii).

30 17 CFR 240.14a-6(b).

31 Rule 14a-16(i) [17 CFR 240.14a-16(i)].

32 Rule 14a-16(b)(1) [17 CFR 240.14a-16(b)(1)].

33 Rule 14a-16(b)(3) [17 CFR 240.14a-16(b)(3)].

34 Rule 14a-16(b)(2) [17 CFR 240.14a-16(b)(2)].

35 Rule 14a-16(c) [17 CFR 240.14a-16(c)]. See Section II.A.3 of Release 34-55146 (Jan. 22, 2007) [72 FR 4148]. One commenter asked the Commission to consider the costs of requiring such formats. See letter from ICI. We believe that requiring readable and printable formats is important so that shareholders have meaningful access to the proxy materials. When determining the readability and printability of formats, issuers should consider the size of the files because many shareholders do not have broadband connections. Although some types of files may be suitable for persons with high-speed Internet access, the readability and printability of a document may be affected significantly by the time that it takes to download the document.

The proxy materials must remain available on that Web site through the conclusion of the shareholder meeting.[36]

c. **Means to vote**

An issuer also must provide shareholders with a method to execute proxies as of the time the Notice is first sent to shareholders.[37] Several commenters on the proposal questioned whether this provision would require all issuers to establish Internet voting platforms.[38] The final rules do not require, and the proposals would not have required, an issuer to establish an Internet voting platform. Rather, an issuer can satisfy this requirement through a variety of methods, including providing an electronic voting platform, a toll-free telephone number for voting, or a printable or downloadable proxy card on the Web site. As noted above, if a telephone number for executing a proxy is provided, such a telephone number may appear on the Web site, but not on the Notice because it would enable a shareholder to execute a proxy without having access to the proxy statement.

d. **Request for paper or e-mail copies**

An issuer must provide paper or e-mail copies at no charge to shareholders requesting such copies.[39] It also must allow shareholders to make a permanent election to receive paper or e-mail copies of proxy materials distributed in connection with future proxy solicitations, and maintain records of those elections.[40] Further, the issuer must provide a toll-free telephone number, e-mail address, and Internet Web site address as a

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36 Rule 14a-16(b)(1) [17 CFR 240.14a-16(b)(1)].

37 Rule 14a-16(b)(4) [17 CFR 240.14a-16(b)(4)].

38 See letters from ABC, BONY, and Registrar and Transfer.

39 Rule 14à-16(j) [17 CFR 240.14a-16(j)].

40 See Rule 14a-16(d)(5) and (j)(4) [17 CFR 240.14a-16(d)(5) and (j)(4)].

means by which a shareholder can request a copy of the proxy materials for the particular shareholder meeting referenced in the Notice or make a permanent election to receive copies of the proxy materials on a continuing basis with respect to all meetings.[41] The issuer also may include a pre-addressed, postage-paid reply card with the Notice that shareholders can use to request a copy of the proxy materials.[42]

e. Delivery of a proxy card

An issuer may not send a paper or e-mail proxy card to a shareholder until 10 calendar days or more after the date it sent the Notice to the shareholder, unless the proxy card is accompanied or preceded by a copy of the proxy statement and any annual report, if required, to security holders sent via the same medium.[43] This provision is intended to assist an issuer's efforts to solicit proxies if its initial efforts have not produced adequate response. This is similar to many issuers' current practice of sending reminder notices and duplicate proxy cards to shareholders who have not responded to the issuer's original request for proxy voting instructions.

One commenter remarking on this aspect of the proposals expressed concern that shareholders receiving proxy cards separately from the proxy statement and annual report may make their voting decisions without the benefit of access to those disclosure documents.[44] We appreciate this concern. However, at the point that a shareholder receives such a proxy card, the shareholder already would have received a Notice that provides information on how the shareholder can access the proxy materials and request

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41 Rule 14a-16(d)(5) [17 CFR 240.14a-16(d)(5)].

42 Rule 14a-16(f)(2)(i) [17 CFR 240.14a-16(f)(2)(i)].

43 Rule 14a-16(h) [17 CFR 240.14a-16(h)].

44 See letter from CII.

Internet Web sites.[49] Similar concerns regarding potential abuses of shareholder privacy also were raised with regard to the adoption of the voluntary notice and access model.

Although we recognize that the confidentiality requirements may increase the cost of maintaining an Internet Web site, we believe that the protection of shareholder information is important. A rule that permits issuers to discover the identity of a person accessing the Web site could effectively negate a beneficial owner's ability under the proxy rules to object to an intermediary's disclosure of that beneficial owner's identity to the issuer.[50] In addition, a rule without this prohibition on the issuer may make some shareholders hesitant to access the proxy disclosures, which would not promote the purposes of this rule. Therefore we have retained this provision of the rule to help prevent potential abuses of shareholder information.

We do not believe that this requirement will impose any undue burden on companies. Under the rule, a company must refrain from installing cookies and other tracking features on the Web site on which the proxy materials are posted. This may require segregating those pages from the rest of the company's regular Web site or creating a new Web site. However, the rule does not require the company to turn off the Web site's connection log, which automatically tracks numerical IP addresses that connect to that Web site. Although in most cases, this IP address does not provide companies with sufficient information to identify the accessing shareholder, companies may not use these numbers to attempt to find out more information about persons

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49 See letter from CII.

50 See Rules 14b-1(b) and 14b-2(b) [17 CFR 240.14b-1(b) and 240.14b-2(b)].

accessing the Web site. In addition, shareholders still concerned about their anonymity can request copies from their intermediaries.

2. The Full Set Delivery Option: Sending a Notice with a Full Set of Proxy Materials

Under the "full set delivery option," an issuer will follow procedures that are substantially similar to the traditional means of providing proxy materials in paper.[51] Under this option, in addition to sending proxy materials to shareholders as under the traditional method, an issuer must:

- Send a Notice accompanied by a full set of proxy materials,[52] or incorporate all of the information required to appear in the Notice into the proxy statement and proxy card;[53] and
- Post the proxy materials on a publicly accessible Web site no later than the date the Notice was first sent to shareholders.[54]

Issuers may household the Notice and other proxy materials pursuant to Rule 14a-3(e).[55]

a. Contents of the Notice or incorporation of Notice information

Under the final rules that we are adopting, a separate Notice is not required if the issuer presents all of the information required in the Notice in its proxy statement and

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51 Under the traditional proxy delivery scheme, issuers could send proxy materials to shareholders via e-mail provided they followed Commission guidance regarding such delivery, which typically required obtaining affirmative consent from individual shareholders. See Release No. 33-7233 (Oct. 6, 1995) [60 FR 53458]. Issuers may continue to rely on such guidance to send materials electronically to shareholders. See Section II.A. of this release.

52 A "full set" of proxy materials would contain (1) a proxy statement or information statement, (2) an annual report if one is required by Rule 14a-3(b) or Rule 14c-3(a), and (3) a proxy card or, in the case of a beneficial owner, a request for voting instructions, if proxies are being solicited.

53 See new Rule 14a-16(n)(2).

54 As discussed below, this date does not have to be at least 40 days prior to the shareholder meeting date.

55 17 CFR 240.14a-3(e).

proxy card.[56] In the proposing release, we solicited comment on whether we should permit the issuer that is sending a full set to incorporate the information required in the Notice into the proxy statement and proxy card, rather than require that issuer to prepare a separate Notice. Although we did not receive any comment on this issue, we do not see a compelling reason to require an issuer to include a separate Notice when it already is sending a shareholder a full set of proxy materials. We believe that providing the Notice information in the proxy materials will provide shareholders with sufficient information to access the materials on the Internet, while reducing costs to issuers. However, an issuer may prepare a separate Notice if it desires.

The information required in the Notice, or proxy materials if no separate Notice is prepared, includes much, but not all, of the information that is required under the notice only option, including the following:[57]

- A prominent legend in bold-face type that states:

  "Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].

  - **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**

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56 Because issuers are obligated to provide proxy materials to beneficial owners, we recommend that issuers place only information required by the Notice that is relevant to all shareholders (record and beneficial owners) in the proxy statement, and present information that is relevant only to record holders on the proxy card so that beneficial owners are not confused by information in the proxy statement that would only be applicable to record holders. Required information disclosed on the proxy statement need not be repeated on the proxy card.

57 See new Rule 14a-16(n)(4). Appropriate changes must be made if the issuer is providing an information statement pursuant to Regulation 14C, seeking to effect a corporate action by written consent, or is a legal entity other than a corporation.

- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on and the issuer's recommendations, if any, regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- Any control/identification numbers that the shareholder needs to access his or her proxy card; and
- Information about attending the shareholder meeting and voting in person.

The issuer is not required to provide paper or e-mail copies upon request to shareholders to whom it has furnished proxy materials under this option because it would already have provided those shareholders with a copy of the proxy materials as part of its initial distribution.[58] Therefore, the issuer need not provide instructions in the Notice as to how shareholders can request paper or e-mail copies of the proxy materials.[59]

If the issuer prepares a separate Notice, it must be written in plain English.[60] The Notice may contain only the information specified by the rules and any other information required by state law, if the issuer chooses to combine the Notice with any shareholder meeting notice that state law may require.[61] However, the Notice may contain a protective warning to shareholders, advising them that no personal information other than

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58 See new Rule 14a-16(n)(3)(ii).

59 See new Rule 14a-16(n)(4)(ii).

60 Rule 14a-16(g) [17 CFR 240.14a-16(g)].

61 Rule 14a-16(e) [17 CFR 240.14a-16(e)].

the identification or control number is necessary to execute a proxy.[62] The issuer must file any such separate Notice with the Commission pursuant to Rule 14a-6(b) no later than the date that it first sends the Notice to shareholders.[63]

b. Design of the specified publicly-accessible Web site

An issuer must post all proxy materials identified in the Notice, or proxy statement and proxy card if no separate Notice is prepared, on the publicly accessible Web site address specified in the Notice on or before the date that it sends the proxy materials to shareholders.[64] The specified Web site may not be the Commission's EDGAR system.[65] The issuer also must post any subsequent additional soliciting materials on the Web site no later than the date on which such materials are first sent to shareholders or made public.[66] The materials must be presented on the Web site in a format, or formats, convenient for both reading online and printing on paper.[67] The proxy materials must remain available on that Web site through the conclusion of the shareholder meeting.[68]

c. Means to vote

The notice and access model requires an issuer to provide shareholders with a method to execute proxies as of the time the Notice is first sent to shareholders.[69] If an

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62 Rule 14a-16(e)(2)(ii) [17 CFR 240.14a-16(e)(2)(ii)].

63 Rule 14a-16(i) [17 CFR 240.14a-16(i)]. If the issuer incorporates the contents of the Notice into the proxy materials, a separate filing is not required.

64 Rule 14a-16(b)(1) [17 CFR 240.14a-16(b)(1)].

65 Rule 14a-16(b)(3) [17 CFR 240.14a-16(b)(3)].

66 Rule 14a-16(b)(2) [17 CFR 240.14a-16(b)(2)].

67 Rule 14a-16(c) [17 CFR 240.14a-16(c)]. See Section II.A.3 of Release 34-55146 (Jan. 22, 2007) [72 FR 4148].

68 Rule 14a-16(b)(1) [17 CFR 240.14a-16(b)(1)].

69 Rule 14a-16(b)(4) [17 CFR 240.14a-16(b)(4)].

issuer follows the full set delivery option, the proxy card or request for voting instructions included in the full set of proxy materials satisfies this requirement. Therefore, the issuer does not need to provide another means for shareholders to execute proxies or submit voting instructions for accounts receiving proxy materials through the full set delivery option.

d. Repeat Delivery of a Proxy Card

Even though a proxy card already will be included in the full set of proxy materials, an issuer relying on the full set delivery option subsequently may choose to deliver another copy of the proxy card to shareholders who have not returned the card. This is permissible under the current rules, and issuers commonly do so as a reminder for shareholders to vote. The reminder proxy card does not have to be accompanied by the Notice because the reminder card would have been preceded by the proxy statement via the same medium and may be sent at any time after the full set of proxy materials has been sent.[70]

e. Web site confidentiality

As under the notice only option, an issuer must maintain the Internet Web site on which it posts its proxy materials in a manner that does not infringe on the anonymity of a person accessing that Web site.[71] An issuer also may not use any e-mail address provided by a shareholder solely to request a copy of proxy materials for any purpose other than to send a copy of those materials to that shareholder.[72] The issuer also may not

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70 See new Rule 14a-16(h)(2).

71 Rule 14a-16(k)(1) [17 CFR 240.14a-16(k)(1)]. See Section II.A.1.b.iii of Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148].

72 Rule 14a-16(k)(2) [17 CFR 240.14a-16(k)(2)].

disclose a shareholder's e-mail address to any person other than the issuer's employee or agent to the extent necessary to send a copy of the proxy materials to a requesting shareholder.

3. Differences Between the Full Set Delivery Option and the Notice Only Option

The full set delivery option varies from the notice only option in the following ways:

- An issuer may accompany the Notice with a copy of the proxy statement, annual report to security holders, if required by Rule 14a-3(b),[73] and a proxy card;[74]
- An issuer need not prepare a separate Notice if the issuer incorporates all of the Notice information into the proxy statement and proxy card;[75]
- Because the issuer already has provided shareholders with a full set of proxy materials, the issuer need not provide the shareholder with copies of the proxy materials upon request;[76]
- Because shareholders will not need extra time to request paper or e-mail copies, the issuer need not send the Notice and full set of proxy materials at least 40 days before the meeting date;[77]

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73 The requirement in Exchange Act Rules 14a-3(b) and 14c-3(a) to furnish annual reports to security holders does not apply to registered investment companies [17 CFR 240.14a-3(b) and 240.14c-3(a)]. A soliciting person other than the issuer also is not subject to this requirement. Finally, an issuer is required to provide such a report for shareholder meetings at which directors are to be elected.

74 See new Rule 14a-16(n)(1).

75 See new Rule 14a-16(n)(2)(ii). See also footnote 58, above.

76 See new Rule 14a-16(n)(3)(ii).

77 See new Rule 14a-16(n)(3)(i).

- Because the full set of proxy materials includes a proxy card or request for voting instructions, the issuer need not provide another means for voting at the time the Notice is provided unless it chooses to do so; and
- The issuer need not include the part of the prescribed legend relating to security holder requests for copies of the documents and instructions on how to request a copy of the proxy materials.[78]

a. Inclusion of a Full Set of Proxy Materials

The notice only option does not permit an issuer to accompany the Notice with any other documents.[79] In contrast, an issuer relying on the full set delivery option will deliver a full set of proxy materials, including a proxy statement, annual report to shareholders if required by Rule 14a-3(b), and a proxy card, along with the Notice. Under this option, when the Notice is initially sent, it must be accompanied by all of these documents, not just some of them. For example, an issuer may not send only the Notice and a proxy card to a shareholder as part of its initial distribution of proxy materials.[80]

b. Request for Copies of the Proxy Materials

As noted above, because an issuer relying on the full set delivery option will send shareholders copies of all of the proxy materials along with the Notice, there is no need for the issuer to provide these shareholders with a means to request a copy of the proxy

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78 See new Rule 14a-16(n)(4).

79 Rule 14a-16(f)(1) [17 CFR 240.14a-16(f)(1)]. We note however, that under the notice only option, an issuer may send the Notice and proxy card together 10 days or more after it initially sends the Notice. See new Rule 14a-16(h)(1).

80 However, it may send a reminder proxy card at any time after it initially sends the Notice accompanied by the full set of proxy materials. See new Rule 14a-16(h)(2).

materials. The issuer therefore may exclude information from the Notice on how a shareholder may request such copies.[81]

c. 40-Day Deadline

Under the full set delivery option, if an issuer or other soliciting person sends a full set of the proxy materials with the Notice, it need not comply with the 40-day deadline in Rule 14a-16 for sending the Notice. Thus, if an issuer is unable or unwilling to meet the 40-day deadline, it still may begin its solicitation after that deadline provided that it complies with the full set delivery option. Six commenters on the proposal questioned whether the proposal would have required all issuers to prepare their proxy materials at least 40 days prior to the meeting.[82] We have clarified that an issuer must comply with the 40-day period <u>only</u> if it intends to comply with the notice only option.[83]

B. Implications of the Notice and Access Model for Intermediaries

An issuer or other soliciting person must provide each intermediary with the information necessary to prepare the intermediary's Notice in sufficient time for the intermediary to prepare and send its Notice to beneficial owners within the timeframes of the model. An issuer that complies with the notice only option must provide the intermediary with the relevant information in sufficient time for the intermediary to prepare and send the Notice and post the proxy materials on the Web site at least 40 calendar days before the shareholder meeting date.[84]

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81 See Rule 14a-16(n)(4).

82 See, for example, letters from Chamber of Commerce, CII, Commerce Financial Printers, Elmore & Allen, ICI, and STA.

83 See Rule 14a-16(n)(3)(i).

84 If a soliciting person other than the issuer elects to follow the notice only option, the Notice must be sent to shareholders by the later of: (1) 40 calendar days prior to the security holder meeting date or, if no meeting is to be held, 40 calendar days prior to the date the votes, consents, or authorizations may be used to effect the corporate action; or (2) 10 calendar days after the date

An issuer that complies with the full set delivery option need not comply with the 40-day deadline. The issuer need only provide the Notice information to the intermediary in sufficient time for the intermediary to prepare and send the Notice along with the full set of materials provided by the issuer. Under this option, as with the traditional method of delivering proxy materials, the intermediary must forward the issuer's full set of proxy materials to beneficial owners within five business days of receipt from the issuer or the issuer's agent.[85]

The intermediary's Notice generally must contain the same types of information as an issuer's Notice, but must be tailored specifically for beneficial owners.[86] With respect to beneficial owners who receive a Notice under the notice only option, the intermediary also must forward paper or e-mail copies of the proxy materials upon request, permit the beneficial owners to make a permanent election to receive paper or e-mail copies of the proxy materials, keep records of beneficial owner preferences, provide proxy materials in accordance with those preferences, and provide a means to access a request for voting instructions for its beneficial owner customers no later than the date the Notice is first sent.

When the issuer is delivering full sets of proxy materials to beneficial owners, the intermediary must either prepare a separate Notice and forward it with the full set of proxy materials, or incorporate any information required in the Notice, but not appearing in the issuer's proxy statement, in its request for voting instructions.

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that the registrant first sends its proxy statement or Notice of Internet Availability of Proxy Materials to security holders. See Rule 14a-16(l)(2) [17 CFR 240.14a-16(l)(2)].

85 See Rule 14b-1(b)(2) [17 CFR 240.14b-1(b)(2)].

86 For a more complete discussion of the content of the intermediary's Notice, see Section II.B.2 of Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148].

C. Reliance on the Notice and Access Model by Soliciting Persons Other Than the Issuer

Under the amendments, a soliciting person other than the issuer also must comply with the notice and access model. Such a person may solicit proxies pursuant to the notice only option, the full set delivery option, or a combination of the two.[87] Consistent with the existing proxy rules and the voluntary model, the amendments treat such soliciting persons differently from the issuer in certain respects.

First, a soliciting person is not required to solicit every shareholder or to furnish an information statement to shareholders not being solicited. It may select the specific shareholders from whom it wishes to solicit proxies. For example, under the notice and access model, a soliciting person other than the issuer can choose to send Notices only to those shareholders who have not previously requested paper copies.[88]

Second, if a soliciting person other than the issuer elects to follow the notice only option, it must send a Notice to shareholders by the later of:

- 40 calendar days prior to the shareholder meeting date or, if no meeting is to be held, 40 calendar days prior to the date that votes, consents, or authorizations may be used to effect the corporate action; or

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87 That is, as in the case of an issuer, a soliciting person other than the issuer may solicit some shareholders using the notice only option, while soliciting other shareholders using the full set delivery option.

88 Under Rule 14a-7(a)(2) [17 CFR 240.14a-7(a)(2)], an issuer is required to either mail the Notice on behalf of the soliciting person, in which case the soliciting person can request that the issuer send Notices only to shareholders who have not requested paper copies, or provide the soliciting person with a shareholder list, indicating which shareholders have requested paper copies. For a more complete discussion of the interaction of the model with Rule 14a-7, see Section II.C.4 of Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148].

- 10 calendar days after the date that the issuer first sends its proxy materials to shareholders.[89]

This timing requirement does not apply to a solicitation pursuant to the full set delivery model.

If, at the time the Notice is sent, a soliciting person other than the issuer is not aware of all matters on the shareholder meeting agenda, the Notice must provide a clear and impartial identification of each separate matter to be acted upon at the meeting, to the extent known by the soliciting person.[90] The soliciting person's Notice also must include a clear statement that there may be additional agenda items that the soliciting person is unaware of, and that the shareholder cannot direct a vote for those items on the soliciting person's proxy card provided at that time.[91] If a soliciting person other than the issuer sends a proxy card that does not reference all matters that shareholders will act upon at the meeting, the Notice must clearly state whether execution of the proxy card would invalidate a shareholder's prior vote using the issuer's card on matters not presented on the soliciting person's proxy card.[92]

III. Clarifying Amendments

Since adopting the notice and access model as a voluntary model, we have received several questions regarding implementation of that model. Some of these questions were received as comments on the proposing release to these amendments. To the extent such comments relate to the previously adopted voluntary model, the

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89 Rule 14a-16(l)(2) [17 CFR 240.14a-16(l)(2)].

90 Rule 14a-16(l)(3)(i) [17 CFR 240.14a-16(l)(3)(i)].

91 Id.

92 Rule 14a-16(l)(3)(ii) [17 CFR 240.14a-16(l)(3)(ii)].

Commission's staff is working with those commenters to provide guidance regarding implementation of those rules. However, several comments indicated aspects of the adopted rules that we believe would benefit from clarification in the regulatory text. To help clarify our intent, we are adopting the following technical amendments.

A. No Requirement to Provide Recommendations

Rule 14a-16(d)(3),[93] as it was initially adopted under the voluntary notice and access model, required the Notice to contain "[a] clear and impartial identification of each separate matter intended to be acted on and the soliciting person's recommendation regarding those matters." Our intent with this provision was not to require an issuer or other soliciting person to have a recommendation for every matter. Therefore, we are revising this provision to clarify that an issuer or other a soliciting person must present its recommendation only if it chooses to make a recommendation on a particular matter to be acted upon by shareholders.

B. Deadline for Responding to Requests for Copies After the Meeting

We are also amending the requirements about the fulfillment of requests for paper or e-mail copies received after the conclusion of the meeting. The rules that we initially adopted as part of the voluntary notice and access model made no distinction in the fulfillment requirements based on whether the issuer received a request for a paper or e-mail copy before or after the meeting date. We did state in the adopting release for the voluntary notice and access model that the post-meeting fulfillment provision is intended to require issuers to provide a copy of the proxy statement for one year "[j]ust as the proxy rules require issuers to undertake in their proxy statements or annual reports to

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93 17 CFR 240.14a-16(d)(3).

shareholders to provide copies of annual reports on Form 10-K for the most recent fiscal year to requesting shareholders."[94] The rule relating to providing copies of the annual report on Form 10-K does not require the use of First Class mail or that the issuer respond within three business days.[95] After the meeting is concluded, we do not believe there is such an urgent need to provide copies of the proxy materials in a timely manner to impose such requirements. Therefore, we are revising Rule 14a-16(j)(3)[96] to clarify that, with respect to requests for copies received after the conclusion of the meeting, an issuer is not required to use First Class mail and is not required to respond within three business days.

C. Item 4 of Schedule 14A

Item 4 of Schedule 14A[97] requires that an issuer or other soliciting person describe the methods used for soliciting proxies if not using the mails. Because the amendments require issuers and other soliciting persons to comply with Rule 14a-16 with respect to all proxy solicitations not related to business combination transactions, we are revising this item to clarify that issuers and other soliciting persons need not describe the notice and access model when they are using it to solicit proxies.

IV. Compliance Dates

Large accelerated filers, not including registered investment companies, must comply with the amendments with respect to solicitations commencing on or after January 1, 2008. Registered investment companies, soliciting persons other than the

94 See Release No. 33-55146 (Jan. 22, 2007) [72 FR 4148].

95 See Rule 14a-3(b) [17 CFR 240.14a-3(b)].

96 17 CFR 240.14a-16(j)(3).

97 17 CFR 240.14a-101.

issuer, and issuers that are not large accelerated filers conducting proxy solicitations (1) may comply with the amendments for solicitations commencing on or after January 1, 2008 and (2) must comply with the notice and access model for solicitations commencing on or after January 1, 2009. For example, a soliciting person other than the issuer that is soliciting proxies with respect to a shareholder meeting of a large accelerated filer is not required to follow the notice and access model until January 1, 2009, even though the large accelerated filer would be required to follow the model. However, such a soliciting person may voluntarily follow the model.

As stated above, the primary concern of most commenters on the proposal was the Commission's aggressive timetable for adopting the proposed rules. All 14 commenters on this topic requested that the Commission delay adoption of the proposed rules.[98] This group of commenters included trade associations representing issuers, transfer agents, intermediaries, proxy distribution service providers, institutional investors, and other shareholders.

Eight of these commenters were concerned that the short period between effectiveness of the voluntary model and adoption of the amendments in this release would not permit the Commission and the industry to properly evaluate the results of the voluntary model and prepare an adequate cost-benefit analysis.[99] Data that the commenters felt would be important to capture regarding the voluntary model included: (1) the effect on voter participation; (2) the costs of implementing the model; and (3) the extent to which predicted savings are actually realized by companies and other soliciting

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98 See letters from AARP, ABC, ADP, BONY, Chamber of Commerce, CII, Computershare, ICI, Reed Smith, Registrar and Transfer, SCSGP, SIFMA, SSA, and STA.

99 See letters from Chamber of Commerce, BONY, ICI, Reed Smith, Registrar and Transfer, SCSGP, SIMFA, and STA.

persons. These commenters recommended that the Commission not adopt the proposed amendments until it has had the opportunity to assess the data received regarding companies' experiences with the voluntary model.

With respect to costs, three of these commenters were concerned regarding the cost of adopting rules that would require issuers to develop, or hire outside services to develop, an Internet voting platform.[100] The rules that we are adopting do not require, and the proposals would not have required, such an Internet voting platform. Similarly, five commenters raised concerns regarding the ability of issuers to prepare their proxy materials at least 40 days before the date of the shareholder meeting, and costs associated with these efforts.[101] The rules that we are adopting do not require, and the proposal would not have required, all issuers to comply with the 40-day deadline if they are unable, or choose not, to do so.

As we have explained above, an issuer or other soliciting person may elect to comply with either: (1) the notice only option which is identical to the voluntary notice and access model; or (2) the full set delivery option. The latter option is substantially the same as the traditional system of providing proxy materials in paper, except that an issuer or other soliciting person complying with the full set delivery option also will have to:

- prepare and send a Notice, or incorporate the Notice information into its proxy statement and proxy card; and
- post its proxy materials on a publicly accessible Web site.

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100 See letters from ABC, BONY and Registrar and Transfer.

101 See letters from Chamber of Commerce, CII, Commerce Financial Printers, Elmore & Allen, ICI, and STA.

As we discuss more fully in our cost-benefit analysis, we believe that the cost to issuers and other soliciting persons to comply with these two requirements will not be significant, and therefore are expanding Internet availability of proxy materials to all shareholders. Many of the commenters' concerns regarding costs were based on beliefs that the proposal would require an electronic voting platform, preparation of proxy materials at least 40 days before the shareholder meeting, and anonymity controls on the Web site that exceed what the proposal would actually require. As noted above, the proposals would not have required, and the final rules do not require, such provisions. Rather, an issuer or other soliciting person can substantially continue to follow the traditional method of proxy delivery with minimal changes. Because the amendments will not have a significant impact on the requirements placed on issuers and other soliciting persons, we believe it is appropriate to adopt them now.

We also note that commenters have expressed concern, particularly in relation to the voluntary model, that if the model has a negative effect on shareholder participation, issuers may use the model to disenfranchise certain shareholders. We recognize these concerns and intend to monitor shareholder participation and take any steps necessary to prevent such abuse.

Furthermore, the tiered compliance dates address commenters' concerns because they will allow the Commission to better analyze the impact of the rules on a subset of issuers constituting large accelerated filers.[102] As noted above, a review of existing Web sites of such issuers indicated that approximately 80% of them already post their filings,

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102 One commenter specifically noted that the timeframe would not allow the Commission to analyze the effects of one-full year of compliance for large accelerated filers who chose to accept the voluntary model. See letter from the Chamber of Commerce. The tiered system will allow the

including proxy materials, on their Web site. Thus, most of the issuers that will be subject to the rules in the first year will be large issuers that appear to already post their proxy materials on their Web site. Therefore, we believe that this group is in the best position with respect to implementation costs in the first year while we evaluate the performance of the model. Adopting the amendments before the 2008 proxy season effectively creates a test group of issuers, enabling the Commission to study the performance of the model with a significant number of larger issuers and providing the Commission with an opportunity to make any necessary revisions to the rules before they apply to all issuers and other soliciting persons.

V. Paperwork Reduction Act

Certain provisions of the amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"), including preparation of Notices, maintaining Web sites, maintaining records of shareholder preferences, and responding to requests for copies. The titles for the collections of information are:

Regulation 14A (OMB Control No. 3235-0059)

Regulation 14C (OMB Control No. 3235-0057)

We requested public comment on these collections of information in the release proposing the notice and access model as a voluntary model for disseminating proxy materials,[103] and submitted them to the Office of Management and Budget ("OMB") for review in accordance with the PRA. We received approval for the collections of

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Commission to analyze a full year of experience under the notice and access model for all large accelerated filers.

[103] Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597].

information. We submitted a revised PRA analysis to OMB in conjunction with the release adopting the notice and access model as a voluntary model.[104] In those releases, we assumed conservatively that all issuers and other persons soliciting proxies would follow the voluntary model because the proportion of issuers and other soliciting persons that would elect to follow the model was uncertain.

The rules that we are adopting require all issuers and other soliciting persons to follow the notice and access model, including the preparation of the Notice, as we assumed for our prior PRA analysis. Therefore, we estimate that the rule amendments will not impose any new recordkeeping or information collection requirements beyond those described in the release adopting the voluntary model, or necessitate revising the burden estimates for any existing collections of information requiring OMB's approval.

VI. Cost-Benefit Analysis

A. Background

We are adopting amendments to the proxy rules under the Exchange Act substantially as proposed that require issuers and other soliciting persons (jointly referred to as "soliciting parties") to follow the notice and access model for furnishing proxy materials. The amendments are intended to provide all shareholders with the ability to choose the means by which they access proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications.

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104 Release No. 34-55146 (Jan. 22, 2007) [72 FR 4147].

B. Summary of the Amendments

The notice and access model that we are adopting requires soliciting parties to furnish proxy materials by posting them on a specified, publicly-accessible Internet Web site (other than the Commission's EDGAR Web site) and providing shareholders with a notice informing them that the materials are available and explaining how to access them. Under the model, soliciting parties may choose between two options with respect to how they will provide proxy materials to shareholders. Under the first option, the notice only option, a soliciting party may follow the procedures in Exchange Act Rule 14a-16 that we adopted on January 22, 2007 in connection with the voluntary model.[105] Under this option, a soliciting party would send only a Notice indicating the Internet availability of the proxy materials to a solicited shareholder at least 40 days prior to the shareholders meeting and provide that shareholder with a paper or e-mail copy of the proxy materials upon request.

Under the second option, the full set delivery option, soliciting parties may follow procedures substantially similar to the traditional method of sending paper copies of the proxy materials to a shareholder by accompanying the Notice with a full set of proxy materials. Under the full set delivery option, the soliciting party is not required to send the Notice and the full set of proxy materials at least 40 days prior to the shareholders meeting and need not provide a means for shareholders to request another set of the proxy materials. Moreover, a soliciting party need not prepare a separate Notice if it includes all of the information otherwise required in a Notice in the proxy statement or proxy card.

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105 Release No. 34-55146 (Jan. 22, 2007) [72 FR 4147].

A soliciting party may use the notice only option to provide proxy materials to some shareholders and the full set delivery option to provide proxy materials to other shareholders. The amendments also require intermediaries to follow similar procedures to provide beneficial owners with access to the proxy materials. Soliciting parties may not use the model with respect to a business combination transaction.

C. Benefits

1. Versatility of the Internet

Historically, soliciting parties decided whether to provide shareholders with the choice to receive proxy materials by electronic means. The amendments, which build on and incorporate the voluntary model that we adopted in January, are intended to provide all shareholders with the ability to choose the means by which they access proxy materials, to expand use of the Internet potentially to lower the costs of proxy solicitations, and to improve the efficiency of the proxy process and shareholder communications. The amendments provide all shareholders with the ability to choose whether to access proxy materials in paper, by e-mail or via the Internet. As technology continues to progress, accessing the proxy materials on the Internet should increase the utility of our disclosure requirements to shareholders. Information in electronic documents is often more easily searchable than information in paper documents. Shareholders will be better able to go directly to any section of the document that they are particularly interested in. The amendments also will permit shareholders to more easily evaluate data and transfer data using analytical tools such as spreadsheet programs. Such tools enable users to compare relevant data about several companies more easily.

In addition, encouraging shareholders to use the Internet in the context of proxy solicitations may encourage improved shareholder communications in other ways. Current and future Internet communications innovations may enhance shareholders' ability to interact not only with management, but with each other. Such access may improve shareholder relations to the extent that shareholders feel that they have enhanced access to management. Centralizing an issuer's disclosure on a Web site may facilitate shareholder access to other important information, such as research reports and news concerning the issuer. We believe that increased reliance on the Internet for making proxy materials available to shareholders could ultimately lower the cost of soliciting proxies for all soliciting parties.

2. Paper Processing Costs

One of the purposes of the voluntary model was to reduce paper processing costs related to proxy solicitations. We previously estimated savings assuming that soliciting parties responsible for 10% to 50% of all proxy mailings would follow that model. We do not assume that the amendments will cause a soliciting party to change its decision under the voluntary model whether to send only a Notice or to send a full set of proxy materials to shareholders. Therefore, we do not assume for this analysis any savings in paper processing costs as a result of these particular amendments. However, because the voluntary model just recently became effective for proxy solicitations commencing on or after July 1, 2007, and therefore has not been used by many soliciting parties and because these amendments create a single notice and access model that includes aspects of the voluntary model, we are presenting a cost-benefit analysis that addresses the notice and access model as a whole, including our assessment of the benefits and costs created by the amendments.

As we discussed in the adopting release for the voluntary model, the paper-related benefits of the notice and access model are limited by the volume of paper processing that would occur otherwise. As we noted in that release, Automatic Data Processing, Inc.[106] (ADP) handles the vast majority of proxy mailings to beneficial owners.[107] ADP publishes statistics that provide useful background for evaluating the likely consequences of the rule amendments. ADP estimates that, during the 2006 proxy season,[108] over 69.7 million proxy material mailings were eliminated through a variety of means, including householding and existing electronic delivery methods. During that season, ADP mailed 85.3 million paper proxy items to beneficial owners. ADP estimates that the average cost of printing and mailing a paper copy of a set of proxy materials during the 2006 proxy season was $5.64. We estimate that soliciting parties spent, in the aggregate, $481.2 million in postage and printing fees alone to distribute paper proxy materials to beneficial owners during the 2006 proxy season.[109] Approximately 50% of all proxy pieces mailed by ADP in 2005 were mailed during the proxy season.[110] Therefore, extrapolating this

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106 ADP recently spun off its brokerage services group, which is now called Broadridge Financial Solutions, Inc. However, because its comment letter was submitted when the group was part of ADP and carries the ADP letterhead, we continue to refer to the company as ADP for purposes of this release.

107 We expect savings per mailing to record holders to roughly correspond to savings per mailing to beneficial owners.

108 According to ADP data, the 2006 proxy season extended from February 15, 2006 to May 1, 2006.

109 85.3 million mailings x $5.64/mailing = $481.2 million.

110 According to ADP, in 2005, 90,013,175 proxy pieces out of a total 179,833,774 proxy pieces were mailed during the 2005 proxy season. Thus, we estimate that 50% of proxy pieces are mailed during the proxy season (90,013,175 proxy pieces during the season / 179,833,774 total proxy pieces = 0.5 or 50%).

percentage to 2006, we estimate that soliciting parties from beneficial owners spent approximately \$962.4 million in 2006 in printing and mailing costs.[111]

As was the case with the voluntary model, for soliciting parties following the notice only option, paper-related savings may be reduced by the cost of fulfilling requests for paper copies.[112] We estimate that approximately 19% of shareholders would request paper copies from such soliciting parties. Commenters on the voluntary model provided alternate estimates. For example, Computershare, a large transfer agent, estimated that less than 10% of shareholders would request paper copies.[113] According to a survey conducted by Forrester Research for ADP, 12% of shareholders report that they would always take extra steps to get their proxy materials, and as many as 68% of shareholders report that they would take extra steps to get their proxy materials in paper at least some of the time. The same survey also finds that 82% of shareholders report that they look at their proxy materials at least some of the time. These survey results suggest that shareholders may review proxy materials even if they do not vote. During the 2005 proxy season, only 44% of accounts were voted by beneficial owners. Put differently, 56%, or 84.8 million accounts, did not return requests for voting instructions. Our estimate that 19% of shareholders would request paper copies reflects the diverse estimates suggested by the available data.

Based on the assumption that 19% of shareholders would choose to have paper copies sent to them when a soliciting party initially sends them only a Notice, we

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111 \$481.2 million / 50% = \$962.4 million.

112 Soliciting parties that choose to follow the full set delivery option will not incur fulfillment costs. Such soliciting parties are not required to provide paper copies to shareholders upon request because they would have provided such copies at the outset.

113 See letter commenting on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598] from Computershare.

estimated that the voluntary model could produce annual paper-related savings ranging from $48.3 million (if soliciting parties responsible for 10% of all proxy mailings choose to follow the notice only option) to $241.4 million (if soliciting parties responsible for 50% of all proxy mailings choose to follow the notice only option).[114] This estimate excludes the effect of the provision of the amendments that would allow shareholders to make a permanent request for paper copies. That provision enables soliciting parties to take advantage of bulk printing and mailing rates for those requesting shareholders, and therefore should reduce the on-demand costs reflected in these calculations.

Although we expect the savings to be significant from the notice and access model as a whole, the actual paper-related benefits will be influenced by several factors that we estimate should become less important over time. First, to the extent that shareholders request paper copies of the proxy materials, the benefits of the notice and access model in terms of savings in printing and mailing costs will be reduced. Soliciting parties have expressed concern that the cost per paper copy would be significantly greater if they have to mail copies of paper proxy materials to shareholders on an on-demand basis, rather than mailing the paper copies in bulk. Thus, if a significant number of

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114 This range of potential cost savings depends on data on proxy material production, home printing costs, and first-class postage rates provided by Lexecon and ADP, and supplemented with modest 2006 USPS postage rate discounts. The fixed costs of notice and proxy material production are estimated to be $2.36 per shareholder, including $0.42 to print and mail the Notice. The variable costs of fulfilling a paper request, including handling, paper, printing and postage, are estimated to be $6.11 per copy requested. Our estimate of the total number of shareholders is based on data provided by ADP and SIFMA (at the time it submitted these comments, the SIFMA was known as the Securities Industry Association or SIA). According to SIFMA's comment letter on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598], 78.49% of shareholders held their shares in street name. We estimate that the total number of proxy pieces mailed to both registered holders and beneficial owners is approximately 229,116,797 (179,833,774 proxy pieces to beneficial owners / 78.49% = 229,116,799 total proxy pieces). To calculate the potential cost savings, for the percentage of proxy piece mailings replaced by the Notice (10% or 50% times 229,116,799 proxy pieces), we estimate the total savings of not printing and sending full sets ($5.64) and subtract the estimated costs of printing and sending Notices and fulfilling paper requests ($2.36 + (19.2% x

shareholders request paper, the savings will be substantially reduced. Second, soliciting parties may face a high degree of uncertainty about the number of requests that they may get for paper proxy materials and may maintain unnecessarily large inventories of paper copies as a precaution. As soliciting parties gain experience with the number of sets of paper materials that they need to supply to requesting shareholders, and as shareholders become more comfortable with receiving disclosures via the Internet, the number of paper copies are likely to decline, as would soliciting parties' tendency to print many more copies than ultimately are requested. This should lead to growth in paper-related savings from the notice and access model over time.

3. Reduction in the Cost of Proxy Contests

Benefits would accrue under the notice and access model from additional reductions in the costs of proxy solicitations by persons other than the issuer. Soliciting persons other than the issuer also must comply with the notice and access model, but can limit the scope of their proxy solicitations to shareholders who have not requested paper copies of the proxy materials. The flexibility afforded to persons other than the issuer under the model ultimately may reduce the cost of engaging in proxy contests, thereby increasing the effectiveness and efficiency of proxy contests as a source of discipline in the corporate governance process. However, because the amendments do not significantly change the options available to such soliciting person from the existing rules, we do not anticipate that the amendments will change significantly the number of soliciting persons other than issuers who select the notice only option as opposed to the number who would have chosen to follow the voluntary model.

\$6.11)). 10% x 229,116,799 proxy pieces x (\$5.64 - (\$2.36 + (19.2% x \$6.11)) = \$48.3 million. 50% x 229,116,799 proxy pieces x (\$5.64 - (\$2.36 + (19.2% x \$6.11)) = \$241.4 million.

The effect of the notice and access model of lessening the costs associated with a proxy contest will be limited by the persistence of other costs. One commenter on the proposal to create the voluntary model noted that a large percentage of the costs of effecting a proxy contest go to legal, document preparation, and solicitation fees, while a much smaller percentage of the costs is associated with printing and distribution of materials.[115] However, other commenters suggested that the paper-related cost savings that can be realized from the rule amendments are substantial enough to change the way many contests are conducted.[116]

4. Environmental Benefits

Finally, some benefits from the notice and access model, as revised, may arise from a reduction in what may be regarded as the environmental costs of the proxy solicitation process.[117] Specifically, proxy solicitation involves the use of a significant amount of paper and printing ink. Paper production and distribution can adversely affect the environment, due to the use of trees, fossil fuels, chemicals such as bleaching agents, printing ink (which contains toxic metals), and cleanup washes. Although not all of these costs may be internalized by paper producers, to the extent that such producers do internalize these costs and the costs are reflected in the price of paper and other materials consumed during the proxy solicitation process, our dollar estimates of the paper-related benefits reflect the elimination of these adverse environmental consequences under the model.

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115 See letter commenting on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598] from ADP.

116 See letters commenting on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598] from CALSTRS, Computershare, ISS, and Swingvote.

117 See letter commenting on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598] from American Forests.

D. Costs

The amendments require all soliciting parties, including those who follow the full set delivery option, to (1) prepare and print a Notice (or incorporate Notice information into its proxy statement and proxy card) and (2) post the proxy materials on an Internet Web site. Because the notice only option is identical to the voluntary model, soliciting parties that choose that option will incur the same costs and savings as they would have under the voluntary model.

1. Costs Under the Notice Only Option

A soliciting party that chooses to follow the notice only option would incur the same costs as a soliciting party that chose to follow the voluntary model. These costs include the following: (1) the cost of preparing, producing, and sending the Notice to shareholders; (2) the cost of posting proxy materials on an Internet Web site; (3) providing a means to execute a proxy as of the date that the Notice is sent; and (4) the cost of processing shareholders' requests for copies of the proxy materials and maintaining their permanent election preferences if a soliciting party elects to follow the notice only option.

Under the amendments, soliciting parties must prepare and print the Notice to shareholders and post their proxy materials on an Internet Web site. As noted above, these costs would apply to soliciting parties irrespective of which option they choose. A soliciting party following the notice only option also must separately send the Notice to shareholders. As we stated in the release adopting the voluntary model, the paper-related savings to soliciting parties discussed under the benefits section above are adjusted for the cost of preparing, printing and sending Notices.

In the release adopting the voluntary model, we assumed, for purposes of the PRA, that all soliciting parties would elect to follow the procedures, resulting in a total estimated cost to prepare the Notice of approximately $2,020,475.[118] We are adjusting this amount to $2,469,475 to reflect a change in the basis of our cost estimate for personnel time.[119] Based on the percentage range of soliciting parties that we estimated would adopt the voluntary model, we estimated that these costs for soliciting parties who follow the notice only option could range between $246,948 (if soliciting parties responsible for 10% of all proxy mailings followed the notice only option) and $1,234,736 (if soliciting parties responsible for 50% of all proxy mailings followed the notice only option).[120]

If Notices are sent by mail, then the mailing costs may vary widely among parties. Postage rates likely would vary from $0.14 to $0.41 per Notice mailed, depending on numerous factors. In our estimates of the paper-related benefits above, we assume that each Notice costs a total of $0.13 to print and $0.29 to mail. Based on data from ADP and SIA, we estimate that soliciting parties send a total of 229,116,797 proxy pieces per year.[121] In the release adopting the voluntary model, we assumed that only those

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118 In the voluntary model adopting release, we estimated that soliciting parties would spend a total of $897,975 on outside professionals to prepare this disclosure. We also estimated that soliciting parties would spend a total of 8,980 hours of personnel time preparing this disclosure. We estimated the average hourly cost of personnel time to be $125, resulting in a total cost of $1,122,500 for personnel time and a total cost of $2,020,475 ($1,122,500 + $897,975 = $2,020,475).

119 We are adjusting this estimate of personnel time to be $175 to be consistent with our other releases. This results in an in-house cost of $1,571,500 (8,980 hours x $175/hour = $1,571,500) and a total cost of $2,469,475 ($1,571,500 + $897,975 = $2,469,475) for soliciting parties following the notice only option. For purposes of the PRA analysis, we are not adjusting the hourly burden imposed on soliciting parties and, therefore, are not revising our PRA submission.

120 $2,469,475 * 10% = $246,948. $2,469,475 * 50% = $1,234,736.

121 See www.ics.adp.com/release11/public_site/about/stats.html stating that ADP handled 179,833,774 in fiscal year 2005 and letter commenting on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598] from SIFMA stating that beneficial accounts represent 78.49% of total accounts.

soliciting parties that choose to follow the voluntary model would incur these printing and mailing costs. We estimated that the costs to print the Notices would range from $9.6 million (if soliciting parties responsible for 10% of all current proxy mailings choose to follow the notice only option) and $48.1 million (if soliciting parties responsible for 50% of current proxy mailings choose to follow the notice only option).[122] These same costs would be incurred by soliciting parties following the notice only option under the revised model.

Soliciting parties that follow the notice only option must post their proxy materials on an Internet Web site. Although costs for establishing a Web site and posting materials on it can vary greatly, the rules do not require elaborate Web site design. The rules only require that a soliciting party obtain a Web site and post several documents on that Web site. Several companies currently provide Web hosting services for free, including significant memory to post the required documents and bandwidth to handle several thousand "hits" per month.[123] We also noted that several Web hosting services provided Web sites which would handle up to five million hits per month are available

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122 10% x 229,116,797 x ($0.13 + $0.29) = $9.6 million. 50% x 229,116,797 x ($0.13 + $0.29) = $48.1 million. As stated above, these costs would be significantly offset by savings as a result of not being required to print and mail full sets of proxy materials, resulting in a net savings of $48.3 million (if issuers responsible for 10% of all proxy mailings choose to follow the notice only option) to $241.4 million (if issuers responsible for 50% of all proxy mailings choose to follow the notice only option) for issuers choosing to follow the notice only option.

123 A review found free Web hosting services that permit the posting of up to 100M of data, with a bandwidth capacity of 10,000MB. A document's size can vary dramatically depending on its design. Typical proxy statement and annual report sizes vary from 200KB for documents with few graphics such as an annual report on Form 10-K to 5MB for elaborate "glossy" annual reports. Based on this range of sizes, we estimate that a free Web hosting service would enable between 1,000 and 25,000 "hits" per month.

for approximately $5 to $8 per month, or $60 to $96 per year.[124] Based on a review of several Internet Web page design firms, we estimate that the cost of designing a Web site that meets the basic requirements of the notice and access model would be approximately $300. Thus, we estimate that the approximate total cost to establish a new Web site would be approximately $360 per year for a soliciting party, or a range of $0.3 million (if soliciting parties responsible for 10% of all proxy mailings would not have followed the voluntary model) to $1.4 million (if soliciting parties responsible for 50% of all proxy mailings would not have followed the voluntary model).[125] This estimate assumes that the soliciting party obtains a new Web site to post the proxy materials. We believe that the cost to soliciting parties that already maintain Web sites would be less.

The Web site on which the proxy materials are posted must maintain the anonymity of shareholders accessing the site. As discussed elsewhere in the release, this requirement requires a soliciting party to refrain from installing software on the Web site that tracks the identity of persons accessing the Web site. Thus, this requirement does not impose any added burden on soliciting party establishing new Web sites. A soliciting party that already has a Web site must segregate a portion of that Web site so that any tracking software on its general Web site does not track persons accessing the portion containing the proxy materials. Such segregation of the Web site requires minimal effort and should not impose a significant burden on such parties.

The rules also require that the proxy materials be posted in a format or formats convenient for printing on paper or viewing online. One commenter was concerned that

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124 We found several services which permit the posting of up to 300GB of data, with a bandwidth capacity of 3000GB, and include web design programs at prices between $5 and $8 per month.

125 Based on filings in our last fiscal year, we estimate 7,982 proxy solicitations per year. 10% x 7,982 x $360 = $0.3 million. 50% x 7,982 x $360 = $1.4 million.

this would impose an unnecessary burden on soliciting parties. Currently, Internet Web sites regularly present the same document in multiple formats for the convenience of readers. In particular, Internet Web sites regularly post large files for Internet users with broadband connections and smaller files for users who do not have broadband connections. In light of this common practice on the Internet, we do not believe that this requirement will impose a significant burden on soliciting parties.

Soliciting parties must provide a means to vote as of the date on which the Notice is first sent. Those following the notice only option can do so by creating an electronic voting platform, providing a telephone number or posting a printable proxy card on the Web site. Some commenters questioned whether the model would require the creation of an electronic voting platform, which they estimated would cost approximately \$3,000.[126] The amendments do not require such a voting platform. A soliciting party may simply post a printable proxy card or a telephone number for executing a proxy on its Web site, which should impose little burden.

The cost of processing shareholders' requests for copies of the proxy materials if a soliciting party elects to follow the notice only option is addressed as an offset to the savings discussed in the Benefits section of this analysis.

The amendments also require issuers and intermediaries to maintain records of shareholders who have requested paper and e-mail copies for future proxy solicitations. We estimate that this total cost if all issuers followed the notice only option would be approximately \$13,098,500.[127] Thus, we estimated the cost due to the voluntary model

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126 See letters from BONY and Registrar and Transfer.

127 In the voluntary model adopting release, we estimated, for PRA purposes, that issuers and intermediaries would spend a total of 79,820 hours of issuer and intermediary personnel time maintaining these records. We estimate the average hourly cost of issuer and intermediary

would be approximately $1.3 million (if issuers responsible for 10% of all proxy mailings followed the notice only option) and $6.5 million (if issuers responsible for 50% of all proxy mailings followed the notice only option).[128]

2. Costs Under the Full Set Delivery Option

A soliciting party following the full set delivery option must either prepare a Notice or incorporate the Notice information into its proxy statement or proxy card. We base our estimates on preparing a separate Notice because we believe this would involve a greater cost. However, we anticipate that a significant number of soliciting parties would choose to incorporate the information into their materials. Based on the range that we estimated for soliciting parties following the notice only option, we estimate that soliciting parties responsible for 50% to 90% of all proxy mailings would choose to follow the full set delivery option. Soliciting parties who follow this option would not incur mailing costs in addition to costs incurred under the traditional system because the Notice would be included in the much larger package of the full set of proxy materials.

When the Commission adopted the voluntary model, we estimated that soliciting parties responsible for 10% to 50% of all proxy mailings would rely on the voluntary model. Under the amendments, we assume that soliciting parties that we estimated would not have followed the voluntary model (i.e., soliciting parties responsible for 50% to 90% of all proxy mailings) would incur the cost of preparing and printing a Notice (or

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personnel time to be $175, resulting in a total cost of $13,068,500 for issuer and intermediary personnel time.

128 $13,098,500 x 10% = $1,309,850. $13,098,500 * 50% = $6,549,250.

incorporating Notice information into their proxy materials)[129] and posting the proxy materials on an Internet Web site.

We estimate that the cost for soliciting parties that would not have followed the voluntary model to prepare a Notice will range between $1.2 million (if soliciting parties responsible for 50% of all proxy mailings would not have followed the voluntary model) and $2.2 million (if soliciting parties responsible for 90% of all proxy mailings would not have followed the voluntary model).[130]

Similarly, we estimate that the cost for such parties of printing the Notice will range between $14.9 million[131] (if soliciting parties responsible for 50% of all proxy mailings would not have followed the voluntary model) and $26.8 million[132] (if soliciting parties responsible for 90% of all proxy mailings would not have followed the voluntary model). Soliciting parties can significantly reduce this cost to print the Notice by incorporating the Notice information into the proxy materials instead of printing a separate Notice. Printing costs for the full set of proxy materials would be identical to such costs under the traditional method of providing proxy materials by mail and therefore do not represent an incremental cost increase as a result of these rules.

We do not expect an incremental increase in mailing cost for the Notice for soliciting parties that choose the full set delivery option because the Notice is

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129 We do not expect an incremental increase in mailing cost for the Notice for soliciting parties that choose the full set delivery option because the Notice is substantially smaller than the full set of proxy materials currently sent under the traditional system and must accompany that full set (or be incorporated into those materials).

130 As noted above, we calculated a total cost of $2,469,475 for preparing the Notice for purposes of the PRA. $2,469,475 * 50% = $1,234,736. $2,469,475 * 90% = $2,222,528.

131 50% x 229,116,797 x $0.13 = $14.9 million.

132 90% x 229,116,797 x $0.13 = $26.8 million. We assume that the additional cost of mailing the Notice together with the full set of proxy materials is negligible.

substantially smaller than the full set of proxy materials currently sent under the traditional system and must accompany that full set (or be incorporated into the proxy statement and proxy card).

In addition, under the amendments, soliciting parties that would not have followed the voluntary model must post their proxy materials on an Internet Web site. As we noted above, although costs for establishing a Web site and posting materials on it can vary greatly, the rules do not require elaborate Web site design. The rules only require that a soliciting party obtain a Web site and post several documents on that Web site. As with the notice only option, we estimate that the approximate total cost to establish a new Web site would be approximately $360 per year for a soliciting party, or a range of $1.4 million (if soliciting parties responsible for 50% of all proxy mailings would not have followed the voluntary model) to $2.6 million (if soliciting parties responsible for 90% of all proxy mailings would not have followed the voluntary model).[133]

3. Costs to Intermediaries

Soliciting parties and intermediaries will incur additional processing costs under the notice and access model. The amendments require an intermediary such as a bank, broker-dealer, or other association to follow the notice and access model with respect to all issuers. An intermediary must prepare its own Notice to beneficial owners, along with instructions on when and how to request paper copies and the Web site where the beneficial owner can access his or her request for voting instructions. Since soliciting parties reimburse intermediaries for their reasonable expenses of forwarding proxy materials and intermediaries and their agents already have systems to prepare and deliver

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[133] 50% x 7,982 x $360 = $1.4 million. 90% x 7,982 x $360 = $2.6 million.

requests for voting instructions, we do not expect the involvement of intermediaries in sending their Notices to significantly affect the costs associated with the rules.

Under the notice and access model, a beneficial owner desiring a copy of the proxy materials from a soliciting party following the notice only option must request such a copy from its intermediary. The costs of collecting and processing requests from beneficial owners may be significant, particularly if the intermediary receives the requests of beneficial owners associated with many different soliciting parties that specify different methods of furnishing the proxy. We expect that these processing costs will be highest in the first year after adoption but will subsequently decline as intermediaries develop the necessary systems and procedures and as beneficial owners increasingly become comfortable with accessing proxy materials online. In addition, the amendments permit a beneficial owner to specify its preference on an account-wide basis, which should reduce the cost of processing requests for copies. These costs ultimately are paid by the soliciting party.

4. Costs to Shareholders

Under the amendments, a shareholder can avoid any additional cost by accessing the proxy materials on the Internet if they already have Internet access or by requesting copies of the proxy materials from the soliciting parties if the shareholder is a record holder or the intermediary if the shareholder is a beneficial owner. Shareholders who do not already have Internet access and wish to access the proxy materials online would incur any necessary costs associated with gaining access to the Internet. In addition, some shareholders may choose to print out the posted materials, which would entail paper and printing costs. We estimate that approximately 10% of all shareholders receiving a

Notice under the notice only option would print out the posted materials at home at an estimated cost of $7.05 per proxy package. Based on these assumptions, we estimated that the voluntary model could produce incremental annual home printing costs ranging from $16 million (if soliciting parties responsible for 10% of all current proxy mailings follow the notice only option) to $80 million (if soliciting parties responsible for 50% of all current proxy mailings follow the notice only option).[134] Shareholders of issuers that follow the full set delivery option would not incur such costs.

5. Comments Regarding Unanticipated Costs

Several commenters expressed concern with the adoption of these amendments before the Commission has collected operating data from the voluntary model. The recommended delaying adoption until the market has had more experience with the voluntary model before requiring companies to follow the notice and access model. As we note elsewhere in the release, the amendments adopted in this release do not require soliciting parties to follow procedures substantially different from the procedures available under the voluntary model. Soliciting parties who wish to furnish their proxy materials via traditional paper delivery may continue to do so, with the only added requirements being that they must post their proxy materials on an Internet Web site and prepare a Notice (or incorporate the Notice information into their proxy statement and proxy card).

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134 This range of potential home printing costs depends on data provided by Lexecon and ADP. See letter from ADP. The Lexecon data was included in the ADP comment letter. To calculate home printing cost, we assume that 50% of annual report pages are printed in color and 100% of proxy statement pages are printed in black and white. The estimated percentage of shareholders printing at home is derived from Forrester survey data furnished by ADP and adjusted for the reported likelihood that an investor will take extra steps to get proxy materials. Total number of shareholders estimated as above based on data provided by ADP and SIFMA. See letters commenting on Release No. 34-52926 (Dec. 8, 2005) [70 FR 74598] from ADP and SIFMA.

In addition, only large accelerated filers that are subject to the proxy rules will be subject to the requirements in 2008. All other filers need not, but may, follow the notice and access model before January 1, 2009. Most large accelerated filers already appear to post their proxy materials on the Internet. As noted above, a review of existing Web sites of such issuers indicated that approximately 80% of them already post their filings, including proxy materials, on their Web site. Thus, most of the issuers that will be subject to the rules in the first year will be large issuers that already post their proxy materials on their Web site. Therefore, we believe that no company will incur significant cost as a result of these amendments in the first year, while we evaluate the performance of the model. Although they may need to implement some procedures to ensure the anonymity of persons accessing those materials, we do not believe this requirement will impose a significant burden on these companies.

Furthermore, the tiered compliance dates address commenters' concerns because they will allow the Commission to better analyze the impact of the rules on a subset of issuers constituting large accelerated filers.[135] Adopting the amendments for large accelerated filers before the 2008 proxy season effectively creates a test group of issuers, enabling the Commission to study the performance of the model with a significant number of larger issuers and to make any necessary revisions to the rules before they apply to all issuers and other soliciting persons.

135 One commenter specifically noted that the timeframe would not allow the Commission to analyze the effects of one-full year of compliance for large accelerated filers who chose to accept the voluntary model. See letter from the Chamber of Commerce. The tiered system will allow the Commission to analyze a full year of experience under the notice and access model for all large accelerated filers.

6. Comment on the Complexity of the Notice and Access Model

One commenter expressed concern that the proposed rule would make the proxy delivery system too complex for beneficial owners holding in street name through their brokers or other intermediaries.[136] We acknowledge that the amendments provide shareholders with more options with respect to the manner in which they are able to access their proxy materials, and thereby add complexity to the proxy distribution system. However, we believe that shareholder choice as to the means by which they access proxy materials and the expanded use of the Internet to provide such information to shareholders ultimately will provide shareholders with better access to information, which we believe can make the proxy process more efficient. In adopting the voluntary model, we created a provision that allows a shareholder to make a one-time election of the means by which they access proxy materials to simplify the model for those shareholders. In addition, by choosing to follow the full set delivery option, issuers and other soliciting persons wishing to do so can continue to furnish their proxy materials through procedures substantially similar to traditional methods of furnishing proxy materials. These provisions should significantly simplify the process for all shareholders.

VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act[137] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the

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136 See letter from Reed Smith. We received similar comments on our proposals to adopt the notice and access model as a voluntary means of furnishing proxy materials.

137 15 U.S.C. 78w(a)(2).

Exchange Act. Section 3(f) of the Exchange Act[138] and Section 2(c) of the Investment Company Act of 1940[139] require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The amendments require all issuers and other soliciting persons to follow the notice and access model for all proxy solicitations, other than those associated with business combination transactions. The amendments are intended to provide all shareholders with the ability to choose the means by which they access proxy materials, to expand use of the Internet to lower the costs of proxy solicitations, and to improve shareholder communications. Historically, issuers decided whether to provide shareholders with the choice to receive proxy materials by electronic means. The amendments provide all shareholders with the ability to choose whether to access proxy materials in paper, by e-mail or via the Internet. We believe that expanded use of electronic communications to replace current modes of disclosures on paper and physical mailings will increase the efficiency of the shareholder communications process. Use of the Internet permits technology developers to enhance a shareholder's experience with respect to such communications. It permits interactive communications at real-time speeds. Improved shareholder communications may improve relationships between shareholders and management. Retail investors may have easier access to management.

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138 15 U.S.C. 78c(f).

139 15 U.S.C. 80a-2(c).

In turn, this may lead to increased confidence and trust in well-managed, responsive issuers.

The amendment may have the effect of initially raising costs on issuers and other soliciting persons by requiring persons who choose to follow the full set delivery option to post the proxy materials on a Web site and prepare a Notice (or incorporate Notice information into their proxy statement and proxy card). Commenters were concerned that the amendments may create other inefficiencies such as reducing shareholder voting participation and increased reliance on broker discretionary voting. The amendments do not significantly differ from the voluntary model. Issuers who are concerned about a reduction in voting participation still have the option to send a full set of proxy materials to all shareholders. Therefore, we do not believe that the amendments will have a significant impact compared to the previously-adopted voluntary model on shareholder voting participation, and hence reliance on broker discretionary voting.

We also considered the effect of the amendments on competition and capital formation, including the effect that the amendments may have on industries servicing the proxy soliciting process. We do not anticipate any significant effects on capital formation. We also anticipate that some companies whose business model is based on the dissemination of paper-based proxy materials may experience some adverse competition effects from the amendments. However, the full set delivery option permits companies to continue to send paper copies to shareholders. Thus, we do not anticipate that the amendments will have an incremental impact on this industry different from the voluntary model. The amendments may also promote competition among Internet-based information services.

VIII. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to amendments to the rules and forms under the Exchange Act that require issuers, other persons soliciting proxies, and intermediaries to follow the notice and access model for all proxy solicitations except for those associated with a business combination transaction. An Initial Regulatory Flexibility Analysis (IRFA) was prepared in accordance with the Regulatory Flexibility Act in conjunction with the proposing release. The proposing release included, and solicited comment on, the IRFA.

A. Need for the Amendments

On January 22, 2007, we proposed amendments to the rules regarding provision of proxy materials to shareholders. We are adopting those amendments, substantially as proposed. Specifically, the amendments require issuers and other persons soliciting proxies to provide shareholders with Internet access to proxy materials. The amendments are intended to provide all shareholders with the ability to choose the means by which they access proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications. We anticipate that the model will enhance the ability of investors to make informed decisions and ultimately to lower the costs of proxy solicitations.

The amendments also will provide all shareholders with the ability to choose whether to access proxy materials in paper, by e-mail or via the Internet. Developing technologies on the Internet should expand the ways in which required disclosures can be used by shareholders. Electronic documents are more easily searchable than paper documents. Users are better able to go directly to any section of the document that they believe to be the most important. They also permit users to more easily evaluate data. It enables users to more easily download data into spreadsheet or other analytical programs so that they can perform their own analyses more efficiently. A centralized Web site containing proxy-related disclosure may facilitate shareholder access to other relevant information such as research reports and news about the issuer.

In addition, encouraging shareholders to use the Internet in the context of proxy solicitations may have the side-effect of improving shareholder communications in other ways. Internet tools may enhance shareholders' ability to communicate not only with management, but with each other. Such direct access may improve shareholder relations to the extent shareholders have improved access to management.

B. Significant Issues Raised by Public Comment

Five commenters were concerned that smaller firms may not realize the savings contemplated by the mandatory model and may even incur increased costs.[140] One commenter suggested that the Commission develop "ways to 'scale' the notice and access model for smaller public companies so as to reduce the cost of compliance," but did not provide any recommendations on how to do so.[141]

Several commenters were concerned about the increased set-up costs for issuers, including small entities. One commenter estimated that, based on its "back-of-envelope" estimate, the cost of outsourcing the requirements to a third party provider could cost companies over $5,000 and may exceed $10,000, including the establishment of an Internet voting platform.[142] Three other commenters estimated that the proposal would

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140 See letters from ABC, BONY, Reed Smith, Registrar and Transfer, and STA.

141 See letter from ABC.

142 See letter from ABC.

cost companies approximately $3,000 to establish such an Internet voting platform.[143] However, as noted previously, the amendments do not require companies to establish such a platform.[144] One of these commenters noted that although posting the proxy materials on the Internet is not necessarily expensive or difficult, outsourcing this function to an outside firm could cost hundreds, if not thousands, of dollars to do so.[145]

One commenter was concerned that the prohibition on "cookies" raises the costs for maintaining the Web sites.[146] Although this prohibition does raise the cost to maintain the Web sites, we believe that eliminating this prohibition may have a negative effect on shareholders' willingness to access the proxy materials via an Internet Web site. We do not believe this requirement will create undue burden on companies. Soliciting parties must refrain from installing cookies and other tracking features on the Web site or portion of the Web site where the proxy materials are posted. This may require segregating those pages from the rest of the soliciting party's regular Web site or creating a new Web site. However, the rules do not require the company to turn off the Web site's connection log, which automatically tracks numerical IP addresses that connect to that Web site. Although in most cases, this IP address does not provide a soliciting party with sufficient information to identify the accessing shareholder, soliciting parties may not use these numbers to attempt to find out more information about persons accessing the Web site.

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143 See letters from BONY, Registrar and Transfer, and STA.

144 See letters from BONY and Registrar and Transfer.

145 See letter from Registrar and Transfer.

146 See letter from ICI.

C. Small Entities Subject to the Amendments

The amendments affect issuers that are small entities. Exchange Act Rule 0-10(a)[147] defines an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,100 public companies, other than investment companies, that may be considered small entities.[148]

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[149] Approximately 164 registered investment companies meet this definition. Moreover, approximately 51 business development companies may be considered small entities.

Paragraph (c)(1) of Rule 0-10 under the Exchange Act[150] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to §240.17a-5(d); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. As of 2005, the

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147 17 CFR 240.0-10(a).

148 The estimated number of reporting small entities is based on 2007 data including the Commission's EDGAR database and Thomson Financial's Worldscope database. This represents an update from the number of reporting small entities estimated in prior rulemakings. See, for example, Executive Compensation and Related Disclosure, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] (in which the Commission estimated a total of 2,500 small entities, other than investment companies).

149 17 CFR 270.0-10.

150 17 CFR 240.0-10(c)(1).

Commission estimates that there were approximately 910 broker-dealers that qualified as small entities as defined above.[151] Small Business Administration regulations define "small entities" to include banks and savings associations with total assets of $165 million or less.[152] The Commission estimates that the rules might apply to approximately 9,475 banks, approximately 5,816 of which could be considered small banks with assets of $165 million or less.

D. Reporting, Recordkeeping and Other Compliance Requirements

The amendments require all issuers, including small entities, to follow the notice and access model. This model does not significantly change an issuer's obligations under current rules. An issuer choosing to follow the notice only option would incur costs identical to costs that it would have incurred under the voluntary model. An issuer following the full set delivery option would incur two costs in addition to the current cost of sending proxy materials under the traditional method: (1) the cost of preparing a Notice of Internet Availability of Proxy Materials and (2) the cost of posting the proxy materials on a Web site with anonymity controls.

For purposes of the Paperwork Reduction Act, we have estimated that the Notice would take approximately 1.5 hours to prepare because the information is readily available to the issuer. We estimated that 75% of that burden would be incurred by in-house, while 25% of the burden would reflect costs of outside counsel, at a cost of $400 per hour, or approximately $150 per Notice. With respect to printing the Notice, for purposes of the Cost-Benefit Analysis we estimated a cost of $0.13 per copy to print the

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[151] These numbers are based on a review by the Commission's Office of Economic Analysis of 2005 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

[152] 13 CFR 121.201.

Notice. However, an issuer may reduce this cost by incorporating the Notice information into its proxy materials.

As we noted in our Cost-Benefit Analysis, we anticipate the cost of posting the proxy materials on a publicly accessible Web site to be relatively low. Although an issuer may choose to pay more for an elaborate Web site, the rules do not require such a Web site. An issuer with a small shareholder base may be able to post its materials on a free Web hosting service. As we note in more detail in the Cost-Benefit Analysis, based on our estimate of the typical size of a proxy statement and annual report, we estimate such services provide sufficient bandwidth for approximately 1,000 to 25,000 hits per month.[153] We also noted that several Web hosting services provided Web sites which would handle up to five million hits per month are available for approximately \$5 to \$8 per month, or \$60 to \$96 per year. Based on a review of several Internet Web page design firms, we estimate that the design of a Web site meeting the base requirements of the rules would be approximately \$300.

Intermediaries must follow substantially similar requirements with respect to beneficial owners of the issuer's securities. Issuers, including small entities, are required to reimburse intermediaries for the cost of complying with these requirements. These costs are incorporated in our estimate of costs to issuers.

E. Agency Action to Minimize Effect on Small Entities

The amendments require all issuers and intermediaries, including small entities, to follow the notice and access model. The purpose of the amendments is to provide all

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153 These calculations are based on typical file sizes of proxy statements and annual reports. The lower capacity (1,000) corresponds to files that are elaborate "glossy" annual statements. We believe the higher capacity (25,000) is a more reasonable estimate for small entities because small

shareholders with the ability to choose the means by which they can access proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications. Exempting small entities would not be consistent with this goal and we do not believe that the additional compliance requirements that we are imposing are significant.

We believe that in the long run, use of the Internet for shareholder communications not only may decrease costs for all issuers, but also may improve the quality of shareholder communications by enhancing a shareholder's ability to search and manipulate proxy disclosures. However, in the short term, we are adopting a tiered system of compliance dates to minimize the burdens on smaller issuers, including small entities. Under this tiered system, issuers that are not large accelerated filers need not comply with the requirements until January 1, 2009. This would provide smaller issuers more time to adjust to the amendments and learn from the experiences of larger filers. Furthermore, adopting the amendments for large accelerated filers before the 2008 proxy season effectively creates a test group of issuers, enabling the Commission to study the performance of the model with a significant number of larger issuers and to make any necessary revisions to the rules before they apply to all issuers, including small entities.

Intermediaries that are small entities also are subject to the amendments. We understand that the task of forwarding proxy materials to over 95% of beneficial ownership accounts currently is handled by a single entity. Because a third-party outsourcing alternative is readily available and issuers are required to reimburse such costs to the intermediary, we believe that imposing the amendments on small entities will

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entities tend to send annual reports on Form 10-K to meet their Rule 14a-3(b) requirements rather than spend the significant cost of producing a "glossy" annual report.

not create a substantial burden on small entities. Thus, we have decided not to exempt intermediaries that are small entities from the amendments. Such an exemption may create disparity in the way shareholders receive proxy materials. Shareholders owning securities through such intermediaries would not have the ability to choose the means by which they receive proxy disclosures.

We considered the use of performance standards rather than design standards in the amendments. The amendments contain both performance standards and design standards. We are adopting design standards to the extent that we believe compliance with particular requirements is necessary. For example, we are using a design standard with respect to the contents of the Notice so that investors get uniform information regarding access to important information. However, to the extent possible, we are adopting rules that impose performance standards to provide issuers, other soliciting persons and intermediaries with the flexibility to devise the means through which they can comply with such standards. For example, we are adopting a performance standard for providing for anonymity on the Web site so that issuers and other soliciting persons can determine for themselves the least costly option to meet the requirement.

IX. Statutory Basis and Text of Amendments

We are adopting the amendments pursuant to Sections 3(b), 10, 13, 14, 15, 23(a), and 36 of the Securities Exchange Act of 1934, as amended, and Sections 20(a), 30, and 38 of the Investment Company Act of 1940, as amended.

List of Subjects

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows.

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Amend §240.14a-3 by revising paragraph (a) to read as follows:

240.14a-3 Information to be furnished to security holders.

(a) No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with:

(1) A publicly-filed preliminary or definitive proxy statement, in the form and manner described in §240.14a-16, containing the information specified in Schedule 14A (§240.14a–101);

(2) A preliminary or definitive written proxy statement included in a registration statement filed under the Securities Act of 1933 on Form S-4 or F-4 (§239.25 or §239.34 of this chapter) or Form N–14 (§239.23 of this chapter) and containing the information specified in such Form; or

(3) A publicly-filed preliminary or definitive proxy statement, not in the form and manner described in §240.14a-16, containing the information specified in Schedule 14A (§240.14a–101), if:

(i) The solicitation relates to a business combination transaction as that term is defined in §230.165 of this chapter; or

(ii) The solicitation may not follow the form and manner described in §240.14a-16 pursuant to the laws of the state of incorporation of the registrant;

* * * * *

3. Amend §240.14a-7 by removing Note 3 to §240.14a-7.

4. Amend §240.14a-16 by:

a. Revising paragraphs (a), (d)(3), (f)(2)(i), (f)(2)(ii), (h), (j)(3), and (n); and

b. Adding paragraph (f)(2)(iii).

The revisions and additions to read as follows:

240.14a-16 Internet availability of proxy materials.

(a)(1) A registrant shall furnish a proxy statement pursuant to §240.14a–3(a), or an annual report to security holders pursuant to §240.14a–3(b), to a security holder by sending the security holder a Notice of Internet Availability of Proxy Materials, as described in this section, 40 calendar days or more prior to the security holder meeting date, or if no meeting is to be held, 40 calendar days or more prior to the date the votes, consents or authorizations may be used to effect the corporate action, and complying with all other requirements of this section.

(2) Unless the registrant chooses to follow the full set delivery option set forth in paragraph (n) of this section, it must provide the record holder or respondent bank with all information listed in paragraph (d) of this section in sufficient time for the record holder or respondent bank to prepare, print and send a Notice of Internet Availability of Proxy Materials to beneficial owners at least 40 calendar days before the meeting date.

* * * * *

(d) * * *

(3) A clear and impartial identification of each separate matter intended to be acted on and the soliciting person's recommendations, if any, regarding those matters, but no supporting statements;

* * * * *

(f) * * *

(2) * * *

(i) A pre-addressed, postage-paid reply card for requesting a copy of the proxy materials;

(ii) A copy of any notice of security holder meeting required under state law if that notice is not combined with the Notice of Internet Availability of Proxy Materials; and

(iii) In the case of an investment company registered under the Investment Company Act of 1940, the company's prospectus or a report that is required to be transmitted to stockholders by section 30(e) of the Investment Company Act (15 U.S.C. 80a-29(e)) and the rules thereunder.

* * * * *

(h) The registrant may send a form of proxy to security holders if:

(1) At least 10 calendar days or more have passed since the date it first sent the Notice of Internet Availability of Proxy Materials to security holders and the form of proxy is accompanied by a copy of the Notice of Internet Availability of Proxy Materials; or

(2) The form of proxy is accompanied or preceded by a copy, via the same medium, of the proxy statement and any annual report to security holders that is required by §240.14a-3(b).

* * * * *

(j) * * *

(3) The registrant must provide copies of the proxy materials for one year after the conclusion of the meeting or corporate action to which the proxy materials relate, provided that, if the registrant receives the request after the conclusion of the meeting or corporate action to which the proxy materials relate, the registrant need not send copies via First Class mail and need not respond to such request within three business days.

* * * * *

(n) <u>Full Set Delivery Option.</u>

(1) For purposes of this paragraph (n), the term full set of proxy materials shall include all of the following documents:

(i) A copy of the proxy statement;

(ii) A copy of the annual report to security holders if required by §240.14a-3(b); and

(iii) A form of proxy.

(2) Notwithstanding paragraphs (e) and (f)(2) of this section, a registrant or other soliciting person may:

(i) Accompany the Notice of Internet Availability of Proxy Materials with a full set of proxy materials; or

(ii) Send a full set of proxy materials without a Notice of Internet Availability of Proxy Materials if all of the information required in a Notice of Internet Availability of Proxy Materials pursuant to paragraphs (d) and (n)(4) is incorporated in the proxy statement and the form of proxy.

(3) A registrant or other soliciting person that sends a full set of proxy materials to a security holder pursuant to this paragraph (n) need not comply with

(i) The timing provisions of paragraphs (a) and (l)(2); and

(ii) The obligation to provide copies pursuant to paragraph (j).

(4) A registrant or other soliciting person that sends a full set of proxy materials to a security holder pursuant to this paragraph (n) need not include in its Notice of Internet Availability of Proxy Materials, proxy statement, or form of proxy the following disclosures:

(i) Paragraphs 1 and 3 of the legend required by paragraph (d)(1);

(ii) Instructions on how to request a copy of the proxy materials; and

(iii) Instructions on how to access the form of proxy pursuant to paragraph (d)(7).

5. Amend §240.14a-101 by revising the first sentence of Item 4(a)(c) to read as follows:

§240.14a-101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 4. Persons Making the Solicitation—(a) * * *

(3) If the solicitation is to be made otherwise than by the use of the mails or pursuant to §240.14a-16, describe the methods to be employed. * * *

* * * * *

6. Amend §240.14b-1 by:

a. Revising the introductory text of paragraph (d); and

b. Adding paragraph (d)(5).

The revision and addition read as follows.

§240.14b-1 Obligation of registered brokers and dealers in connection with the prompt forwarding of certain communications to beneficial owners.

* * * * *

(d) Upon receipt from the soliciting person of all of the information listed in §240.14a-16(d), the broker or dealer shall:

* * * * *

(5) Notwithstanding any other provisions in this paragraph (d), if the broker or dealer receives copies of the proxy statement and annual report to security holders (if applicable) from the soliciting person with instructions to forward such materials to beneficial owners, the broker or dealer:

(i) Shall either:

(A) Prepare a Notice of Internet Availability of Proxy Materials and forward it with the proxy statement and annual report to security holders (if applicable); or

(B) Incorporate any information required in the Notice of Internet Availability of Proxy Materials that does not appear in the proxy statement into the broker or dealer's request for voting instructions to be sent with the proxy statement and annual report (if applicable);

(ii) Need not comply with the following provisions:

(A) The timing provisions of paragraph (d)(1)(ii); and

(B) Paragraph (d)(4); and

(iii) Need not include in its Notice of Internet Availability of Proxy Materials or request for voting instructions the following disclosures:

(A) Legends 1 and 2 in §14a-16(d)(1) of this chapter; and

(B) Instructions on how to request a copy of the proxy materials.

* * * * *

7. Amend §240.14b-2 by:

a. Revising the introductory text of paragraph (d); and

b. Adding paragraph (d)(5).

The revision and addition read as follows.

§240.14b-2 Obligation of banks, associations and other entities that exercise fiduciary powers in connection with the prompt forwarding of certain communications to beneficial owners.

* * * * *

(d) Upon receipt from the soliciting person of all of the information listed in §240.14a-16(d), the bank shall:

* * * * *

(5) Notwithstanding any other provisions in this paragraph (d), if the bank receives copies of the proxy statement and annual report to security holders (if applicable) from the soliciting person with instructions to forward such materials to beneficial owners, the bank:

(i) Shall either:

(A) Prepare a Notice of Internet Availability of Proxy Materials and forward it with the proxy statement and annual report to security holders (if applicable); or

(B) Incorporate any information required in the Notice of Internet Availability of Proxy Materials that does not appear in the proxy statement into the bank's request for voting instructions to be sent with the proxy statement and annual report (if applicable);

(ii) Need not comply with the following provisions:

(A) The timing provisions of paragraph (d)(1)(ii); and

(B) Paragraph (d)(4); and

(iii) Need not include in its Notice of Internet Availability of Proxy Materials or request for voting instructions the following disclosures:

(A) Legends 1 and 2 in §14a-16(d)(1) of this chapter; and

(B) Instructions on how to request a copy of the proxy materials.

* * * * *

8. Amend §240.14c-2 by revising paragraph (d) to read as follows:

§240.14c-2 Distribution of information statement.

* * * * *

(d) A registrant shall transmit an information statement to security holders pursuant to paragraph (a) of this section by satisfying the requirements set forth in §240.14a-16; provided, however, that the registrant shall revise the information required in the Notice of Internet Availability of Proxy Materials, including changing the title of that notice, to reflect the fact that the registrant is not soliciting proxies for the meeting.

9. Amend §240.14c-3 by revising paragraph (d) to read as follows:

§240.14c-3 Annual report to be furnished security holders.

* * * * *

(d) A registrant shall furnish an annual report to security holders pursuant to paragraph (a) of this section by satisfying the requirements set forth in §240.14a-16.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

July 26, 2007

Commissioner Atkins
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2622 / July 26, 2007

Admin. Proc. File No. 3-12171

In the Matter of	:	CORRECTED
TERRY HARRIS	:	

ORDER DISMISSING PROCEEDING

I.

Terry Harris appeals from the decision of an administrative law judge. 1/ After both Harris and the Division of Enforcement (the "Division") filed Motions for Summary Disposition, the law judge granted the Division's Motion for Summary Disposition and, pursuant to Section 203(f) of the Investment Advisers Act of 1940, 2/ barred Harris from association with any registered or unregistered investment adviser.

Harris is, and was during all relevant times, the president, director, and owner of at least a seventy-five percent interest in N2K Trading Academy, Inc. ("N2K"). On December 21, 2005, N2K filed a Form ADV with the Commission, seeking registration as an investment adviser. In response to questions concerning the background of firm principals, N2K's Form ADV stated that Harris had been the subject of state disciplinary action in Alabama and Illinois. Advisers Act Section 203(f), as relevant here, authorizes the Commission to determine whether a sanction, including a bar, is in the public interest based on findings that an individual has been convicted of certain crimes, or is subject to a final order of a state securities commission that bars the individual from engaging in the business of securities or that is based on violations of a law that

1/ Terry Harris, Initial Decision Rel. No. 311, 87 SEC Docket 3251 (May 11, 2006).

2/ 15 U.S.C. § 80b-3(f).

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prohibits fraud. 3/ Accordingly, the Commission instituted this proceeding to determine whether it was in the public interest to impose a federal sanction on Harris based on the state disciplinary actions against him.

II.

The Order Instituting Proceedings ("OIP") alleged three state disciplinary actions as bases for a proceeding under Advisers Act Section 203(f): (1) Harris's January 2005 state criminal conviction in Alabama, which was based on Harris's guilty plea for his failure to register properly as an investment adviser under Alabama law (the "Alabama Conviction"); 4/ (2) an August 2004 order issued by the Illinois Secretary of State that directed Harris to cease and desist from the offer or sale of securities in Illinois after finding that Harris had sold unregistered securities in Illinois (the "Illinois Order"); and (3) a June 2003 cease and desist order issued by the Alabama Securities Commission ("ASC"), which found that Harris had committed fraud 5/ and had collected funds from investors for the purpose of investing with an expectation of receiving a profit without benefit of registration (the "Alabama Order"). 6/

In determining that the Commission could impose a sanction on Harris under Advisers Act Section 203(f), the law judge relied solely on the Alabama Conviction. With respect to the Illinois Order, the law judge stated, "It could be argued that Illinois did not 'bar [Harris] from engaging in the business of securities' within the meaning of Advisers Act Section 203(e)(9) because he was not prohibited from engaging in investment adviser activities in the securities business." Because the Alabama Conviction provided a basis for the Commission's proceeding under Advisers Act Section 203(f), the law judge did not resolve the question of whether the Illinois Order provided an additional basis. She did, however, take the Illinois Order "into account in determining the sanction." With respect to the Alabama Order, before the law judge, Harris challenged whether the Alabama Order was final, as required by Advisers Act Section 203(f). The law judge had some evidence on the issue of finality but, in "view of the parties' divergence on this issue," made no findings as to the Alabama Order and did not rely on it in making her determination to bar Harris.

3/ These bases for the imposition of a sanction are found in Advisers Act Section 203(e)(9), 15 U.S.C. § 80b-3(e)(9), which Advisers Act Section 203(f), 15 U.S.C. § 80b-3(f), incorporates by reference.

4/ See Ala. Code § 8-6-3(b).

5/ See Ala. Code § 8-6-17(a)(1), (2), and (3)

6/ See Ala. Code § 8-6-3(a).

III.

On March 26, 2007, the Division of Enforcement filed a Motion to Supplement the Record before the Commission (the "Division's Motion to Supplement"). Attached to the Division's Motion to Supplement was a March 23, 2007, opinion of the Alabama Court of Criminal Appeals reversing Harris's conviction and remanding it to the trial court on the basis of ineffective assistance of counsel. 7/ Because it has been reversed, the Alabama Conviction may no longer serve as the basis for Commission sanctions under Advisers Act Section 203(f). 8/

The Division of Enforcement did not appeal the law judge's determination to limit her reliance on the Illinois Order to the assessment of sanctions. Under Commission Rule of Practice 411(c), 9/ the Commission may, on its own initiative, order review of any portion of any initial decision not before the Commission on appeal, within twenty-one days after the end of the period established for filing a petition for review. The Commission did not order review of this determination by the law judge during the specified period. Accordingly, the issue of whether the Illinois Order provides a basis for proceeding against Harris under Advisers Act Section 203(f) is not before us.

Neither party addressed the finality of the Alabama Order in their briefs on appeal to the Commission, and the Division did not appeal the law judge's determination to make no findings as to the Alabama Order. Because of the limited evidence on the question of the finality of the Alabama Order and its potential importance, the Commission, pursuant to Rule of Practice 411(c), issued an Order Directing the Filing of Additional Briefs from the parties on the question of the finality of the Alabama Order and, if final, its impact on the sanctions to be imposed on Harris.

The parties responded with additional materials and arguments. We have reviewed the materials and arguments submitted by the parties, and we do not believe that they establish with sufficient weight whether the Alabama Order is final. Since, on this record, the finality of the Alabama Order is in question, it cannot serve as a basis for proceeding against Harris under Advisers Act Section 203(f).

7/ Harris v. State, __ So.2d __, 2007 WL 866214 (Ala. Crim. App. 2007).

8/ We note that the Alabama Court of Criminal Appeals, in its decision reversing the Alabama Conviction, remanded the proceeding to the trial court for a new trial. If, on remand, Harris is convicted of a criminal violation set forth in Advisers Act Section 203(e)(9), that could provide a basis for a new proceeding to determine whether it is in the public interest to impose a sanction on Harris.

9/ 17 C.F.R. § 201.411(c).

IV.

For the reasons discussed above, none of the three bases for proceeding under Advisers Act Section 203(f) that were alleged in the OIP remains valid on the record before us on appeal.

Accordingly, it is ORDERED that this proceeding be, and it hereby is, dismissed.

By the Commission.

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56145; File No. SR-NASD-2007-023)

July 26, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc.

I. Introduction

On March 19, 2007, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission" or "SEC") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend the By-Laws of NASD ("NASD By-Laws") to implement governance and related changes to accommodate the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. ("NYSE Regulation"), a wholly-owned subsidiary of New York Stock Exchange LLC ("NYSE LLC"). The proposed rule change was published for comment in the Federal Register on March 26, 2007.[3] The Commission received 80 comment letters from 72 commenters on the proposed rule change.[4]

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 55495 (March 20, 2007), 72 FR 14149 ("Notice").

4 A list of commenters on the rule proposal, whose comments were received as of July 16, 2007, is attached as Exhibit A to this Order. The public file for the proposal, which includes comment letters received on the proposal, is located at the Commission's Public Reference Room located at 100 F Street, NE, Washington, DC 20549. The comment letters are also available on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml).

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The NASD filed a response to comments on May 29, 2007 and a supplemental response to comments on July 16, 2007.[5] This order approves the proposed rule change.

II. Description of the Proposed Rule Change

In November 2006, NASD and NYSE Group, Inc. ("NYSE Group")[6] announced their plan to consolidate their member regulation operations into a single self-regulatory organization

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5 See Letter from Patrice M. Gliniecki, Senior Vice President and Deputy General Counsel, NASD, to Nancy M. Morris, Secretary, Commission, dated May 29, 2007 ("NASD Response Letter") and Letter from T. Grant Callery, Executive Vice President and General Counsel, NASD, to Nancy M. Morris, Secretary, Commission, dated July 16, 2007 ("NASD Supplemental Response Letter"). NASD Dispute Resolution also filed two letters in response to comments. See Letter from Linda D. Fienberg, President, NASD Dispute Resolution, to the Public Members of SICA, dated January 26, 2007 ("NASD Dispute Resolution Letter I") and Letter from Linda D. Fienberg, President, NASD Dispute Resolution, to Nancy M. Morris, Secretary, Commission, dated May 29, 2007 ("NASD Dispute Resolution Letter II"). NASD submitted an opinion of counsel regarding the approval by NASD members of proposed amendments to the NASD By-Laws and the amount of the payment to NASD members under Delaware Law. See Letter from William J. Haubert, Richards, Layton & Finger, to Nancy M. Morris, Secretary, Commission, dated July 16, 2007 ("RLF Letter"). NASD also submitted an opinion of counsel describing generally the case law, statutory provisions, and guidance published by the Internal Revenue Service ("IRS") relevant to the disclosure in the NASD's proxy statement to members. See Letter from Mario J. Verdolini, Davis Polk & Wardwell, to Nancy M. Morris, Secretary, Commission, dated July 16, 2007 ("DPW Letter").

6 NYSE Group recently combined with Euronext N.V. ("Euronext") to form a single, publicly traded holding company named "NYSE Euronext." NYSE Group and Euronext became separate subsidiaries of NYSE Euronext. The corporate structure for the businesses of NYSE Group (including the businesses of the NYSE LLC and NYSE Arca, Inc., a registered national securities exchange) remained unchanged following the combination. Specifically, NYSE LLC remains a wholly-owned subsidiary of NYSE Group. NYSE Market remains a wholly-owned subsidiary of the NYSE LLC and conducts NYSE LLC's business. NYSE Regulation remains a wholly-owned subsidiary of NYSE LLC and performs the regulatory responsibilities for NYSE LLC pursuant to a delegation agreement with NYSE LLC and many of the regulatory functions of NYSE Arca pursuant to a regulatory services agreement with NYSE Arca. See Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007).

Commenters on the proposed rule change generally referred to NYSE Group as "NYSE."

("SRO") that would provide member firm regulation for securities firms that do business with the public in the United States ("Transaction"). Pursuant to the Transaction, the member firm regulation and enforcement functions and employees from NYSE Regulation would be transferred to NASD, and NASD would adopt a new corporate name. In the proposed rule change, the NASD proposes to amend the NASD By-Laws to implement governance changes that are integral to the Transaction. The proposed rule change and this Order refer to the NASD, whose name would be changed to the Financial Industry Regulatory Authority, as the "New SRO" and the amended NASD By-Laws as the "New SRO By-Laws."

The New SRO would be responsible for regulatory oversight of all securities firms that do business with the public; professional training, testing and licensing of registered persons; arbitration and mediation; market regulation by contract for The NASDAQ Stock Market, Inc., the American Stock Exchange LLC, and the International Securities Exchange, LLC; and industry utilities, such as Trade Reporting Facilities and other over-the-counter operations. NASD represents that none of NASD's current functions and activities would be eliminated as a result of the Transaction.

The closing of the Transaction ("Closing") and the consolidation of the member firm regulatory functions of the NASD and NYSE Regulation are subject to the execution of definitive agreements between NASD and NYSE Group, the Commission's approval of the proposed rule change, and certain additional regulatory approvals.[7] The effective date of the

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7 On March 7, 2007, NASD and NYSE Group filed notification reports with the Department of Justice and the Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. NASD represented that the waiting period for such a filing expired on April 6, 2007. NASD also represented that it received a favorable ruling by the IRS that the Transaction would not affect the tax-exempt status of NASD or NASD Regulation. See NASD Supplemental Response Letter, supra note 5, at 3.

proposed rule change would be the date of the Closing. There would be a transitional period commencing on the date of the Closing and ending on the third anniversary of the date of the Closing ("Transitional Period").

A description of the most significant changes to the NASD By-Laws follows.

A. Composition of the New SRO Board

The proposed rule change would implement a governance structure that includes both public and industry representation, and designates certain Governor[8] positions on the New SRO Board of Governors ("New SRO Board") to represent member firms. Members would not have the ability to elect all Governors of the New SRO Board, but would have the ability to elect Governors that are from member firms that are similar in size to their own firms. All other Governors would be appointed, as described below. All members would continue to have the ability to vote on any future amendments to the New SRO By-Laws,[9] to petition to propose amendments to the New SRO By-Laws,[10] to vote in district elections,[11] and to petition to nominate a candidate for the Governor position(s) they are entitled to elect.[12]

1. Composition of New SRO Board during the Transitional Period

During the Transitional Period, the New SRO Board would consist of 23 Governors as follows: (a) eleven Governors would be "Public Governors;"[13] (b) ten Governors would be

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8 A "Governor" is a member of the Board of Governors of the New SRO. See New SRO By-Laws, Article I(q).

9 See New SRO By-Laws, Article XVI, Section 1.

10 Id.

11 See Article VIII of the NASD Regulation, Inc. By-Laws ("NASD Regulation By-Laws").

12 See New SRO By-Laws, Article VII, Section 10.

13 A "Public Governor" means any Governor who is not the Chief Executive Officer of the New SRO or, during the Transitional Period, the CEO of NYSE Regulation, who is not

"Industry Governors";[14] and (c) two Governors initially would be Richard G. Ketchum, currently Chief Executive Officer ("CEO") of NYSE Regulation and Mary L. Schapiro, currently CEO of NASD. Mr. Ketchum would serve as Chair of the New SRO Board ("Chair")[15] for a term of three years.[16] Ms. Schapiro would serve as CEO of the New SRO.

Initially, five Public Governors would be appointed by the Board of Directors of NYSE Group ("NYSE Group Board"); five Public Governors would be appointed by the NASD Board of Governors in office prior to the Closing ("NASD Board"); and one Public Governor would be appointed jointly by the NYSE Group Board and the NASD Board (the "Joint Public Governor"). A Public Governor must not have any material business relationship with a broker or dealer or an SRO registered under the Exchange Act (other than serving as a public director of such an SRO).[17]

The ten Industry Governors would consist of: (a) three Governors who are registered with members that employ 500 or more registered persons ("Large Firm Governors"); (b) one

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an Industry Governor (as defined below) and who otherwise has no material business relationship with a broker or dealer or an SRO registered under the Exchange Act, other than as a public director of such an SRO. See New SRO By-Laws, Article I(tt).

14 An "Industry Governor" is the Floor Member Governor (as defined below), the Independent Dealer/Insurance Affiliate Governor (as defined below), the Investment Company Affiliate Governor (as defined below) or any other Governor (excluding the CEO of the New SRO and, during the Transitional Period, the CEO of NYSE Regulation) who: (a) is or has served in the prior year as an officer, director (other than as an independent director), employee or controlling person of a broker or dealer, or (b) has a consulting or employment relationship with or provides professional services to an SRO registered under the Exchange Act, or has had any such relationship or provided any such services at any time within the prior year. See New SRO By-Laws, Article I(t).

15 See infra text accompanying notes 63 to 65 for a more detailed description of the Chair.

16 During the Transitional Period, Mr. Ketchum, the current CEO of NYSE Regulation, would serve as the Chair so long as he remains a Governor. See New SRO By-Laws, Article XXII, Section 2(b).

17 See supra note 13.

Governor who is registered with a member that employs at least 151 and no more than 499 registered persons ("Mid-Size Firm Governor"); (c) three Governors who are registered with members that employ at least one and no more than 150 registered persons ("Small Firm Governors" and, together with the Large Firm Governors and the Mid-Size Firm Governors, "Firm Governors"); (d) one Governor who is associated with a floor member (or a firm in the process of becoming a floor member) of the New York Stock Exchange ("Floor Member Governor");[18] (e) one Governor who is associated with an independent contractor financial planning member firm or an affiliate of an insurance company ("Independent Dealer/Insurance Affiliate Governor");[19] and (f) one Governor who is associated with an affiliate of an Investment Company ("Investment Company Affiliate Governor").[20] During the Transitional Period, the three Small Firm Governors would be nominated by the NASD Board and elected by members that have at least one and no more than 150 registered persons, although members of that size also would have the right to nominate opposing candidates for the Small Firm Governor position. The one Mid-Size Firm Governor would be nominated jointly by the NYSE Group Board and the NASD Board and elected by members that have at least 151 and no more than 499 registered persons, although members of that size also can nominate opposing candidates for the Mid-Size Firm Governor position. The three Large Firm Governors would be nominated by the NYSE Group Board and elected by members

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18 See New SRO By-Laws, Article I(n).

19 See New SRO By-Laws, Article I(r). See infra text accompanying note 213 for additional discussion regarding the definition of Independent Dealer/Insurance Affiliate Governor.

20 See New SRO By-Laws, Article I(w). See infra text accompanying note 213 for additional discussion regarding the definition of Investment Company Affiliate Governor.

that have 500 or more registered persons, although members of that size also can nominate opposing candidates for the Large Firm Governor position. In addition, the one Floor Member Governor would be appointed by the NYSE Group Board; the one Independent Dealer/Insurance Affiliate Governor would be appointed by the NASD Board; and the one Investment Company Affiliate Governor would be appointed jointly by the NYSE Group Board and the NASD Board.[21]

To implement the New SRO Board structure described above, the NYSE Group Board and the NASD Board would appoint the Public Governors and Industry Governors that they, either individually or jointly, have the power to appoint, effective as of the Closing. The Public Governors, the Floor Member Governor, the Investment Company Affiliate Governor, and the Independent Dealer/Insurance Affiliate Governor would hold office for the three-year Transitional Period. The three Small Firm Governors, three Large Firm Governors, and one Mid-Size Firm Governor would be elected as Governors at the first annual meeting of members of the New SRO following the Closing, which is expected to be held within ninety days after the Closing, and would hold office until the first annual meeting of members of the New SRO following the Transitional Period.[22] During the interim period from the Closing until the first annual meeting of members, the Small Firm Governor, Large Firm Governor, and Mid-Size Firm Governor seats would be filled by three interim Industry Governors appointed by the NASD Board from industry governors currently on the NASD Board, three interim Industry Governors appointed by the NYSE Group Board, and one interim Industry Governor jointly appointed by the NYSE

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21 See New SRO By-Laws, Article XXII, Sections 3 and 4.

22 Id.

Group Board and the NASD Board, in each case prior to the Closing.[23]

2. Composition of the New SRO Board after the Transitional Period

The composition of the New SRO Board would remain the same after the Transitional Period, except that the term of office of the CEO of NYSE Regulation as a member of the New SRO Board would automatically terminate at the end of the Transitional Period. Thus, the authorized number of members of the New SRO Board would be reduced by one.[24] Other changes after the Transitional Period are described below.

As of the first annual meeting of members following the Transitional Period, the Large Firm Governors, the Mid-Size Firm Governor, and the Small Firm Governors would be divided into three classes.[25] The composition of the classes would be arranged as follows:[26]

- First class: consisting of one Large Firm Governor and one Small Firm Governor, who would be elected for a term of office expiring at the first succeeding annual meeting of members;
- Second class: consisting of one Large Firm Governor, one Mid-Size Firm Governor, and one Small Firm Governor, who would be elected for a term of office expiring at the

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23 See New SRO By-Laws, Article XXII, Section 2(a).

24 Under New SRO By-Laws, Article VII, Section 4 (Composition and Qualification of the Board), the total number of Governors is determined by the Board of Governors, with such number being no fewer than 16 nor more than 25 Governors. The number of Public Governors must exceed the number of Industry Governors. As a practical matter, the New SRO Board cannot have fewer than 22 Governors due to the number of designated Industry Governor positions and the requirement that the number of Public Governors must exceed the number of Industry Governors. Thus, absent the filing of a proposed rule change under Section 19(b) of the Exchange Act, there would be a minimum number of ten Industry Governors, eleven Public Governors, plus the CEO of the New SRO. See NASD Response Letter, supra note 5, at 3.

25 See New SRO By-Laws, Article VII, Section 5.

26 Id.

second succeeding annual meeting of members; and

- Third class: consisting of one Large Firm Governor and one Small Firm Governor, who would be elected for a term of office expiring at the third succeeding annual meeting of members.

While these classes are designed to ensure staggered board seats, at no time would there be less than ten Industry Governor positions on the New SRO Board. At each annual election following the first annual meeting of members after the Transitional Period, Large Firm Governors, Small Firm Governors, and Mid-Size Firm Governors would be elected for a term of three years to replace those Governors whose terms have expired.[27] These Governors would serve until a successor is duly appointed and qualified, or until death, resignation, disqualification or removal. A Governor elected by the members may not serve more than two consecutive terms.

As of the first annual meeting of members following the Transitional Period, the Public Governors, the Floor Member Governor, the Independent Dealer/Insurance Affiliate Governor, and the Investment Company Affiliate Governor ("Appointed Governors") would be divided by the New SRO Board into three classes, as equal in number as possible, with the first class holding office until the first succeeding annual meeting of members, the second class holding office until the second succeeding annual meeting of members, and the third class holding office until the third succeeding annual meeting of members. Each class would initially contain as equivalent a number as possible of Appointed Governors who were members of the New SRO

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[27] Governors would be elected by a plurality of the votes of the members of the New SRO present in person or represented by proxy at the annual meeting of the New SRO and entitled to vote for such category of Governors. See New SRO By-Laws, Article VII, Section 13.

Board appointed or nominated by the NYSE Group Board or are successors to such Governor positions, on the one hand, and Appointed Governors who were members of the New SRO Board appointed or nominated by the NASD Board or are successors to such Governor positions, on the other hand, to the extent the New SRO Board determines such persons are to remain Governors after the Transitional Period. At each annual election following the first annual meeting of members following the Transitional Period, Appointed Governors would be appointed by the New SRO Board for a term of three years to replace those whose terms expire. These Governors would serve until a successor is duly appointed and qualified, or until death, resignation, disqualification or removal. No Appointed Governor may serve more than two consecutive terms.[28]

B. Governor Vacancies

1. During the Transitional Period

As noted above, the CEO of NYSE Regulation would be a Governor and the Chair during the Transitional Period. In the event of a vacancy in the Governor position held by Mr. Ketchum (or his successor) during the Transitional Period, the new CEO of NYSE Regulation would serve as a Governor for the remainder of the Transitional Period. If Mr. Ketchum ceases to occupy the office of Chair for any reason during the Transitional Period, then his successor as Chair would be selected by the NYSE Group Committee,[29] from among its members, with the exception that those Governors who also serve as NYSE Group directors may not become Chair nor may Mr.

28 See New SRO By-Laws, Article VII, Section 5.

29 "NYSE Group Committee" means a committee of the New SRO Board composed of the five Public Governors and the Floor Member Governor appointed as such by the Board of NYSE Group, and the Large Firm Governors which were nominated for election as such by the Board of NYSE Group, and in each case their successors. See New SRO By-Laws, Article I(pp).

Ketchum's successor as CEO of NYSE Regulation become Chair.[30]

In the event of any vacancy among the Large Firm Governors, the Mid-Size Firm Governor, or the Small Firm Governors during the Transitional Period, (a) such vacancy would be filled, and nominations for persons to fill such vacancy would be made, by the NYSE Group Committee in the case of a Large Firm Governor vacancy; (b) such vacancy would be filled by the Board, and nominations for persons to fill such vacancy would be made by the New SRO's Nominating Committee in the case of a Mid-Size Firm Governor vacancy; and (c) such vacancy would be filled, and nominations for persons to fill such vacancy would be made by the NASD Group Committee[31] in the case of a Small Firm Governor vacancy.[32] In the event the remaining term of office of any such Governor is more than twelve months, nominations would be made as set forth above, but such vacancy would be filled by the New SRO members entitled to vote on such Governor position at a meeting of members called to fill the vacancy.[33]

In the event of any vacancy among the Floor Member Governor, the Investment Company Affiliate Governor, or the Independent Dealer/Insurance Affiliate Governor during the Transitional Period, (a) such vacancy would be filled by, and nominations for persons to fill such vacancy would be made by the NYSE Group Committee in the case of a Floor Member Governor vacancy; (b) such vacancy would be filled by the New SRO Board, and nominations

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30 See New SRO By-Laws, Article XXII, Section 2(b).

31 "NASD Group Committee" means a committee of the New SRO Board composed of the five Public Governors and the Independent Dealer/Insurance Affiliate Governor appointed as such by the NASD Board in office prior to the Closing, and the Small Firm Governors which were nominated for election as such by the NASD Board in office prior to the Closing, and in each case their successors. See New SRO By-Laws, Article I(jj).

32 See New SRO By-Laws, Article XXII, Section 3.

33 Id.

for persons to fill such vacancy would be made by the New SRO's Nominating Committee in the case of an Investment Company Affiliate Governor vacancy; or (c) such vacancy would be filled by, and nominations for persons to fill such vacancy would be made by, the NASD Group Committee in the case of an Independent Dealer/Insurance Affiliate Governor vacancy.[34]

In the event of any vacancy among those Public Governors appointed by the NYSE Group Board (or their successors), such vacancy would be filled by, and nominations for persons to fill such vacancy would be made by, the NYSE Group Committee. In the event of any vacancy among those Public Governors appointed by the NASD Board (or their successors), such vacancy would be filled by, and nominations for persons to fill such vacancy would be made by, the NASD Group Committee. In the event of any vacancy of the Public Governor position jointly appointed by the NYSE Group Board and the NASD Board (or their successors), such vacancy would be filled by the New SRO Board, and nominations for persons to fill such vacancy would be made by the New SRO's Nominating Committee.[35]

2. After the Transitional Period

In the event of any vacancy among the Large Firm Governors, the Mid-Size Firm Governor, or the Small Firm Governors, such vacancy would be filled by the Large Firm Governor Committee[36] in the case of a Large Firm Governor vacancy, the New SRO Board in the case of a Mid-Size Firm Governor vacancy, or the Small Firm Governor Committee[37] in the

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34 Id.

35 Id.

36 "Large Firm Governor Committee" means a committee of the Board composed of all of the Large Firm Governors. See New SRO By-Laws, Article I(aa).

37 "Small Firm Governor Committee" means a committee of the Board composed of all the Small Firm Governors. See New SRO By-Laws, Article I(yy).

case of a Small Firm Governor vacancy; provided, however, that in the event the remaining term of office of any Large Firm, Mid-Size Firm, or Small Firm Governor position becomes vacant for more than twelve months, such vacancy would be filled by the members of the New SRO entitled to vote thereon at a meeting thereof convened to vote thereon.[38] Whether a vacancy is filled by the appropriate committee for a position that is vacant for twelve months or less or by election if the vacancy is greater than twelve months, nominations would be made by the Nominating Committee as described below.[39]

In the event of any vacancy among the Public Governors or among the Floor Member Governor, the Investment Company Affiliate Governor, or the Independent Dealer/Insurance Affiliate Governor after the Transitional Period, such vacancies would be filled by the New SRO Board from candidates recommended to the Board by the Nominating Committee.[40]

C. Committees of the New SRO Board

1. Committees Generally

a. During the Transitional Period

During the Transitional Period, the New SRO is required to have the following

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38 If a Governor is appointed to fill a vacancy of an elected Governor position for a term of less than one year, the Governor may serve up to two consecutive terms following the expiration of the Governor's initial terms. See New SRO By-Laws, Article VII, Section 5.

39 See New SRO By-Laws, Article VII, Sections 5 and 9.

40 Id. If a Governor is appointed to fill the vacancy of an Appointed Governor position for a term of less than one year, the Governor may serve up to two consecutive terms following the expiration of the Governor's initial terms. See New SRO By-Laws, Article VII, Section 5.

committees of the Board[41]: the NASD Group Committee; the NYSE Group Committee; the Small Firm Governor Committee, and the Large Firm Governor Committee. The New SRO also is required to have an Audit,[42] Finance,[43] and Nominating Committees and, during the first year of the Transitional Period, or as may be extended thereafter by the Board, an Integration Committee.[44] In addition, the New SRO would have an Investment Committee, which would not be a committee of the Board.[45]

Unless otherwise provided in the New SRO By-Laws, any other committee having the authority to exercise the powers and authority of the New SRO Board must have a number of

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41 See New SRO By-Laws, Article IX, Section 1(a). These committees play a role in the filling of vacancies on the Board and appointing the Chair of the Board of the New SRO. See New SRO By-Laws, Article XXII, Section 3.

42 The Audit Committee would consist of four or five Governors, none of whom would be officers or employees of the New SRO. The Audit Committee would perform the following functions: (i) ensure the existence of adequate controls and the integrity of the financial reporting process of the New SRO; (ii) recommend to the New SRO Board, and monitor the independence and performance of, the certified public accountants retained as outside auditors by the New SRO; and (iii) direct and oversee all the activities of the New SRO's internal review function, including, but not limited to, management's responses to the internal review function. See New SRO By-Laws, Article IX, Section 5.

43 The Finance Committee would consist of four or more Governors, including the CEO of the New SRO. A Finance Committee member would hold office for a term of one year. The Finance Committee would advise the Board with respect to the oversight of the financial operations and conditions of the New SRO, including recommendations for the annual operating and capital budgets and proposed changes to the rates and fees charged by the New SRO. See New SRO By-Laws, Article IX, Section 6(a)-(c).

44 The Integration Committee would have a term not to exceed one year from the Closing, unless continued for a longer period by resolution of the Board. The Chair of the Board would be the Chair of the Integration Committee unless, in the case of the Integration Committee continuing beyond one year after the Closing, otherwise determined by the Board. See New SRO By-Laws, Article IX, Section 7.

45 The majority of the Investment Committee during the Transitional Period would be composed of members of the Investment Committee immediately prior to the Closing, unless otherwise determined by the NASD Group Committee, and a minority of the Investment Committee during the Transitional Period would be composed of members of the NYSE Group Committee. See New SRO By-Laws, Article IX, Section 6(d).

Public Governors that is greater than the number of Industry Governors.[46] In addition, any committee of the New SRO Board having the authority to exercise the powers and authority of the Board (with the exception of the Large Firm Governor Committee, the Small Firm Governor Committee, the NASD Group Committee, and the NYSE Group Committee) also must have: (i) a percentage of members (to the nearest whole number of committee members) that are members of the NASD Group Committee at least as great as the percentage of Governors on the Board that are members of the NASD Group Committee; and (ii) a percentage of members (to the nearest whole number of committee members) that are members of the NYSE Group Committee at least as great as the percentage of Governors on the Board that are members of the NYSE Group Committee.[47]

The New SRO Board may appoint an Executive Committee which can exercise all the powers and authority of the New SRO Board in the management and affairs of the New SRO between meetings of the New SRO Board, subject to the limitations in the New SRO's Certificate of Incorporation[48] and applicable state law.[49] The Executive Committee would consist of no fewer than five and no more than eight Governors. The Executive Committee would include the CEO of the New SRO and the Chair of the New SRO Board.[50]

b. After the Transitional Period

After the Transitional Period, the New SRO is required to have the following committees

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46 See New SRO By-Laws, Article IX, Section 1(b).

47 Id.

48 NASD will be submitting a proposed rule change to amend its Certificate of Incorporation to reflect the New SRO By-Laws.

49 See New SRO By-Laws, Article IX, Section 4(a).

50 See New SRO By-Laws, Article IX, Section 4(b).

of the Board: the Small Firm Governor Committee and the Large Firm Governor Committee. New SRO also is required to have Audit, Finance, and Nominating Committees. The structure and composition of the Executive Committee, and any other committee having the authority to exercise the powers and authority of the Board, remains unchanged from that described above for the Transitional Period.

2. Nominating Committee

The Nominating Committee would be a committee of the New SRO Board and would replace the NASD's National Nominating Committee.[51]

a. During the Transitional Period

For the first annual meeting following the Closing, nominations for the seven elected industry seats would not be made by the Nominating Committee. Instead, the NASD Board would make nominations for the Small Firm Governors positions, the NYSE Group Board would make nominations for the Large Firm Governors positions, and the NASD Board and NYSE Group Board jointly would make the nominations for the Mid-Size Firm Governor position.[52] In addition, prior to the Closing, the NASD Board would identify and appoint five Public Governors and the Independent Dealer/Insurance Affiliate Governor; the NYSE Group Board would identify and appoint five Public Governors and the Floor Member Governor; and the NASD Board and the NYSE Group Board would jointly identify and appoint one Public Governor and the Investment Company Affiliate Governor.[53]

During the Transitional Period, members of the Nominating Committee would be

51 See New SRO By-Laws, Article I(oo) and Article VII, Section 9.

52 See New SRO By-Laws, Article XXII, Section 4.

53 See New SRO By-Laws, Article XXII, Section 3.

appointed jointly by the New SRO CEO and the CEO of NYSE Regulation as of Closing (or his duly appointed or elected successor as Chair of the New SRO Board), subject to ratification of the appointees by the New SRO Board.[54] The Nominating Committee would be responsible solely for nominating persons to fill vacancies in Governor positions for which the New SRO Board has the authority to fill, namely, the Mid-Size Firm Governor position, the Investment Company Affiliate Governor position, and the one Public Governor position that is initially appointed jointly by the NYSE Group Board and the NASD Board in office prior to the Closing.[55]

b. After the Transitional Period

Following the Transitional Period, the members of the Nominating Committee would be determined by the New SRO Board.[56] At all times, the number of Public Governors on the Nominating Committee must equal or exceed the number of Industry Governors on the Nominating Committee.[57] In addition, the Nominating Committee must at all times be composed of a number of Governors that is a minority of the entire New SRO Board.[58] The New SRO CEO may not be a member of the Nominating Committee. The Nominating Committee would be responsible for nominating persons for appointment or election to the New SRO Board, as well as nominating persons to fill vacancies in appointed or elected Governor seats.[59]

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54 See New SRO By-Laws, Article XXII, Section 1.

55 See New SRO By-Laws, Article XXII, Section 3.

56 See New SRO By-Laws, Article VII, Sections 9(b) and 9(c).

57 See New SRO By-Laws, Article VII, Section 9(b). At least 20% of the Nominating Committee is expected to be composed of Industry Governors. See NASD Response Letter, supra note 5, at 7.

58 Id.

59 See New SRO By-Laws, Article VII, Section 9(a).

D. Additional Changes

1. Annual Meetings

a. During the Transitional Period.

Except for the first annual meeting following the Closing at which Large Firm Governors, the Mid-Size Firm Governor, and Small Firm Governors would be elected, there would be no annual meetings of members during the Transitional Period.[60] At such first annual meeting, Small Firm members would be entitled to vote for the election of Small Firm Governors, Mid-Size Firm members would be entitled to vote for the election of the Mid-Size Firm Governor, and Large Firm members would be entitled to vote for the election of Large Firm Governors.[61]

b. After the Transitional Period.

An annual meeting of members of the New SRO would be held on a date and at a place as the New SRO Board designates.[62] The business of the annual meeting includes the election of the Small, Mid-Size, and Large Firm Governors of the New SRO Board. Small Firm members would be entitled to vote for the election of Small Firm Governors, Mid-Size Firm members would be entitled to vote for the election of the Mid-Size Firm Governor, and Large Firm members would be entitled to vote for the election of Large Firm Governors.

2. Chair

During the Transitional Period, the Chair would be the CEO of NYSE Regulation as of the Closing as long as he remains a Governor of the New SRO.[63] In the event the CEO of

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60 See New SRO By-Laws, Article XXI, Section 1.

61 Id. See also New SRO By-Laws, Article XXII, Section 3.

62 Id. See also New SRO By-Laws, Article XXI, Section 1.

63 See New SRO By-Laws, Article XXII, Section 2(b).

NYSE Regulation as of the Closing ceases to be the Chair during the Transitional Period, subject to the New SRO Certificate of Incorporation and the By-Laws, the Chair would be selected by the NYSE Group Committee from among its members, provided that the Chair so selected may not be a member of the Board of Directors of NYSE Group nor may the successor CEO of NYSE Regulation serve as Chair.[64]

After the Transitional Period, the Chair would be elected by the New SRO Board from among its members.[65]

3. Lead Governor

The New SRO Board would have a Governor who would preside over executive sessions of the New SRO Board in the event the Chair is recused ("Lead Governor").[66]

a. During the Transitional Period.

During the Transitional Period, the Lead Governor would be selected by the New SRO Board, after consultation with the New SRO's CEO, but cannot be a member who is concurrently serving on the NYSE Group Board.[67] The New SRO Board, the CEO, the Chair, and the Lead Governor of the New SRO each would have the authority to call meetings of the New SRO Board.[68] Both the CEO and Chair, and for matters from which the CEO and Chair are recused from considering, the Lead Governor, would have the authority to place items on the New SRO Board agendas.[69]

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64 Id.

65 See New SRO By-Laws, Article VII, Section 4(b).

66 See New SRO By-Laws, Article I(bb) and Article VII, Section 4(b).

67 See New SRO By-Laws, Article I(bb) and Article XXII, Section 1.

68 See New SRO By-Laws, Article VII, Section 8.

69 Id.

b. After the Transitional Period.

After the Transitional Period, the New SRO Board would continue to have a Lead Governor who would preside over executive sessions of the New SRO Board in the event the Chair is not present or recused.[70] The Lead Governor would be elected by the Board but cannot be a member who is concurrently serving on the NYSE Group Board.[71] The New SRO Board, the New SRO CEO, the Chair, and the Lead Governor would have the authority to call meetings of the New SRO Board.[72] Both the New SRO CEO and the Chair, and for matters from which the New SRO CEO and the Chair are recused from considering, the Lead Governor, would have the authority to place items on the New SRO Board agenda.[73]

4. Definition of Disqualification

The New SRO By-Laws also include changes or additions to certain defined terms. In addition to changes to accommodate the New SRO's new governance structure, the proposed rule change would amend the definition of "disqualification" in the NASD By-Laws to conform to the federal securities laws, such that any person subject to a statutory disqualification under the Exchange Act also would be subject to disqualification under NASD rules.[74]

5. References to the NASD

In addition, NASD proposes other technical changes to its By-Laws. For example, each

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70 See New SRO By-Laws, Article VII, Section 4(b).

71 See New SRO By-Laws, Article I(bb).

72 See New SRO By-Laws, Article VII, Section 8.

73 Id.

74 NASD represented that it will file a proposed rule change, which will be reviewed by the Commission pursuant to Section 19(b) of the Exchange Act, to address the applicable eligibility proceedings for persons subject to disqualification as a result of the proposed change in definition. See Notice, supra note 3.

reference to "NASD" in the NASD By-Laws would be replaced with "Corporation" in contemplation of the change in the name of the Corporation. In addition, each reference to the "Rules of the Association" in the NASD By-Laws would be replaced with "Rules of the Corporation."

6. Proposed Changes to NASD Regulation By-Laws

In 2000, NASD created a subsidiary for its mediation and arbitration functions, NASD Dispute Resolution, pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries ("Delegation Plan"). NASD proposes to make limited conforming changes to the NASD Regulation By-Laws solely to reflect the proposed governance structure of the New SRO Board.

First, in light of the new proposed composition of the New SRO Board, the proposed rule change would amend Section 5.2 of the NASD Regulation By-Laws (Number of Members and Qualifications of the National Adjudicatory Council ("NAC")) to eliminate the reference that the Chairman of the NAC would serve as a Governor of the NASD Board for a one-year term. Second, because the Chairman of the NAC may continue to serve as a Director of the NASD Regulation Board, the proposed rule change would eliminate the requirement in Section 4.3 of the NASD Regulation By-Laws (Qualifications) that only Governors of the NASD Board are eligible for election to the NASD Regulation Board. Finally, NASD proposes to amend the statement in Section 4.3 of the NASD Regulation By-Laws that provides that the CEO of NASD would be an ex-officio non-voting member of the NASD Regulation Board, to reflect that Ms. Schapiro would occupy both the position of CEO of the New SRO and the President of NASD Regulation. In particular, the proposed rule change would clarify that where the CEO of the New SRO also serves as President of NASD Regulation, then the person would have all powers, including voting powers, granted to all other Directors of NASD Regulation pursuant to applicable law, the Certificate of Incorporation of NASD Regulation, the Delegation Plan, and the NASD Regulation By-Laws.

III. Summary of Comments on the Proposal

The Commission received a total of 80 comment letters from 72 commenters on the proposal.[75] Seventeen commenters supported the proposed New SRO By-Laws,[76] some of whom believed that the consolidation proposal would streamline regulation and simplify compliance with a uniform set of regulations.[77] Forty-four commenters urged the Commission not to approve the proposal, generally arguing that the proposed New SRO By-Laws do not protect investors or provide enough representation for industry members or smaller member firms.[78] Three commenters supported the consolidation but opposed the New SRO By-Laws

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75 Exhibit A to this Order contains a list of comment letters received by the Commission on the proposal as of July 16, 2007, including the citations to the comment letters referenced in this Order.

76 See Vanguard Letter, Kirk Letter, SIFMA Letter, Casady Letter, Moloney Letter, Stringer Letter, Alsover Letter, Johnstone Letter, Castiglioni Letter, Robertson Letter, Pictor Letter, NAIBD Letter, FSI Letter, Bakerink Letter, NSCP Letter, Mungenast Letter, and NASAA Letter.

77 See Vanguard Letter, SIFMA Letter, Castiglioni Letter, FSI Letter, NSCP Letter, and Bakerink Letter.

78 See Mortarotti Letter, Lek Letter, Darcy Letter, Jordan Letter, Blumenschein Letter, Kosinsky Letter, Roberts Letter, Botzum Letter, Busacca Letter, RKeenan Letters I & II, King Letter, Flater Letter, Hebert Letter, Schunk Letter, Arnold Letter, High Letter, Eitel Letters I & II, Cohen Letter, Vande Weerd Letter, Jester Letters I & II, Schultz Letter, Benchmark Letter, Benchmark/Standard Letter I, de Leeuw Letter, Elish Letter, Hanson Letter, Horney Letter, Mayfield Letter, Solomon Letter, Patterson Letter, Daily Letter, Cray Letter, Biddick Letter, Penrod Letter, Spindel Letter, Isolano Letter, Lundgren Letters I & II, Haney Letter, Schooler Letter, Callaway Letter, John Q Letter, Miller Letters, JKeenan Letter, and Massachusetts Letter.

primarily because of the member voting provisions.[79] Other commenters were concerned about the fairness and independence of the arbitration process and the loss of an arbitration forum resulting from the consolidation which would allocate sole responsibility for arbitration and mediation to the New SRO.[80] One commenter provided copies of an amended complaint and an order relating to a lawsuit filed by an NASD member firm against NASD, NYSE Group and certain NASD officers.[81] Four commenters raised additional issues relating to the proposed rule

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79 See Kramer Letter, IASBDA Letter, and Wachtel Letter.

80 See e.g., Public Members of SICA Letter, Greenberg Letters I & II, and Caruso Letter. One commenter who objected to the consolidation also argued that investor rights would be reduced by cutting the number of arbitration venues in half. See Lundgren Letter I. As discussed below, NASD Dispute Resolution responded directly to one commenter. See NASD Dispute Resolution Letter I, supra note 5.

81 See Johnny Q Member Letters I & II. The Commission also received a letter on behalf of Benchmark Financial Services, Inc. ("Benchmark") and Standard Investment Chartered, Inc. ("Standard"), forwarding certain documents and pleadings relating to the lawsuit filed by Standard against the NASD, the NYSE, and three individuals defendants (Mary L. Schapiro, NASD's CEO; Richard F. Brueckner, Presiding Governor of the NASD Board of Governors; and Barbara Z. Sweeney, NASD's Senior Vice President and Corporate Secretary) (collectively, with NASD and NYSE, the "Defendants") in the U.S. District Court for the Southern District of New York ("Standard Lawsuit"). See Benchmark/Standard Letter I.

The Court recently granted the Defendants' motion to dismiss, finding that Standard had failed to exhaust its administrative remedies. See Standard Investment Chartered, Inc. v. National Association of Securities Dealers, Inc., No. 07-CV-2014 (S.D.N.Y.), 2007 WL 1296712 (May 2, 2007). On July 13, 2007, the Court denied Standard's motion for reconsideration. See Standard Investment Chartered, Inc. v. National Association of Securities Dealers, Inc., No. 07-CV-2014 (S.D.N.Y.) (July 13, 2007) (denying Plaintiff's Motion for Reconsideration of the Court's May 2, 2007 Opinion and Order). Standard's complaint alleged seven state law claims: (1) that the individual Defendants breached fiduciary duties to the proposed class in negotiating the proposed Transaction and failing to disclose all material facts in the proxy statement; (2) that the Defendants engaged in negligent misrepresentation with respect to the proxy statement; (3) that the NYSE and the individual Defendants will be unjustly enriched by the Transaction; (4) that NASD members have been denied their right to elect Governors of the NASD in violation of Section 211 of the Delaware General Corporation Law, 8 Del. C. § 211(a); (5) that the Defendants have improperly converted or, if the Transaction is effected, will have taken change.[82] The commenters generally addressed issues falling into one or more of the categories discussed below.

A. Fair Representation

1. Classification of Member Governors

Some commenters argued that the New SRO should retain the NASD's current "one firm, one vote" election process, whereby each NASD member is currently entitled to vote for the election of all NASD Governors (other than the CEO of NASD, the President of NASD Regulation, the Chair of the NAC, and, if applicable, a second officer of NASD).[83] In this regard, several commenters argued that the proposal would dilute the voting rights of members in New SRO Board elections, particularly with respect to small member firms.[84] These commenters also expressed concern that the New SRO By-Laws would result in the New SRO's

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the prospective class members' assets and/or "Member's Equity"; (6) that the Defendants have caused a substantial diminution in the value of NASD membership, with imminent completion of such diminution; and (7) that the Defendants have deprived the prospective class members of their voting membership.

82 See Harriman-Thiessen Letter (requesting that the Commission determine why NASD member firms voted the way they did), Judith Schapiro Letter (see text accompanying infra note 105), Schriner Letter (not opposed to reducing regulatory redundancies but believes that the proposed combination does not satisfy standards of "just and equitable principles of fair trade"), and Hawks Letter (see infra note 88).

83 See Lek Letter, Kosinsky Letter, Roberts Letter, RKeenan Letter II, Miller Letters, Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Callaway Letter, Isolano Letter, Hebert Letter, Biddick Letter, John Q Letter, and Schriner Letter.

84 See Mortarotti Letter, Jordan Letter, Roberts Letter, Botzum Letter, Arnold Letter, High Letter, Eitel Letter I, Cohen Letter, JKeenan Letter, Schultz Letter, Benchmark Letter, Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector), Solomon Letter, Isolano Letter, Haney Letter, Callaway Letter, Cray Letter, Blumenschein Letter, Biddick Letter, and Wachtel Letter.

Board being dominated by the large firms at the expense of the views and concerns of the small firms.

One commenter stated that there has been insufficient review to address the concerns of small independent broker-dealers.[85] One commenter maintained that the current NASD By-Laws state that firms, not the number of representatives or revenues collected, dictate the "one firm, one vote rule."[86] Other commenters argued that the proposal is designed to prevent the voices of the small member firms from being heard[87] or to eliminate small firms by escalating the cost of doing business.[88] Commenters also believed that there is no rational connection between the "one firm, one vote" policy and the consolidation of regulatory rules and procedures, arguing that "the NASD Board has used this regulatory consolidation . . . as a means of consolidating its power and, in turn, limiting the power of an institution that has wholly democratic origins."[89]

The FSI, along with two other commenters, expressly supported the proposed New SRO By-Laws, noting that the New SRO By-Laws would provide for effective, diverse representation

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85 See Horney Letter.

86 See Blumenschein Letter.

87 See Callaway Letter.

88 See Haney Letter (defining "small" firms as those firms with one to ten representatives). Four commenters were concerned about burdensome regulation of small broker-dealers generally. See Penrod Letter (stating that small broker-dealers might be better off forming another organization designed for small broker-dealers), Hawks Letter, Roberts Letter, and Callaway Letter.

89 See Benchmark Letter and Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector). The Benchmark Letter also noted that it does not dispute that the regulatory consolidation has some merit. See also Busacca Letter (arguing that there was no specific reason given by the NASD or NYSE for "member firms . . . surrender[ing] their right to vote for their Board of Governors").

of all members of the securities industry on the New SRO Board.[90] These commenters believed that the proposal is a reasonable way to maintain proper representation on the New SRO Board. The FSI also believed that the New SRO's governance structure is designed to insure that neither the largest nor the smallest broker-dealer firms can dominate the New SRO Board.[91] Another commenter, which identified itself as a small broker-dealer, supported the proposal and argued that small members would have increased representation on the New SRO Board as a result of the increase in their representation to three seats from the current one seat.[92]

2. Appointed Governors

Commenters were concerned that the majority of the Governors serving on the New SRO Board would be appointed by the New SRO Board itself and would not be elected by member firms.[93] Similarly, some commenters objected to members no longer having the right to vote for all Governors.[94] In addition, one commenter argued that the New SRO Board structure could create a "self-perpetuating" club in which the New SRO Board's Governors would not be held accountable to serve the members' needs.[95]

Some of these commenters maintained that the appointment of Governors is contrary to good corporate governance and questioned the independence and accountability of the appointed

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90 See Castiglioni Letter, FSI Letter, and Bakerink Letter.

91 See FSI Letter.

92 See Moloney Letter.

93 See Lek Letter, RKeenan Letters I & II, Hebert Letter, Mayfield Letter, Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Schriner Letter, Roberts Letter, and Biddick Letter.

94 See Kramer Letter and Hebert Letter.

95 See Wachtel Letter.

Governors.[96] Another commenter was concerned that the Public Governors would be appointed by the securities industry representatives on the Board.[97] This commenter believed that Public Governors should be chosen by the investing public or their representatives which would ensure that the views of investors would be heard and that their interests would be protected.[98]

3. Industry Representation

A number of commenters objected to the proposed composition of the New SRO Board for failing to include more industry representatives to serve as Governors.[99] These commenters stated that the ten Governor positions allocated to industry representatives are insufficient. These commenters also opined that the lack of industry representatives on the Board would defeat the purpose of self-regulation.

In contrast, one commenter stated that the New SRO Board structure would have too many industry representatives and not enough Public Governors.[100] This commenter noted that, because the New SRO Board would include ten Industry Governors as well as representatives of the NASD and NYSE Group on an ex officio basis, Governors who are from the securities industry would outnumber the Public Governors on the New SRO Board. Another commenter added that, because the current NASD definition of Public Governors would be amended, any ex-industry official or ex-industry regulator would be eligible to be a Public Governor, thereby biasing the New SRO Board toward industry interests.[101]

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96 See Mayfield Letter, Isolano Letter, Hebert Letter, Wachtel Letter, and Lek Letter.

97 See Massachusetts Letter.

98 Id.

99 See, e.g., Roberts Letter, Busacca Letter, Blumenschein Letter, and Miller Letters.

100 See Massachusetts Letter.

101 See Blumenschein Letter.

Several commenters supported the regulatory consolidation, noting that the proposed amendments are intended to maintain adequate representation on the New SRO Board for industry members.[102] Two commenters noted that the proposed composition of the industry members on the New SRO Board and in New SRO Board committees appears to promote diversity among industry representation on the Board.[103] Another commenter indicated that balanced representation of industry and non-industry members, as well as large and small firms, would reflect a broad spectrum of industry experience and would preserve the constructive feedback of non-industry participants.[104]

One commenter noted confusion about the proposed rule change regarding the eligibility for the "Independent Dealer/Insurance Affiliate Governor" and "Investment Company Affiliate Governor" positions.[105]

B. State Law and Proxy

1. Timing

Several commenters claimed that the proxy process was rushed, which forced members to make quick and uninformed decisions.[106] Other commenters stated that the proxy process was deceptive because it was held over the holiday season and involved alleged procedural omissions and coercive tactics by the NASD, including the threat of Commission action if the By-Law

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102 See NAIBD Letter, Vanguard Letter, Moloney Letter, and FSI Letter.

103 See NAIBD Letter and FSI Letter.

104 See Vanguard Letter.

105 See Judith Schapiro Letter.

106 See Mortarotti Letter, Jordan Letter, Busacca Letter, Schunk Letter, and Cray Letter.

revisions were not approved.[107] Another commenter did not dispute the results of the vote but expressed concerns about the lack of discussion of alternative ways to structure the New SRO Board.[108]

In addition, a few commenters claimed that the NASD did not present the New SRO By-Laws to the NASD membership for a vote quickly enough, thereby violating current NASD By-Laws that require a membership vote within 30 days of the submission of the proposal to the membership.[109]

2. Disclosure

Several commenters questioned the adequacy of the proxy statement.[110] These commenters indicated that oral statements made by NASD staff were not contained in the proxy statement, such as representations that the Commission would force consolidation in the event the members did not support the proposal[111] and that the NYSE required the New SRO By-Law

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107 See Benchmark Letter, Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector), Daily Letter, Cray Letter, Eitel Letter I, Miller Letters, and John Q Letter.

108 See IASBDA Letter.

109 See Jester Letter I, Miller Letters, and Blumenschein Letter. In response to the NASD Response Letter, Jester submitted a supplemental comment letter, asserting that the NASD was still required to comply with Article XVI of the NASD By-Laws which requires that By-Law amendments must be approved within 30 days of the submission of the proposal to the membership, even if the By-Law amendments are approved at a special meeting. See Jester Letter II.

110 See Darcy Letter, Roberts Letter, Busacca Letter, Benchmark Letter, Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector), Benchmark/Standard Letter II, Cray Letter, Spindel Letter, and Schriner Letter.

111 See Roberts Letter, Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Biddick Letter, Wachtel Letter, Isolano Letter, and Miller Letters.

provisions.[112] Two other commenters stated that the proxy statement failed to explain why the merger is connected to the governance changes, specifically the one firm, one vote policy.[113] These commenters also believed that the transaction is unfair to the NASD members who are not also NYSE members.[114] Another commenter objected to the proposed payments to the NYSE and believed that proposed consolidation needed more study by the current NASD members.[115]

3. Payment of $35,000

Several commenters questioned the calculation and origin of the $35,000 one-time payment to the NASD members.[116] Two commenters specifically posited whether the representation by the NASD that the payment came from reduced costs is misleading.[117] Other commenters expressed concern that the $35,000 amount appears arbitrary and may have been calculated based on financial information the NASD knows about its member firms.[118] One commenter believed that the $35,000 is a fraction of the value of the NASD,[119] while other

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112 See Wachtel Letter.

113 See Benchmark Letter and Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector). Some commenters also noted that they were unable to get answers to their questions about the consolidation from the NASD. See, e.g., Miller Letters.

114 Id.

115 See Kramer Letter.

116 See Kosinsky Letter, Busacca Letter, Benchmark Letter, Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector), Benchmark/Standard Letter II, Daily Letter, Miller Letters, Wachtel Letter, John Q Letter, and Schriner Letter.

117 See Busacca Letter and Schriner Letter.

118 See Isolano Letter, Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, and Biddick Letter.

119 See Lundgren Letter I.

commenters wanted an explanation as to why a larger payment to members is not possible.[120] One of these commenters submitted a supplemental comment letter in response to the discussion of the proposed $35,000 payment to NASD members in the NASD Response Letter.[121] This commenter stated that, from the perspective of an NASD member, the focus of the proxy statement was "the fundamental change in members' voting rights and the $35,000 that each member is to receive in exchange for 'surrendering' members' equity valued at as much as $300,000, or more, per NASD member."[122] The commenter believed that the discussion of the $35,000 in the proposed rule change was inadequate, and stated that the Commission "should disapprove the rule change, re-notice the issue properly or limit its findings to the issues it noticed."[123]

Some commenters questioned whether the payment was an improper inducement to members in order to obtain their vote.[124] One commenter expressed its concern that NASD member firms would receive funds for voting in favor of the consolidation, while public investors would not receive any financial benefit from the anticipated cost savings.[125] Commenters also inquired whether a fairness opinion was done in connection with the

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120 See Benchmark Letter, Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector), and Benchmark/Standard Letter II.

121 See Benchmark/Standard Letter II.

122 Id. (also noting that at least 22 comments mentioned or raised issues relating to the $35,000 payment, which, according to the commenter, "clearly demonstrate the materiality of the representations about the $35,000 payment").

123 Id.

124 See Eitel Letter II, Blumenschein Letter, Busacca Letter, Isolano Letter, Spindel Letter, Elish Letter, de Leeuw Letter, Patterson Letter, and Biddick Letter.

125 See Caruso Letter.

consolidation or the $35,000 payment[126] and whether the Internal Revenue Service gave a legal opinion on this payment.[127]

Two commenters believed that the monetary aspect of the proposed consolidation is simply a return of monies to the members for increased efficiency.[128] One of these commenters, which identified itself as a small NASD member firm, believed that the $35,000 payment would benefit many of the small firms financially.[129] This commenter did not believe that members' votes were bought or that members had given up voting rights because members retain a vote on any future By-Law changes.[130]

4. Delaware Law

One commenter argued that the proposal violates Delaware law because the omission in the proxy materials of the merger contract between NYSE and NASD makes the transaction illegal.[131] This commenter further believed that the proposed merger may have violated Delaware law by providing a proxy statement that allegedly had conclusory, one-sided statements.[132]

Another commenter argued that NASD violated Delaware law because it has not held an annual meeting in 13 months, which, according to the commenter, is required under Delaware

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126 See Cohen Letter, Lundgren Letter I, and Miller Letters.

127 See Daily Letter.

128 See Moloney Letter and FSI Letter.

129 See Moloney Letter.

130 Id.

131 See Cray Letter.

132 Id.

law.[133] Another commenter stated that the proposed combination, "by combining under current unknown By-Laws," violates the NASD's charter as stated on August 7, 1936.[134]

5. Antitrust Laws

Some commenters posited that the proposal violates antitrust laws.[135]

C. Efficiency and Investor Protection

1. Efficiency

Some commenters explicitly questioned the benefits of the proposed consolidation.[136] Three commenters argued that the consolidation would benefit mainly the larger firms;[137] two commenters noted specifically that firms should not have to incur costs to make changes in advertising, letterhead, and signage because the proposal mainly would benefit the larger firms.[138] Several commenters argued that the proposal would benefit the larger firms, while being disruptive to small broker-dealers.[139]

One commenter did not believe that the merger would be effective in reducing duplicative regulation because there are only about 170 firms subject to both NASD and NYSE rules.[140] The commenter believed that it would be easier for those 170 firms to be regulated by

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133 See John Q Letter.

134 See Blumenschein Letter.

135 See Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, and Biddick Letter.

136 See RKeenan Letter I, Mayfield Letter, and Schooler Letter.

137 See Vande Weerd Letter, Isolano Letter, and Eitel Letter II.

138 See Flater Letter (also noting that the $35,000 payment does not cover the cost of these changes) and Vande Weerd Letter.

139 See Schooler Letter, Biddick Letter, de Leeuw Letter, Eitel Letter II, Elish Letter, Blumenschein Letter, Isolano Letter, and Patterson Letter.

140 See Spindel Letter.

NYSE than to effect the consolidation solely for the benefit of those 170 firms.[141] One commenter argued that the merger is unnecessary because most firms already belong to the NASD.[142]

Commenters who supported the proposal believed that the proposed consolidation would benefit investors by streamlining regulation and simplifying compliance with a uniform set of regulations[143] or by increasing efficiency.[144] In this regard, some of these commenters believed that the use of two distinct rulebooks has caused unnecessary redundancy, complication, and conflict, which in their view undermines basic SRO objectives of effectively and efficiently protecting the capital markets and investors.[145] In addition, two commenters believed that combining the conflicting rules of the two SROs into one set of rules and eliminating inconsistent interpretations would be benefit both large and small firms.[146]

2. Investor Protection

Some commenters noted that having one less regulator overseeing the securities firms that deal with the public would harm investors.[147] One commenter likened the regulatory

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141 Id.

142 See Hebert Letter.

143 See Vanguard Letter, SIFMA Letter, Stringer Letter, Bakerink Letter, NSCP Letter, and FSI Letter. In addition, six commenters stated their agreement with SIFMA's Letter. See Casady Letter, Alsover Letter, Johnstone Letter, Robertson Letter, Mungenast Letter, and Pictor Letter.

144 See Moloney Letter, Kirk Letter, Castiglioni Letter, and NAIBD Letter.

145 See Vanguard Letter, SIFMA Letter, and NSCP Letter. In addition, seven commenters stated their agreement with SIFMA's Letter. See Casady Letter, Alsover Letter, Johnstone Letter, Robertson Letter, Mungenast Letter, Stringer Letter, and Pictor Letter.

146 See Bakerink Letter and Vanguard Letter.

147 See King Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Biddick Letter, and Massachusetts Letter.

consolidation to reducing the number of "police departments" that oversee the markets.[148] Another commenter stated that the proposal would remove any competitiveness between the two SROs and any choice that firms would have.[149] Yet another commenter added that having two independent regulatory entities would create advantages from a regulatory point of view.[150] This commenter noted that the NASD and NYSE are able to bring distinct perspectives to regulating their member firms and that such independence is vital to preventing SROs and other regulators from becoming myopic about certain regulatory issues. On the other hand, one commenter believed that the proposed structure would offer the best opportunity for balanced and effective regulation in furtherance of customer protection.[151]

Other commenters believed that the proposal overlooked investor interests because of the failure to include investors in the merger talks,[152] the lack of accountability and control over NASD/NYSE management by owners,[153] and the conflict of interest on the part of the NASD management because of benefits they may receive in connection with the merger.[154] Other

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148 See King Letter.

149 See Schooler Letter.

150 See Massachusetts Letter.

151 See FSI Letter.

152 See King Letter. One commenter who supported the consolidation urged that compliance professionals be included in the consolidation process. See NSCP Letter.

153 See Lundgren Letter I.

154 See Lundgren Letter II, Eitel Letter II, de Leeuw Letter, Biddick Letter, Elish Letter, Isolano, and Patterson Letter. Several commenters also questioned the compensation packages of the NASD management. See, e.g., Isolano Letter, Mayfield Letter, and Daily Letter.

commenters questioned the effectiveness of the regulatory oversight of a board whose members are directly funded by the persons they are regulating.[155]

D. Arbitration

Five commenters focused on the effects the merger may have on the arbitration of customers' disputes with their brokers.[156] One commenter urged the Commission to disapprove the merger, stating that it would reduce investor rights "by cutting the number of major available arbitration venues in half."[157] Another recommended that the Commission consider holding public hearings to discuss anticipated benefits and detriments of consolidating the NASD and NYSE dispute resolution forums before approving the merger.[158]

One commenter expressed the view that a single SRO arbitration forum will heighten public investors' suspicion that SRO arbitration is "less than independent and hence less than fair."[159] This commenter suggested either creating an "independent securities arbitration forum, with SEC oversight and public investor and securities industry participation" or providing that public investors may choose between resolving their disputes in court or in arbitration. In addition, this commenter stated that the role of the Securities Industry Conference on Arbitration ("SICA") should be strengthened and that public members should compose at least one half of the voting members of SICA.

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155 See Biddick Letter, de Leeuw Letter, Eitel Letter II, Elish Letter, Isolano Letter, and Patterson Letter.

156 See Caruso Letter, Greenberg Letters I & II, Lundgren Letter, Massachusetts Letter, and Public Members of SICA Letter.

157 See Lundgren Letter.

158 See Caruso Letter.

159 See Public Members of SICA Letter.

Another commenter cited those views with approval, stating that combining the NASD and NYSE arbitration forum is "not desirable" and called for changes in the arbitration system "to make it fairer to investors" including the elimination of "industry" arbitrators.[160] This commenter also expressed concern about the use of dispositive motions in SRO arbitration and stated that the New SRO should incorporate the relevant NYSE rule rather than the NASD rule in its arbitration code.

One commenter noted that the NASD and NYSE forums have different rules, procedures, and administrative practices, and stated this "can often have a significant procedural impact on an arbitration proceeding."[161] Expressing skepticism that a single forum will provide "any recognizable benefits" for public customers, this commenter stated that a "notable portion of the anticipated cost savings" from the regulatory consolidation should be allocated toward the reduction of public investors' filing, administrative and forum fees.

As discussed more fully below, NASD responded to comments, in part, by citing studies and reports analyzing its arbitration forum, and noting that it is subject to SEC oversight, including through inspections and the rule approval process.[162] One commenter questioned the methodology and impartiality of the studies and reports, as well as the efficacy of SEC oversight.[163] This commenter also noted that he had filed a petition for rulemaking with the Commission calling for a number of changes in arbitration rules and stated that these changes

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160 See Massachusetts Letter.

161 See Caruso Letter.

162 See NASD Dispute Resolution Letter, supra note 5.

163 See Greenberg Letters I & II.

would "correct many aspects of the arbitration process, which make the process unfair to the investing public."[164]

E. Other Matters

1. Request for Delay

Several commenters argued that the proposal should be put on hold for one year,[165] while two other commenters[166] suggested tabling the proposal until after the resolution of the Standard Lawsuit.[167] Another commenter suggested that the Commission could approve the consolidation but require another vote in three years on the composition of the New SRO Board, after the firms and the public have had a chance to evaluate the effects of the merger.[168] This commenter did

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164 Id. See also Request for rulemaking under the Securities Exchange Act of 1934 concerning arbitration sponsored by NASD Dispute Resolution, Submitted by Les Greenberg, Esq., File No. 4-502 (May 13, 2005).

165 See Busacca Letter. Three commenters argued that the proposal should be put on hold and membership should be consulted and given the opportunity for input. See also Miller Letters, Kramer Letter, and Hebert Letter.

166 See Benchmark Letter and Benchmark/Standard Letter I (adding Standard to the Benchmark Letter to be an additional objector).

167 The Court recently granted the Defendants' motion to dismiss, finding that Standard had failed to exhaust its administrative remedies. See Standard Investment Chartered, Inc. v. National Association of Securities Dealers, Inc., No. 07-CV-2014 (S.D.N.Y.), 2007 WL 1296712 (May 2, 2007). According to the Benchmark/Standard Letter II, the Plaintiffs filed a motion for reconsideration on May 17, 2007. See supra note 81. On July 13, 2007, the Court denied Standard's motion for reconsideration. See Standard Investment Chartered, Inc. v. National Association of Securities Dealers, Inc., No. 07-CV-2014 (S.D.N.Y.) (July 13, 2007) (denying Plaintiff's Motion for Reconsideration of the Court's May 2, 2007 Opinion and Order).

168 See IASBDA Letter. This commenter argued that a reassessment in three years might "possibly calm the concerns of a large number of small firms. . .which feel disenfranchised by a process that shows no discussion of alternatives."

not express concern about the voting results but about the lack of any discussion of other alternatives to the New SRO Board's composition.[169]

Other commenters believed that the proposed regulatory consolidation should occur as soon as practicable or in the timeframe announced by the NASD and NYSE Group.[170] One of these commenters believed that the regulatory consolidation should proceed because a majority of the members already have given their approval to the proposed regulatory consolidation.[171]

2. Public Hearing

Two commenters urged the Commission to consider the proposal at a public hearing.[172] As noted above, one of these commenters recommended that the Commission consider holding public hearings to discuss anticipated benefits and detriments of consolidating the NASD and NYSE dispute resolution forums before approving the consolidation.[173] Another commenter stated that the Commission and government oversight committees should be part of the discussion of the consolidation.[174]

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169 Id. A commenter suggested that, in lieu of this proposed rule change, it would be "easier for those firms that are currently regulated by NYSE to simply not be regulated by NASD at all and to instead be regulated by NYSE staff using current SEC and NYSE rules which could be supplemented by NYSE adopting many of the current NASD rules to which the large New York Stock Exchange member organizations must currently comply, since they are also NASD members." See Spindel Letter.

170 See Johnstone Letter, Casady Letter, SIFMA Letter, Moloney Letter, Stringer Letter, Alsover Letter, Robertson Letter, and Pictor Letter.

171 See Moloney Letter.

172 See Harriman-Thiessen Letter and Caruso Letter.

173 See Caruso Letter.

174 See Darcy Letter.

IV. NASD Response to the Comment Letters

NASD submitted two letters to respond to issues raised by the commenters, including the proposed governance structure, the proxy statement, the approval process for the By-Law amendments, and the $35,000 payment.[175] NASD also submitted two letters providing opinions of counsel with respect to the approval process of the By-Law amendments and the $35,000 payment.[176] In two separate letters, NASD Dispute Resolution responded to comments regarding the effects of the consolidation on arbitration of customers' disputes with member firms.

A. Fair Representation

NASD stated that the proposed rule change was designed to provide a "carefully balanced and calibrated governance structure that was approved by a majority of the membership," rather than the existing NASD governance structure preferred by a number of commenters.[177] NASD stated that the proposed By-Law changes satisfy the statutory requirement for "fair representation" pursuant to Section 15A(b)(4) of the Exchange Act.[178]

1. Industry Representation and Classification of Governors

In response to commenters who contended that the New SRO Board would have insufficient industry representation, NASD stated that the proposal "ensures substantial industry representation, while still maintaining the overall independence of the New SRO Board and the

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175 See NASD Response Letter and NASD Supplemental Response Letter, supra note 5.

176 See RLF Letter and DPW Letter, supra note 5.

177 NASD Response Letter, supra note 5, at 4.

178 Id. at 4-5.

numerical dominance of Public Governors" and "comfortably fits within the parameters the Commission has previously articulated to comply with the fair representation requirement."[179] Specifically, NASD noted that 40% of the New SRO Board would be composed of industry representatives.[180] NASD also noted that the member representation on the New SRO Board would exceed the member representation of The NASDAQ Stock Market LLC ("Nasdaq") (whose Board is composed of 20% member representatives), NYSE LLC (whose Board is wholly independent), NYSE Regulation (whose Board is wholly independent[181]), and would be comparable to member representation of the Chicago Stock Exchange ("CHX") (twelve directors, of which five are "participants") and the International Securities Exchange LLC ("ISE") (14 directors, of which six are market participants allocated by business types).[182]

In response to commenters who stated that the proposed rule change would abolish the current "one-member-one-vote" governance structure and the existing right to elect all of the NASD Board seats (with the exception of the Chair of the National Adjudicatory Council and the NASD CEO, who hold seats based on position), NASD stated that the proposed governance structure ensures diversity of member representation on the New SRO Board by guaranteeing

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179 Id. at 5.

180 Id.

181 The Commission notes that all of the directors on the Board of NYSE Regulation, with the exception of the Chief Executive Officer, must qualify as independent under the independence policy of the board of directors of NYSE Euronext. See Second Amended and Restated By-Laws of NYSE Regulation, Inc., Article III, Section 1.

182 NASD Response Letter, supra note 5, at 5-7. In addition to the 14 directors cited in the NASD Response Letter, the Commission notes that the President and CEO of ISE also serves on the ISE Board of Directors for a total of 15 directors. See ISE Constitution, Article III, Section 3.2.

certain seats for different size firms and those with particular business models.[183] In this regard, NASD noted that small firm representation would increase from one to three guaranteed seats.[184] NASD also noted that the "proposed composition of and selection process for the Small Firm Governors and Large Firm Governors are identical, ensuring fairness and balance between those firms that make up the largest percentage of membership and those firms that employ the largest percentage of the registered representative population."[185]

NASD noted that the "New SRO intends to maintain additional member involvement in the administration of the New SRO's affairs through representation on District Committees, Standing Committees, the Advisory Council (consisting of the Chairs of the District Committees and the Market Regulation Committee), the Small Firm Advisory Board, disciplinary panels and the National Adjudicatory Council."[186] NASD also noted that the amended By-Law changes would maintain a one-member-one-vote-system for all future By-Law changes.[187]

Finally, NASD noted its belief that the presence of no fewer than eleven Public Governors, none of which may have a material relationship with a broker or dealer or registered SRO, satisfies the requirement to have at least one director representative of issuers and investors.[188]

183 NASD Response Letter, supra note 5, at 5.

184 Id.

185 Id.

186 Id. at 6.

187 Id. at 5.

188 Id.

2. <u>Appointed Governors</u>

In response to commenters who objected to the number of Governors who would be appointed rather than elected, NASD believed that these commenters failed to appreciate that the proposed governance structure "strikes a balance between the necessity of overall independence and the desire for substantial, meaningful and diverse industry representation."[189] NASD noted that the proposal provides for the "Small Firm, Mid-Size Firm, and Large Firm Governors to be elected by firms of corresponding size, each with an equal vote." NASD also noted that the proposal exceeds the representation and participation requirements of other SROs whose governance rules have previously been approved by the Commission. Specifically, NASD noted that the business combination between New York Stock Exchange, Inc. ("NYSE Inc.") and Archipelago Holdings, Inc. satisfied a parallel fair representation standard pursuant to Section 6(b)(3) of the Exchange Act with the requirement that members could elect 20% of the boards of New York Stock Exchange LLC and NYSE Regulation and a provision allowing members to nominate directly candidates for those seats through a petition process.[190] NASD stated that the New SRO By-Laws would allow members to elect at least 28% of the total number of directors on the Board.[191] NASD noted that members may petition to place alternative candidates on the ballot for their respective member-elected seats.

NASD noted that the proposed rule change provides for three additional industry seats, namely, the Investment Company Affiliate Governor, Independent Dealer/Insurance Affiliate

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189 <u>Id.</u> at 6.

190 <u>Id.</u> at 5.

191 <u>Id.</u>

Governor, and Floor Member Governor.[192] Moreover, NASD has committed that the Charter of the New SRO's Nominating Committee provides that at least 20% of the Committee will be composed of Industry Governors that are associated with New SRO members.[193] According to NASD, as a trade-off to substantial industry participation on the Board and to maintain its overall independence, "it is reasonable and sensible to ensure that public members are selected by a nominating committee and that the Board is not dominated by the industry."[194] NASD noted that the three appointed Industry Governors represent seats with distinct business models and that are important in informing the Board's deliberations.[195]

B. State Law and Proxy

In response to some commenters who contended that NASD failed to follow its existing procedures for adopting By-Law amendments, specifically obtaining approval within the 30-day timeframe as set forth in Article XVI of the NASD By-Laws,[196] NASD stated that it acted in a manner consistent with state law, which provides alternative means to propose and adopt certain corporate governance changes. NASD stated that Article XVI of the NASD By-Laws is not an exclusive means by which member approval of amendments to the By-Laws can be obtained.

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192 Id. at 7.

193 NASD Supplemental Response Letter, supra note 5, at 4. NASD also noted that the proposal establishes a Nominating Committee that would nominate candidates for each seat other than that of the CEO. The Nominating Committee would be a subset of the Board determined in number and composition by the Board from time to time, provided that the number of Public Governors on the committee must always exceed then number of Industry Governors on it. NASD Response Letter, supra note 5, at 6.

194 NASD Response Letter, supra note 5, at 7.

195 Id.

196 Article XVI of the NASD By-Laws provides that amendments to the NASD By-Laws could become effective as of a date prescribed by the NASD Board, if the amendment is approved by a majority of the members voting within 30 days after the date of submission to the membership, and is approved by the Commission.

NASD noted that "[m]embers of a Delaware non-stock corporation, including NASD, may take action at an annual or special meeting held pursuant to 8 Del. C. § 211(a) or, unless otherwise restricted by such corporation's certificate of incorporation, by written consent pursuant to 8 Del. C. § 228." NASD explained that, under this authority, it convened a special meeting of NASD members pursuant to Article XXI of the NASD By-Laws at which the New SRO By-Law amendments were approved.[197] In addition, to further support its position, NASD submitted an opinion of counsel that, under Delaware law, "it is within the authority of the Members to approve proposed amendments to the By-Laws . . . at a special meeting held more than thirty days after the proposed By-Laws had been submitted to the Members," and that the vote of NASD members "was a valid exercise" of the members' franchise rights and authorized by Delaware law.[198]

NASD took issue with the view of several commenters that the proxy was incomplete or that certain statements by NASD management regarding the potential consequences of failing to approve the proposed By-Law changes were misleading.[199] NASD noted that all the issues raised by the commenters were subject to lively debate in advance of the member vote. Specifically, members received communications from both the NASD and groups opposing the transaction over a five week period that included "28 town hall meetings, conference calls, mailings, emails, and telephone calls."[200] NASD stated that it "provided access to its members contact list to groups opposing the transaction, and thereby afforded these groups the opportunity

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197 See NASD Response Letter, supra note 5, at 7.

198 See RLF Letter, supra note 5.

199 See NASD Response Letter, supra note 5, at 8-9.

200 Id. at 9.

to raise all of the issues to the membership," who approved the By-Law amendments after considering all of these arguments.[201] In addition, NASD noted that the "proxy statement contained an extensive discussion of the negotiations with NYSE Group, the rationale for the $35,000 payment, and how the By-Law changes would affect the voting rights of NASD members."[202] NASD maintained that the statements made prior to the member vote were consistent with the proxy statement.[203]

In response to commenters' concerns regarding the amount of the $35,000 payment to be made to members upon the Closing of the Transaction, NASD noted that the proxy statement disclosed that the $35,000 payment was based on the expected future incremental cash flows that would result from the regulatory consolidation and was consistent with public guidance from the Internal Revenue Service ("IRS").[204] In the NASD Supplemental Response Letter, NASD stated that its Certificate of Incorporation prohibits NASD from paying dividends to its members, and that doing so would result in forfeiture of NASD's tax-exempt status under Section 501(c)(6) of the Internal Revenue Code.[205] NASD also explained that the proposed $35,000 member payments did not constitute a prohibited dividend or comparable distribution, because they "are based on (and limited by) expected future incremental cash flows that would result from the

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201 Id.

202 Id.

203 Id.

204 Id.

205 See NASD Supplemental Response Letter, supra note 5, at 2 (citing 26 U.S.C. § 501(c)(6) (requirement that "no part" of an exempt entity's net earnings inure to any private shareholder or individual); I.R.S. Gen. Couns. Mem. 39862 (November 22, 1991) ("There is no de minimis exception to the inurement prohibition."); see also Spokane Motorcycle Club v. United States, 222 F. Supp. 15 1, 153-54 (E.D. Wash. 1963) (refreshments provided at no cost to club members invalidated tax exemption)).

regulatory consolidation."[206] Further, NASD stated that "any direct payment unrelated to those efficiencies would be inconsistent with NASD's tax-exempt status."[207] NASD determined that "$35,000 was the maximum member payment that the IRS could be expected, with a sufficient degree of confidence, to approve within the timeframe contemplated for the transaction."[208] NASD requested a private letter ruling from the IRS approving the proposed regulatory consolidation, including the $35,000 payment, and, according to NASD, "[i]t was on this basis that the IRS agreed to issue such a ruling."[209] NASD explained that "the proxy materials accurately state that member payments in excess of $35,000 could not be possible because such a payment, without the IRS's approval, could 'seriously jeopardize' NASD's tax-exempt status."[210] To further support its position, NASD submitted an opinion of its outside tax counsel that described generally the case law, statutory provisions, and guidance published by the IRS relevant to the disclosure in the NASD's proxy statement, and concluded that if NASD had increased the amount of the $35,000 payment, there would have been a "serious risk" that the IRS would not have issued the rulings and that NASD could be found to violate the prohibition against private inurement.[211] In addition, NASD's outside Delaware counsel stated that, because the NASD's Certificate of Incorporation contains a prohibition against inurement, any payment

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206 See NASD Supplemental Response Letter, supra note 5, at 2.

207 Id. at 3.

208 Id.

209 Id.

210 Id.

211 See DPW Letter, supra note 5.

that violates the federal tax code prohibition against inurement would also be void under Delaware law.[212]

In response to a commenter's question about the eligibility for the positions of the Investment Company Affiliate Governor and the Independent Dealer/Insurance Affiliate Governor, respectively, NASD stated that the "proposed rule change is intended to continue the presence on the New SRO Board of representatives from the particular business models of independent dealers/insurance companies and investment companies and to provide the Nominating Committee the flexibility to fill those Board seats with the best available candidates affiliated with a firm from those industry segments."[213]

C. Efficiency and Investor Protection

NASD stated that the commenters who stated that the consolidation would result in less investor protection by reducing the number and diversity of regulators overseeing the industry overstated the value of a second, duplicative regulator and understated the benefits of the regulatory consolidation.[214] NASD stated that the combination would achieve "greater efficiencies, clarity and cost savings in the regulation of the financial markets" and that the "investor ultimately would be better protected by a single, more efficient regulator administering a single streamlined set of rules with the combined resources" of the two organizations.[215]

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212 See RLF Letter, supra note 5, at 5.

213 See NASD Response Letter, supra note 5, at 8.

214 Id.

215 Id.

D. Arbitration

NASD separately addressed comments regarding the merger of the NASD and NYSE arbitration forums.[216] It highlighted the results of studies commissioned by NASD[217] and the Commission[218] during the past decade, which focused on forum users' perceptions of fairness, as well as two General Accounting Office reports.[219] In NASD's view, "it is the quality of the forum that dictates fairness rather than an investor's ability to select one dispute resolution forum over another."[220] NASD also noted that it currently administers over 94% of investor disputes with broker-dealers and that over the past decade the Commission has approved consolidation of the arbitration programs of other SROs with NASD with no adverse effects.[221]

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216 See NASD Dispute Resolution Letters I & II, supra note 5.

217 NASD Dispute Resolution Letter I, supra note 5 (citing G. Tidwell, K. Foster and M. Hummell, Party Evaluations of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations (August 5, 1999) http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009528.pdf).

218 NASD Dispute Resolution Letter I, supra note 5 (citing M. Perino, Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations (November 4, 2002) http://www.sec.gov/pdf/arbconflict.pdf).

219 NASD Dispute Resolution Letter I, supra note 5 (citing Actions Needed to Address Problem of Unpaid Awards, GAO/GGD-00-115 (June 2000); Securities Arbitration: How Investors Fare, GAO/GGD-92-74 (May 11, 1992)).

220 See NASD Dispute Resolution Letter I, supra note 5.

221 Id. (citing Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (approving consolidation with Nasdaq); Securities Exchange Act Release No. 45094 (November 21, 2001), 66 FR 60230 (December 3, 2001) (International Securities Exchange); Securities Exchange Act Release No. 40622 (October 30, 1998), 63 FR 59819 (November 5, 1998) (American Stock Exchange); Securities Exchange Act Release No. 40517 (October 1, 1998), 63 FR 54177 (October 8, 1998) (Philadelphia Stock Exchange); Securities Exchange Act Release No. 39378 (December 1, 1997), 62 FR 64417 (December 5, 1997) (Municipal Securities Rulemaking Board)).

With respect to the independence of its forum – and the suggestion for creating an "independent" forum – NASD stated that it "is an independent forum."[222] NASD explained that the majority of its Dispute Resolution Board and its National Arbitration and Mediation Committee are public representatives. It also noted that it is a member of SICA. In addition, NASD stressed that it is financially self-sufficient in that it is funded by fees charged to users of the forum – broker-dealers, their associated persons, and investors.[223] In this regard, NASD also stated that although the consolidation should result in economies of scale and increased efficiencies in administering the New SRO arbitration forum, investors do not contribute toward administrative costs.[224] Rather, NASD stated that investors "pay only the marginal (that is, direct) costs attached to their particular claim."[225]

Responding to the suggestion that NASD rules provide that public investors may choose between resolving their disputes in court or in arbitration, NASD cited Shearson/American Express, Inc. v. McMahon[226] and subsequent cases in which the Supreme Court upheld the use of pre-dispute arbitration agreements. In NASD's view, the commenter's proposal "seeks to overturn federal case law dating back 20 years."[227] Moreover, NASD stated that "[w]hen

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222 NASD Dispute Resolution Letter I, supra note 5.

223 Id.

224 NASD Dispute Resolution Letter II, supra note 5.

225 Id.

226 482 U.S. 220 (1987).

227 NASD Dispute Resolution Letter I, supra note 5.

investors (and other parties) were offered a choice of another arbitration forum under the 2000 SICA Pilot, there was little interest."[228]

NASD also noted that it "continues to make significant improvements to the dispute resolution forum to make the process more transparent, fair, and efficient for investors and others who use the forum."[229] With respect to a comment on the composition of arbitration panels, NASD noted that current NASD and NYSE rules provide that customer arbitrations are resolved either by a single public arbitrator or by a panel of two public and one non-public arbitrator.[230] Moreover, NASD stated that it and NYSE are working to harmonize their definitions of "public" and "non-public" arbitrators, and any resulting proposed rule changes would be filed with the Commission and subject to public comment at that time.[231] With respect to the comments regarding the use of dispositive motions at NASD and NYSE, NASD stated that it understands that NYSE arbitrators determine whether such motions will be heard at a hearing as well as the timing of the hearing. In contrast, NASD proposed a specific rule regarding dispositive motions.[232] NASD indicated that it will consider the comments pertaining to dispositive motions in the context of that specific rule proposal "and may further amend the proposal."[233]

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228 Id. In particular, NASD noted "[t]he SICA Twelfth Report sums up the pilot's results this way: 'From its inception, few investors (or their attorneys) elected to proceed at a non-SRO forum.' Based upon responses to a survey of investors, SICA reported that investors' main reasons for not using the alternative forums were the higher fees at non-SRO forums, and a general degree of comfort with existing and more familiar procedures."

229 Id.

230 NASD Dispute Resolution Letter II, supra note 5.

231 Id.

232 Id. (citing Securities Exchange Act Release No. 54360 (August 24, 2006), 71 FR 51879 (August 31, 2006) (File No. SR-NASD-2006-088)).

233 NASD Dispute Resolution Letter II, supra note 5.

V. Discussion

After careful review, and consideration of commenters' views and the NASD's correspondence responding to comments, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities association.[234] In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(2) of the Exchange Act,[235] which requires a national securities association to be so organized and have the capacity to carry out the purposes of the Exchange Act and to enforce compliance by its members and persons associated with its members with the provisions of the Exchange Act. The Commission also finds that the proposed rule change is consistent with Section 15A(b)(4) of the Exchange Act, which requires that the rules of a national securities association assure the fair representation of its members in the selection of its directors and administration of its affairs, and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.[236] Further, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,[237] in that it is designed, among other things, to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

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234 In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

235 15 U.S.C. 78o-3(b)(2).

236 15 U.S.C. 78o-3(b)(4).

237 15 U.S.C. 78o-3(b)(6).

Self regulation is the cornerstone of the regulatory system governing the U.S. securities markets. Over the years, the self-regulatory system has functioned effectively and has served investors, the securities industry, and the government well. However, NASD and NYSE and many of their members believe that the current self-regulatory system as it applies to member regulation should be simplified and duplicative rules and conflicting interpretations of such rules should be eliminated. To that end, NASD and NYSE Group have agreed to consolidate their regulation of member firms. The proposal before the Commission, which would amend the NASD By-Laws to establish the By-Laws of the New SRO, is a key component in effectuating this regulatory consolidation. These amendments would establish the structure of the New SRO, which, among other things, would be responsible for reviewing and harmonizing the duplicative NASD and NYSE rules governing member firm regulation and conflicting interpretations of those rules. NASD stated that it expects the New SRO to submit to the Commission within one year of the date of the Closing proposed rule changes that would constitute a significant portion of a harmonized rulebook, with the remaining rules being submitted to the Commission within two years of the Closing.[238] The Commission has requested that the New SRO provide the Commission with quarterly progress reports on the harmonization project. In the Commission's view, the consolidation of NASD and NYSE member firm regulation should help reduce unnecessary regulatory costs while, at the same time, increase regulatory effectiveness and further investor protection.

The Commission discusses below the significant aspects of the proposed amendments to the NASD By-Laws.

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238 See NASD Supplemental Response Letter, supra note 5.

A. Fair Representation of Members

1. Introduction

Section 15A(b)(4) of the Exchange Act[239] requires that the rules of a national securities association assure the fair representation of its members in the selection of its directors and administration of its affairs. This requirement helps to assure that members have a stake in the governance of the national securities association, which is charged with self-regulatory responsibilities under the Exchange Act. Under the New SRO By-Laws, the New SRO Board initially would consist of eleven Public Governors and ten Industry Governors, including a Floor Member Governor, an Independent Dealer/Insurance Affiliate Governor, an Investment Company Affiliate Governor, three Small Firm Governors, one Mid-Size Firm Governor, and three Large Firm Governors.[240] The CEO of the New SRO and, during the Transitional Period, the CEO of NYSE Regulation, also would be Governors on the New SRO Board.[241] The three Small Firm Governors, the one Mid-Size Firm Governor, and the three Large Firm Governors (collectively, "Firm Governors") would be elected by the members of the New SRO.[242]

2. Board Composition

i. Classification of Member Governors

A number of commenters, who are NASD members, argued that the New SRO should retain the NASD's current "one firm, one vote" election process. These commenters contended that they would be disenfranchised by the New SRO By-Laws because, instead of being allowed

239 15 U.S.C. 78o-3(b)(4).

240 See New SRO By-Laws, Article VII, Section 4 and Article XXII, Section 2(a).

241 See New SRO By-Laws, Article VII, Section 4, and Article XXII, Section 2.

242 See New SRO By-Laws, Article I(z), Article I(dd), Article I(xx), and Article VII, Section 4(a).

to elect all Governors, New SRO members would be allowed to elect only those Governors who are from member firms that are comparable in size to their own firm.[243] Other commenters believed that the New SRO By-Laws would provide for effective, diverse representation of all members of the securities industry on the New SRO Board.[244] In response, NASD stated that the proposed governance structure ensures a diversity of member representation on the New SRO Board by guaranteeing certain seats for different size firms and for those firms with particular business models.[245] NASD also noted that small firm representation on the Board would increase from one to three guaranteed seats.[246] The Commission finds that the structure of the New SRO Board – specifically the requirement that three Governors be elected by Small Firm members, one Governor be elected by Mid-Size Firm members, and three Governors be elected by Large Firm members[247] – is consistent with the fair representation requirement of the Exchange Act. In the Commission's view, this structure is a reasonable method to assure the fair representation of the New SRO's members on the New SRO's Board by affirmatively providing various New SRO constituencies with representation on the New SRO Board.[248] As a result,

243 See, e.g., Lek Letter, Kosinsky Letter, Roberts Letter, RKeenan Letter II, Miller Letters, Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Callaway Letter, Isolano Letter, Hebert Letter, Biddick Letter, John Q Letter, and Schriner Letter.

244 See Castiglioni Letter, FSI Letter, and Bakerink Letter.

245 See NASD Response Letter, supra note 5, at 5.

246 Id.

247 See New SRO By-Laws, Article I(z), Article I(dd), Article I(xx), and Article VII, Section 4(a).

248 NASD noted that the proposed composition of and selection process for the Small Firm Governors and Large Firm Governors are identical, ensuring, according to the NASD, fairness and balance between those firms that comprise the largest percentage of membership and those firms that employ the largest percentage of the registered representative population. See NASD Response Letter, supra note 5, at 5.

neither the largest nor the smallest firms would be able to dominate the New SRO Board. Moreover, issues or concerns of a particular New SRO constituency could be brought to the attention of, and considered by, the New SRO Board.

The Commission notes that it has previously approved a governance structure in which members are entitled to elect only those directors that are from the same class as the member.[249] Specifically, Primary Market Makers, Competitive Market Makers, and Electronic Access Members on the ISE are entitled to elect two directors each to represent these categories of ISE's members on the ISE Board.[250] In approving the governance structure of the ISE, the Commission found that the composition of the ISE Board and the selection of directors of ISE satisfied the fair representation requirement of Section 6(b)(3)[251] of the Exchange Act.[252] The Commission believes that New SRO having Governor positions based on the size of a firm is not

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249 See Securities Exchange Act Release No. 53705 (April 21, 2006), 71 FR 25260 (April 28, 2006) (relating to the reorganization of the ISE into a holding company structure, whereby ISE Holdings, Inc. would be the publicly-traded holding company of ISE, the SRO) ("Release No. 53705").

250 The holders of "PMM Rights," which Primary Market Makers must hold to obtain trading rights on the ISE, are entitled to elect two directors. The holders of "CMM Rights," which Competitive Market Makers must hold to obtain trading rights on the ISE, are entitled to elect two directors. The holders of "EAM Rights," which Electronic Access Members must hold to obtain trading rights on the ISE, are entitled to elect two directors. Id.

251 15 U.S.C. 78f(b)(3). Section 6(b)(3) of the Exchange Act is identical to Section 15A(b)(4) of the Exchange Act, except that Section 6(b)(3) applies to national securities exchanges and Section 15A(b)(4) applies to national securities associations.

252 See Securities Exchange Act Release No. 53705 (April 21, 2006), 71 FR 25260 (April 28, 2006) (noting that the ISE's proposed governance structure was substantially the same as that of its predecessor entity). In approving the governance structure of the predecessor entity, the Commission found that the selection of six of the 15 directors on the predecessor entity's board, and the manner in which such directors are nominated and selected, satisfied the fair representation requirement of Section 6(b)(3) of the Exchange Act. See Securities Exchange Act Release No. 45803 (April 23, 2002), 67 FR 21306 (April 30, 2002) (approving the predecessor entity's governance structure).

dissimilar to the governance structure of the ISE, which allocates rights to elect Board seats based on the nature of the member's business.

ii. Appointed Governors

Several commenters expressed concern that, because some Governors would be appointed, member firms would not have the right to elect all New SRO Governors.[253] NASD, however, stated that these commenters "fail[ed] to appreciate that the proposed governance structure strikes a balance between the necessity of overall independence and the desires for substantial, meaningful and diverse industry representation."[254] NASD noted that, under the proposed New SRO By-Laws, members not only would be entitled to elect at least 28% of the total number of Governors, but also would be represented through three additional Industry Governor positions and the potential for member-elected Governors to serve on the Nominating Committee.[255] NASD also noted that the Commission previously approved governance structures that provided for a lower threshold of member representation regarding the selection of an SRO's directors and administration of its affairs than in the proposed New SRO By-Laws. Specifically, NASD noted that the Commission found consistent with the fair representation requirement the governance structure of NYSE LLC, whereby members elect 20% of the wholly independent board of directors of NYSE LLC and have the right to nominate directly candidates

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253 See Lek Letter, RKeenan Letter I & II, Hebert Letter, Mayfield Letter, Blumenschein Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Schriner Letter, Roberts Letter, and Biddick Letter. See also Johnny Q Member Letters I & II, Benchmark/Standard Letter I, and Benchmark Letter, which referred to the Standard Lawsuit, supra note 81.

254 See NASD Response Letter, supra note 5, at 6.

255 Id. at 7.

through a petition process.[256] NASD also noted that the Commission found that the governance structure of the Nasdaq, whose Board of Directors also is composed of 20% member representatives, satisfies the fair representation standard of the Exchange Act, and that member representation on the proposed New SRO Board would exceed that of the Nasdaq's Board of Directors.[257]

The Commission finds that the structure of the New SRO Board, in which specified Governors are appointed and Firm Governors are elected, is consistent with the Exchange Act. The Commission notes that New SRO members will have the right to elect a total of seven Firm Governors out of 23 Governors (22 after the Transitional Period), or approximately 30% of all Governors. The Commission previously approved structures in which members were not guaranteed the right to elect all directors.[258] For example, the Commission approved ISE governance documents that provide that the holding company for ISE, not ISE members, would elect eight non-industry directors. In addition, Nasdaq's governance documents provide that Nasdaq members would have the right to elect 20% of Nasdaq's directors, while the holding

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256 Id. at 5 (citing Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (relating to the NYSE's business combination with Archipelago Holdings, Inc.) ("Release No. 53382")).

257 Id. at 6 (citing Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006)). NASD also stated that member representation on the New SRO Board is comparable to member representation on the Chicago Stock Exchange (twelve directors, of which five are members) and the International Securities Exchange (14 directors, of which six are members). Id.

258 See, e.g., Release No. 53705, supra note 249 (approving the proposal to allow ISE Holdings, Inc. to elect eight non-industry directors of ISE, the holders of PMM Rights to elect two directors of ISE, the holders of CMM Rights to elect two directors of ISE, and the holders of EAM Rights to elect two directors of ISE).

company for Nasdaq would have the right to elect the remaining directors.[259] The Commission does not believe that the statute's standard of fair representation requires that members have the opportunity to vote for all SRO directors.

3. Industry Representation

Several commenters argued that the New SRO Board lacks sufficient industry representation.[260] In contrast, one commenter argued that the New SRO Board would have too many industry representatives,[261] and other commenters supported the proposed balance between Industry Governors and Public Governors.[262] In response, NASD noted that the proposed governance structure ensures that at least 40% of the New SRO Board would be composed of industry representatives, which, according to the NASD, "ensures substantial industry representation, while still maintaining the overall independence of the New SRO Board and the numerical dominance of Public Governors."[263]

The Commission believes that the requirement that the number of Public Governors

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259 See Limited Liability Company Agreement of The NASDAQ Stock Market LLC, Section 9.

Similarly, the Board members of the Boston Options Exchange Regulation, LLC ("BOXR") are not directly elected by options participants at the Boston Options Exchange, LLC ("BOX"). BOXR's by-laws provide that all of the BOXR board of director positions are appointed by the Boston Stock Exchange, Inc. ("BSE") Board, subject to two of the positions on the BOXR board being nominated by BOX options participants. BOXR has regulatory oversight authority over BOX, which is the exchange facility for BSE for the trading of standardized equity options securities. BSE is the sole shareholder of BOXR. See Securities Exchange Release No. 49065 (January 13, 2004), 69 FR 2768 (January 20, 2004) (SR-BSE-2003-04) (approving the creation of BOXR).

260 See, e.g., Roberts Letter, Busacca Letter, Blumenschein Letter, Eitel Letter II, and Miller Letters.

261 See Massachusetts Letter.

262 See NAIBD Letter; see also FSI Letter.

263 See NASD Response Letter, supra note 5, at 5.

exceed the number of Industry Governors on the New SRO Board is consistent with the Exchange Act.[264] Specifically, the Commission believes that this requirement represents a reasonable method to permit the New SRO Board to consider the needs of the entire SRO community, including large and small investors, issuers, and securities firms, while at the same time broadly assuring the independence of the regulatory function. The Commission notes that under the by-laws of certain other SROs and the current NASD By-Laws, the number of non-industry Governors must equal or exceed the number of industry governors (excluding the CEO).[265] In fact, the Commission has previously stated its belief that the fair representation requirement would not prohibit exchanges and associations from having boards of directors composed solely of independent directors (other than the CEO), and that in such case, the candidate or candidates selected by members would have to be independent.[266]

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264 See New SRO By-Laws, Article VII, Section 4(a).

265 See, e.g., Philadelphia Stock Exchange ("Phlx") Certificate of Incorporation, Article FOURTH (b)(iii)(A) and Phlx By-Laws, Article I, Sections 1-1(o) and (p) and Article IV, Section 4-1 (providing that Phlx board will have a total of 23 governors, including twelve independent governors); and ISE Constitution, Article III, Section 3.2 (providing that the ISE Board will consist of 15 directors, including eight non-industry directors, of which two must be public representatives). Article VII, Section 4(a) of the current NASD By-Laws also provides that, if the number of Industry and Non-Industry Governors is 13–15, the Board shall include at least four Public Governors. If the number of Industry and Non-Industry Governors is 16–17, the Board shall include at least five Public Governors. If the number of Industry and Non-Industry Governors is 18–23, the Board shall include at least six Public Governors. In the instant proposal, NASD proposes to eliminate the Non-Industry Governor category and, thus, the New SRO Board would be composed of only Industry Governors, Public Governors, the CEO of the New SRO, and, during the Transitional Period, the CEO of NYSE Regulation.

266 See Release No. 53382, supra note 256.

The Commission previously approved NYSE Inc. governance changes that established a fully independent board (other than the CEO), finding that such a board was consistent with the Exchange Act. See Securities Exchange Act Release No. 48946 (December 17, 2003), 68 FR 74678 (December 24, 2003) (relating to the amendment and restatement of

4. Nominating Committee

The New SRO would have a Nominating Committee that, during the Transitional Period, would be responsible for nominating persons to fill vacancies in Governor positions for which the full New SRO Board has the authority to fill.[267] Following the Transitional Period, the Nominating Committee would be responsible for nominating persons for appointment or election to the New SRO Board, as well as nominating persons to fill vacancies in appointed or elected Governor positions.[268]

During the Transitional Period, the Nominating Committee would not nominate candidates for the seven Firm Governor positions to be elected at the first annual meeting following the Closing.[269] Instead, the NASD Board as constituted prior to the Closing would make nominations for the Small Firm Governors, the NYSE Group Board as constituted prior to the Closing would make nominations for the Large Firm Governors, and the NASD Board and NYSE Group Board jointly would make the nominations for the Mid-Size Firm Governor. In addition, prior to the Closing, the NASD Board and the NYSE Group Board would identify and appoint the eleven Public Governors and the three remaining Industry Governors. The Commission believes that the process for nominating the Industry Governors to be elected by the New SRO members at the first annual meeting, to be held during the Transitional Period, is a reasonable transitional measure that combines the input of the NASD Board (which includes

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the NYSE Constitution to reform the governance and management architecture of the NYSE).

267 See New SRO By-Laws, Article XXII, Section 3. During the Transitional Period, the full New SRO Board would have the authority to fill vacancies in the Investment Company Affiliate Governor position and in the Joint Public Governor position.

268 See New SRO By-Laws, Article VII, Section 9.

269 See New SRO By-Laws, Article XXII, Section 4.

member representatives) and the NYSE Group Board. Accordingly, the Commission finds that this transitional nominating process is consistent with the fair representation requirements of the Exchange Act.

The Nominating Committee would be composed of a number of Governors that is a minority of the entire New SRO Board.[270] During the Transitional Period, members of the Nominating Committee would be appointed jointly by the New SRO CEO and the CEO of NYSE Regulation as of Closing (or his duly appointed or elected successor as Chair of the New SRO Board), subject to ratification by the New SRO Board.[271] Following the Transitional Period, the composition of the Nominating Committee would be determined by the New SRO Board. The number of Public Governors on the Nominating Committee must equal or exceed the number of Industry Governors on the Nominating Committee.[272]

The Commission believes that, to satisfy the Exchange Act's fair representation requirement, the New SRO must assure that its members have a say in the nomination of Governors for the New SRO Board. Other SROs have satisfied this requirement by having at least 20% member representation on their nominating committees.[273] In this regard, NASD has committed that the Charter of the New SRO's Nominating Committee provides that at least 20%

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270 NASD represented that a minority of the entire New SRO Board means "at least one less than half of the New SRO Board." See NASD Response Letter, supra note 5, at 6. In addition, the number of Public Governors on the Nominating Committee must equal or exceed the number of Industry Governors on the Nominating Committee, and the New SRO CEO may not be a member of the Nominating Committee. See New SRO By-Laws, Article VII, Section 9(b).

271 See New SRO By-Laws, Article XXII, Section 1.

272 See New SRO By-Laws, Article VII, Section 9.

273 See, e.g., Securities Exchange Act Release No. 53734 (April 27, 2006), 71 FR 26589 (May 5, 2006) (SR-Phlx-2005-93); Phlx By-Laws Article X, Section 10-19(a).

of the Committee will be composed of Industry Governors that are associated with New SRO members.[274] The inclusion on the Nominating Committee of Industry Governors who are New SRO members should help to ensure that the input of members will be considered by the Nominating Committee when selecting nominee(s). Accordingly, the Commission finds that the structure and composition of the Nominating Committee are consistent with the fair representation requirements in Section 15A(b)(4) of the Exchange Act.

5. Petition Process

The New SRO By-Laws contain a petition process that would allow Small, Mid-Size, and Large Firms to nominate one or more candidates whose name(s) would be placed on the ballot in addition to the candidates selected by the Nominating Committee.[275] Specifically, a candidate could be included on the ballot if at least three percent of the members entitled to vote for such candidates' election (in other words, three percent of the members entitled to vote for the Small Firm Governor, Mid-Size Firm Governor, and Large Firm Governor, respectively) petitions for the inclusion of such candidate.[276] In the case of petitions in support of more than one candidate for a Governor position, petitions would be required to be submitted by at least ten percent of the members entitled to vote for such nominees' election. The New SRO By-Laws also provide that

274 See NASD Supplemental Response Letter, supra note 5, at 4.

275 See New SRO By-Laws, Article VII, Section 10.

276 The Secretary of the New SRO also would be required to certify that: (i) the petitions are duly executed by the Executive Representatives of the requisite number of members entitled to vote for such nominee's/nominees' election, and (ii) the candidate(s) satisfies/satisfy the classification (Large Firm, Mid-Size Firm or Small Firm) of the position(s) to be filled, based on such information provided by the candidate(s) as is reasonably necessary to make the certification. See New SRO By-Laws, Article VII, Section 10.

the New SRO would provide administrative support to the candidates in a contested election by sending up to two mailings of materials prepared by the candidates.

The Commission notes that other SROs also have comparable petition processes that allow their members to nominate opposing candidates.[277] The Commission finds that the proposed petition process, coupled with the New SRO By-Law provisions on Board and Nominating Committee composition, should help ensure that all New SRO members are assured fair representation in the selection of Governors of the New SRO Board and therefore is consistent with the Exchange Act.

6. Future By-Law Amendments

The New SRO By-Laws contain a provision that would give members a voice in proposing changes to the New SRO By-Laws.[278] Specifically, amendments to the New SRO By-Laws could be proposed by a Governor or a committee appointed by the New SRO Board or any 25 members of the New SRO by petition signed by such members. Any such proposed amendment would be required to be considered by the Board. The Board, upon adoption of any such amendment to the By-Laws (except as to spelling or numbering corrections or as otherwise provided in the By-Laws) by a majority vote of the Governors then in office, would be required to submit the proposed amendments to the New SRO's members for approval. If the amendment was approved by a majority of the members voting within 30 days after the date of submission to

277 See, e.g., ISE Constitution, Article III, Section 3.10 (providing that persons entitled to elect an ISE director also would be able to nominate rival candidates) and Phlx By-Laws, Article III, Section 3.7 (providing that Phlx member organizations will be permitted to make independent nominations for designated Phlx governors, which consist of the two member governors, the two designated independent governors, and the one Philadelphia Board of Trade governor)

278 See New SRO By-Laws, Article XVI, Section 1.

the membership, and were approved by the Commission as provided in the Exchange Act, it would then become effective as of a date prescribed by the Board. The Commission believes that the procedures governing amendments to the New SRO By-Laws should help ensure that all New SRO members are assured fair representation in the administration of the New SRO's affairs and therefore is consistent with the Exchange Act.

7. Member Participation on Committees

In addition, the Commission finds that New SRO members' participation on various committees further provides for the fair representation of members in the administration of the affairs of an SRO, particularly with respect to participation on committees relating to rulemaking and relating to the disciplinary process.[279] In this regard, NASD noted that New SRO will continue extensive member involvement in the administration of its affairs through representation on various subject matter committees, disciplinary hearing panels, and the National Adjudicatory Council.[280] Such member participation includes, depending on the particular Committee or group, having input on the New SRO's rulemaking process and involvement in the disciplinary process.[281]

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279 See Release No. 53382, supra note 256, at 11260 (stating that the Commission believes that members' participation on various committees, including the Market Performance Committee of the NYSE Market, and the Regulatory Advisory Committee and Committee for Review of NYSE Regulation, further provides for the fair representation of members in the administration of the affairs of the exchange, including rulemaking and the disciplinary process, consistent with Section 6(b)(3) of the Act).

280 See NASD Supplemental Response Letter, supra note 5, at 4.

281 Id.

B. Representation of Issuers and Investors

Section 15A(b)(4) of the Exchange Act[282] requires that the rules of an association provide that one or more directors be representative of issuers and investors and not be associated with a member of the association or with a broker or dealer. In the NASD Response Letter, NASD stated that it believes that the presence of no fewer than eleven Public Governors, none of which may have a material relationship with a broker or dealer or registered SRO, satisfies the requirement to have at least one director representative of issuers and investors.[283] The Commission believes that the inclusion of public, non-industry representatives on New SRO Board is critical to an SRO's ability to protect the public interest.[284] Further, public representatives help to ensure that no single group of market participants has the ability to systematically disadvantage other market participants through the SRO governance process. The Commission believes that the New SRO Board's Public Governors could provide unique, unbiased perspectives that could enhance the ability of the New SRO's Board to address issues in a non-discriminatory fashion.

The Commission finds that the composition of the New SRO Board is consistent with the issuer and investor representation requirement of Section 15A(b)(4) of the Exchange Act.[285]

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282 15 U.S.C. 78o-3(b)(4).

283 See NASD Response Letter, supra note 5, at 5.

284 See Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (stating that "representation of the public on an oversight body that has substantive authority and decision making ability is critical to ensure that an exchange actively works to protect the public interest and that no single group of investors has the ability to systematically disadvantage other market participants through use of the exchange governance process").

285 15 U.S.C. 78o-3(b)(4).

C. State Law, Proxy, and Other Issues Raised by Commenters[286]

NASD filed the proposed rule change on Form 19b-4, which provides, in Instruction E thereto, that "[t]he Commission will not approve a proposed rule change before the self-regulatory organization has completed all action required to be taken under its constitution, articles of incorporation, bylaws, rules, or instruments corresponding thereto. . . ."[287] In addition, Section 19(b)(2) of the Exchange Act[288] requires that the Commission approve an SRO's proposed rule change only if it finds that the proposal is consistent with the requirements of the Exchange Act, and the rules thereunder applicable to the SRO. Among other things, national securities associations are required under Section 15A(b)(2) of the Exchange Act[289] to comply with their own rules. Thus, if NASD has failed to complete all action required to be taken under, or to comply with, its own Certificate of Incorporation or By-Laws, which are rules of the association, the Commission could not approve the proposed rule change under Section 19 of the Exchange Act.[290]

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286 Commenters also stated that the regulatory consolidation would violate the antitrust laws. See supra Section III.B.5. With respect to the alleged violation of the antitrust laws, the Commission notes that NASD and NYSE Group filed notification reports with the Department of Justice and the Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and the waiting period for such a filing expired on April 6, 2007. See supra note 7.

287 17 CFR 249.819. However, the SRO is not required to complete all actions specified in any such constitution, articles of incorporation, bylaws, rules, or instruments with respect to (i) compliance with the procedures of the Exchange Act or (ii) the formal filing of amendments pursuant to state law prior to Commission approval. Id.

288 15 U.S.C. 78s(b)(2).

289 15 U.S.C. 78o-3(b)(2).

290 15 U.S.C. 78s.

A number of commenters expressed concern about the approval process for the proposed amendments to the NASD By-Laws.[291] Some of these commenters argued that NASD violated various aspects of Delaware law, particularly with respect to obtaining member approval within the 30-day timeframe as set forth in Article XVI of the NASD By-Laws.[292] Other commenters questioned the adequacy of the disclosures in the proxy statement, particularly with respect to the proposed $35,000 payment by NASD.[293] In addition, the plaintiff in the Standard Lawsuit, as well as another entity, Benchmark Financial Services, Inc., through their attorneys, submitted a comment letter contending that, from the perspective of an NASD member, the focus of the proxy statement was "the fundamental change in members' voting rights and the $35,000 that each member is to receive in exchange for 'surrendering' members' equity valued at as much as $300,000, or more, per NASD member."[294] Specifically, the Benchmark/Standard Letter II alleged an inconsistency between the statements in the proxy statement and the statements in the NASD Response Letter regarding the $35,000 payment[295] and concluded that "[t]he SEC cannot approve the $35,000 payment without determining whether the statements with respect to the

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291 See supra notes 106 through 134 and accompanying text.

292 See supra notes 131 through 134 and accompanying text.

293 See, e.g., Johnny Q Member Letters I & II, Benchmark/Standard Letters I & II, and Benchmark Letter.

294 See Benchmark/Standard Letter II.

295 The Benchmark/Standard Letter II noted that the proxy statement "unequivocally states that a payment larger than $35,000 'is not possible;' that it will be 'funded by – and therefore limited by – the expected value of the incremental cash flows that will be produced by the consolidation transaction' and that if the 'payment was higher, it could seriously jeopardize NASD's status as a tax-exempt organization.'" The Benchmark/Standard Letter II then stated that the discussion of the $35,000 payment in the NASD Response Letter – specifically the NASD's statement that the $35,000 "payments would fall within public IRS guidance, and the proxy statement made clear that the payments would be made by NASD" – is inconsistent with the proxy statement. See Benchmark/Standard Letter II.

Proxy Statement were truthful and complete."[296] The Benchmark/Standard Letter II also argued that the discussion of the $35,000 in the proposed rule change was inadequate because neither the proposed rule change nor the Notice "mentioned or invited comment from the public or NASD members about the $35,000 payment."[297] Accordingly, the Benchmark/Standard Letter II argued that the Commission "should disapprove the rule change, re-notice the issue properly or limit its findings to the issues it noticed."[298] The Benchmark/Standard Letter I also quoted a statement in the district court's opinion in the Standard Lawsuit in which the court responded to Standard's contention that its lawsuit should not be dismissed for failure to exhaust administrative remedies because the Commission is an unsuitable forum in which to challenge the truthfulness of the proxy statement. The letter quoted from the district court decision as follows:

> The Court is incredulous that the SEC would endorse proposed SRO rule changes that [as alleged in the Amended Complaint] were approved by the membership pursuant to a "proxy statement that could not possibly pass [muster] under the nation's securities laws and the disclosure requirements of the SEC's own rules (see, e.g., § 14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 promulgated thereunder by the SEC and applicable Supreme Court precedent)." (Am. Compl. ¶ [4])[299]

To the extent the Benchmark/Standard Letters suggested that the proxy statement delivered by the NASD to its members was not in compliance with the federal securities laws,

296 See Benchmark/Standard Letter II.

297 Id.

298 Id.

299 See Benchmark/Standard Letter I (quoting Standard Lawsuit, 2007 WL 1296712 at *8) (first alteration added in the Benchmark/Standard Letter I, second alteration in court decision, third alteration added here to correct the Benchmark/Standard Letter I's omission of paragraph number).

the Commission notes that Rule 14a-9 under the Exchange Act[300] applies only to the solicitation of proxies with respect to securities registered pursuant to Section 12 of the Exchange Act and that none of the membership interests in NASD are so registered.[301]

Whether an SRO failed to complete all action required to be taken under its constitution, articles of incorporation, bylaws, rules, or similar instruments ordinarily is not an issue before the Commission at the time it considers whether to approve a proposed rule change. However, in instances where there is a dispute about whether the SRO has failed to complete all necessary action prior to Commission approval, or where there is an alleged defect in such action, the Commission generally requests the SRO to supplement the proposed rule change to address issues raised by commenters. Accordingly, the Commission requested that NASD provide additional information about the disclosures regarding the $35,000 payment noted in the proxy statement, as well as about the fact that the time period between the submission of the proxy statement to members and the vote by members exceeded 30 days.

In response to the Commission's request, NASD submitted a supplemental response letter providing additional information about its disclosures in the proxy statement regarding the $35,000 payment and the propriety of its decision to call a special meeting of members to amend the NASD By-Laws.[302] Specifically, NASD stated that "the proxy materials accurately state that member payments in excess of $35,000 would not be possible because such a payment, without the IRS's approval, could 'seriously jeopardize' NASD's tax-exempt status."[303] In support of its

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300 See 17 CFR 240.14a-9.

301 See also Rule 14a-2 under the Exchange Act, 17 CFR 240.14a-2.

302 See NASD Supplemental Response Letter, supra note 5.

303 See NASD Supplemental Response Letter, supra note 5, at 3.

contention, NASD stated that Section 501(c)(6) of the Internal Revenue Code and its Certificate of Incorporation prohibit it from paying any dividends to its members.[304] NASD explained that any member payments in connection with the Transaction are "based on (and limited by) expected future incremental cash flows that would result from the regulatory consolidation."[305] Therefore, based on "public IRS guidance, the terms of the initial agreement between NASD and NYSE Group, Inc., and the importance of preserving NASD's tax-exempt status, NASD concluded that $35,000 was the maximum member payment that the IRS could be expected, with a sufficient degree of confidence, to approve within the timeframe contemplated for the transaction."[306] NASD stated that it reached this conclusion, and decided to request the IRS's approval of the regulatory consolidation with a $35,000 payment, "through the exercise of business judgment by its disinterested Board of Governors."[307] According to NASD, NASD Board members "fully informed themselves concerning the economics of the transaction (in particular the projected cost savings), the practical need for IRS approval, and the likelihood of obtaining that approval before determining that $35,000 was the maximum sum for which NASD

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304 Id. In response to the statement that NASD members would be "surrendering' members' equity valued at as much as $300,000" in the Benchmark Standard Letter II, NASD stated that the "combined effect of the prohibition against inurement to members of a tax-exempt organization (as outlined in [DPW Letter, supra note 5]) and of the certificate provision [which states that 'no part of its net revenues or earnings shall inure to the benefit of any individual, subscriber, contributor, or member'] (as described in [the RLF Letter, supra note 5]) makes such an 'equity' distribution impermissible." See NASD Supplemental Response Letter, supra note 5, at 2.

305 See NASD Supplemental Response Letter, supra note 5, at 2.

306 Id. at 3.

307 Id. at 3. NASD stated that (a) a majority of the NASD Board is drawn from outside the securities industry, (b) no NASD Board member had any material conflict in connection with the proposed regulatory consolidation; and (c) no NASD Board member was dominated by anyone else with such a conflict. Id.

could seek and expect to obtain approval from the IRS" and that "the Board's decision was taken in good faith and in full compliance with the Board members' fiduciary duties, and the resulting business judgment is entitled to deference."[308] NASD then noted that, pursuant to this business judgment, "NASD requested a private letter ruling from the IRS approving the proposed regulatory consolidation, including a one-time payment [of $35,000] . . . based on the expected future incremental cash flows, examined in conjunction with other costs attributable to the transaction (including future dues rebates to be considered annually by the NASD Board over the following five years)."[309] NASD further noted that "[i]t was on this basis that the IRS agreed to issue such a ruling."[310] Thus, NASD believes that the proxy materials accurately stated that payments in excess of $35,000 per member would not be possible because any such payment, without IRS approval, could "seriously jeopardize" NASD's tax-exempt status.[311]

In addition, NASD furnished two opinions of outside counsel, one from NASD's tax counsel[312] and one from NASD's Delaware counsel.[313] With respect to the $35,000 member payment and pertinent to the commenters' argument that NASD could pay members more than $35,000 based on "member's equity valued at as much as $300,000, or more, per NASD member,"[314] NASD's outside tax counsel described generally the case law, statutory provisions, and guidance published by the IRS relevant to the disclosure in the NASD's proxy statement.

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308 Id.

309 Id.

310 Id.

311 Id.

312 See DPW Letter, supra note 5.

313 See RLF Letter, supra note 5.

314 See supra note 304.

This letter concluded that if NASD had increased the amount of the proposed $35,000 payment, there would have been a serious risk that the IRS would not have issued the rulings to NASD and NASD Regulation, Inc. that the proposed Transaction, which includes the $35,000 payment, would not affect the tax-exempt status of NASD and NASD Regulation. This letter stated that NASD "could be found to violate the prohibition against private inurement if it went forward with the proposed [$35,000 payment] without the benefit of a ruling."[315] Specifically, NASD's outside tax counsel noted that "tax law contains an absolute prohibition on a distribution of assets by tax exempt organizations, including the NASD, to their members" but that there are limited exceptions to that prohibition for rebates of dues or fees,[316] distributions upon liquidation, and reasonable and appropriate expenses.[317] NASD's outside tax counsel discussed each exception and concluded that "[n]one of these exceptions clearly authorizes the proposed [$35,000 payment]" and that "the only way that NASD could make the proposed [$35,000 payment] was by securing a private letter ruling from the IRS."[318] With respect to the determination of the amount of the payment to members, NASD's outside tax counsel stated that the proposed payment "was supported economically by the present value of the expected

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315 See DPW Letter, supra note 5, at 4-5.

316 NASD's outside tax counsel noted that "[a]lthough the aggregate amount of the proposed Member Payments fits within the amount of allowable rebates, the rebate exception does not squarely apply here because a $35,000 payment would far exceed the $1,200 of current-year paid-in dues of those NASD members subject to the lowest annual payments" and "[u]nder the published rulings, a payment of $35,000 could not be made to those small members without risking the loss of NASD's tax exemption." Thus, based on these published rulings, if NASD had utilized the rebate of dues and fees exception, small-firm members would receive a rebate in the range of $1,200, while large-firm members would receive a much larger rebate. Id. at 3.

317 Id. at 1-4.

318 Id. at 1-2.

incremental future cash flows attributable to the Proposed Transaction after taking into account transaction costs, including future rebates and other reductions in fees that were described in the Proxy Statement."[319] Thus, according to NASD's outside tax counsel, the IRS approved the proposed Transaction, including the payment, "because of (i) the importance of the payment to the Proposed Transaction as a whole; (ii) the financial data presented by NASD explaining that the amount of the [$35,000 payment] is expected to be paid out of the value of expected incremental future cash flows, rather than the value of NASD's equity; and (iii) the unique facts and circumstances of the Proposed Transaction, including the [$35,000 payment]."[320]

NASD's outside Delaware counsel addressed both the comment that a larger member payment could have been made based on "member's equity" and the comment that NASD should have obtained approval of the By-Law amendments within the 30-day timeframe as set forth in Article XVI of the NASD By-Laws.[321] With respect to the $35,000 payment, NASD's outside Delaware counsel stated that the language in Article 4 of NASD's Certificate of Incorporation tracks that of the Internal Revenue Code in that no part of the organization's net earnings may inure to the benefit of any private shareholder or individual.[322] NASD's outside Delaware counsel stated that any action in contravention of the Internal Revenue Code's prohibition on inurement would also be in contravention of the prohibition against inurement set forth in NASD's Certificate of Incorporation and thus would be void under Delaware law.[323] With respect to the 30-day timeframe, NASD's outside Delaware counsel confirmed NASD's

319 Id. at 4.

320 Id. at 4-5.

321 See RLF Letter, supra note 5.

322 Id. at 4-5.

323 Id. at 5.

analysis that Article XVI of the NASD By-Laws provides a non-exclusive means by which member approval of amendments to the By-Laws can be obtained.[324]

The Commission ordinarily does not make determinations regarding state law issues but, when required to do so because state law necessarily informs its findings under the Exchange Act, it relies on the conclusions of experts or other authorities. In this regard, the Commission has relied on analysis by NASD's Delaware counsel that the vote of NASD's members at the special meeting approving the proposed amendments to the By-Laws "was a valid exercise of the Member's franchise rights and authorized by Delaware law."[325] With respect to the adequacy of the proxy statement, the Commission has considered the NASD's explanation regarding the proxy statement's representations about the $35,000 payment. The Commission believes that NASD has made a prima facie showing that these representations were not misleading and that NASD's explanation is uncontradicted by the commenters' submissions regarding this matter. Accordingly, after reviewing the record in this matter, the Commission believes that NASD has provided sufficient basis on which the Commission can find that, under the Exchange Act, NASD complied with its Certificate of Incorporation and By-Laws with respect to the proxy approval process and that the proposed amendments to its By-Laws were properly approved by NASD members.

D. Approval of NASD Regulation By-Laws

The NASD Regulation By-Laws contain provisions that conflict with the proposed amendments to the NASD By-Laws.[326] Accordingly, NASD proposes to conform those

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324 See RLF Letter and NASD Response Letter, supra note 5.

325 See RLF Letter, supra note 5.

326 See Section II.D.6, supra, for a description of these provisions.

provisions of the NASD Regulation By-Laws to the relevant provisions in the New SRO By-Laws. Because the proposed NASD Regulation By-Law changes conform to and reflect the proposed governance structure set forth in the New SRO By-Laws, the Commission finds that the amendments to the NASD Regulation By-Laws are consistent with the Exchange Act.

E. Efficiency and Investor Protection

Some commenters explicitly questioned the benefits of the proposed consolidation,[327] and other commenters noted that having one less regulator overseeing the securities firms that deal with the public would harm investors.[328] NASD stated that the consolidation is intended, among other things, to increase efficient, effective, and consistent regulation of securities firms, provide cost savings to securities firms of all sizes, and strengthen investor protection and market integrity. NASD also stated that the consolidation would streamline the broker-dealer regulatory system, combine technologies, and permit the establishment of a single set of rules and a single set of examiners with complementary areas of expertise within a single SRO. The Commission believes that NASD's expectations are reasonable. In the Commission's view, the consolidation of NASD and NYSE member firm regulation is intended to help reduce unnecessary regulatory costs while, at the same time, increase regulatory effectiveness and further investor protection. The Commission notes that the Transaction holds the potential to reduce unnecessary regulatory costs because New SRO firms would deal with only one group of examiners and one enforcement staff for member firm regulation.

327 See RKeenan Letter I, Mayfield Letter, and Schooler Letter.

328 See King Letter, Eitel Letter II, de Leeuw Letter, Elish Letter, Patterson Letter, Biddick Letter, and Massachusetts Letter.

F. Arbitration

Section 15A(b)(6) of the Exchange Act[329] provides that the rules of an association must be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission finds that NASD's proposal to consolidate the NASD and NYSE arbitration forums is consistent with the Act because it will maintain a fair arbitration forum available for all NYSE arbitration claims, while continuing to maintain a fair forum for NASD claims and claims that it already administers on behalf of other SROs.[330] Merging the NYSE arbitration program with the NASD arbitration program takes advantage of economies of scale, particularly in light of the NYSE's comparatively small caseload. Moreover, as NASD noted, it has a decade of experience in administering arbitrations on behalf of other SROs.

Commenters' suggestions for creating a separate securities arbitration forum, or providing that public investors may choose between resolving their disputes in court or in arbitration, are outside the scope of the proposed rule change. The Commission notes, however, that the Supreme Court upheld the use of pre-dispute arbitration agreements to resolve securities disputes in Shearson/American Express, Inc. v. McMahon[331] and subsequent cases.

NASD has the ability to impose sanctions against its members for failing to submit a dispute to arbitration, failing to comply with provisions of the NASD Code of Arbitration

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329 15 U.S.C. 78o-3(b)(6).

330 In considering proposed arbitration rules and rule changes, the Commission considers their effect on the fairness of the forum. See generally Securities Exchange Act Release No. 55158 (January 24, 2007). See also Section 15A(b)(6) of the Exchange Act.

331 482 U.S. 220 (1987).

Procedure for Customer Disputes, and failing to honor an award.[332] In light of the policy supporting arbitration evinced by the Federal Arbitration Act[333] and Supreme Court precedent upholding securities industry arbitration agreements,[334] and the requirements of Section 19(b)(2) of the Exchange Act, the Commission cannot find as a matter of law that consolidation of the NASD and NYSE arbitration forums must be conditioned on providing customers with a choice of another dispute resolution forum.

NASD has committed to consider the comments regarding the use of dispositive motions in connection with its pending rule filing in this area.[335] With respect to other comments concerning the classification of arbitrators, NASD stated that it is working with the NYSE to

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332 NASD Rule IM-12000.

333 9 U.S.C. 1-14.

334 In 1987, the Supreme Court decided Shearson/American Express, Inc. v. McMahon, 482 U.S. 222 (1987), which determined that customers who sign predispute arbitration agreements with their brokers may be compelled to arbitrate claims arising under the Exchange Act. In a companion case, Perry v. Thomas, 482 U.S. 483 (1987), the Court concluded that an employee of a broker-dealer could be compelled to arbitrate disputes by virtue of the employee having signed a Form U-4 and because the NYSE had rule in place requiring arbitration. Two years later, the Supreme Court applied the reasoning of McMahon to compel arbitration of claims arising under the Securities Act of 1933. Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989).

Thereafter, in Gilmer v. Interstate/Johnson Lane, Corp., 500 U.S. 20 (1991), the Supreme Court determined that statutory civil rights claims may be subject to compulsory arbitration, provided that a valid arbitration agreement exists between the registered representative and the firm. Specifically, the Gilmer Court stated that "by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum." Id. at 26 (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985)). The Court stressed that "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function.'" Id. at 28 (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 (1985)).

335 NASD Dispute Resolution Letter II, supra note 5.

harmonize their rules and that any resulting rule changes will be filed for Commission consideration, subject to notice and comment.[336]

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change (SR-NASD-2007-023) is approved.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

336 Id.

EXHIBIT A

List of Comment Letters as of July 16, 2007

1. Letter from Franco Mortarotti, Zermatt Capital Management, dated December 11, 2006 ("Mortarotti Letter").

2. Letter from Samuel F. Lek, Lek Securities Corporation, to Christopher Cox, Chairman, Commission, dated December 15, 2006 ("Lek Letter").

3. Letter from Mary S. Darcy, Managing Partner, The Darcy Group LLC, dated December 21, 2006 ("Darcy Letter").

4. Letter from Michael Jordan, Control Officer/Securities Industry, dated April 4, 2007 ("Jordan Letter").

5. Letter from Joseph Kosinsky, NASD Member, dated April 2, 2007 ("Kosinsky Letter").

6. Letter from Judith Schapiro, dated March 30, 2007 ("Judith Schapiro Letter").

7. Letter from Daniel W. Roberts, NASD District One Committee Member, dated March 29, 2007 ("Roberts Letter").

8. Letter from Charles Botzum, III, dated March 29, 2007 ("Botzum Letter").

9. Letter from John B. Busacca, III on behalf of North American Clearing, Inc., The Financial Industry Association, dated March 28, 2007 ("Busacca Letter").

10. Letters from Robert Keenan, CEO, St Bernard Financial Services, Inc., dated March 28, 2007 and April 13, 2007 ("RKeenan Letter I" and "RKeenan Letter II," respectively).

11. Letter from Bob and Linda King, dated April 7, 2007 ("King Letter").

12. Letter from Joel Blumenschein, President, EZ Stocks, Inc., dated March 29, 2007 ("Blumenschein Letter").

13. Letter from Peter J. Chepucavage, General Counsel, Plexus Consulting, dated March 26, 2007 (on behalf of the International Association of Small Broker Dealers and Advisers) ("IASBDA Letter").

14. Letter from Donald R. Hawks, Commander, Retired, USN; President, Registered Principal, Alpha Business Control Systems Inc., dated March 28, 2007 ("Hawks Letter").

15. Letter from the Public Members of the Securities Industry Conference on Arbitration to Christopher Cox, Chairman, Commission, dated January 12, 2007 ("SICA Public Members Letter").

16. Letter from Gretchen Harriman-Thiessen to Christopher Cox, Chairman, Commission, dated April 4, 2007 ("Harriman-Thiessen Letter").

17. Letters from Les Greenberg, Attorney, Law Offices of Les Greenberg, to Nancy M. Morris, Secretary, Commission, dated April 8, 2007 and April 11, 2007 ("Greenberg Letter I" and "Greenberg Letter II," respectively).

18. Letter from Ari Gabinet, Principal, Securities Regulation, The Vanguard Group, Inc., to Nancy M. Morris, Secretary, Commission, dated April 11, 2007 ("Vanguard Letter").

19. Letter from Douglas W. Schriner, CEO, Harrison Douglas, Inc., dated April 11, 2007 ("Schriner Letter").

20. Letter from Gary L. Flater, CEO, dated April 12, 2007 ("Flater Letter").

21. Letter from Chester Hebert, President, CIM Securities, LLC, to the Commissioners, dated April 12, 2007 ("Hebert Letter").

22. Letter from Luke C. Schunk, Registered Representative, dated April 12, 2007 ("Schunk Letter").

23. Letter from Eric B. Arnold, President, Fenwick Securities, Inc., dated April 12, 2007 ("Arnold Letter").

24. Letter from Kevin J. High, Managing Director, dated April 12, 2007 ("High Letter").

25. Letters from Mary M. Eitel dated April 12, 2007 and April 16, 2007 ("Eitel Letter I" and "Eitel Letter II," respectively).

26. Letter from Martin J. Cohen, dated April 12, 2007 ("Cohen Letter").

27. Letter from Sennett Kirk, Kirk Securities Corporation, dated April 12, 2007 ("Kirk Letter").

28. Letter from Alan Vande Weerd, CFP, Eagle One Investments, LLC, dated April 12, 2007 ("Vande Weerd Letter").

29. Letters from Jack D. Jester, to Nancy M. Morris, Secretary, Commission, dated April 5, 2007 and June 4, 2007 ("Jester Letter I" and "Jester Letter II," respectively).

30. Letter from Francis D. de Leeuw, dated April 13, 2007 ("de Leeuw Letter").

31. Letter from Jerome S. Keenan, Vice President, International Equities Services Inc., dated April 13, 2007 ("JKeenan Letter").

32. Letter from Wayne A. Schultz, Esq., dated April 13, 2007 ("Schultz Letter").

33. Letter from Peter M. Elish, President, Elish Elish, Inc., dated April 13, 2007 ("Elish Letter").

34. Letter from Edward A. H. Siedle, President, Benchmark Financial Services, Inc., to Christopher Cox, Chairman, Commission, dated April 13, 2007 ("Benchmark Letter").

35. Letter from Jonathan W. Cuneo, and Richard D. Greenfield, dated May 4, 2007 and June 11, 2007, with attachments ("Benchmark/Standard Letter I" and "Benchmark/Standard Letter," respectively, and, collectively, the "Benchmark/Standard Letters").

36. Letter from Tom Hanson, VP of Operations and Compliance, dated April 13, 2007 ("Hanson Letter").

37. Letter from Warren R. Horney, Vice President, WFP Securities Corporation, dated April 13, 2007 ("Horney Letter").

38. Letter from Dan Mayfield, dated April 13, 2007 ("Mayfield Letter").

39. Letter from Sam P. Solomon, dated April 13, 2007 ("Solomon Letter").

40. Letter from Ronald Patterson, President, Southcoast Investment Group Inc., to Christopher Cox, Chairman, Commission, dated April 13, 2007 ("Patterson Letter").

41. Letter from Steven B. Caruso, President, Public Investors Arbitration Bar Association, dated April 16, 2007 ("Caruso Letter").

42. Letter from Mark S. Casady, Chairman and Chief Executive Officer, Linsco/Private Ledger Financial Services, to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Casady Letter").

43. Letter from Charlie Cray, Director, Center for Corporate Policy, dated April 16, 2007 ("Cray Letter").

44. Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("SIFMA Letter").

45. Letter from I. P. Daily, dated April 15, 2007 ("Daily Letter").

46. Letter from Albert Kramer, President of Kramer Securities Corporation, dated April 16, 2007 ("Kramer Letter").

47. Letter from E. John Moloney, President and Chief Executive Officer, Moloney Securities Co., Inc., dated April 16, 2007 ("Moloney Letter").

48. Letter from David Stringer, President, Prospera Financial Services, Inc., to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Stringer Letter").

49. Letter from Deborah Castiglioni, Chief Executive Officer, Cutter & Company, to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Castiglioni Letter").

50. Letter from Bonnie K. Wachtel, dated April 16, 2007 ("Wachtel Letter").

51. Letter from Lisa Roth, Chairman, National Association of Independent Broker/Dealers ("NAIBD"), to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("NAIBD Letter").

52. Letter from William C. Alsover, Chairman, Centennial Securities Company, LLC, to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Alsover Letter").

53. Letter from Craig M. Biddick, President, Mission Securities Corp., dated April 16, 2007 ("Biddick Letter").

54. Letter from Donald R. Penrod, President, Penrod and Company, dated April 16, 2007 ("Penrod Letter").

55. Letter from Howard Spindel, Senior Managing Director, Integrated Management Solutions USA, LLC, to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Spindel Letter").

56. Letter from William A. Johnstone, President and CEO, D.A.Davidson & Co., to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Johnstone Letter").

57. Letter from David Isolano, Chief Executive Officer, Max International Broker Dealer Corp., dated April 16, 2007 ("Isolano Letter").

58. Letters from Kathryn L. Lundgren, dated April 16, 2007 ("Lundgren Letter I") and April 17, 2007 ("Lundgren Letter II").

59. Letter from Gary L. Haney, Chief Executive Officer, United Insurance Group, Inc., dated April, 14, 2007 ("Haney Letter").

60. Letter from John E. Schooler, President, WFP Securities, dated April, 13, 2007 ("Schooler Letter").

61. Letter from Corey N. Callaway, President, Callaway Financial Services, Inc., dated April 13, 2007 ("Callaway Letter").

62. Letters from Johnny Q Member, to Nancy M. Morris, Secretary, Commission, dated April 16, 2007, with attachments ("Johnny Q Member Letter I" and "Johnny Q Member Letter II," respectively).

63. Letter from John Q., NASD Member, dated April 13, 2007 ("John Q Letter").

64. Letters from Mike Miller, President, Miller Financial Corp., dated April 15, 2007, with attachment ("Miller Letters" collectively).

65. Letter from Dale E. Brown, Executive Director and CEO, Financial Services Institute, to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("FSI Letter").

66. Letter from William R. Pictor, President, Trubee, Collins & Co., Inc., to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Pictor Letter").

67. Letter from Walter S. Robertson, III, President and CEO, Scott & Stringfellow, Inc., to Nancy M. Morris, Secretary, Commission, dated April 16, 2007 ("Robertson Letter").

68. Letter from M. LaRae Bakerink, CEO, WBB Securities, LLC, to Christopher Cox, Chairman, Commission, dated April 16, 2007 ("Bakerink Letter").

69. Letter from William F. Galvin, Secretary of the Commonwealth, Commonwealth of Massachusetts, to Nancy M. Morris, Secretary, Commission, dated April 18, 2007 ("Massachusetts Letter").

70. Letter from Joseph P. Borg, President, North American Securities Administrators Association, Inc., and Director, Alabama Securities Commission, to Nancy M. Morris, Secretary, Commission, dated April 17, 2007 ("NASAA Letter").

71. Letter from Joan Hinchman, Executive Director, President and CEO, National Society of Compliance Professional Inc., to Nancy M. Morris, Secretary, Commission, dated April 26, 2007 ("NSCP Letter").

72. Letter from Michael J. Mungenast, CEO and President, Proequities, to Nancy M. Morris, dated April 23, 2007 ("Mungenast Letter").

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56146; File No. SR-NASD-2007-053)

July 26, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to the Restated Certificate of Incorporation of National Association of Securities Dealers, Inc.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on July 24, 2007, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change to amend the Restated Certificate of Incorporation of NASD ("Certificate") as described in Items I and II below, which Items have been substantially prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is simultaneously approving the proposal on an accelerated basis.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD proposes to amend its Certificate to reflect the governance and related changes proposed by NASD to accommodate the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. and to conform the Certificate to the amended NASD By-Laws. The proposed amendments to the Certificate also reflect NASD's change in corporate name to Financial Industry Regulatory Authority, Inc. ("FINRA") as of the closing of the Transaction (defined below). The text of the proposed rule change, including the Certificate, is available at NASD, the Commission's Public Reference Room, and http://nasd.complinet.com.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

On November 28, 2006, NASD and the NYSE Group, Inc. ("NYSE Group") announced a plan to consolidate their member regulation operations into a combined organization ("Transaction") that will be the sole U.S. private-sector provider of member firm regulation for securities firms that conduct business with the public. This consolidation will streamline the broker-dealer regulatory system, combine technologies, permit the establishment of a single set of rules and group examiners with complementary areas of expertise in a single organization—all of which will serve to enhance oversight of U.S. securities firms and help ensure investor protection. Moreover, NASD notes that the new organization will be committed to reducing regulatory costs and burdens for firms of all sizes through greater regulatory efficiency.

On January 19, 2007, NASD held a special meeting of the members of NASD eligible to vote on amendments to the NASD By-Laws. A quorum of members entitled to vote on the matter was present, in person or by proxy, at such meeting, and a majority of the quorum approved the amendments to the NASD's By-Laws. On March 19, 2007, NASD filed with the Commission a proposed rule change to amend the NASD By-Laws to implement the governance and related changes to accommodate the consolidation of the member regulatory functions of NASD and NYSE Regulation, Inc.[3]

The purpose of this proposed rule change is to make the necessary amendments to the Certificate to reflect the governance and related changes in connection with the Transaction, the related changes to the NASD By-Laws, and NASD's change in corporate name to FINRA as of the date of closing of the Transaction.[4]

The effective date of the proposed rule change will be the closing of the Transaction. The proposed rule change will not become effective if the Transaction does not close.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,[5] including Section 15A(b)(2) of the Act,[6] in that it will permit FINRA to carry out the purposes of the Act, to comply with the Act, and to enforce compliance by FINRA

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3 See Securities Exchange Act Release No. 55495 (March 20, 2007), 72 FR 14149 (March 26, 2007) (SR-NASD-2007-023). Today, the Commission approved the amendments to NASD's By-Laws proposed in connection with the Transaction. See Securities Exchange Act Release No. 56145 (July 26, 2007) ("Release No. 34-56145").

4 Article XXII, Section 3 of the NASD By-Laws, as amended in Release 34-56145, supra note 3, addresses the term of office of Governors for a transitional period commencing on the date of closing of the Transaction and ending on the third anniversary of the date of closing. Among other things, Article XXII, Section 3 provides that ". . . in the event the remaining term of office of any Large Firm, Mid Size Firm or Small Firm Governor position that becomes vacant is for more than 12 months, nominations shall be made as set forth above in this paragraph, but such vacancy shall be filled by the members entitled to vote thereon at a meeting thereof convened to vote thereon (emphasis added)." Article Eleventh of the Certificate does not reiterate the applicable nomination process in such instances, insofar as the text solely restates those persons entitled to make nominations as reflected elsewhere in Article Eleventh. In short, in filling any such vacancies, NASD represents that the nominations will be made in accordance with the provisions of Article XXII, Section 3 of the amended NASD By-Laws.

5 15 U.S.C. 78o-3.

6 15 U.S.C. 78o-3(b)(2).

members, and persons associated with FINRA members, with the Act, the rules and regulations thereunder, and FINRA rules.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2007-053 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2007-053. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2007-053 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission Findings

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.[7] Specifically, the Commission believes that the proposal is consistent with Section 15A(b)(2) of the Act[8] in that it will permit FINRA to be so organized to carry out the purposes of the Act, to comply with the Act and to enforce compliance by FINRA members and persons associated with members with the Act, the rules and regulations thereunder, and FINRA rules. Further, the Commission finds that the proposed rule change is consistent with Section

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7 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

8 15 U.S.C. 78o–3(b)(2).

15A(b)(6) of the Act[9] in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The proposed rule change amends the Certificate to conform to the changes in the NASD By-Laws that the Commission is approving today, and to reflect the NASD's new name, FINRA.[10] Specifically, the amended Certificate incorporates the governance structure in FINRA's By-Laws, as approved today, including with respect to the three-year transitional period and thereafter. The proposed revisions to the Certificate do not make changes to the governance of FINRA not already contemplated by the proposed changes to FINRA's By-Laws, which were published for comment and approved by the Commission.[11] The Commission believes that the proposed changes to the Certificate are consistent with the Act.

The Commission finds good cause to approve the proposal prior to the thirtieth day after the proposal was published for comment in the Federal Register. This approval allows the proposed rule change to take effect without delay. The proposed revisions to the Certificate do not make changes to the governance of FINRA not already contemplated by the proposed changes to FINRA's By-Laws, which were published for comment and approved by the Commission.[12] Therefore, interested persons were provided the opportunity to submit comments on essentially identical changes. For this reason, the Commission finds good cause, consistent with Section 19(b)(2) of the Act, to grant accelerated approval to the proposed changes to the Certificate.

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9 15 U.S.C. 78o-3(b)(6).

10 See Release No. 34-56145, supra note 3.

11 Id.

12 Id.

The Commission finds good cause, consistent with Section 19(b)(2) of the Act, to grant accelerated approval to the proposed change of the NASD's name to FINRA because it is technical and does not impact members or other market participants.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-2007-053) is hereby approved on an accelerated basis.[13]

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

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[13] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56147; File No. SR-NASD-2007-054)

July 26, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Incorporate Certain NYSE Rules Relating to Member Firm Conduct

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on July 24, 2007, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change to incorporate into its rulebook certain rules of the New York Stock Exchange LLC ("NYSE") relating to the regulation of member firm conduct ("Incorporated NYSE Rules") as described in Items I and II below, which Items have been substantially prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is simultaneously approving the proposal on an accelerated basis.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

In connection with the proposed transaction to combine the member regulation operations of NASD and NYSE into a single organization ("Transaction"), NASD proposes to add the Incorporated NYSE Rules to its rules. As discussed below, the Incorporated NYSE Rules will apply solely to members of the Financial Industry Regulatory Authority, Inc. ("FINRA")[3] that

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 In connection with the Transaction, NASD will change its corporate name to FINRA as of the date of closing of the Transaction ("Closing"). See Securities Exchange Act Release No. 56146 (July 26, 2007) (changing the name of NASD to FINRA in the Restated Certificate of Incorporation).

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also are members of NYSE ("Dual Members") on or after the date of closing ("Closing") of the Transaction. The text of the proposed rule change, including the list of the Incorporated NYSE Rules, is available at NASD, the Commission's Public Reference Room, and http://nasd.complinet.com.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Currently, both NASD and NYSE Regulation, Inc. ("NYSE Regulation")[4] oversee the activities of U.S.-based broker-dealers doing business with the public, approximately 170 of which are regulated by both organizations. According to NASD, the result is a duplicative, sometimes conflicting system that makes inefficient use of resources and, as such, can be detrimental to the ultimate goal of investor protection.

NASD states that it has long supported the adoption of a hybrid model of self-regulation, with one self-regulatory organization ("SRO") having responsibility for all member firm regulation.[5] NASD further notes that, at the same time, the Commission, Congress, securities

4 NYSE Regulation is a wholly-owned subsidiary of NYSE.

5 See NASD comment letter dated March 15, 2005 in response to the SEC's Concept

firms and independent observers have long encouraged greater efficiencies, clarity and cost savings in the regulation of the U.S. financial markets.

With these goals in mind, on November 28, 2006, NASD and the NYSE Group, Inc. ("NYSE Group") announced a plan to consolidate their member regulation operations into a combined organization that will be the sole U.S. private-sector provider of member firm regulation for securities firms that conduct business with the public.[6] This consolidation is intended to streamline the broker-dealer regulatory system, combine technologies, and permit the establishment of a single set of rules and group examiners with complementary areas of expertise in a single organization—all of which will serve to enhance oversight of U.S. securities firms and help ensure investor protection. Moreover, NASD notes that the new organization will be committed to reducing regulatory costs and burdens for firms of all sizes through greater regulatory efficiency.

Incorporation of NYSE Conduct Rules – General

NASD represents that FINRA will work expeditiously to consolidate the rules that apply to its member firms, reducing to one the two sets of rules currently applicable to Dual Members. During an interim period, however, until the approval of a consolidated rulebook, NASD is proposing to incorporate into FINRA's rulebook the Incorporated NYSE Rules.[7] The

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Release Concerning Self-Regulation, Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) (File No. S7-40-04).

6 Today, the Commission approved the amendments to the NASD's By-Laws proposed in connection with the Transaction. Securities Exchange Act Release No. 56145 (July 26, 2007).

7 The text of the Incorporated NYSE Rules, as of the effective date of the proposed rule change, will be available on the FINRA Web site. To the extent the Commission has approved an amendment to an Incorporated NYSE Rule that has not yet become effective prior to the closing of the Transaction, NASD is proposing to incorporate any such amendment into FINRA's rulebook (with such amendment becoming effective upon its

Incorporated NYSE Rules will apply solely to Dual Members until such time as FINRA adopts, subject to Commission approval, consolidated rules applicable to all of its members.[8]

The proposed rule change would incorporate those NYSE rules pertaining to the regulation of member firm conduct.[9] In applying the Incorporated NYSE Rules to Dual Members, FINRA also would incorporate the related interpretative positions set forth in the NYSE Rule Interpretations Handbook and NYSE Information Memos.

Importantly, under the proposed rule change, there would be no new rule requirements placed on member firms as a result of the Transaction. Until the adoption of a consolidated rulebook by FINRA, those members that are NASD-only members as of the date of the Closing would continue to comply with NASD (and not NYSE) rules; those members that were Dual Members as of the date of Closing would continue to be subject to NASD and NYSE rules; and NYSE members that were not also members of NASD as of the date of Closing ("NYSE-only members") would continue to comply with NYSE (and not NASD) rules, provided that any such NYSE-only member does not engage in any activities that would require it to be an NASD

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scheduled effective date). In the event the NYSE were to file a proposed rule change to amend an NYSE rule relating to member firm conduct following the closing of the Transaction, NASD is not proposing to incorporate any such amendment into FINRA's rulebook, absent a separate rule filing by FINRA to adopt conforming changes.

8 The Incorporated NYSE Rules would continue to apply to the same categories of persons to which they currently apply. In other words, in addition to applying to Dual Members, the Incorporated NYSE Rules would apply to persons affiliated with those firms to the same extent and in the same manner that the Incorporated NYSE Rules currently apply. NASD stated that it expects FINRA to submit to the Commission within one year of the date of Closing proposed rule changes that would constitute a significant portion of a harmonized rulebook, with the remaining rules being submitted to the Commission within two years of the Closing. See Letter from T. Grant Callery, Executive Vice President and General Counsel, NASD to Nancy M. Morris, Secretary, Commission, dated July 16, 2007.

9 To the extent an Incorporated NYSE Rule includes a reference to NYSE or the Exchange, such terms will be construed to mean FINRA, unless the context otherwise requires.

member, in which case the NYSE-only member would be subject to both NYSE and NASD rules.[10] In short, the proposed rule change is designed to ensure that all firms, whether Dual Members or members of only NYSE or NASD, will have the same set of regulatory obligations immediately following the Closing of the Transaction that those firms had prior to the Closing of the Transaction.

Because NYSE Group would maintain the functions it currently carries out with respect to market operations, including market surveillance functions, the proposed rule change would not incorporate NYSE rules in such areas as market regulation, including those rules addressing NYSE's Order Tracking System ("OTS") and listing standards. The proposed rule change also would not incorporate NYSE's proxy rules. Further, the proposed rule change would not incorporate NYSE arbitration rules, as FINRA would operate its arbitration and mediation forums pursuant to the NASD Code of Arbitration Procedure.[11]

Disciplinary Matters

Because FINRA would conduct its disciplinary proceedings in accordance with the NASD Code of Procedure, the proposed rule change would not incorporate the NYSE disciplinary rules. With respect to any disciplinary investigations pending at NYSE Regulation as of the Transaction's Closing date that pertain to the Incorporated NYSE Rules, the applicable

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10 NASD anticipates NYSE's filing a proposed rule change to require its members to be members of FINRA, and expects to file a separate rule change to establish a waive-in application process for the NYSE-only members. These NYSE-only members will be subject to FINRA's By-Laws and Schedules to the By-Laws, including Schedule A (Assessments and Fees), as well as the NASD Rule 8000 Series (Investigations and Sanctions) and Rule 9000 Series (Code of Procedure).

11 NYSE recently filed a proposed rule change to provide guidance regarding new and pending arbitration claims in light of the consolidation of NYSE Regulation's arbitration department with that of NASD Dispute Resolution, Inc. See Securities Exchange Act Release No. 56015 (July 5, 2007), 72 FR 37811 (July 11, 2007) (Notice of Filing of Proposed Rule Change and Amendment No. 1) (SR-NYSE-2007-48).

rules and forum would depend on whether NYSE Regulation has filed a Charge Memorandum or Stipulation of Facts and Consent to Penalty ("Stipulation and Consent") as of the date of Closing. In the event NYSE Regulation has filed a Charge Memorandum or Stipulation and Consent as of the date of Closing, the matter (including any later appeals) would be adjudicated in accordance with the NYSE disciplinary rules and before the NYSE Hearing Board. Similarly, to the extent an NYSE Hearing Board decision remains subject to appeal as of the date of Closing, any such appeal would be addressed pursuant to the NYSE disciplinary rules.[12]

In contrast, if as of the date of Closing, NYSE Regulation has not filed a Charge Memorandum or Stipulation and Consent in an investigation relating to the Incorporated NYSE Rules, the matter (including any later appeals) would be adjudicated by FINRA, pursuant to the FINRA Code of Procedure, which includes the Acceptance, Waiver and Consent process pursuant to the FINRA Code of Procedure.[13]

Regarding summary proceedings currently adjudicated pursuant to NYSE Rule 475, the applicable rule and forum would depend on whether NYSE Regulation has notified the person or entity in writing of the summary action before the Closing date. If the notification in writing has occurred before the Closing date, then the matter would be adjudicated pursuant to NYSE

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12 See SR-NYSE-2007-69 (Information Memo to NYSE members reflecting changes to disciplinary proceedings at NYSE Regulation as a result of the Transaction).

13 Under the proposed rule change, FINRA would incorporate NYSE Rule 477 (Retention of Jurisdiction-Failure to Cooperate) with respect to matters relating to potential violations of the Incorporated NYSE Rules. NYSE Rule 477 governs, among other things, NYSE's retention of jurisdiction over certain persons for purposes of initiating disciplinary actions. The rule generally provides that NYSE shall retain jurisdiction over such persons if, prior to termination, or within one year following receipt by NYSE of written notice of the termination, of a person's status as a member, member organization, allied member, approved person or registered or non-registered employee of a member or member organization, NYSE serves written notice on such person that it is making inquiry into matters occurring prior to the termination of such person's status.

disciplinary rules. If no such notification has occurred, the matter would be addressed by FINRA, pursuant to FINRA rules.

Finally, with regard to fines imposed pursuant to NYSE Rule 476A (Imposition of Fines for Minor Violation(s) of Rules) (or summary fines), if a summary fine notice is issued before the date of Closing, the matter would be handled pursuant to NYSE rules. With respect to matters arising after the date of Closing, NASD expects to file with the Commission a proposed rule change to modify its Minor Rule Violation Plan ("MRVP") to include the Incorporated NYSE Rules that, as of the date of such filing, are enumerated in NYSE's MRVP. Thus, NASD states that after the date of Closing, if the Commission were to approve the proposed rule changes, FINRA would be authorized to impose fines under NASD's MRVP for minor violations by Dual Members of the NYSE rules that are set forth in FINRA's MRVP.

Non-Exclusive Common Rules

As further detailed in the Agreement between NASD, NYSE, and NYSE Regulation pursuant to Rule 17d-2 under the Act[14] ("Rule 17d-2 Agreement"), certain of the Incorporated NYSE Rules have been designated "Non-Exclusive Common Rules" for which both FINRA and NYSE will bear responsibility when performing their respective regulatory responsibilities. To the extent a Non-Exclusive Common Rule pertains to matters other than member firm regulation as set forth in the Rule 17d-2 Agreement, the potential violation of such a rule would continue to be adjudicated by NYSE Regulation, in accordance with NYSE disciplinary rules. In addition, NYSE Regulation would retain sole authority to investigate and prosecute any violations of the NYSE rules that are not Incorporated NYSE Rules.

The effective date of the proposed rule change will be the Closing date of the

[14] 17 CFR 240.17d-2.

Transaction. The proposed rule change will not become effective if the Transaction does not close.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,[15] including Section 15A(b)(2) of the Act,[16] in that it will permit FINRA to carry out the purposes of the Act, to comply with the Act and to enforce compliance by FINRA members and persons associated with members with the Act, the rules and regulations thereunder and FINRA rules. NASD further believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[17] which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. As a result of the proposed rule change, firms that currently are regulated by both NASD and NYSE Regulation will continue to comply with the same set of rules applicable to their operations, with minimal disruption to the businesses. FINRA will work expeditiously to consolidate the rules applicable to such members, so that they are required to comply with only one set of rules.

B. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

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15 15 U.S.C. 78o-3.

16 15 U.S.C. 78o–3(b)(2).

17 15 U.S.C. 78o-3(b)(6).

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2007-054 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2007-054. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2007-054 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission Findings

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.[18] Specifically, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act[19] in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission also finds that the proposed rule change is consistent with Section 15A(b)(2) of the Act[20] in that it will permit FINRA to be so organized to carry out the purposes of the Act, to comply with the Act and to enforce compliance by FINRA members and persons associated with members with the Act, the rules and regulations thereunder, and FINRA rules.

As a result of the proposed rule change, firms that currently are regulated by both NASD and NYSE will continue to comply with the same member conduct rules following the Transaction until the member conduct rules of the NASD and NYSE Regulation are consolidated into a single set of FINRA rules. NASD represents that FINRA will work expeditiously to

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18 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

19 15 U.S.C. 78o-3(b)(6).

20 15 U.S.C. 78o–3(b)(2).

consolidate the rules applicable to Dual Members.[21] In the Commission's view, the proposed rule change is an important step in the process of consolidating the member firm regulatory functions of the NASD and NYSE. This regulatory consolidation is intended, among other things, to increase efficient, effective, and consistent regulation of securities firms, provide cost savings to securities firms of all sizes, and strengthen investor protection and market integrity.

The Commission notes that the Incorporated NYSE Rules will be subject to the Rule 17d-2 Agreement in which the regulatory responsibility for these rules will be allocated to FINRA, although specified Non-Exclusive Common Rules as set forth in the Rule 17d-2 Agreement also would continue to be adjudicated by NYSE in accordance with NYSE disciplinary rules.[22] The proposed rule change also provides clarity with respect to the handling of disciplinary proceedings and summary proceedings initiated by NYSE prior to the date of Closing.

The Commission finds good cause to approve the proposed rule change prior to the thirtieth day after the proposal was published for comment in the Federal Register. Accelerating approval of the proposed rule change facilitates the proposed consolidation of NASD and NYSE's regulatory functions without delay. No changes are being made to the Incorporated NYSE Rules aside from their placement in FINRA's rulebook and no changes are being made to the class of members to which the Incorporated NYSE Rules apply. As NASD noted, the proposed rule change is designed to ensure that all firms, whether Dual Members, NYSE-only members, or NASD-only members, will have the same set of regulatory obligations immediately following the Closing of the Transaction that such firms had prior to the Closing of the

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21 See supra note 8.

22 The Commission declared the Rule 17d-2 Agreement effective today. See Securities and Exchange Act Release No. 56148 (July 26, 2007).

Transaction. In addition, the Commission finds good cause to approve the proposal that any disciplinary matter in which a Charge Memorandum or Stipulation and Consent is filed after the date of Closing would be adjudicated pursuant to the FINRA Code of Procedure and that any summary proceeding in which the person or entity is notified in writing after the date of Closing, would be adjudicated pursuant to FINRA rules. This proposal reflects the fact that as of the date of Closing, FINRA will be responsible, under the Rule 17d-2 Agreement, for conducting disciplinary proceedings involving violations of FINRA's rules, including the Incorporated NYSE Rules, by Dual Members. Dual Members are already familiar with, and subject to, the NASD Code of Procedure, which is the FINRA Code of Procedure, and NASD rules, which are FINRA rules. While there are some distinctions between NASD's and NYSE's rules, both sets of rules applicable to the disciplinary process were previously approved by the Commission as consistent with the Act, generally following full notice and comment. Accordingly, although Dual Members and their associated persons no longer would be subject to NYSE's disciplinary procedures, but to FINRA's instead, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,[23] to grant accelerated approval to the proposed rule change.

[23] 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NASD-2007-054) is hereby approved on an accelerated basis.[24]

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

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24 15 U.S.C. 78s(b)(2).

Chairman Cox
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56138 / July 26, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2658 / July 26, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12712

In the Matter of **DELTA & PINE LAND COMPANY** **and** **TURK DELTAPINE, INC.,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act") against Delta & Pine Land Company ("Delta & Pine") and Turk Deltapine, Inc. ("Turk Deltapine") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist, Making Findings, and Imposing a Cease-and-Desist Order

Document 49 of 59

Pursuant to Section 21C of the Securities and Exchange Act of 1934 ("Order"), as set forth below.[1]

III.

On the basis of this Order and Respondents' Offers, the Commission finds[2] that:

A. Respondents

1. Respondent Delta & Pine is a Delaware corporation with its headquarters in Scott, Mississippi. Delta & Pine is primarily engaged in the breeding, production, conditioning and marketing of proprietary varieties of cotton planting seed. Delta & Pine conducts operations in a number of foreign jurisdictions, including Turkey. Delta & Pine's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and was traded on the New York Stock Exchange during the relevant time. Delta & Pine was acquired by Monsanto on June 1, 2007, subject to the terms of a settled Proposed Final Judgment that Monsanto and the Department of Justice filed on May 31, 2007, and, pursuant to the acquisition, its common stock was delisted and deregistered on June 5, 2007.

2. Respondent Turk Deltapine is a Delaware corporation with its headquarters in Scott, Mississippi. Turk Deltapine is a wholly-owned subsidiary of Delta & Pine and is engaged in the production and sale of cottonseed in Turkey, both for domestic consumption in Turkey and for export to other countries.

B. Facts

Summary

1. From 2001-2006, Turk Deltapine made payments valued at approximately $43,000 (including cash, payment of travel and hotel expenses, air conditioners, computers, office furniture and refrigerators) to multiple officials of the Turkish Ministry of Agricultural and Rural Affairs ("MOA"). Turk Deltapine made the payments in order to obtain governmental reports and certifications that were necessary for Turk Deltapine to operate its business in Turkey. These payments, which assisted the Respondents in obtaining and retaining business, violated the anti-bribery provisions of the Foreign Corrupt Practices Act ("FCPA"). In addition, in connection with these improper payments, Delta & Pine failed to keep accurate books and records, and

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[1] In addition, the Commission has contemporaneously filed a complaint in the United States District Court for the District of Columbia charging Respondents with the violations set forth in this order and seeking a civil penalty. Without admitting or denying the Commission's allegations, Delta & Pine and Turk Deltapine have consented to the entry of a final judgment by the Court that would require Delta & Pine and Turk Deltapine to jointly and severally pay a $300,000 civil penalty. *See SEC v. Delta & Pine Land Co.*, No. 1:07-cv-01352 (RWR) (D.D.C) (July 25, 2007).

[2] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

failed to have effective internal controls. Accordingly, Delta & Pine violated the books and records and internal controls provisions of the FCPA.

Turk Deltapine's Payments to Turkish Officials

2. Turk Deltapine contracts annually with a number of Turkish farmers to grow seed on their farms for Turk Deltapine. The Turkish farmers own the seed until it is sold to Turk Deltapine. Inspectors from provincial offices of MOA inspect the fields to determine the spacing and size of the fields, and to estimate their anticipated production. The inspections are time-sensitive, in that they must occur while the cotton crop is in the field and before more than one-third of the cotton bolls open. Upon completion of the inspection, MOA inspectors are required to complete inspection reports. The inspections and inspection reports must be completed before Turk Deltapine can purchase the cotton seeds from Turkish farmers. In a number of cases, MOA inspectors receiving payments from Turk Deltapine did not actually inspect the fields prior to completing inspection reports, as they were required to do.

3. Turk Deltapine also was required to obtain certifications from laboratories authorized by MOA to perform tests required by the Organisation for Economic Cooperation and Development ("OECD") for quality and to confirm the absence of certain characteristics. Turk Deltapine also needed another certificate from MOA's plant protection office to export seed for sale. In order to obtain these certifications, inspectors from MOA obtain samples of the seed from Turk Deltapine facilities. The sampling officials collect samples from each lot of seed and seal the sample in an official envelope before sending the seed to laboratories for testing and certification. During the process of sampling and preparing the seed for transmission to laboratories, the sampling officials are required to certify that the seed samples have been properly chemically treated and bagged. These MOA certifications must be completed before Turk Deltapine is permitted to sell its seeds in Turkey or export the seeds to other countries. In a number of cases, MOA officials providing the certifications, and who received payments from Turk Deltapine, did not comply with regulations concerning the chemical treatment and bagging of seed.

4. Prior to May 2004, payments to MOA officials were made in part using revenue generated from the sale of Turk Deltapine waste products and products from waste allowance. These sales, and the payments to MOA officials made from the proceeds of those sales, were not recorded in Respondents' books, records, and accounts. In addition, some payments to MOA officials were recorded in Turk Deltapine's books, records, and accounts as "Porter Fees" paid to non-existent persons.

Delta & Pine Learns of Turk Deltapine's Payments but the Payments Continue

5. In May 2004, Delta & Pine officers in the United States learned that Turk Deltapine was making payments to MOA officials. Delta & Pine reviewed the circumstances of the payments, but did not receive all facts concerning those payments from Turk Deltapine employees.

6. Instead of halting the payments, Delta & Pine permitted the payments to continue using the following procedure in consultation with Turk Deltapine employees. Rather than Turk Deltapine making the payments directly to MOA employees, Turk Deltapine arranged to have the payments made by a chemical company supplier to Turk Deltapine. Turk Deltapine employees estimated the annual amount of payments that would be made to MOA employees, and arranged to have the chemical company pay those amounts to MOA employees. The chemical company, in turn, would include those sums, plus a 10 percent fee for handling the transactions, in its invoices for chemicals supplied to Turk Deltapine. The payments to MOA officials made after May 2004 therefore similarly were not recorded in the books, records, and accounts of Turk Deltapine or Delta & Pine. Moreover, in setting out this procedure, an internal Delta & Pine memorandum noted that there were "no effective controls to put in place to monitor this process."

7. Turk Deltapine's payments to MOA officials did not cease until 2006, when the payments came to light in connection with due diligence being performed by a potential acquirer of Delta & Pine.

C. Legal Analysis

Section 30A of the Exchange Act prohibits issuers, and certain other persons including agents of issuers, from, among other things, making improper payments to foreign officials for the purpose of influencing their decisions in order to obtain or retain business. Exchange Act Section 13(b)(2)(A) requires public companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and Exchange Act Section 13(b)(2)(B) requires such companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets. 15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B).

As detailed above, Turk Deltapine, as agent for Delta & Pine, made numerous improper payments to MOA inspectors, with the purpose and effect of influencing their decisions in order to obtain or retain business. Throughout the relevant period, MOA inspectors were foreign officials within the meaning of the FCPA, and MOA was an instrumentality of a foreign government within the meaning of the FCPA. Turk Deltapine therefore violated the anti-bribery provisions of Exchange Act Section 30A. Moreover, in connection with these payments, Delta & Pine failed to make and keep accurate books, records, and accounts as required by Exchange Act Section 13(b)(2)(A). Finally, and as evidenced by the extent and duration of the improper payments to foreign officials, and the improper recording of these payments in its subsidiary's books and records, Delta & Pine failed to devise and maintain an effective system of internal controls to prevent these violations of the FCPA, as required by Exchange Act Section 13(b)(2)(B).

IV.

As a result of the conduct described above, Delta & Pine violated Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C.. § 78m(b)(2)(A), which requires issuers to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and Section 13(b)(2)(B) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(B), which requires issuers to devise and maintain a system of internal accounting controls sufficient to provide the reasonable assurances set forth in that statute.

As a result of the conduct described above, Turk Deltapine violated Section 30A of the Exchange Act, 15 U.S.C. § 78dd-1, which provides that it is unlawful for an agent of an issuer corruptly to give, promise to give, or authorize the giving of anything of value to any foreign official for purposes of (i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

Based on the foregoing, the Commission finds that Turk Deltapine violated Exchange Act Section 30A and Delta & Pine violated Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B).

V.

Respondent Delta & Pine has undertaken to:

1. Retain, through Delta & Pine's Board of Directors, within 60 days after the entry of this order, an independent consultant ("Independent Consultant"), not unacceptable to the staff of the Commission, to review and evaluate Delta & Pine's internal controls, record-keeping, and financial reporting policies and procedures as they relate to its compliance with the books and records, internal accounting controls, and anti-bribery provisions of the FCPA, codified at Sections 13(b)(2)(A), 13(b)(2)(B) and 30A of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A) & (B) and 78dd-1]. Delta & Pine shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to its files, books, records, and personnel as reasonably requested for the review;

2. Require that the Independent Consultant issue a report, within sixty (60) days after being retained, summarizing the review and recommending policies and procedures reasonably designed to ensure compliance with the federal securities laws as they relate to the FCPA. Simultaneously with providing that report to Delta & Pine's Board of Directors, Delta & Pine shall require that the Independent Consultant contemporaneously transmit a copy to Kenneth R. Lench, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-6041;

3. Adopt all recommendations in the report of the Independent Consultant; provided, however, that within sixty (60) days after the Independent Consultant serves that report, Delta & Pine shall in writing advise the Independent Consultant and the Commission of any recommendations that it considers to be unduly burdensome, impractical, or costly. With respect to any recommendation that Delta & Pine considers unduly burdensome, impractical or costly, Delta & Pine need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose. As to any recommendation on which Delta & Pine and the Independent Consultant do not agree, such parties shall attempt in good faith to reach an agreement within sixty (60) days after Delta & Pine serves the written advice. In the event Delta & Pine and the Independent Consultant are unable to agree on an alternative proposal, Delta & Pine will abide by the determinations of the Independent Consultant;

4. Require the Independent Consultant to undertake a review, which shall be completed within one year of the entry of this order, of Delta & Pine's policies and procedures regarding compliance with the federal securities laws as they relate to the FCPA. During the review of Delta & Pine's compliance program, the Independent Consultant shall (i) certify that Delta & Pine's policies and procedures are appropriately designed to accomplish their goals, (ii) monitor Delta & Pine's implementation and compliance with the policies and procedures, and (iii) report on the Independent Consultant's findings as to the effectiveness of the policies and procedures to Delta & Pine's Audit Committee. Should the Independent Consultant, during this period, determine that there is a reasonable likelihood that corrupt payments have been offered, promised, paid, or authorized by any Delta & Pine entity, including agents, consultants, and joint ventures, shareholders acting on Delta & Pine's behalf, and contractors and sub-contractors working directly or indirectly for Delta & Pine, the Consultant shall promptly report such payments to Delta & Pine's Audit Committee, and Delta & Pine shall then be obligated to promptly report the same to the staff of the Commission at the address listed above. Should Delta & Pine fail to make such disclosure, the Independent Consultant shall independently disclose its findings to the staff of the Commission, at the address listed above. Further, the Independent Consultant shall disclose to the staff of the Commission in the event that Delta & Pine, or its officers, employees, consultants, agents, and joint ventures, or shareholders acting on Delta & Pine's behalf, or contractors or sub-contractors working directly or indirectly for Delta & Pine refuse to provide information necessary for the performance of the Independent Consultant's responsibilities. Delta & Pine agrees that it will not take any action to retaliate against the Independent Consultant for such disclosures. During the period, Delta & Pine shall immediately disclose to the staff of the Commission, at the address listed above, any information of which it learns that suggests there is a reasonable likelihood that corrupt payments were offered, promised, paid, or authorized by any Delta & Pine entity, including agents, consultants, and joint ventures, shareholders working on Delta & Pine's behalf, and contractors or sub-contractors working directly or indirectly for Delta & Pine; and

5. Require the Independent Consultant to enter into an agreement with Delta & Pine that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Delta & Pine, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Securities and Exchange Commission's Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Delta & Pine, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

6. These undertakings shall be binding upon any acquirer or successor in interest to Delta & Pine or substantially all of Delta & Pine's assets and liabilities or business.

7. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above.

VI.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 21C of the Exchange Act, that:

(i) Respondent Delta & Pine cease and desist from committing or causing any violations and any future violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B);

(ii) Respondent Turk Deltapine cease and desist from committing or causing any violations and any future violations of Exchange Act Section 30A; and

(ii) Delta & Pine comply with the undertaking set forth in Section V above.

By the Commission.

Nancy Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Casey Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 56137 / July 26, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
RELEASE NO. 2656 / July 26, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12711

In the Matter of PATRICK T. CHEW, CPA, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Patrick E. Chew ("Respondent" or "Chew") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)].[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the

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1 Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III. 3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[2] that:

1. Chew, age 40, was the controller of SmartForce's U.S. subsidiary, which generated 70 percent of the Company's business, from January 1998 until February 2002. Chew was responsible for recognizing revenue on standard agreements but did not set or otherwise determine the Company's revenue recognition policy. During all relevant times, Chew was a certified public accountant.

2. SmartForce PLC ("SmartForce"), now known as SkillSoft PLC ("SkillSoft"), was at all relevant times a company organized under the laws of the Republic of Ireland with its principal place of business in Redwood City, California. SmartForce provided Internet-based training courseware and professional services geared toward business and IT professionals. At all relevant times, SmartForce's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on NASDAQ National Market.

3. On July 19, 2007, the Commission filed a complaint against Chew in SEC v. Patrick T. Chew (Civil Action No. 07CV220). On July 23, 2007, the court entered an order permanently enjoining Chew, by consent, from future violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. Chew was also ordered to pay $67,559 in disgorgement, representing losses avoided as a result of the conduct alleged in the Complaint, and $18,326 in prejudgment interest; and a $25,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Chew engaged in improper accounting practices which resulted in SmartForce filing materially false and misleading financial statements in the company's quarterly reports on Form 10-Q for the second and third quarters of fiscal year 2001, and in the company's annual report on Form 10-K for the fiscal year ended December 31, 2001. These practices included improperly recognizing revenue from non-binding agreements and from a transaction for which no product was shipped to the customer. As a result of these practices, SmartForce's annual and quarterly revenue and net income were materially increased.

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2 The findings herein are made pursuant to Respondent' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Chew's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent is suspended from appearing or practicing before the Commission as an accountant.

B. After three (3) years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that the Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board or equivalent Canadian organization and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board or equivalent Canadian organization, and has complied with all terms and conditions of any sanctions imposed (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as the Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his certified public accountant and/or chartered accountant license is current and he has resolved all other disciplinary issues with the Board or applicable Canadian organization. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56136 / July 26, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2655 / July 26, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12710

In the Matter of **ANNE M. PEMBER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Anne M. Pember ("Respondent" or "Pember") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, and the findings contained in Section III, paragraph 4, below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent, age 47, was the Controller of CUC International Inc. ("CUC") from June 1997 through the December 1997 merger of CUC and HFS Incorporated ("HFS") that formed Cendant Corporation ("Cendant"). From the time of the merger until March 1998, she was part of the management of the accounting unit at Cendant Membership Services, the post-merger name for the former CUC business units. Prior to becoming Controller of CUC, from 1989 to 1997, Pember was Controller of CUC's largest division, the Comp-U-Card division. Beginning in 1996, she also held the title of Senior Vice President. She resides in Madison, Connecticut and was licensed as a certified public accountant in Connecticut until November 2001.

2. CUC, a Delaware corporation that had its headquarters in Stamford, Connecticut, was principally engaged in membership-based consumer services, such as auto, dining, shopping, and travel "clubs." CUC's Comp-U-Card division marketed individual memberships in these clubs. CUC was a public company whose common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and which was required to file periodic reports with the Commission pursuant to Section 13 of the Exchange Act. Its common stock was listed on the New York Stock Exchange ("NYSE").

3. Cendant, a Delaware corporation with its headquarters in New York City, was created through the December 17, 1997, merger of CUC and HFS. Cendant provided membership-based and Internet-related consumer services and owned the rights to franchise brand names in the hotel-hospitality, residential real estate brokerage, car rental, and tax preparation businesses. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and it was required to file periodic reports with the Commission pursuant to Section 13 of the Exchange Act. Its common stock was listed on the NYSE. In July 2006, Cendant spun-off its real estate and hospitality businesses, and in August 2006, the company spun-off its membership-based travel services business. In August 2006, Cendant was renamed Avis Budget Group, Inc.

4. On June 14, 2000, the Commission filed a complaint against Respondent in Securities and Exchange Commission v. Cosmo Corigliano, et al. (Civil Action Number 00-2873), in the United States District Court for the District of New Jersey. On July 25, 2000, the Commission filed an amended complaint in that action. Respondent neither admits nor denies the allegations of the amended complaint. On June 27, 2007, a final judgment was entered by consent against Respondent, permanently enjoining her from committing violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5, 13b2-1, and 13b2-2, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-13, 13b2-2, and 14a-9. The final judgment ordered Respondent to pay $100,000 in disgorgement of unjust enrichment and prohibits Respondent, pursuant to Section 21(d) of the Exchange Act, from acting as an officer or a director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

5. The Commission's amended complaint alleges, among other things, that during the period when Respondent was Controller of the Comp-U-Card division at CUC and subsequently Controller of CUC, she oversaw several fraudulent accounting practices that significantly overstated CUC's and later Cendant's publicly reported earnings and income from operations. As alleged in the amended complaint, Respondent oversaw the practice of fraudulently altering the accounting for membership sales revenue so that certain anticipated future revenues were recognized immediately. The amended complaint further alleges that Respondent oversaw the practice of delaying or avoiding the recognition of expenses incurred as a result of membership cancellations and sales commissions owed to third-party vendors. The amended complaint further alleges that, for several years, Respondent directed reversals of the company's merger and purchase accounting reserves to enhance CUC's and Cendant's reported earnings. The amended complaint alleges that these practices overstated CUC's and Cendant's publicly reported earnings and income from operations by hundreds of millions of dollars between 1996 and 1998. In addition, the amended complaint alleges that Respondent made materially false statements to CUC's and Cendant's public accountants and directed less senior managers to restrict and withhold material information sought by CUC's public accountant.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

Pember is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-56152; File No. PCAOB-2007-02)

July 27, 2007

Public Company Accounting Oversight Board; Order Approving Proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, a Related Independence Rule, and Conforming Amendments

I. Introduction

On May 25, 2007, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") Proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements ("Auditing Standard No. 5"), a Related Independence Rule 3525, and Conforming Amendments, pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act") and Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). Auditing Standard No. 5 will supersede Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements ("Auditing Standard No. 2"), to provide the professional standards and related performance guidance for independent auditors when an auditor is engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements pursuant to Sections 103(a)(2)(A)(iii) and 404(b) of the Act. Additionally, Rule 3525 further implements Section 202 of the Act's pre-approval requirement by requiring auditors to take certain

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steps as part of seeking audit committee pre-approval of internal control related non-audit services. Finally, the conforming amendments update the Board's other auditing standards in light of Auditing Standard No. 5, move certain information that was contained in Auditing Standard No. 2 to the Board's interim standards, and change the existing requirement that "generally, the date of completion of the field work should be used as the date of the independent auditor's report" to "the auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient competent evidence to support the auditor's opinion."

Notice of the proposed standard, the related independence rule, and the conforming amendments was published in the Federal Register on June 12, 2007,[1] and a supplemental notice of additional solicitation of comments on the rules and amendments was published in the Federal Register on June 20, 2007 ("Supplemental Notice").[2] The Commission received 37 comment letters on the proposed rules and amendments. For the reasons discussed below, the Commission is granting approval of the proposed standard, the related independence rule, and conforming amendments.

II. Description

The Act establishes the PCAOB to oversee the audits of public companies and related matters, in order to protect the interests of investors and further the public interest in preparation of informative, accurate and independent audit reports.[3] Section 103(a) of the Act directs the PCAOB to establish auditing and related attestation standards, quality

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1 Release No. 34-55876 (June 7, 2007); 72 FR 32340 (June 12, 2007).

2 Release No. 34-55912 (June 15, 2007); 72 FR 34052 (June 20, 2007); Notice of Additional Solicitation of Comments on the Filing of Proposed Rule on Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements, and Related Independence Rule and Conforming Amendments.

3 Section 101(a) of the Act.

control standards, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Commission.

Section 103(a)(2)(A)(iii) of the Act requires the Board's standard on auditing internal control to include "testing of the internal control structure and procedures of the issuer...." Under Section 103, the Board's standard also must require the auditor to present in the audit report, among other things, "an evaluation of whether such internal control structure and procedures...provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with generally accepted accounting principles...." Section 404 of the Act requires that registered public accounting firms attest to and report on an assessment of internal control made by management and that such attestation "shall be made in accordance with standards for attestation engagements issued or adopted by the Board."

The Board's proposed Auditing Standard No. 5, which will supersede Auditing Standard No. 2, provides the new professional standards and related performance guidance for independent auditors to attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under Sections 103 and 404 of the Act.

The auditor's report on internal control over financial reporting issued pursuant to Auditing Standard No. 5 will express one opinion – an opinion on whether the company has maintained effective internal control over financial reporting as of its fiscal year-end. In order for the auditor to render an opinion, Auditing Standard No. 5 requires the auditor to evaluate and test both the design and the operating effectiveness of internal control to be satisfied that management's assessment about whether the company maintained effective internal control over financial reporting as of its fiscal year-end is correct and, therefore, fairly stated. Additionally, paragraph 72 of Auditing Standard No. 5 requires the auditor to evaluate whether management has included in its annual assessment report all of the disclosures required by Commission rules.[4] If the auditor determines that management's assessment is not fairly stated, Auditing Standard No. 5 requires that the auditor modify his or her audit report on the effectiveness of internal control over financial reporting.

III. Discussion

As discussed in detail below, the Commission believes there are many aspects of Auditing Standard No. 5 that are expected to result in improvements in both the effectiveness and efficiency of integrated audits that are currently being conducted in accordance with Auditing Standard No. 2. For example, Auditing Standard No. 5 focuses the audit on the matters most important to internal control. Auditing Standard No. 5 also eliminates unnecessary procedures by, among other things, removing the requirement to evaluate management's process; permitting consideration of knowledge obtained during previous audits; refocusing the multi-location testing requirements on risk rather than coverage; and removing unnecessary barriers to using the work of others. Further, Auditing Standard No. 5 encourages scaling of the audit for smaller companies by directing the auditor to tailor the audit to reflect the attributes of smaller, less complex companies. Lastly, Auditing Standard No. 5 simplifies the requirements by reducing

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4 Item 308 of Regulations S-B and S-K.

detail and specificity; reflecting more accurately the sequential flow of an audit of internal control; and improving readability.

The PCAOB received 175 comment letters when it published a draft of Auditing Standard No. 5 for public comment on December 19, 2006. On April 4, 2007, the Commission held an open meeting to discuss the comments received by the PCAOB and by the Commission in connection with its proposed interpretive guidance for management. At this meeting the Commission directed its staff to focus on four areas when working with the PCAOB staff: aligning the proposed auditing standard with the Commission's proposed interpretive guidance for management, particularly with regard to prescriptive requirements, definitions and terms; scaling the audit to account for the particular facts and circumstances of all companies, particularly smaller companies; encouraging auditors to use professional judgment, particularly in using risk-assessment; and following a principles-based approach to determining when and to what extent the auditor can use the work of others.[5]

The PCAOB addressed these areas, in addition to other matters raised by commenters, in the version of Auditing Standard No. 5 that was filed with the Commission. For example, the PCAOB made revisions to its proposed standard to: make the auditing standard more principles-based and reduce prescriptiveness; align definitions and terminology with the Commission's final interpretive guidance for management; better incorporate scaling concepts throughout the auditing standard; further emphasize fraud controls; enhance and align the discussion of entity-level controls; eliminate the requirement to separately assess risk at the individual control

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[5] See Commission Press Release dated April 4, 2007, "SEC Commissioners Endorse Improved Sarbanes-Oxley Implementation To Ease Smaller Company Burdens, Focusing Effort On What Truly Matters."

level; clarify the manner in which the evidence regarding design of controls can be obtained; and clarify the framework by which auditors can make judgments regarding whether and to what extent the auditor can use the work of others, including management.

The Commission received 37 comment letters in response to its request for comments on Auditing Standard No. 5, the related independence rule, and conforming amendments. The comment letters came from issuers,[6] registered public accounting firms,[7] professional associations,[8] investors,[9] and others.[10] In general, many commenters expressed support for the proposed standard[11] and recommended that the Commission approve the standard and the related conforming amendments, with some of these commenters requesting that this approval be done on an expedited basis to enable auditors to implement the provisions of Auditing Standard No. 5 prior to the required

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6 Alamo Group; Pepsico; and XenoPort, Inc.

7 BDO Seidman, LLP; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; KPMG LLP; and PricewaterhouseCoopers LLP.

8 American Bankers Association; American Bar Association Section of Business Law Committees on Federal Regulation of Securities and Law and Accounting; America's Community Bankers; Biotechnology Industry Organization; Center for Audit Quality; Independent Community of Bankers of America; Institute of Chartered Accountants in England and Wales; Institute of Internal Auditors (IIA); Institute of Management Accountants; Organization for International Investment; National Venture Capital Association; New York State Society of Certified Public Accountants; The Hundred Group of Finance Directors; and U.S. Chamber Center for Capital Markets Competitiveness.

9 California Public Employees Retirement System; Centre for Financial Market Integrity; and Council of Institutional Investors.

10 Accretive Solutions; Thomas E. Damman; David A. Doney; Benjamin P. Foster; Frank Gorrell; Simone Heidema and Erick Noorloos; J. Lavon Morton; Monica Radu; Robert Richter; R.G. Scott & Associates, LLC; and United States Government Accountability Office.

11 See for example, Accretive Solutions; America's Community Bankers; BDO Seidman, LLP; California Public Empolyees Retirement System; Center for Audit Quality; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; KPMG LLP; Institute of Chartered Accountants in England and Wales; New York State Society of Certified Public Accountants; PricewaterhouseCoopers LLP; The 100 Group of Finance Directors; and Unites States Government Accountability Office.

effective date.[12] A number of the commenters noted that the new audit standard includes appropriate investor safeguards, will facilitate a more effective and efficient approach to the implementation,[13] and that the PCAOB appropriately responded to concerns raised by issuers, auditors, investors and others.[14] Specifically, some commenters noted that the standard's focus on principles rather than prescriptive requirements expands the opportunities for auditors to apply well-reasoned professional judgment.[15] Many of these commenters had provided similar communication directly to the PCAOB during its comment period, and to the Commission as part of its consideration of its proposed interpretive guidance for management.

A few commenters expressed their continuing concerns that the Commission (in its recently approved rule amendments) and the PCAOB had retained the wrong auditor opinion, indicating their belief that auditors should opine on the assessment made by management in order to comply with Section 404(b) of the Sarbanes-Oxley Act.[16] These commenters expressed their belief that the auditor's opinion directly on internal control over financial reporting (as opposed to management's assessment) entails unnecessary and duplicative work. The Commission has carefully considered this comment and continues to believe that, consistent with Sections 103 and 404 of the Sarbanes-Oxley

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12 See for example, America's Community Bankers; BDO Seidman, LLP; California Public Employees Retirement System; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; KPMG LLP; and PricewaterhouseCoopers LLP.

13 See for example, American Bankers Association; Accretive Solutions; BDO Seidman, LLP; Center for Audit Quality; KPMG LLP; PricewaterhouseCoopers LLP; and The 100 Group of Finance Directors.

14 See for example, American Bankers Association; America's Community Bankers; Council of Institutional Investors; Ernst & Young LLP; Grant Thornton LLP; The 100 Group of Finance Directors; and Unites States Government Accountability Office.

15 See for example, BDO Seidman, LLP; Center for Audit Quality; Ernst & Young LLP; Institute of Chartered Accountants in England and Wales; PricewaterhouseCoopers LLP; and The 100 Group of Finance Directors.

16 See for example, Alamo Group; Robert Richter; Institute of Chartered Accountants in England and Wales; Institute of Management Accountants; and The 100 Group of Finance Directors.

Act, the Commission's recent rule amendments and Auditing Standard No. 5 require the appropriate opinion to be expressed by the auditor. The Commission notes that this view is consistent with the view expressed by the Board in its release. Further, the Commission believes that an auditing process that is restricted to evaluating what management has done would not necessarily provide the auditor with a sufficient level of assurance to render an independent opinion as to whether management's assessment about the effectiveness of internal control over financial reporting is correct.[17] Finally, the Commission believes that the expression of a single opinion directly on the effectiveness of internal control over financial reporting provides clear communication to investors that the auditor is not responsible for issuing an opinion on management's process for evaluating internal control over financial reporting.[18] In the Commission's view, such an opinion may not only have the unintended consequence of hindering management's ability to apply appropriate judgment in designing their evaluation approach, but also may have the effect of increasing audit costs without commensurate benefit to issuers and investors.

Two commenters noted their belief that there was not sufficient incentive for auditors to modify their methods of performing the audit of internal control and therefore, were concerned that the benefits afforded by Auditing Standard No. 5 would not be fully realized. These commenters noted that it was important for the PCAOB to adjust its inspection program to align it with the changes in the audit standard and to respect the auditors' use of judgment in conducting the audit.[19] Additionally, commenters noted that

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17 See Release No. 33-8809 (June 20, 2007), Amendments to Rules Regarding Management's Report on Internal Control Over Financial Reporting.

18 Ibid.

19 America's Community Bankers and the Institute of Chartered Accountants in England and Wales.

the PCAOB's inspection process should monitor the extent to which, and the expediency with which, audit firms implement Auditing Standard No. 5 in the manner expected.[20] This has been an area both the Commission and the PCAOB recognize and continue to focus on. For example, it was an area specifically identified in the Commission's and the PCAOB's 2006 announcement of actions following the Commission's second roundtable on Section 404 implementation.[21] The PCAOB has incorporated procedures to evaluate the efficiency and effectiveness of audits of internal control over financial reporting in their inspection process and, in April 2007, issued its second report on auditors' implementation of the internal control standard.[22] The Commission also recognizes this concern and, as a result and consistent with its previous 2006 announcement in this area, will be carefully monitoring the implementation, including directing the Commission staff to examine whether the PCAOB inspections of registered accounting firms have been effective in encouraging changes in the conduct of integrated audits to improve both efficiency and effectiveness of attestations on internal control over financial reporting.

The Commission received one comment with respect to the indicators of a material weakness that are included in Auditing Standard No. 5. Under Auditing Standard No. 5, if an auditor determines that a deficiency might prevent prudent officials from concluding that they have reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally

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20 See for example. America's Community Bankers, the Institute of Chartered Accountants in England and Wales, The 100 Group of Finance Directors and U.S. Chamber Center for Capital Markets Competitiveness.

21 See for example. SEC Press Release 2006-75 (May 16, 2006).

22 See PCAOB Press Release dated April 18, 2007, "Board Issues Second Year Report On Auditors' Implementation of Internal Control Standard".

accepted accounting principles, an auditor should regard such a determination as an indicator of a material weakness. One commenter took exception to this requirement and requested that such a determination made by the auditor be regarded as an indicator of a deficiency that is at least a significant deficiency rather than an indicator of a material weakness; or that Auditing Standard No. 5 be revised to use the word "would" instead of "might" when describing the level of assurance that would satisfy prudent officials in the conduct of their own affairs.[23] The Commission notes that the commenter's suggestion to change the word "might" to "would" is not necessary or appropriate given that the PCAOB and the Commission both stated in their respective releases that the determination of whether or not a material weakness exists requires judgment and the presence of one or more indicators does not mandate a conclusion that a material weakness exists. Moreover, the Commission notes that the indicators are not intended to supplant or replace the definition of material weakness. This particular indicator is intended as a reminder of the requirement in Section 13(b)(2)(B) of the Exchange Act that every issuer "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" and of the explanation in Section 13(b)(7) of the Exchange Act that the term "reasonable assurances" in this context means "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." The Commission agrees with the list of indicators of a material weakness included in Auditing Standard No. 5, and agrees with the principles in Auditing Standard No. 5, which allow an auditor to use his or her judgment.

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23 American Bar Association Section of Business Law Committees on Federal Regulation of Securities and Law and Accounting.

The Commission received one comment with respect to the PCAOB's proposed Independence Rule 3525, which relates to the requirement for auditors to obtain audit committee pre-approval of non-audit services related to internal control over financial reporting. This commenter requested a transition provision in order to clarify that internal control-related services pre-approved by audit committees before the final rule is approved by the Commission do not require re-approval under Rule 3525.[24] Auditing Standard No. 2 (paragraph 33) required specific pre-approval of internal-control related non-audit services. The Commission notes that non-audit services that have already been pre-approved by audit committees would not require re-approval with the communications required by Rule 3525. Accordingly, a transition period is not necessary.

The Commission did not receive any comments with respect to the PCAOB's proposed conforming amendments. In some cases, these proposed amendments are administrative in nature, such as updating references in the interim standards to the proposed new standard's paragraph numbers and definitions. In other cases, the amendments have been proposed to move information currently contained in Auditing Standard No. 2 to the Board's existing standards. Further, the Commission notes that the Board addressed the single comment that it received on its conforming amendments. The Commission believes that the conforming amendments proposed by the Board are appropriate.

As proposed by the PCAOB, Auditing Standard No. 5, PCAOB Rule 3525, and the Conforming Amendments will be effective and required for integrated audits

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24 KPMG LLP.

conducted for fiscal years ending on or after Nov. 15, 2007. However, earlier adoption is permitted by the Board. The Board has stated that auditors who elect to comply with Auditing Standard No. 5 after Commission approval but before its effective date must also comply, at the same time, with Rule 3525 and other PCAOB standards as amended by this release. The Commission believes the effective date allows for appropriate transition time and at the same time encourages early adoption. In that regard, the Commission's recent amendments to Regulation S-X become effective on August 27, 2007 and the Commission will begin accepting the single auditor's attestation report on the effectiveness of internal control over financial reporting prescribed in Auditing Standard No. 5 in timely filings received starting on that date.

In its Supplemental Notice, the Commission sought comments on seven specific questions. The following discussion addresses the comments received related to each of those questions.

(1) Is the standard of materiality appropriately defined throughout AS5 to provide sufficient guidance to auditors? For example, is materiality appropriately incorporated into the guidance regarding the matters to be considered in planning an audit and the identification of significant accounts?

The majority of the commenters who expressed a view on this question noted that Auditing Standard No. 5 appropriately addresses the concept of materiality when planning and performing an integrated audit.[25] Some commenters elaborated that while application of materiality concepts in the context of planning and performing an audit

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[25] See for example, BDO Seidman, LLP; California Public Employees Retirement System; Center for Audit Quality; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; Institute of Chartered Accountants in England and Wales; KPMG LLP; New York State Society of Certified Public Accountants; PepsiCo; PricewaterhouseCoopers LLP; and The Hundred Group of Finance Directors.

requires the use of judgment, Auditing Standard No. 5 specifies the basis on which those judgments should be made.[26]

A few commenters expressed a view that some auditors may need further and clearer guidance than is provided.[27] However, one commenter indicated its view that the Commission should not provide more guidance and interpretation, especially as related to the application of quantitative criteria to the definitions of material weakness and significant deficiency.[28] Moreover, another commenter noted that although its view was that materiality was not sufficiently defined in Auditing Standard No. 5, it recognized that the definition of materiality extends to matters beyond just Section 404 of the Act.[29]

The Commission agrees that Auditing Standard No. 5 adequately addresses materiality throughout the standard. For example, as a number of commenters observed, paragraph 20 of Auditing Standard No. 5 states that "in planning the audit of internal control over financial reporting, the auditor should use the same materiality considerations he or she would use in planning the audit of the company's financial statements." Further, the Commission does not believe that the auditing standard is the appropriate forum to address broader questions about materiality, as the concept of materiality is fundamental to the federal securities laws.

<u>(2) Please comment on the requirement in Paragraph 80 that the auditor consider whether there are any deficiencies or combinations of deficiencies that are significant deficiencies and, if so, communicate those to the audit committee. Specifically, will the</u>

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26 See for example, KPMG LLP and PricewaterhouseCoopers LLP.

27 See for example, Accretive Solutions; The Institute of Internal Auditors; Rod G. Scott; National Venture Capital Association; and U.S. Chamber Center for Capital Markets Competitiveness.

28 The Institute of Chartered Accountants in England and Wales.

29 National Venture Capital Association.

communication requirement regarding significant deficiencies divert auditors' attention away from material weaknesses?

Commenters who expressed a view on this matter overwhelmingly observed that the auditor's requirement to communicate significant deficiencies would not divert auditors' attention away from material weaknesses since Auditing Standard No. 5 clearly directs the auditor to identify material weaknesses, with many of the commenters noting the importance of communicating significant deficiencies to the audit committee.[30]

The Commission agrees with commenters that the communication requirement related to significant deficiencies should not divert auditors' attention away from material weaknesses due to the clear statement in Auditing Standard No. 5 that in planning the audit, the auditor is not required to search for deficiencies that, individually, or in combination, are less severe than a material weakness. Further, the Commission agrees with the Board that limiting the discussion regarding significant deficiencies to the section of the auditing standard that relates to communications is appropriate in order to help clarify that the audit should not be scoped to identify deficiencies that are less severe than a material weakness.

(3) Is AS5 sufficiently clear that for purposes of evaluating identified deficiencies, multiple control deficiencies should only be looked at in combination if they are related to one another?

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[30] See for example, American Bar Association Section of Business Law Committees on Federal Regulation of Securities and Law and Accounting; Accretive Solutions; BDO Seidman, LLP; Center for Audit Quality; Centre for Financial Market Integrity; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; Institute of Chartered Accountants in England and Wales; KPMG LLP; J. Lavon Morton; New York State Society of Certified Public Accountants; PepsiCo; PricewaterhouseCoopers LLP; Rod G. Scott; and The 100 Group of Finance Directors, but see The Institute of Internal Auditors.

Most of those commenting on this question agreed that multiple control deficiencies should be aggregated for assessment purposes if they are related to each other and that Auditing Standard No. 5 is sufficiently clear in this regard.[31] Two commenters disagreed with the direction that multiple control deficiencies should only be evaluated in combination if they are related to one another given that the auditor is expressing an opinion on the effectiveness of internal control as a whole.[32]

The Commission agrees with the view of most of the community that Auditing Standard No. 5 is sufficiently clear with respect to aggregation of control deficiencies and further notes that this guidance is appropriately aligned with the guidance that is contained in the Commission's interpretive guidance for management.

(4) Please comment on whether the definition of "material weakness" in Paragraph A7 (which is consistent with the definition that the SEC adopted) appropriately describes the deficiencies that should prevent the auditor from finding that ICFR is effective.

The majority of those commenting on this topic expressed agreement with Auditing Standard No. 5's definition of material weakness and stated that it appropriately describes those deficiencies that should prevent the auditor from concluding that internal control over financial reporting is effective,[33] while a couple commenters stated that the definition was not as clear as it could be, thereby potentially leading to subjective

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31 See for example, Accretive Solutions; BDO Seidman, LLP; Center for Audit Quality; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP, Institute of Chartered Accountants in England and Wales; PepsiCo; PricewaterhouseCoopers LLP; R.G. Scott; and The 100 Group of Finance Directors.

32 See California Public Employees' Retirement Systems; and Unites States Government Accountability Office.

33 See for example, BDO Seidman, LLP; Center for Audit Quality; California Public Employees Retirement System; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; Institute of Chartered Accountants in England and Wales; New York State Society of Certified Public Accountants; PepsiCo; PricewaterhouseCoopers LLP; and The 100 Group of Finance Directors.

assessments of whether a control deficiency is a material weakness.[34] One commenter suggested providing guidance regarding the period of time to which reasonable possibility relates,[35] and another suggested reconsideration of the likelihood threshold included in the definition.[36] Two commenters suggested that the requirement to evaluate deficiencies against interim results due to the reference to interim financial statements in the definition of material weakness should be eliminated,[37] with one of these two commenters stating that this consideration should not delay the Commission's prompt approval of Auditing Standard No. 5.[38]

The Commission agrees that the definition of material weakness included in Auditing Standard No. 5, which is aligned with the Commission's interpretive guidance for management, appropriately describes the conditions that, if they exist, should be disclosed to investors and should preclude a conclusion that internal control over financial reporting is effective. Regarding the reference to interim financial statements in the definition of material weakness, the Commission continues to believe, as it stated in its release adopting the definition of a material weakness, that:

> "...[while] annual materiality considerations are appropriate when making judgments about the nature and extent of evaluation procedures, the Commission believes that judgments about whether a control is adequately designed or operating effectively should consider the requirement to provide investors reliable interim and annual financial

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34 See for example, Accretive Solutions; R.G. Scott; and U.S. Chamber Center for Capital Markets Competitiveness.

35 See The Institute of Internal Auditors.

36 See National Venture Capital Association.

37 See National Venture Capital Association and PricewaterhouseCoopers LLP.

38 PricewaterhouseCoopers LLP.

reports. Further, if a deficiency is identified that poses a reasonable possibility of a material misstatement in the company's quarterly reports, the Commission believes that the deficiency should be disclosed to investors and internal control over financial reporting should not be assessed as effective."[39]

(5) Is AS5 sufficiently clear about the extent to which auditors can use the work of others?

The majority of those who commented on this question expressed their view that Auditing Standard No. 5 is clear about the extent to which auditors can use the work of others to gain efficiencies in the audit,[40] with some noting that Auditing Standard No. 5 provides substantial flexibility in the application of auditor judgment when determining whether, and to what extent, to use the work of others.[41] A small number of commenters noted that further clarification regarding the extent that auditors can rely on the work of others when conducting walkthroughs would be helpful.[42] Two commenters recommended that if the work of others is found to be competent and reliable, then the standard should require the auditor to utilize it.[43]

The Commission agrees that Auditing Standard No. 5 is sufficiently clear about the extent to which the auditor can use the work of others. Further, while the Commission would anticipate auditors would use the work of others under appropriate

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39 See Release No. 33-8809 (June 20, 2007), Amendments to Rules Regarding Management's Report on Internal Control Over Financial Reporting.

40 See for example, Accretive Solutions; BDO Seidman, LLP; Center for Audit Quality; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; KPMG LLP; PepsiCo; and PricewaterhouseCoopers LLP.

41 See for example, Deloitte & Touche LLP; KPMG LLP; and PricewaterhouseCoopers LLP.

42 See for example, The 100 Group of Finance Directors; and J. Lavon Morton.

43 See American Bankers Association and Biotechnology Industry Organization.

circumstances, including when the approach results in greater efficiency, the Commission does not believe it is necessary or appropriate to preclude the auditor from utilizing his or her judgment in determining whether or not to use the work of others based on the particular facts and circumstances of the engagement.

(6) Will AS5 reduce expected audit costs under Section 404, particularly for smaller public companies, to result in cost-effective, integrated audits?

A number of commenters stated their view that Auditing Standard No. 5, as approved by the PCAOB, together with the Commission's guidance for management on assessing internal control over financial reporting, will result in a reduction of the total Section 404 compliance effort.[44] Some commenters agreed that a cost reduction would occur, but also noted that the amount of reduced effort and cost associated with the audit of internal control over financial reporting will vary by company depending on factors such as size, complexity, the degree of change from year-to-year, the quality of internal control systems and documentation, and the extent to which management appropriately applies the Commission's interpretive guidance for management.[45] None of the commenters suggested that costs would increase.

Some of the features of Auditing Standard No. 5 that the Commission expects will result in improved effectiveness and efficiency include the direction provided to auditors to focus on what matters most, the elimination of unnecessary procedures from the audit, the ability to scale the audit to fit the size and complexity of the company, the alignment

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44 See for example. BDO Seidman, LLP; Center for Audit Quality; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; KPMG LLP; New York State Society of Certified Public Accountants; PricewaterhouseCoopers LLP; The 100 Group of Finance Directors; and The Institute of Internal Auditors.

45 See for example. Accretive Solutions; BDO Seidman, LLP; Center for Audit Quality; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; and PricewaterhouseCoopers LLP.

with the Commission's interpretive guidance for management, and its less prescriptive nature. Consequently, the Commission believes that Section 404 compliance costs, for both management's evaluation as well as the external audit, will decrease as a result of the Commission's efforts and Auditing Standard No. 5.

Some commenters noted that while Auditing Standard No. 5 may curtail excessive testing of controls and reduce some of the unnecessary documentation currently required for Section 404 audits, they still have concerns about the extent to which it will reduce costs for smaller public companies.[46] A number of commenters urged the Commission and PCAOB to monitor closely the extent to which the standard as implemented achieves a reduction in cost, and to take action if there is not an appropriate reduction.[47]

In response to continued concerns about the extent of cost reductions, the Commission's staff is planning to analyze and report on the costs associated with the implementation of the Commission's interpretive guidance for management as well as the implementation of Auditing Standard No. 5. The staff will make any recommendations it believes appropriate to the Commission.

<u>(7) Does AS5 inappropriately discourage or restrict auditors from scaling audits, particularly for smaller public companies?</u>

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46 See for example, America's Community Bankers; David A. Doney; Independent Community Bankers of America; National Venture Capital Association; J Lavon Morton; R.G. Scott; XenoPort, Inc.; and U.S. Chamber Center for Capital Markets Competitiveness.

47 See for example, American Bankers Association; America's Community Bankers; Biotechnology Industry Organization; Independent Community Bankers of America; Institute of Chartered Accountants in England and Wales; Institute of Management Accountants; The 100 Group of Finance Directors; and U.S. Chamber Center for Capital Markets Competitiveness.

With regards to scalability, most commenters who responded to this question noted that Auditing Standard No. 5 appropriately discusses the concepts of scalability based on size and complexity without including inappropriate restrictions on the auditor's ability to scale the audit.[48] Other commenters observed that where feasible, Auditing Standard No. 5 should also provide additional guidance on how to effectively plan an integrated audit for smaller public companies and a discussion of related best practices to enhance a broader understanding of risk-based auditing.[49] One commenter expressed concern that an objective definition of "smaller company" is necessary in order to provide meaningful direction in scaling the audit and that the standard should clarify that both smaller and less complex companies would be subject to scaled audits.[50]

The Commission believes that Auditing Standard No. 5 appropriately discusses the concepts of scalability without including inappropriate restrictions on the auditor's ability to scale the audit. Further the Commission agrees with the guidance in Auditing Standard No. 5 that provides for scaling and tailoring of all audits to fit the relevant facts and circumstances. The Commission also agrees with the statement made by the Board in its release to Auditing Standard No. 5 that "scaling will be most effective if it is a natural extension of the risk-based approach and applicable to all companies."[51] As a result, Auditing Standard No. 5 contains not only a separate section on scaling the audit, but it also contains specific discussion of scaling concepts throughout the standard. The Commission believes that these concepts will enable tailoring of internal control audits to

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48 See for example, BDO Seidman, LLP; Center for Audit Quality; Council of Institutional Investors; Deloitte & Touche LLP; Ernst & Young LLP; Grant Thornton LLP; PepsiCo; PricewaterhouseCoopers LLP; and The Institute of Internal Auditors.

49 See for example, New York State Society of Certified Public Accountants.

50 Biotechnology Industry Organization.

51 See PCAOB Release No. 2007-005 (May 24, 2006).

fit the size and complexity of the company being audited rather than the company's control system being made to fit the auditing standard. Additionally, as some commenters observed, the PCAOB's project to develop guidance and education for auditors of smaller public companies, along with the Committee of Sponsoring Organizations of the Treadway Commission's ("COSO") project to develop guidance designed to help organizations monitor the quality of their internal control systems and other COSO guidance directed to smaller public companies, should also facilitate the implementation of Section 404 in an effective and efficient manner.[52]

In summary, the Commission believes that Auditing Standard No. 5, the related independence rule, and the conforming amendments will enable better integrated, more effective, and more efficient audits while satisfying the requirements set forth in Sections 103 and 404 of the Act. Further, the Commission notes that Auditing Standard No. 5 is appropriately aligned with the Commission's own rules and interpretive guidance for management.

IV. Conclusion

On the basis of the foregoing, the Commission finds that proposed Auditing Standard No. 5, the related independence rule, and the conforming amendments are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that proposed Auditing Standard No. 5, <u>An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial</u>

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52 See for example, Center for Audit Quality, Deloitte & Touche LLP; and PricewaterhouseCoopers LLP.

Statements, the Related Independence Rule, and Conforming Amendments (File No. PCAOB-2007-02) be and hereby are approved.

By the Commission.

Nancy M. Morris
Secretary

Commissioners Campos & Nazareth Disapproved

Securities and Exchange Commission

17 CFR PART 240

[Release No. 34-56161; IC-27914; File No. S7-17-07]

RIN 3235-AJ95

Shareholder Proposals Relating to the Election of Directors

Agency: Securities and Exchange Commission.

Action: Proposed rule.

Summary: The Securities and Exchange Commission is publishing this interpretive and proposing release to clarify the meaning of the exclusion for shareholder proposals related to the election of directors that is contained in Rule 14a-8(i)(8) under the Securities Exchange Act of 1934. Rule 14a-8 is the Commission rule that provides shareholders with an opportunity to place a proposal in a company's proxy materials for a vote at an annual or special meeting of shareholders. The Commission is publishing its interpretation of and proposing amendments to Rule 14a-8(i)(8) to provide certainty regarding the meaning of the exclusion in that Rule.

DATES: Comments should be received by [insert date 60 days after Federal Register publication].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-17-07 on the subject line; or

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- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-17-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Lillian Brown, Steven Hearne, or Tamara Brightwell, at (202) 551-3700, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3010.

SUPPLEMENTARY INFORMATION: We are publishing our interpretation of Rule 14a-8(i)(8)[1] under the Securities Exchange Act of 1934.[2] We also are proposing

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[1] 17 CFR 240.14a-8(i)(8).

[2] 15 U.S.C. 78a et seq.

amendments to Rule 14a-8(i)(8).

I. Overview

A. Federal Regulation of the Proxy Process

Regulation of the proxy process is a core function of the Commission and is one of the original responsibilities that Congress assigned to the agency in 1934. Section 14(a) of the Exchange Act[3] stemmed from a Congressional belief that "fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange."[4] The Congressional committees recommending passage of Section 14(a) proposed that "the solicitation and issuance of proxies be left to regulation by the Commission."[5] Congress intended that Section 14(a) give the Commission the "power to control the conditions under which proxies may be solicited"[6] and that this power would be exercised "as necessary or appropriate in the public interest or for the protection of investors."[7] Because the Commission's authority under Section 14(a) encompasses both disclosure and proxy mechanics,[8] the proxy rules have long governed not only the

3 15 U.S.C. 78n(a).

4 Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970), quoting H. R. Rep. No. 1383, 73d Cong., 2d Sess., at 13 (1934). See also J. I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).

5 S. Rep. No. 792, 73d Cong., 2d Sess., at 12 (1934).

6 H.R. Rep. No. 1383, 73d Cong., 2d Sess., at 14 (1934). The same report demonstrated a congressional intent to prevent frustration of the "free exercise of the voting rights of stockholders." Id.

7 15 U.S.C. 78n(a).

8 See Business Roundtable v. SEC, 905 F.2d 406, 411 (D.C. Cir. 1990) ("We do not mean to be taken as saying that disclosure is necessarily the sole subject of §14"); Roosevelt v. E.I. du Pont de Nemours & Co., 958 F.2d 416, 421-22 (D.C. Cir. 1992) (Congress "did not narrowly train section 14(a) on the interest of stockholders in receiving information necessary to the intelligent exercise of their" state law rights); SEC v. Transamerica Corp., 163 F.2d 511, 518 (3d Cir. 1947) (in which the Commission's authority to promulgate Exchange Act Rule 14a-8 was upheld), cert. denied, 332 U.S. 847 (1948). See also John C. Coffee Jr., Federalism and the SEC's Proxy Proposals, New York Law Journal 5 (March 18, 2004) (Section 14(a) "does not focus exclusively on

information required to be disclosed to ensure that shareholders receive full disclosure of all information that is material to the exercise of their voting rights under state law and the corporation's charter, but also the procedure for soliciting proxies.[9]

B. Exchange Act Disclosure Requirements for Contested Elections

Several Commission rules, including Exchange Act Rule 14a-12,[10] regulate contested proxy solicitations to assure that investors receive adequate disclosure to enable them to make informed voting decisions in elections. The requirements to provide these disclosures to shareholders from whom proxy authority is sought are grounded in Rule 14a-3,[11] which requires that any party conducting a proxy solicitation file with the Commission, and furnish to each person solicited, a proxy statement containing the information in Schedule 14A.[12] Items 4(b) and 5(b) of Schedule 14A require numerous specified disclosures if the solicitation is subject to Rule 14a-12(c). A solicitation is subject to Rule 14a-12(c) if it is made "for the purpose of opposing" a solicitation by any

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disclosure; rather, it contemplates SEC rules regulating procedure in order to grant shareholders a 'fair' right of corporate suffrage"); Louis Loss & Joel Seligman, Securities Regulation 1936-37 (3d ed. 1990) (The Commission's "power under §14(a) is not necessarily limited to ensuring full disclosure. The statutory language is considerably more general than it is under the specific disclosure philosophy of the [Securities Act of 1933].")

9 E.g., Exchange Act Rule 14a-4 (17 CFR 240.14a-4), Exchange Act Rule 14a-7 (17 CFR 240.14a-7), and Exchange Act Rule 14a-8 (17 CFR 240.14a-8). Each specifies procedural requirements that companies must observe in soliciting proxies. Exchange Act Rule 14a-4(b)(2) requires that the form of proxy furnish the security holder with the means to withhold approval for the election of a director. Exchange Act Rule 14a-7 provides a procedure under which a security holder may be able to obtain a list of security holders. Exchange Rule 14a-8 provides a procedure under which a qualifying security holder can obligate the company to include certain types of proposals, along with statements in support of those proposals, in the company's proxy statement.

10 17 CFR 240.14a-12.

11 17 CFR 240.14a-3.

12 Rule 14a-3 provides, in pertinent part, that "[n]o solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with a publicly-filed preliminary or definitive written proxy statement containing the information specified in Schedule 14A...."

other person "with respect to the election or removal of directors…."[13] Thus, the result of Schedule 14A's cross-referencing of Rule 14a-12(c) is to trigger, when a solicitation with respect to the election of directors is conducted in opposition to another solicitation, a number of disclosures relevant in proxy contests, including disclosure of:[14]

- by whom the solicitation is made;
- the methods to be employed to solicit;
- total expenditures to date and anticipated in connection with the solicitation;
- by whom the cost of the solicitation will be borne;
- any substantial interest of each participant in the solicitation;
- the name, address, and principal occupation or principal business of each participant;
- whether any participant has been convicted in a criminal proceeding within the past 10 years;
- the amount of each class of securities of the company owned by the participant and the participant's associates;
- information concerning purchases and sales of the company's securities by each participant within the past two years;
- whether any part of the purchase price or market value of such securities is represented by funds borrowed;

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13 Because numerous protections of the federal proxy rules are triggered only by the presence of a solicitation made in opposition to another solicitation, the requirements regarding disclosures and procedures in contested elections do not contemplate the presence of nominees from different vying factions in the same proxy materials.

14 See 17 CFR 240.14a-101, Items 4(b) and 5(b).

- whether a participant is a party to any contract, arrangements or understandings with any person with respect to securities of the company;
- certain related party transactions between the participant or its associates and the company;
- whether the participant or any of its associates have any arrangement or understanding with any person with respect to any future employment with the company or its affiliates, or with respect to any future transactions to which the company or its affiliates will or may be a party; and
- with respect to any person who is a party to an arrangement or understanding pursuant to which a nominee is proposed to be elected, any substantial interest that such person has in any matter to be acted upon at the meeting.[15]

In addition, Item 7 of Schedule 14A requires the furnishing of additional information as to nominees for director, including nominees of "persons other than the [company]" (e.g., shareholders), including:[16]

- any arrangement or understanding between the nominee and any other person(s) (naming such person(s)) pursuant to which the nominee was or is selected as a nominee;[17]

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15 For purposes of Items 4 and 5, a "participant" in the solicitation includes: (i) any person who solicits proxies; (ii) any director nominee for whose election proxies are being solicited; and (iii) any committee or group, any member of a committee or group, and other persons involved in specified ways in the financing of the solicitation. See Item 4, Instruction 3. Thus, for each of the numerous disclosures required as to a "participant," the information must be disclosed as to all of such persons.

16 See 17 CFR 240.14a-101, Item 7. See also 17 CFR 240.14a-101, Item 22(b).

17 See Item 401(a) of Regulation S-K [17 CFR 229.401(a)], which is referenced in Item 7 of Schedule 14A.

- business experience of the nominee;[18]
- any other directorships held by the nominee in an Exchange Act reporting company;[19]
- the nominee's involvement in certain legal proceedings;[20]
- certain transactions between the nominee and the company;[21] and
- whether the nominee complies with independence requirements.[22]

Finally, and of critical importance, all of these disclosures are covered by the prohibition on the making of a solicitation containing false or misleading statements or omissions that is found in Rule 14a-9.[23]

C. The Shareholder Proposal Process

Rule 14a-8 creates a procedure under which shareholders, subject to certain requirements, may present in the company's proxy materials a broad range of binding and non-binding proposals. The rule permits a shareholder owning a relatively small amount of the company's shares[24] to submit his or her proposal to the company, and requires the

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18 See Item 401(e)(1) of Regulation S-K [17 CFR 229.401(e)(1)], which is referenced in Item 7 of Schedule 14A.

19 See Item 401(e)(2) of Regulation S-K [17 CFR 229.401(e)(2)], which is referenced in Item 7 of Schedule 14A.

20 See Items 103 and 401(f) of Regulation S-K [17 CFR 229.103 and 17 CFR 229.401(f)], which are referenced in Item 7 of Schedule 14A.

21 See Item 404 of Regulation S-K [17 CFR 229.404], which is referenced in Item 7 of Schedule 14A.

22 See Item 407(a) of Regulation S-K [17 CFR 229.407(a)], which is referenced in Item 7 of Schedule 14A.

23 See 17 CFR 240.14a-9.

24 Exchange Act Rule 14a-8(b)(1) (17 CFR 240.14a-8(b)(1)) provides that a holder of at least $2,000 in market value, or 1% of the company's securities entitled to be voted, may submit a shareholder proposal subject to other procedural requirements and substantive bases for exclusion under the rule.

company to include the proposal alongside management's proposals in the company's proxy materials. In all cases, the proposal may be excluded by the company if it fails to satisfy the rule's procedural requirements or falls within one of the rule's thirteen substantive categories of proposals that may be excluded.[25]

Rule 14a-8 specifies that companies must notify the Commission when they intend to exclude a shareholder's proposal from their proxy materials. This notice goes to the staff of the Division of Corporation Finance or the Division of Investment Management. In the notice, the company provides the staff with a discussion of the basis or bases upon which the company intends to exclude the proposal and requests that the staff not recommend enforcement action if the company excludes the proposal. A shareholder proponent may respond to the company's notice, but is not required to do so. Generally, the staff responds to each notice with a "no-action" letter to the company, a copy of which is provided to the shareholder, in which the staff either concurs or declines to concur with the company's view that there is a basis for excluding the proposal.[26]

II. The Election Exclusion in Rule 14a-8(i)(8)

A. Introduction

Rule 14a-8(i)(8) sets forth one of several substantive bases upon which a company may exclude a shareholder proposal from its proxy materials. Specifically, it

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25 With respect to subjects and procedures for shareholder votes that are specified by the corporation's governing documents, most state corporation laws provide that a corporation's charter or bylaws can specify the types of proposals that are permitted to be brought before the shareholders for a vote at an annual or special meeting. Rule 14a-8(i)(1) supports these determinations by providing that a proposal that is violative of the corporation's governing documents may be excluded from the corporation's proxy materials.

26 The staff's response is an informal expression of its views, and does not necessarily reflect the view of the Commission. Either the shareholder proponent or the company may obtain a decision on the excludability of a challenged proposal from a federal court.

provides that a company need not include a proposal that "relates to an election for membership on the company's board of directors or analogous governing body." The purpose of this provision is to prevent the circumvention of other proxy rules that are carefully crafted to ensure that investors receive adequate disclosure and an opportunity to make informed voting decisions in election contests.

In administering Rule 14a-8(i)(8), the staff has applied the following explanation of the election exclusion that the Commission gave in 1976 when it proposed the exclusion:

> [T]he principal purpose of [Rule 14a-8(i)(8)] is to make clear, with respect to corporate elections, that Rule 14a-8 is not the proper means for conducting campaigns or effecting reforms in elections of that nature, since other proxy rules, including Rule 14a-11, are applicable thereto.[27]

In its application of the Commission's explanation, the staff has permitted companies to exclude any shareholder proposal that may result in a contested election. For purposes of Rule 14a-8, the staff has expressed the position that a proposal may result in a contested election if it is a means either to campaign for or against a director nominee or to require a company to include shareholder-nominated candidates in the company's proxy materials. The staff's position is consistent with the explanation that the Commission gave in 1976, and with the Commission's interpretation of the election exclusion.

A recent decision by the U.S. Court of Appeals for the Second Circuit in American Federation of State, County & Municipal Employees, Employees Pension Plan

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27 Exchange Act Release No. 34-12598 (July 7, 1976) [41 FR 29982].

v. American International Group, Inc.,[28] addressed the application of the election exclusion. In that decision, the Second Circuit held that AIG could not rely on Rule 14a-8(i)(8) to exclude a shareholder proposal seeking to amend a company's bylaws to establish a procedure under which a company would be required, in specified circumstances, to include shareholder nominees for director in the company's proxy materials. The Second Circuit interpreted the Commission's statement in 1976 as limiting the election exclusion "to shareholder proposals used to oppose solicitations dealing with an identified board seat in an upcoming election and reject[ing] the somewhat broader interpretation that the election exclusion applies to shareholder proposals that would institute procedures making such election contests more likely."[29] It is the Commission's position that the election exclusion should not be limited in this way.[30]

We are concerned that the Second Circuit's decision has resulted in uncertainty and confusion with respect to the appropriate application of Rule 14a-8(i)(8) and may lead to contested elections for directors without adequate disclosure. In this regard, not only are shareholders and companies unable to know with certainty whether a proposal that could result in an election contest may be excluded under Rule 14a-8(i)(8), but the staff also is severely limited in their ability to interpret Rule 14a-8 in responding to

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28 American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc., 462 F.3d 121 (2d Cir. 2006) (AFSCME v. AIG).

29 Id. at 128.

30 In this regard, we note that the Second Circuit noted in its decision that "...if the SEC determines that the interpretation of the election exclusion embodied in its 1976 Statement would result in a decrease in necessary disclosures or any other undesirable outcome, it can certainly change its interpretation of the election exclusion, provided that it explains its reasons for doing so." Id. at 130.

companies' notices of intent to exclude shareholder proposals. Therefore, to eliminate any uncertainty and confusion arising from the Second Circuit's decision, we are issuing this release to confirm the Commission's position that shareholder proposals that could result in an election contest may be excluded under Rule 14a-8(i)(8). We also are soliciting comment as to whether we should adopt proposed changes to Rule 14a-8(i)(8) to further clarify the rule's application. If clarification of the text of Rule 14a-8(i)(8) would be helpful, we are seeking input as to whether the text of the proposed amendment provides adequate clarity.

B. The Purpose of the Election Exclusion

The proper functioning of the election exclusion is critical to prevent the circumvention of other proxy rules that are carefully crafted to ensure that investors receive adequate disclosure in election contests. Because the board of directors of a company most often will include its own director nominees in its proxy materials, allowing shareholders to include their nominees in company proxy materials would create what is, in fact, a contested election of directors, without the shareholders conducting a separate proxy solicitation.

The detailed and carefully crafted regulatory regime governing contested elections does not contemplate the presence of nominees from different vying factions in the same proxy materials. As explained above, numerous protections of the federal proxy rules are triggered only by the presence of a solicitation made in opposition to another solicitation. Accordingly, were the election exclusion to be applied as contemplated in the Second Circuit's decision in AFSCME v. AIG, it would be possible for a person to wage an election contest without conducting a separate proxy solicitation, and thus without providing the disclosures required by the Commission's present rules governing such contests, and potentially without liability under Rule 14a-9 for misrepresentations made by that person in its proxy solicitations. Such a result would be inconsistent with the Commission's 1976 statement regarding Rule 14a-8(i)(8) and the staff's application of that statement in responding to Rule 14a-8 notices of companies' intent to exclude proposals.

C. Application of the Election Exclusion Since 1976

Since the Commission made its original statement regarding the intended purpose of the election exclusion in 1976, the Commission has made few statements regarding the exclusion, instead leaving application of the exclusion to the staff to implement in accordance with its stated intent at adoption. When the Commission has had occasion to comment on the exclusion or to review staff positions in applying the exclusion, however, it has done so in a manner that is consistent with its longstanding view of the exclusion's purpose.

The Division issued a series of letters in 1990 that addressed nomination proposals similar to that presented in the AFSCME v. AIG matter. In those letters, the Division set forth its framework for applying Rule 14a-8(i)(8) to nomination proposals:

> There appears to be some basis for [the company's] view that the proposal may be omitted pursuant to rule 14a-8[(i)](8). That provision allows the omission of a proposal that "relates to an election to office." In this regard, the staff particularly notes that the Commission has indicated that the "principal purposes of [rule 14a-8(i)(8)] is to make clear [that] with respect to corporate elections, that [r]ule 14a-8 is not the proper means for

conducting campaigns . . . since other proxy rules, including rule [14a-12] are applicable thereto." Securities Exchange Act Release No. 12598 (July 7, 1976). Insofar as it seeks to implement a common ballot procedure, it appears that this proposal . . . would establish a procedure that may result in contested elections to the board which is a matter more appropriately addressed under Rule 14a-12. Accordingly, this Division will not recommend enforcement action to the Commission if the Company excludes the proposal from its proxy materials.[31]

In 1992, in proposing reforms to the proxy rules, the Commission acknowledged the "difficulty experienced by shareholders in gaining a voice in determining the composition of the board of directors" but noted further that:

Proposals to require the company to include shareholder nominees in the company's proxy statement [rather than in the dissident's own proxy statement] would represent a substantial change in the Commission's proxy rules. This would essentially mandate a universal ballot including both management nominees and independent candidates for board seats.[32] (emphasis added).

The Division continued to include the "may result in contested elections" language in its letters regarding shareholder nomination proposals and Rule 14a-8(i)(8) for 10 years.[33] In 1998, the Division included this language in its letter to Storage

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31 See Division letter to Amoco (Feb. 14, 1990).

32 See Exchange Act Release No. 34-31326 (Oct. 16, 1992) [57 FR 48276].

33 In each of 1993 and 1995, the Division issued one letter that took a view that was counter to existing precedent and its own statements with regard to similar proposals. See Dravo Corp. (Feb. 21, 1995); and Pinnacle West Capital Corp. (Mar. 26, 1993) (not permitting exclusion under Rule

Technology Corporation.[34] In that letter, the Division agreed that there was a basis for the company's view that it could exclude, under Rule 14a-8(i)(8), a proposal that sought to amend the company's governing instruments to provide that any three shareholders who owned a combined minimum of 3,000 shares could include a director nominee in the company's proxy materials.[35] The shareholder sought Commission review of this Division position, but the Commission declined to review the no-action determination.[36]

As noted above, the Division continued to include the "contested elections" language in its Rule 14a-8(i)(8) no-action letters through and beyond the Commission's 1998 letter to Storage Technology Corporation. While the Division has continued to follow this analysis in past seasons, it ceased repeating this language in its letters during the 2000 proxy season, as the analysis had been established definitively through 10 years of Division positions and the Commission's letter to Storage Technology.

In 2003, the Division agreed that there was a basis for the view of Citigroup Inc. that it could exclude, under Rule 14a-8(i)(8), a proposal that was substantially similar to the proposal that was submitted to AIG by AFSCME and that was the subject of the

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14a-8(i)(8) of proposals seeking to include qualified nominees in the company's proxy statement). The staff issued these letters in error, as they clearly are inconsistent with the Commission statement in the 1976 release proposing Rule 14a-8(i)(8) and numerous Division statements before and after. Further, these letters are inconsistent with later Commission statements, as described below.

34 See Division letter to Storage Technology Corporation (Mar. 11, 1998) ("There appears to be some basis for your view that the first proposal may be omitted under rule 14a-8[(i)](8). It appears that the first proposal, rather than establishing procedures for nomination or qualification generally, would establish a procedure that may result in contested elections of directors, which is a matter more appropriately addressed under Rule [14a-12]. Accordingly, the Division will not recommend enforcement action to the Commission if the Company excludes the first proposal from its proxy materials in reliance upon Rule 14a-8[(i)](8)").

35 See id.

36 Letter of Jonathan Katz, Secretary of the Commission, to Dr. Seymour Licht P.E. (Apr. 6, 1998).

Second Circuit's recent opinion. In its letter to Citigroup Inc. (Jan. 31, 2003), the Division agreed that there was a basis for the Citigroup's view that the company could exclude a proposal because the proposal, "rather than establishing procedures for nomination or qualification generally, would establish a procedure that may result in contested elections of directors." The shareholder proposal at issue in Citigroup was submitted by AFSCME and, similar to the proposal submitted to AIG, would have amended the company's bylaws to require the company to include the name, along with certain disclosures and statements, of any person nominated for election to the board by a 3% or greater stockholder.

The shareholder sought Commission review of the Division's position in its 2003 letter to Citigroup. The Commission declined to review the staff's determination, stating:

> [t]he Commission has determined not to review the Division's no-action position under Rule 14a-8(i)(8). The Division's current no-action position is consistent with Division positions taken in recent years. Any change in the Division's current interpretation would require other significant adjustments in the system of proxy regulation under Section 14(a) of the Securities Exchange Act of 1934.[37]

While the Commission determined not to review the staff's position, it directed the Division of Corporation Finance to review the proxy rules regarding procedures for the election of corporate directors and provide the Commission

[37] See letter from Jonathan Katz, Secretary of the Commission, to Gerald W. McEntee (Apr. 14, 2003). In that letter, the Commission directed the Division to review the proxy rules and regulations, as well as the Division's interpretations, regarding procedures for the election of corporate directors. This review resulted in the Commission's proposal of revisions to the proxy rules in October 2003.

with recommendations regarding possible changes to the proxy rules.

Following the Division's review of the proxy rules, in 2003 the Commission proposed a comprehensive new set of rules, based on the Division's recommendations, which would govern shareholder director nominations that are not control-related.[38] The Commission would not have taken such action had it believed that Rule 14a-8 provided an appropriate avenue for shareholder director nominations. In fact, in discussing alternatives considered but not chosen in proposing the rules, the Commission specifically noted the alternative of revising Rule 14a-8(i)(8) to enable shareholders to use the shareholder proposal rule to participate more fully in the director nomination process.[39]

D. Commission Interpretation of Rule 14a-8(i)(8)

As noted previously, the Commission stated clearly when it proposed amendments to Rule 14a-8 in 1976 that "Rule 14a-8 is not the proper means for conducting campaigns or effecting reforms in elections of that nature, since other proxy rules, including Rule 14a-11, are applicable thereto."[40] Thus, Rule 14a-8 expressly was not intended to be a substitute, or additional, mechanism for conducting contested elections (the type of elections that would involve the "conducting [of] campaigns"), or

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38 Exchange Act Release No. 34-48626 (Oct. 14, 2003) [68 FR 60784].

39 Id. See also AFSCME at 130, n. 8 (stating that, because of the court's determination, "there might very well be no reason for a rule based on Proposed Rule 14a-11 to co-exist with the procedure that our holding makes available to shareholders").

40 Exchange Act Release No. 34-12598 (July 7, 1976). The Commission's reference in its 1976 statement to "other proxy rules, including Rule 14a-11," reflects the fact that, in 1976, Rule 14a-11 was the Commission proxy rule governing election contests. As part of a series of rule changes in 1999, the Commission rescinded Rule 14a-11 and moved many of the requirements of prior Rule 14a-11 to the current Rule 14a-12. [17 CFR 240.14a-12] See Securities Act Release No. 33-7760 (Oct. 22, 1999) [64 FR 61408]. Accordingly, the Commission's reference to Rule 14a-11 in 1976 was to the rules governing election contests, which now may be found generally elsewhere in the proxy rules and, in particular, in Rule 14a-12.

for effecting reforms in contested elections (elections whose "nature" involves campaigns). Based on the foregoing, it is the Commission's view that a proposal may be excluded under Rule 14a-8(i)(8) if it would result in an immediate election contest (e.g., by making or opposing a director nomination for a particular meeting) or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for subsequent meetings.

In the AFSCME opinion, the Second Circuit agreed with the Commission's view that shareholder proposals can be excluded under Rule 14a-8(i)(8) if they would result in an immediate election contest. The court, however, disagreed with the view that a proposal can be excluded under Rule 14a-8(i)(8) if it "establish[es] a process for shareholders to wage a future election contest."

We believe that the fact a proposal relates to the process for future elections rather than an immediate election is not dispositive in determining whether the election exclusion applies to the proposal. As the Commission stated in 1976, the express purpose of the election exclusion is to make clear that Rule 14a-8 is not a proper "means" to achieve election contests because "other proxy rules" are applicable to such contests. The use of Rule 14a-8 to require companies to include proposals that would require election contests to be conducted without compliance with the specific rules governing such contests would be contrary to the intent of the Commission's 1976 statement.

For these reasons, and to avoid such circumvention, the phrase "relates to an election" in the election exclusion cannot be read so narrowly as to refer only to a proposal that "relates to the current election," or a particular election, but rather must be read to refer to a proposal that "relates to an election" in subsequent years as well. In this regard, if one looked only to what a proposal accomplished in the current year, and not to its effect in subsequent years, the purpose of the exclusion could be evaded easily. For example, such a reading might permit a company to exclude a shareholder proposal that nominated a candidate for election as director for the upcoming meeting of shareholders but not exclude a proposal that required the company to include the same shareholder-nominated candidate in the company's proxy materials for the following year's meeting.

In implementing the Commission's intended meaning, the staff has taken care not to adopt an inappropriately broad reading of whether a proposal "relates to an election," as such a reading would permit the exclusion of all proposals regarding the qualifications of directors, the composition of the board, shareholder voting procedures, and board nomination procedures. We agree with the staff's application of the exclusion in this regard, as an inappropriately broad reading of the exclusion would deny shareholder access to the company proxy materials under Rule 14a-8 with respect to a vast category of election matters of importance to shareholders that would not result in an election contest between management and shareholder nominees, and that do not present significant conflicts with the Commission's other proxy rules.[41]

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[41] In this regard, the staff has taken the position that a proposal relates to "an election for membership on the company's board of directors or analogous governing body" and, as such, may be excluded under Rule 14a-8(i)(8) if it could have the effect of, or proposes a procedure that could have the effect of, any of the following:

- disqualifying board nominees who are standing for election;
- removing a director from office before his or her term expired;
- questioning the competence or business judgment of one or more directors; or
- requiring companies to include shareholder nominees for director in the companies' proxy materials or otherwise resulting in a solicitation on behalf of shareholder nominees in opposition to management-chosen nominees.

Conversely, the staff has taken the position that a proposal may not be excluded under Rule 14a-8(i)(8) if it relates to any of the following:

- qualifications of directors or board structure (as long as the proposal will not remove current directors or not disqualify current nominees);

Our interpretation of the election exclusion is fully consistent with the Commission's statement in 1976, that the rule was not intended "to cover proposals dealing with matters previously not held not excludable by the Commission, such as cumulative voting rights, general qualifications for directors..." In the AFSCME v. AIG opinion, the Second Circuit inferred from this Commission statement that the Commission "reject[ed] the somewhat broader interpretation that the election exclusion applies to shareholder proposals that would institute procedures for making election contests more likely." Our view that Rule 14a-8(i)(8) allows companies to exclude shareholder proposals that could result in election contests without compliance with the contested election proxy rules is consistent with the Commission's statement in 1976. As explained above, the analysis under Rule 14a-8(i)(8) does not focus on whether the proposal would make election contests more likely, but whether the resulting contests would be governed by the Commission's proxy rules for contested elections. The Commission's references in 1976 to proposals relating to "cumulative voting rights" and "general qualifications for directors" simply reflect the long-held belief that these proposals generally do not trigger the contested elections proxy rules and therefore are not excludable under Rule 14a-8(i)(8). Accordingly, the Commission's 1976 statement should not be interpreted to mean that Rule 14a-8(i)(8) is inapplicable to proposals establishing procedures for elections generally.

III. Proposed Amendments to Rule 14a-8(i)(8)

In addition to the guidance provided in this release regarding our interpretation of

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- voting procedures (such as majority or cumulative voting);
- nominating procedures; or
- reimbursement of shareholder expenses in contested elections.

Rule 14a-8(i)(8), we are considering whether it would be appropriate to amend that rule to further clarify the meaning of its exclusion. The text of Rule 14a-8(i)(8) currently specifies only that a proposal may be excluded "[i]f the proposal relates to an election for membership on the company's board of directors or analogous governing body." To clarify the meaning of the exclusion, consistent with the Commission's interpretation of that exclusion, we are proposing to revise the exclusion to read:

> If the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election.

We believe that the added references to "nomination" and "procedure" in the rule text will reflect more appropriately the purpose of the election exclusion. Further, if adopted, we would indicate clearly that the term "procedures" referenced in the election exclusion relates to procedures that would result in a contested election, either in the year in which the proposal is submitted or in subsequent years, consistent with the Commission's interpretation of the exclusion.

As discussed above, we are proposing amendments to Rule 14a-8 that would clarify the operation of the exclusion in Rule 14a-8(i)(8) in a manner that is consistent with the Commission's interpretation of that exclusion. With regard to this proposed amendment, we are soliciting comment as to the following:

- Would the proposed amendments to Rule 14a-8(i)(8) provide sufficient certainty regarding the scope of the exclusion? If not, what additional amendments are necessary?
- Should the exclusion specify those procedures that the staff historically has

found to fall within the exclusion?

- What additional clarification would be helpful and/or appropriate?

For further clarity, should the proposed amendments include a specific reference to the interpretation of the exclusion with respect to procedures that could not result in a contested election? An example of such a further clarification would be:

> In this regard, a proposal relates to "a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election" if it could have the effect of, or proposes a procedure that could have the effect of, any of the following: (A) disqualifying board nominees who are standing for election; (B) removing a director from office before his or her term expired; (C) questioning the competence or business judgment of one or more directors; or (D) requiring companies to include shareholder nominees for director in the companies' proxy materials or otherwise resulting in a solicitation on behalf of shareholder nominees in opposition to management-chosen nominees.

IV. General Request for Comment

We request and encourage any interested person to submit comments regarding:

- the proposed amendments that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors, and other market participants. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments. We will consider all comments responsive to this inquiry in complying with our responsibilities under Section 23(a) of the Exchange Act.[42]

V. Paperwork Reduction Act

A. Background

The proposed amendments affect "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995, the PRA.[43] The title for the affected collection of information is "Proxy Statements - Regulation 14A (Commission Rules 14a-1 through 14a-16 and Schedule 14A)" (OMB Control No. 3235-0059). This regulation was adopted pursuant to the Exchange Act and sets forth the disclosure requirements for proxy statements filed by companies to help investors make informed voting decisions.

The hours and costs associated with preparing and filing the disclosure, filing the forms and schedules and retaining records required by these regulations constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

B. Summary of Proposals

Rule 14a-8 is the Commission rule that provides shareholders with an opportunity to place a proposal in a company's proxy materials for a vote at an annual or special meeting of shareholders. The proposed amendments to that rule are intended to clarify

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42 15 U.S.C. 78w(a).

43 44 U.S.C. 3501 et seq.

the scope of the exclusion in Rule 14a-8(i)(8), consistent with the Commission's interpretation of the exclusion. The amendments would provide certainty regarding the meaning of the exclusion in that rule.

C. Paperwork Reduction Act Burden Estimates

Adoption of the Rule 14a-8(i)(8) amendments would merely revise the text of the rule in a manner that is consistent with the Commission's interpretation of the rule. As such, the amendments proposed today would not change the information that companies are required to provide on Schedule 14A; the same information will be required if the proposed amendments are adopted.

D. Solicitation of Comments

We request comment on this Paperwork Reduction Act Analysis. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

- evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- evaluate the accuracy of the Commission's estimate of burden of the proposed collection of information;
- determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-17-07. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-17-07, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Assistance, Washington, DC 20549.

VI. Cost-Benefit Analysis

We propose amendments that would clarify existing rules. The opinion in American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.[44] has created uncertainty regarding the Commission staff's longstanding administration of Rule 14a-8(i)(8), making it difficult for shareholders and companies to assess the operation of that rule. The proposed amendments to that rule are intended to clarify the scope of the exclusion in Rule 14a-8(i)(8), consistent with the Commission's interpretation of the rule. Without such clarification, shareholders and companies may be uncertain as to the range of shareholder proposals that are required to be included in company proxy materials and may be uncertain as to the proper range of proposals that shareholders may submit to companies for inclusion in those proxy materials. For example, without clarification of the exclusion in Rule 14a-8(i)(8), shareholders may incur costs in preparing and submitting proposals that a company may properly exclude from its proxy materials.

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[44] 462 F.3d 121 (2d Cir. 2006) (AFSCME).

Because the proposed amendments would clarify that the scope of the exclusion in Rule 14a-8(i)(8) is consistent with the Commission's interpretation of that exclusion, shareholders and companies would not incur additional costs to determine the appropriate scope of that exclusion. Further, companies would not incur additional costs with regard to the inclusion of shareholder proposals in proxy materials.

The proposed amendments should improve the ability of shareholders to prepare and submit proposals that will be required to be included in a company's proxy materials, as those shareholders will have a clear understanding of the scope of the Rule 14a-8(i)(8) exemption. Further, without the clarification of the proper scope of the Rule 14a-8(i)(8) exclusion that would be provided by the amendments, shareholders and companies may incur substantial expense in litigating disputes regarding that exclusion.

Request for Comment

We are sensitive to the costs and benefits imposed by our rules. We have identified no costs and certain benefits related to these proposals. We request comment on all aspects of this cost-benefit analysis, including identification of any costs and additional benefits. We encourage commenters to identify and supply relevant data concerning the costs and benefits of the proposed amendments.

VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act[45] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the

[45] 15 U.S.C. 78w(a)(2).

Exchange Act. Section 3(f) of the Exchange Act[46] and Section 2(c) of the Investment Company Act of 1940[47] requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

The AFSCME opinion has created uncertainty regarding the Commission staff's longstanding administration of Rule 14a-8(i)(8), making it difficult for companies and shareholders to assess the operation of that rule. This has resulted in uncertainty regarding whether Rule 14a-8 requires companies to include in their proxy materials shareholder proposals that would establish procedures under which shareholder nominees for director, despite the exclusion provided by Rule 14a-8(i)(8). This uncertainty has made it difficult for shareholders and companies to assess the proper operation of the shareholder proposal rule and has generated economic inefficiency by introducing potential litigation costs, and costs incurred to prepare and respond to shareholder proposals.

The proposed amendments are intended to clarify the scope of the exclusion in Rule 14a-8(i)(8), consistent with the Commission's interpretation of the rule. This should improve shareholders' and companies' ability to assess shareholder proposals with a clear understanding whether Rule 14a-8 will require inclusion of the proposal. Informed decisions in this regard generally promote market efficiency and capital formation. We believe the proposed amendments to Rule 14a-8 would not impose a burden on

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46 15 U.S.C. 78c(f).

47 15 U.S.C. 80a-2(c).

competition.

We request comment on whether the proposed amendments, if adopted, would impose a burden on competition. We also request comment on whether the proposed amendments, if adopted, would promote efficiency, competition and capital formation. Finally, we request commenters to provide empirical data and other factual support for their views if possible.

VIII. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed amendments to Rule 14a-8 that would clarify the application of the exclusion provided by paragraph (i)(8) of that rule.

A. Reasons for, and Objectives of, Proposed Action

The purpose of the proposed amendments is to clarify the requirements of companies to include in their proxy materials shareholder proposals relating to procedures for the inclusion of shareholder nominees for directors in company proxy materials. The proposed amendments would clarify the scope of Rule 14a-8(i)(8), which permits companies to omit certain such proposals from their proxy materials.

The proposals, if adopted, should improve shareholders' and companies' ability to assess shareholder proposals with a clear understanding whether Rule 14a-8 will require inclusion of the proposal.

B. Legal Basis

We are proposing amendments to the rules under the authority set forth in Sections 14 and 23(a) of the Exchange Act, as amended, and Sections 20(a) and 38 of the Investment Company Act of 1940, as amended.

C. Small Entities Subject to the Proposed Rules

The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[48] The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission.[49] A "small business" and "small organization," when used with reference to a company other than an investment company, generally means an company with total assets of $5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,100 companies, other than investment companies, that may be considered reporting small entities.[50] The proposed rules may affect each of the approximately 1,315 small entities that are subject to the Exchange Act reporting requirements.

We request comment on the number of small entities that would be impacted by our proposals, including any available empirical data.

D. Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments would impose no new reporting, recordkeeping, or compliance requirements. The impact of these proposals relates to clarifying the scope of the requirement to include shareholder proposals in company proxy materials.

E. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no rules that conflict with or duplicate the proposed

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48 5 U.S.C. 601(6).

49 Securities Act Rule 157 (17 CFR 230.157), Exchange Act Rule 0-10 (17 CFR 240.0-10) and Investment Company Act Rule 0-10 (17 CFR 270.0-10) contain the applicable definitions.

50 The estimated number of reporting small entities is based on 2007 data, including the Commission's EDGAR database and Thomson Financial's Worldscope database. Approximately 215 investment companies meet this definition.

rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective of our proposals, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments and rules, we considered the following alternatives:

1. the establishment of different compliance or reporting requirements or timetables that take into account the resources available to small entities;
2. the clarification, consolidation, or simplification of the rule's compliance and reporting requirements for small entities;
3. the use of performance rather than design standards; and
4. an exemption from coverage of the proposed rules, or any part thereof, for small entities.

Regarding Alternative 1, we believe that differing compliance or reporting requirements for small entities would be inconsistent with Rule 14a-8, the Commission's intent when it adopted that rule, and the Commission's purpose of providing certainty in the application of that rule. Regarding Alternative 2, the proposals are concise and would clarify the Rule 14a-8(i)(8) exclusion for all entities, including small entities. Regarding Alternative 3, we believe that design rather than performance standards are appropriate because use of performance standards for small entities would not be consistent with the purpose of Rule 14a-8. Finally, an exemption for small entities is not appropriate because the proposals are designed to provide certainty and consistency regarding the application of the exclusion provided by Rule 14a-8.

G. Solicitation of Comment

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposals;
- The existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and
- How to quantify the impact of the proposed rules.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the final regulatory flexibility analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

IX. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[51] a rule is "major" if it has resulted, or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;

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[51] Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 50 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. §601).

- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment or innovation.

X. Statutory Basis and Text of Proposed Amendments

We are proposing amendments to rules pursuant to Sections 14, and 23(a) of the Exchange Act, as amended, and Sections 20(a) and 38 of the Investment Company Act of 1940, as amended.

List of Subjects

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations as follows:

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 24 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; and 18 U.S.C. 1350, unless otherwise noted.

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2. Amend §240.14a-8 by revising paragraph (i)(8) to read as follows:

§240.14a-8 Shareholder proposals.

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(i) * * *

(8) <u>Relates to election</u>: If the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election;

* * * * *

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: July 27, 2007

Chairman Cox Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8827 / July 31, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 56170 / July 31, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2660 / July 31, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12718

In the Matter of

ASPEN TECHNOLOGY, INC.,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Aspen Technology, Inc. ("Aspen" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-

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and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

1. From at least 1999 through 2002, Aspen -- often acting through its Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Chief Operating Officer (COO) -- engaged in a scheme to fraudulently inflate revenues by improperly recognizing revenue on at least nineteen different software license transactions involving at least fifteen different customers world-wide. Motivated by a desire to boost revenues and meet securities analyst earnings expectations, Aspen's CEO, CFO and COO were directly involved in negotiating and improperly recognizing revenue on certain of these transactions. The scheme involved premature recognition of revenue where revenue was not recognizable under generally accepted accounting principles ("GAAP") in the quarters claimed by Aspen either because contracts were not signed within the appropriate quarter or because the earnings process was incomplete due to side letters or other contingency arrangements. In several reporting periods, Aspen would not have met analysts' earnings expectations without the improperly recognized revenue.[2]

2. On March 15, 2005, Aspen restated its financial statements for fiscal years ended June 30, 2000 through June 30, 2004. Among other things, the restatement revealed that Aspen had overstated previously reported license revenue for the fiscal year ended June 30, 2000 by 5.5% and for the fiscal year ended June 30, 2001 by 9.3%, resulting in net income dropping from $5.4 million to a loss of $3.2 million for fiscal 2000 and increasing the previously reported loss for fiscal 2001 by $16 million.

B. RESPONDENT

3. Aspen, a Delaware corporation based in Cambridge, Massachusetts, sells computer software used in chemical, petroleum and other industrial operations. Aspen's stock is registered with the Commission under Section 12(g) of the Exchange Act and trades on the NASDAQ National Market System. Aspen reports its results of operations on a fiscal year basis ending on June 30.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] From June 1, 2000 through May 9, 2002, Aspen financed six acquisitions through private placements of common stock exempt from registration under Section 4(2) of the Securities Act. In addition, Aspen filed Forms S-8 with the Commission to register shares in each of the years 2000, 2001 and 2004; those registration statements incorporated by reference the periodic reports discussed herein.

C. BACKGROUND

License Revenue Fraudulently Recognized in the Fiscal Year Ended June 30, 1999

4. On September 28, 1999, Aspen filed with the Commission its Form 10-K for the year ended June 30, 1999. The financial statements in the Form 10-K overstated Aspen's software license revenue for the quarter ended June 30, 1999 by 25% due to fraudulent accounting on two software license transactions. As described below, Aspen's CFO was directly involved in at least one of the transactions and was aware that recognition of revenue from that transaction was improper.

5. In or about late June or early July 1999, Aspen's outside auditor expressed concern that the terms of a $9.9 million software license agreement with a Texas-based oil company ("the Texas oil company"), would prevent Aspen from recognizing the revenue up front because the agreement included a requirement that Aspen provide additional, as yet undetermined, software products at no additional cost. Under GAAP, revenue may not be recognized up-front where there is a future obligation to provide as yet undetermined products. Aspen's CFO, motivated by a desire to recognize the revenue up-front and thereby meet consensus analyst earnings expectations, evaded the auditor's concerns by causing the sales documents to be revised to remove that provision and by putting the obligation to provide additional products into a separate side agreement, which she signed on August 20, 1999. Aspen then improperly accounted for the license revenue up front: approximately $4.5 million was recorded in Aspen's books and records and improperly recognized as revenue in the quarter ended June 30, 1999 (18% of total license revenue) and approximately $5.4 million was recorded in Aspen's books and records and recognized as revenue in the quarter ended September 30, 2000 (25 % of total license revenue). For the quarter and year ended June 30, 1999 and for the quarter ended September 30, 1999, Aspen exceeded the consensus analyst earnings estimates. Had the revenue from the Texas oil company not been recorded in those periods, Aspen would have significantly missed analyst earnings expectations for each of those periods.

6. Similarly, for the quarter and fiscal year ended June 30, 1999, Aspen recorded in its books and records and recognized $1.7 million in license revenue pursuant to a software license agreement dated June 30, 1999 with a large petroleum refining company based in India ("the Indian refining company"). That revenue should also not have been recognized up front because an Aspen salesman had entered into a side letter with the Indian refining company pursuant to which Aspen agreed to provide additional, as yet undetermined, software products. As noted above, under GAAP, the commitment to provide additional future software required that Aspen record and recognize the license revenue for the transaction with the Indian refining company over a longer period of time.

License Revenue Fraudulently Recognized in the Fiscal Year Ended June 30, 2000

7. During the fiscal year ended June 30, 2000, again as a result of side letter agreements, Aspen fraudulently recorded in its books and records and recognized revenue from two software license transactions. The first transaction involved a Korean engineering and

construction firm ("the Korean company"). For the quarter ended March 31, 2000, Aspen recorded in its books and records and recognized $1.1 million in license revenue pursuant to a software license agreement dated March 31, 2000 with the Korean company. The revenue should not have been recognized because an Aspen salesman entered into two contemporaneous side letter agreements with the Korean company which obligated Aspen to provide $300,000 in cash and $800,000 in services to the Korean company. Under GAAP, because the total amount of software license revenue was offset by Aspen's obligations under the side letters, Aspen should not have recorded or recognized revenue on the transaction. On May 15, 2000, Aspen filed its Form 10-Q for the quarter ended March 31, 2000; the financial statements in the Form 10-Q improperly included approximately $1.1 million in software license revenue from the transaction.

8. The second transaction involved a software license agreement dated March 31, 2000 with a French company ("the French company"). For the quarter ended June 30, 2000, Aspen fraudulently recorded in its books and records and recognized license revenue of $1.5 million relating to that agreement. The revenue should not have been recognized because an Aspen salesman entered into a contemporaneous side letter agreement which created contingencies to the French company's obligations. Under GAAP, the existence of those contingencies prohibited up-front recognition of the license revenue. On September 28, 2000, Aspen filed its Form 10-K for the year ended June 30; the financial statements in the Form 10-K improperly included approximately $1.5 million in software license revenue from the transaction.

License Revenue Fraudulently Recognized in the Fiscal Year Ended June 30, 2001

Second Quarter 2001 Revenue

9. On February 14, 2001, Aspen filed its Form 10-Q for the quarter ended December 31, 2000. In the financial statements included in that filing, Aspen's software license revenue for the quarter was fraudulently inflated by 18.6% as a result of the improper recognition of revenue from five software transactions. As described below, Aspen's CEO, CFO and COO were all aware that the recognition was improper in at least two of those transactions.

10. Aspen's CEO, motivated by a desire to increase revenue at the end of a quarter, was the architect of a fraudulent revenue transaction with an information technology company based in New York ("the New York company"). For the quarter ended December 31, 2000, Aspen improperly recorded in its books and records and recognized $2.8 million in license revenue pursuant to a software license agreement with the New York company. Under GAAP, the revenue from the transaction with the New York company should not have been recognized for two independent reasons: (i) the transaction was still being negotiated after quarter end; and (ii) the New York company's payment to Aspen was contingent on Aspen finding end users to which the New York company could resell the software.

11. Just before the close of the second quarter, around December 25, 2000, the CEO asked the New York company to buy approximately $3 million worth of software. In order to induce the New York company to make the deal, the CEO promised that Aspen would arrange for end-users to purchase the software from the New York company. The CEO further promised that

the New York company would not be required to pay for the licenses until Aspen arranged for those end-users to purchase the software, and that if the New York company was unable to resell all $3 million in licenses, Aspen would arrange financing for the transaction until the licenses were sold through to end-users. On or about January 6, 2001, an employee of the New York company observed to a coworker in an email that: "AspenTech needs to realize the $3M sale in Dec. 2000 business, and they are willing to make some extraordinary concessions for this." Aspen's CEO, CFO, and COO all knew that Aspen and the New York company were still negotiating the terms of the license sale through mid-January 2001, and also knew that, in order to legitimately recognize the revenue in the quarter ended December 31, the deal had to have been signed before December 31, 2000. In an attempt to make it appear that the deal was signed before the close of the quarter, an Aspen salesman asked the New York company representative in January 2001 to sign the software license agreement and to back date it December 29, 2000. The CEO, CFO and COO were motivated to prematurely recognize the revenue by a desire to increase revenues in the quarter and to meet analyst earnings expectations. Including the revenue from the New York company allowed Aspen to exceed analyst earnings expectations for the quarter; without that revenue, Aspen would have missed analyst earnings expectations.

12. Similarly, in a transaction with a British software company ("the British company"), Aspen's CEO, CFO and COO all participated in a deal which resulted in Aspen fraudulently recording in its books and records and recognizing $1.75 million in license revenue for the quarter ended December 31, 2000. Under GAAP, the revenue should not have been recorded or recognized for two independent reasons: (1) the transaction was still being negotiated after quarter end; and (2) the British company's payment for the licenses was contingent on Aspen finding customers who would purchase a minimum amount of software implementation services from the British company. Aspen's CEO was aware that the transaction was being negotiated after quarter end, and both Aspen's CFO and COO knew that the British company's payment was contingent on Aspen finding customers to purchase services from the British company. Despite this, all three caused Aspen to improperly recognize revenue on the transaction in the quarter ended December 31, 2000. Including the revenue from the British company allowed Aspen to exceed analyst earnings expectations for the quarter.

13. In addition, for the quarter ended December 31, 2000, Aspen also fraudulently recorded in its books and records and recognized license revenue of $1.2 million pursuant to a software license agreement dated December 29, 2000 with a South African construction company that was a reseller of Aspen products in Africa, $824,000 pursuant to an agreement dated December 29, 2000 with an Indian reseller of Aspen's software, and $978,000 pursuant to a software license agreement dated December 30, 2000 with a Thailand chemical company. Aspen should not have recognized the revenue up-front on each of these transactions due to the existence of contingencies that, among other reasons, under GAAP made collectibility not probable.

Fourth Quarter 2001 Revenue

14. On September 26, 2001, Aspen filed with the Commission its Form 10-K for the year ended June 30, 2001. Aspen's quarterly and yearly financial results for fiscal 2001 were also reported in a Form 8-K filed with the Commission on August 8, 2001. As a result of fraudulent

revenue recognition from three software license transactions, Aspen's software license revenue for the fourth quarter of 2001 was inflated by 15.8%. Aspen's CEO, CFO and COO knew that the recognition of revenue from at least one of those transactions was improper.

15. Among the fourth quarter 2001 transactions, Aspen fraudulently recorded in its books and records and recognized $4.3 million in license revenue pursuant to a software license agreement with a large petroleum company in Russia ("the Russian company"). Aspen's CEO, CFO and COO all participated in the scheme to improperly recognize revenue from the deal. Under GAAP, the revenue from the transaction with the Russian company should not have been recorded or recognized for two independent reasons: (1) the transaction was still being negotiated after quarter end; and (2) a separate side agreement signed by Aspen's COO created significant contingencies to the Russian company's obligations under the license agreement.

16. Aspen's CEO, COO, and CFO all knew that the deal with the Russian company was not completed within the quarter ended June 30, 2001. The COO, with the knowledge of Aspen's CEO and CFO, had the Russian company sign the software license agreement in July 2001 but back date it June 2001 so that Aspen could fraudulently recognize the revenue in the 2001 fiscal year. On or about July 5, 2001, the COO sent an e-mail, marked "destroy after reading," to the CEO and CFO attaching a draft letter to the Russian company's president. The attached letter to the Russian company's president proposed, in part, that the Russian company sign the contemplated software agreement by July 10, 2001 and stated that "[a]s a quarterly driven software company, our business model requires that we book significant software license revenue. ... By [the Russian company] committing to the software license agreement [by July 10, 2001] ... we can recognize the revenue for our fiscal year ending June 30, 2001 . . . ." In addition, in mid-July 2001, Aspen's COO entered into a side agreement with the Russian company which created significant contingencies. The side agreement gave the Russian company the "unconditional right[]" to withdraw from the software agreement if the parties failed to reach any one of three additional agreements by August 1, 2001. Because the parties failed to enter into any of the additional agreements referenced in the side agreement, the Russian company had no obligation to purchase any software pursuant to the software agreement. Aspen's CEO, CFO and COO were all motivated to prematurely recognize the revenue from the Russian company transaction by a desire to meet consensus analysts' earnings expectations. Without the revenue from the Russian company transaction, Aspen would not have met quarterly analysts' earning expectations.

17. In addition, on or about August 7, 2001, Aspen's CEO, CFO and COO signed a letter to Aspen's outside auditors which falsely represented that "there are no contingencies, amendments or modifications to the original agreement, side agreements (verbal or written) or expected future concessions under [the software agreement] between Aspen and [the Russian company]."

18. Aspen also fraudulently recorded in its books and records and recognized $1.8 million in license revenue pursuant to software license agreements dated June 8, 2001 with a large petroleum refining company in Asia and $225,000 pursuant to a software license agreement dated June 30, 2001 with a Canadian systems integrator. Aspen should not have recognized revenue in

the quarter ended June 30, 2001 on either of these transactions due to contingencies that, among other reasons, under GAAP, caused the fees not to be fixed or determinable.

License Revenue Fraudulently Recognized in the Fiscal Year Ended June 30, 2002

19. On September 30, 2002, Aspen filed with the Commission its Form 10-K for the year ended June 30, 2002. The financial statements in the filing overstated revenue as a result of fraudulent revenue recognition from at least three software license transactions. As described below, Aspen's CFO and COO, again motivated by a desire to increase revenues for the quarter, were directly involved in the improper revenue recognition on at least one of the transactions.

20. In a second instance of improper revenue recognition involving the New York company referenced above, Aspen's CFO and COO caused revenue to be recognized despite knowing that the New York company's obligations were contingent and that revenue could not be recognized. As a result, for the quarter ended March 30, 2002, Aspen fraudulently recorded in its books and records and recognized $1.7 million in license revenue pursuant to a software license agreement with the New York company dated March 28, 2002. This transaction totaled approximately 4.5% of Aspen's license revenue for the quarter and was reported on Aspen's Form 10-Q/A for the quarter ended March 31, 2002, filed with the Commission on September 6, 2002.

21. The revenue from the second New York company deal should not have been recognized up-front because, similar to the prior deal, the New York company's obligation to pay Aspen was contingent upon resale to an end-user, and thus, the license fee did not meet the requirements for up-front revenue recognition. Aspen's CFO and COO were aware of this contingency at the time the revenue was fraudulently recognized. For example, in early March 2002, an Aspen salesman copied Aspen's CFO on an email, stating in part that "We are in the closing stages of completing a deal with [an Italian company]. . . . The deal is most likely to be sold through [the New York company] as they have an existing agreement with [the Italian company] . . . . The timing of [the Italian company] deal will mean we run close to the end of Q3. My question is, if [the New York company] sign [sic] up the deal with us in March but the [Italian company] deal with [the New York company] completes in early April, would we be able to recognize the deal in Q3? [The New York company] would purchase the software on behalf of [the Italian company] as part of the larger project. Let me know asap, as this has a bearing on how much pressure we put on [the Italian company]." Aspen's CFO responded to this email by stating "We have tried this several times with [the New York company] and it hasn't worked as they always want the end customer to be committed before they are committed - SO I am willing to give it a try but don't count on it!!" The CFO then forwarded the email string to, among others, the COO, with a note stating: "THis [sic] is risky!!" Despite the CFO and COO's knowledge that the New York company's commitment was contingent upon resale to a third party, Aspen fraudulently recognized the revenue from the transaction. Recognizing the revenue from the New York deal allowed Aspen to exceed analyst earnings expectations; without the revenue, Aspen would have missed expectations.

22. In a second transaction with the South African company referenced above, for the fiscal quarter ended June 30, 2002, Aspen recorded in its books and records and fraudulently recognized $440,000 in license revenue pursuant to a software license agreement dated June 30, 2002. In mid-2002, an Aspen salesman offered the South African company a $45,000 payment to simply sign a software license agreement to buy $450,000 in software licenses and then transfer the software on to an end-user that Aspen had previously lined-up. The Aspen salesman entered into a letter agreement with the South African company on July 1, 2002 confirming that Aspen, in recognition of the South African company's signing of the license agreement, would sell the software to an end user and pay the South African company a commission of $45,000. Under GAAP, this transaction was not a bona fide sale and thus the revenue should not have been recognized.

23. Lastly, Aspen's COO, motivated by a desire to partially offset a large revenue shortfall in the final days of the quarter, entered into contemporaneous side agreements with a Kuwait company ("the Kuwait company") which affected delivery and caused the fee under the license agreement not to be fixed or determinable. As a result, for the quarter ended June 30, 2002, Aspen fraudulently recorded in its books and records and recognized $1.9 million in license revenue pursuant to a software license agreement with the Kuwait company. Had the revenue from the Kuwait company transaction not been recorded in this period, Aspen would have missed consensus analyst expectations by a greater margin.

The Restatement

24. On October 27, 2004, Aspen announced that its board of directors' audit committee began an investigation of accounting for software license and service agreements entered into during fiscal years 2000 through 2002. On November 24, 2004, Aspen announced that it would file a restatement of its financial statements due to certain accounting improprieties. On March 15, 2005, Aspen restated its financial statements for fiscal years 2000 through 2004. The restatement revealed that Aspen had overstated previously reported license revenue for fiscal 2000 by 5.5% and for fiscal 2001 by 9.3%, resulting in net income dropping from $5.4 million to a loss of $3.2 million in 2000 and increasing the previously reported loss for fiscal 2001 by $16 million. License revenue for the years ended June 30, 2002, 2003, and 2004 was understated by 1.8%, 13.9%, and 4.0% respectively. As a result of prematurely recognized revenue from several transactions in fiscal 2001 and prior, the revenue was moved to these later periods.

D. VIOLATIONS

25. As a result of the conduct described above, Aspen violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale or in connection with the purchase or sale of securities.

26. Also as a result of the conduct described above, Aspen violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 and 12b-20 thereunder.

27. Because Aspen improperly recorded revenue, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

28. In addition, Aspen failed to implement internal accounting controls relating to its revenue accounts sufficient to provide reasonable assurances that these accounts were accurately stated in accordance with GAAP.

29. As a result of the conduct described above, Aspen violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

30. Lastly, as a result of the conduct described above, Aspen violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

E. <u>ONGOING COOPERATION</u>

31. In determining to accept the Offer, the Commission has considered the following undertaking by the Respondent – Aspen shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. Aspen shall: (i) produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission staff; (ii) use its best efforts to cause its employees to be interviewed by the Commission staff at such times as the staff reasonably may direct; and (iii) use its best efforts to cause its employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be reasonably requested by the Commission staff.

F. <u>UNDERTAKINGS</u>

Respondent undertakes to:

a. Retain, through its Board of Directors, within thirty days after the entry of this Order, an Independent Consultant ("Independent Consultant"), not unacceptable to the staff of the Commission, to review Aspen's financial and accounting policies and procedures relating to: (i) revenue recognition on software licensing agreements, including the consideration of SOP 97-2 and documentation of that consideration; (ii) the signing and dating of material sales contracts and purchase orders and the retention by Aspen's corporate finance organization of all such contracts and purchase orders; (iii) written documentation that all sales contingencies have been met in material revenue transactions; (iv) the generation and issuance to customers of sales invoices; and (v) the preparation and review of accounts receivable confirmations. Aspen shall require the Independent Consultant to also consider, based on his/her review, the nature and extent of Aspen's Board of Directors training required to minimize the possibility of future violations of the federal securities laws by Aspen, acting through its finance and accounting employees. At the conclusion of the review, which in no event shall be more than 90 days after the Independent Consultant's retention, Aspen shall require the Independent Consultant to submit a Report to Aspen and to the Boston Regional Office of the Commission. The Report shall address the issues described above and shall include a description of the review performed, the conclusions reached and the Independent Consultant's recommendations for changes in or improvements to policies and procedures, including recommendations as to the nature and extent of Board of Directors' training.

b. Respondent shall adopt all of the Independent Consultant's recommendations for changes in or improvements to policies and procedures as set forth below; provided however, that within 45 days from the date of submission of the Independent Consultant's report, Respondent shall in writing advise the Independent Consultant and the staff of the Commission's Boston Regional Office of any recommendation that Respondent considers to be unnecessary, inappropriate, unreasonable, impractical or infeasible. Respondent need not adopt any such recommendation at that time but shall propose in writing an alternative policy or procedure designed to achieve the same objective.

c. As to any recommendation with respect to Respondent's policies and procedures on which Respondent and the Independent Consultant do not agree, they shall make a good faith attempt to reach agreement within 60 days from the date of submission of the Independent Consultant's report. In the event the Respondent and the Independent Consultant are unable to agree on an alternative proposal, Respondent will follow the recommendation of the Independent Consultant. To the extent the Independent Consultant proposes, in his/her report, alternative recommendations, any one of which is intended to address a given matter, Respondent may adopt one of the proposed alternatives and need not notify the Independent Consultant or the staff of the Commission's Boston Regional Office of alternative recommendations not adopted.

d. Aspen (i) shall not have the authority to terminate the Independent Consultant, without the prior written approval of the Commission's Boston Regional Office; (ii) shall compensate the Consultant, and persons engaged to assist the Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; and, (iii) shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Consultant from transmitting any information, reports, or documents to the staff of the Commission; and

e. Aspen shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Aspen, or any of its present or former affiliates, directors, officers, employees, or agents, respectively, acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Commission's Boston Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Aspen, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Aspen's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Aspen cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent shall comply with the undertakings enumerated in Section III.F, above.

C. Deadlines: For good cause shown, the Commission staff may extend any of the procedural deadlines set forth herein.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioners Atkins & Casey Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[Release No. 34-56160; IC-27913; File No. S7-16-07]

RIN 3235-AJ92

Shareholder Proposals

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to the rules under the Securities Exchange Act of 1934 concerning shareholder proposals and electronic shareholder communications, as well as to the disclosure requirements of Schedule 14A and Schedule 13G. Proposed amendments to Exchange Act Rule 14a-8 would enable shareholders to include in company proxy materials their proposals for bylaw amendments regarding the procedures for nominating candidates to the board of directors. Schedule 14A and Schedule 13G would be amended to provide shareholders with additional information about the proponents of these proposals, as well as any shareholders that nominate a candidate under such an adopted procedure. Included in these nominating shareholder disclosures would be the disclosure requirements that currently apply to traditional proxy contests. Finally, the proposed amendments would revise the proxy rules to clarify that participation in an electronic shareholder forum that may constitute a solicitation would be generally exempt from the proxy rules. This release accompanies a second release, Shareholder Proposals Relating to the Election of Directors, in which we publish an interpretation and propose a rule change to affirm the staff of the Division of Corporation Finance's historical application of Rule 14a-8(i)(8).

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DATES: Comments should be received by [insert date] 60 days after Federal Register publication.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-16-07 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-16-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Lillian Brown, Steven Hearne, or Tamara Brightwell, at (202) 551-3700, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3010.

SUPPLEMENTARY INFORMATION: We are proposing amendments to Rule 14a-2,[1] Rule 14a-6,[2] Rule 14a-8,[3] Schedule 14A,[4] and Schedule 13G[5] under the Securities Exchange Act of 1934,[6] and proposing new Rule 14a-17 and Rule 14a-18 under the Exchange Act.

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1 17 CFR 240.a-2.

2 17 CFR 240.14a-6.

3 17 CFR 240.14a-8.

4 17 CFR 240.14a-101.

5 17 CFR 240.13d-102.

6 15 U.S.C. 78a et seq.

Table of Contents

I. Overview

A. Federal Regulation of the Proxy Process

Regulation of the proxy process is a core function of the Commission and is one of the original responsibilities that Congress assigned to the agency in 1934. Section 14(a) of the Exchange Act[7] stemmed from a Congressional belief that "fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange."[8] The Congressional committees recommending passage of Section 14(a) proposed that "the solicitation and issuance of proxies be left to regulation by the Commission."[9] Congress intended that Section 14(a) give the Commission the "power to control the conditions under which proxies may be solicited"[10] and that this power be exercised "as necessary or appropriate in the public interest or for the protection of investors."[11] Because the Commission's authority under Section 14(a) encompasses both disclosure and proxy mechanics,[12] the proxy rules have long governed not only the

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7 15 U.S.C. 78n(a).

8 Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970), quoting H. R. Rep. No. 1383, 73d Cong., 2d Sess., at 13 (1934). See also J. I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).

9 S. Rep. No. 792, 73d Cong., 2d Sess., at 12 (1934).

10 H.R. Rep. No. 1383, 73d Cong., 2d Sess., at 14 (1934). The same report demonstrated a congressional intent to prevent frustration of the "free exercise of the voting rights of stockholders." Id.

11 15 U.S.C. 78n(a).

12 See Business Roundtable v. SEC, 905 F.2d 406, 411 (D.C. Cir. 1990) ("We do not mean to be taken as saying that disclosure is necessarily the sole subject of §14"); Roosevelt v. E.I. du Pont de Nemours & Co., 958 F.2d 416, 421-22 (D.C. Cir. 1992) (Congress "did not narrowly train section 14(a) on the interest of stockholders in receiving information necessary to the intelligent exercise of their" state law rights); SEC v. Transamerica Corp., 163 F.2d 511, 518 (3d Cir. 1947) (upholding the Commission's authority to promulgate Exchange Act Rule 14a-8), cert. denied, 332 U.S. 847 (1948). See also John C. Coffee Jr., Federalism and the SEC's Proxy Proposals, New York Law Journal 5 (March 18, 2004) (Section 14(a) "does not focus exclusively on disclosure; rather, it contemplates SEC rules regulating procedure in order to grant shareholders a

information required to be disclosed to ensure that shareholders receive full disclosure of all information that is material to the exercise of their voting rights under state law and the corporation's charter, but also the procedure for soliciting proxies.[13]

In assigning this responsibility to the Commission, Congress demonstrated its "intent to bolster the intelligent exercise of shareholder rights granted by state corporate law."[14] To identify the rights that the proxy process should protect, the Commission has taken as its touchstone the rights of security holders guaranteed to them under state corporate law. As Chairman Ganson Purcell explained to a committee of the House of Representatives in 1943:

> The rights that we are endeavoring to assure to the stockholders are those rights that he has traditionally had under State law to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have his proposal voted on.[15]

Thus, the federal proxy authority is not intended to supplant state law, but rather to reinforce state law rights with a sturdy federal disclosure and proxy solicitation regime.

'fair' right of corporate suffrage"); Louis Loss & Joel Seligman, Securities Regulation 1936-37 (3d ed. 1990) (The Commission's "power under §14(a) is not necessarily limited to ensuring full disclosure. The statutory language is considerably more general than it is under the specific disclosure philosophy of the Securities Act of 1933").

13 E.g., Exchange Act Rule 14a-4 (17 CFR 240.14a-4), Exchange Act Rule 14a-7 (17 CFR 240.14a-7) and Exchange Act Rule 14a-8 (17 CFR 240.14a-8). Each specifies procedural requirements that companies must observe in soliciting proxies. Exchange Act Rule 14a-4(b)(2) requires that the form of proxy furnish the security holder with the means to withhold approval for the election of a director. Exchange Act Rule 14a-7 provides a procedure under which a security holder may be able to obtain a list of security holders. Exchange Act Rule 14a-8 provides a procedure under which a qualifying security holder can obligate the company to include certain types of proposals, along with statements in support of those proposals, in the company's proxy statement.

14 Roosevelt, 958 F.2d at 421.

15 Securit[ies] and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce, 78th Cong., 1st Sess., at 172 (1943) (testimony of SEC Chairman Ganson Purcell).

To that end, the Commission has sought to use its authority in a manner that does not conflict with the primary role of the states in establishing corporate governance rights. For example, Rule 14a-8, the shareholder proposal rule, explicitly provides that a shareholder proposal is not required to be included in a company's proxy materials if it "is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization."[16]

One of the key rights that shareholders have under state law is the right to appear in person at an annual or special meeting and, subject to compliance with applicable state law requirements and the requirements contained in the company's charter and bylaws, such as an advance notice bylaw, present their own proposals for a vote by shareholders at that meeting.[17] These proposals can relate to a wide variety of matters, including the nomination of the shareholders' own candidates for the election of directors.[18] Most shareholders, however, vote through the grant of a proxy before the meeting instead of attending the meeting to vote in person. Therefore, an important function of the proxy rules is to provide a mechanism for shareholders to present their proposals to other shareholders, and to permit shareholders to instruct their proxy how to vote on these proposals. Our regulations have been designed to facilitate the corporate proxy process so that it functions, as nearly as possible, as a replacement for an actual, in-person

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16 17 CFR 240.14a-8(i)(1).

17 For example, Section 211(b) of the Delaware General Corporation Law permits any "proper business," in addition to the election of directors, to be conducted at an annual meeting of shareholders. In order to provide for an orderly period of solicitation before a meeting, many corporations have included provisions in their charter or bylaws to require advance notice of any shareholder resolutions, including nominations for director, to be presented at a meeting. See R. Franklin Balotti & Jesse A. Finkelstein, Delaware Law of Corporations & Business Organizations § 7.9 (4th ed. 2006).

18 Id.

gathering of security holders, thus enabling security holders "to control the corporation as effectively as they might have by attending a shareholder meeting."[19]

The Commission's proxy rules provide a means for shareholders to propose matters to other shareholders for a vote at an annual or special meeting. For example, under Rule 14a-8 a company must include in its proxy materials some proposals that shareholders could present at the annual or special meeting under state law. Other proposals can be included in proxy materials prepared by the shareholders themselves. In this regard, the proxy rules permit any shareholder to solicit votes for the election of a nominee to the board through a proxy solicitation by that shareholder. The proxy rules do not, however, require a company to include a shareholder's nominee for director in its proxy materials. Conversely, the proxy rules require the company to include in its proxy materials non-binding resolutions of eligible shareholders on subjects unrelated to the company's ordinary business unless the proposals fall within one of the substantive bases for exclusion in Rule 14a-8. The proposed amendments to the proxy rules discussed below address these matters.

B. The Shareholder Proposal Process

Rule 14a-8 creates a procedure under which shareholders, subject to certain requirements, may present in the company's proxy materials a broad range of binding and non-binding proposals, including non-binding proposals regarding matters that traditionally are within the province of the board and management. The rule permits a

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[19] Business Roundtable, 905 F.2d at 410.

shareholder owning a relatively small amount of the company's shares[20] to submit his or her proposal to the company, and the rule requires the company to include the proposal alongside management's proposals in the company's proxy materials. For example, a proposal concerning a matter that under state law would not be a proper subject for shareholder action alone if it were cast as a binding proposal, may nonetheless be included in the company's proxy materials under Rule 14a-8 if it is cast as a recommendation or request that the board take specified action.[21] In all cases, the proposal may be excluded by the company if it fails to satisfy the rule's procedural requirements or falls within one of the rule's thirteen substantive categories of proposals that may be excluded.

Because the proxy process is meant to serve, as nearly as possible, as a replacement for an actual, in-person meeting of shareholders, it should facilitate proposals concerning only those subjects that could properly be brought before a meeting under the corporation's charter or bylaws and under state law. Most state corporation codes specify certain items of business that are required to be presented to the shareholders for a vote, such as the election of directors, and others that may or may not be brought to a vote, either in the discretion of the chair or as specified by the corporation's charter or bylaws.

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20 Exchange Act Rule 14a-8(b)(1) (17 CFR 240.14a-8(b)(1)) provides that a holder of at least $2,000 in market value, or 1% of the company's securities entitled to be voted, may submit a shareholder proposal subject to other procedural requirements and substantive bases for exclusion under the rule.

21 State corporation statutes generally provide that the business of the corporation shall be managed by, or under the direction of, the board of directors.

With respect to the chair's discretion, in general state law provides that the order of business at a meeting of shareholders and the rules for the conduct of the meeting are determined by the chair, who is usually appointed as provided in the bylaws, or in the absence of such provision, by the board of directors.[22] In order to reinforce the state law rights and responsibilities of shareholders, therefore, the proxy rules should be neutral with respect to the manner in which meetings of shareholders are conducted, and should not interfere with the chair's ability to conduct the meeting in accordance with the requirements of state law and the corporation's governing documents.

With respect to subjects and procedures for shareholder votes that are specified by the corporation's governing documents, most state corporation laws provide that a corporation's charter or bylaws can specify the types of binding or non-binding proposals that are permitted to be brought before the shareholders for a vote at an annual or special meeting. Rule 14a-8(i)(1) supports these determinations by providing that a proposal that is violative of the corporation's governing documents may be excluded from the corporation's proxy materials.

Rule 14a-8 specifies that companies must notify the Commission when they intend to exclude a shareholder's proposal from their proxy materials. This notice goes to the staff of the Division of Corporation Finance. In the notice, the company provides the staff with a discussion of the basis or bases upon which the company intends to exclude the proposal and requests that the staff not recommend enforcement action if the

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22 See, e.g., Section 7.08, Model Business Corporation Act. The Comment to this Section states that it is expected that the chair will not misuse the power to determine the order of business and to establish rules for the conduct of the meeting so as to unfairly foreclose the right of shareholders – subject to state law and the corporation's charter and bylaws – to raise items which are properly a subject for shareholder discussion or action at some point in the meeting prior to adjournment.

company excludes the proposal. A shareholder proponent may respond to the company's notice, but is not required to do so. Generally, the staff responds to each notice with a "no-action" letter to the company, a copy of which is provided to the shareholder, in which the staff either concurs or declines to concur with the company's view that there is a basis for excluding the proposal.[23]

Each proxy season, the Division of Corporation Finance responds to hundreds of these no-action requests.[24] Although the Commission itself is not directly involved in responding to no-action requests, where a matter involves "substantial importance and where the issues are novel or highly complex," the Division may present an issue to the Commission for review – either at the Division's own instance or at the request of the company or the shareholder proponent.[25] Rule 14a-8 thus places the Commission's staff at the center of frequent disputes over whether a proposal must be included in the company's proxy materials.

C. Commission Review of the Proxy Process

In meeting the Commission's statutory obligation under Section 14(a) of the Exchange Act, this agency has monitored the development of the proxy process closely since 1934. Over the decades, we have made numerous improvements and refinements

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23 The staff's response is an informal expression of its views, and does not necessarily reflect the view of the Commission. Either the shareholder proponent or the company may obtain a decision on the excludability of a challenged proposal from a federal court.

24 During the 2006-2007 proxy season, the Division of Corporation Finance responded to approximately 360 Exchange Act Rule 14a-8 no-action requests. To respond to these requests, each proxy season the Division assembles a task force of attorneys who work full-time on the project from approximately January through April of each year.

25 17 CFR 202.1(d).

to the proxy rules based upon practical experience and the needs of investors.[26] This ongoing evaluation of the proxy process leads us to consider changes whenever it appears that the process can be improved to better promote the interests of investors, the efficient functioning of the capital markets, and the health of capital formation.

In 2003, the Commission directed the Division of Corporation Finance to review the proxy rules regarding procedures for the election of corporate directors and provide the Commission with recommendations regarding possible changes to the proxy rules. Following the Division's review of the proxy rules, the Commission proposed a comprehensive new set of rules, based on the Division's recommendations, which would have governed shareholder director nominations that are not control-related.[27] In connection with the rulemaking concerning shareholder director nominations, the Commission held a roundtable regarding the topic of shareholder director nominations generally, and more specifically, the shareholder director nominations release.[28] The Commission also proposed and adopted a new set of disclosure standards concerning director nominations and communications between shareholders and companies.[29]

More recently, the Commission held three roundtables in May 2007. This series of roundtables began with a re-examination of the fundamental principles of federalism

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26 As long ago as 1940, observers noted that "[t]he history of [C]ommission regulation pursuant to authority granted in Section 14 of the Securities Exchange Act has been one of careful expansion based upon experience and demonstrated needs." Sheldon E. Bernstein & Henry G. Fischer, The Regulation of the Solicitation of Proxies: Some Reflections on Corporate Democracy, 7 U. Chi. L. Rev. 226, 228 (1940).

27 Exchange Act Release 34-48626 (Oct. 14, 2003).

28 Security Holder Director Nominations Roundtable (March 10, 2004).

29 Exchange Act Release 34-48825 (Nov. 24, 2003).

that provide the context for our role under Section 14(a) of the Exchange Act. Specifically, the roundtables focused on the relationship between the federal proxy rules and state corporation law,[30] proxy voting mechanics,[31] and the evolution of both binding and non-binding shareholder proposals within the framework of the federal proxy rules.[32]

Roundtable participants argued that, in contrast to the current operation of the federal proxy rules, the federal role should be to facilitate shareholders' exercise of their fundamental state law and company ownership rights to elect the board of directors.[33] Some participants also observed that recent technological developments may provide promising possibilities for additional, complementary means for shareholders to interact and communicate with the management and the board of directors of the company that could be more effective and more efficient.[34] Participants generally agreed that enhanced

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30 Roundtable on the Federal Proxy Rules and State Corporation Law (May 7, 2007). Materials related to the roundtable, including an archived broadcast and a transcript of the roundtable, are available on-line at http://www.sec.gov/spotlight/proxyprocess.htm.

31 Roundtable on Proxy Voting Mechanics (May 24, 2007). Materials related to the roundtable, including an archived broadcast and a transcript of the roundtable, are available on-line at http://www.sec.gov/spotlight/proxyprocess.htm.

32 Roundtable on Proposals of Shareholders (May 25, 2007). Materials related to the roundtable, including an archived broadcast and a transcript of the roundtable, are available on-line at http://www.sec.gov/spotlight/proxyprocess.htm.

33 See, e.g., R. Franklin Balotti, Director, Richards, Layton & Finger, P.A, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 14-17; Leo E. Strine, Jr., Vice Chancellor, Court of Chancery of the State of Delaware, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 18-23; Stanley Keller, Edwards Angell Palmer & Dodge LLP, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 142-143.

34 See, e.g., Stanley Keller, Edwards Angell Palmer & Dodge LLP, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 152-154.

disclosure should accompany any changes the Commission might propose so that shareholders can make fully informed voting decisions.[35]

In light of these issues and developments, the Commission is proposing that the current proxy rules and related disclosure requirements be revised and updated to more effectively serve the essential purpose of facilitating the exercise of shareholders' rights under state law.

II. Proposed Amendments to the Proxy Rules and Related Disclosure Requirements

We are proposing changes to Rule 14a-8 that would facilitate shareholders' exercise of their state law rights to propose bylaw amendments concerning shareholder nominations of directors. Additionally, we are proposing amendments to the proxy rules to make clear that director nominations made pursuant to any such bylaw provisions would be subject to the disclosure requirements currently applicable to proxy contests. These proposed amendments are intended to align the Commission's shareholder proposal rule more closely with the underlying state law rights of shareholders.

As discussed above, in addition to governing the procedure for soliciting proxies, a primary purpose of the federal proxy rules is to provide shareholders with full disclosure of all information for the exercise of their voting rights under state law and the corporation's charter. The amendments we propose today are designed to provide shareholders with additional disclosure to allow for better-informed voting decisions.

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[35] See, e.g., Roberta Romano, Yale Law School, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 26-27; Stephen P. Lamb, Vice Chancellor, Court of Chancery of the State of Delaware, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 123-125.

This additional disclosure is of great importance to informed voting decisions both when shareholders are presented with proposed bylaw amendments and when shareholders are presented with nominees for director submitted under the company's bylaws. As such, we are proposing amendments to Schedule 13G and Schedule 14A that would enhance the disclosure of information about the proponents of bylaw amendments concerning the nomination of directors, about any shareholders that submit director nominees under any adopted bylaw, and about any director nominee that is submitted by a shareholder under such a bylaw.

A. Proposed Amendments Concerning Bylaw Proposals for Shareholder Nominations of Directors

1. Background Regarding the Election Exclusion in Rule 14a-8(i)(8)

Rule 14a-8(i)(8) sets forth one of several substantive bases upon which a company may exclude a shareholder proposal from its proxy materials. Specifically, it provides that a company need not include a proposal that "relates to an election for membership on the company's board of directors or analogous governing body." The purpose of this provision is to prevent the circumvention of other proxy rules that are carefully crafted to ensure that investors receive adequate disclosure and an opportunity to make informed voting decisions in election contests. Last year, the U.S. Court of Appeals for the Second Circuit, in American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc.,[36] held that AIG could not rely on Rule 14a-8(i)(8) to exclude a shareholder bylaw proposal under which the company would be required, under specified circumstances, to include

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[36] 462 F.3d 121 (2d Cir. 2006) (AFSCME).

shareholder nominees for director in the company's proxy materials at subsequent meetings.

The effect of the AFSCME decision was to permit both the bylaw proposal and, had the bylaw been adopted, subsequent election contests conducted under it, to be included in the company's proxy materials, but without compliance with the disclosure requirements of Rule 14a-12 solicitations. Because of the importance that we attach to the provision of meaningful disclosure to investors in election contests, we are revisiting the provisions of Rule 14a-8 in light of the AFSCME decision with a proposal that is designed to ensure that this objective is consistently achieved.

Since the AFSCME case was decided last year, the Commission has undertaken a thorough review of the proxy process. That review, including three recent roundtables on the topic, has led us to conclude that the federal proxy rules can be better aligned with shareholders' fundamental state law rights to nominate and elect directors. At the same time, the vindication of these state law rights must be accomplished in a way that accommodates the abiding federal interest in the full and fair disclosure to shareholders of information that is material to a contested election. This is the policy interest, grounded firmly in Section 14 of the Securities Exchange Act of 1934, that underlies the election exclusion of Rule 14a-8(i)(8).

To achieve the mutually reinforcing objectives of vindicating shareholders' state law rights to nominate directors, on the one hand, and ensuring full disclosure in election contests, on the other hand, we are proposing revisions to Rule 14a-8(i)(8) that would permit a shareholder who makes full disclosure in connection with a bylaw proposal for director nomination procedures, including a proposal such as that in the AFSCME case, to have that proposal included in the company's proxy materials.[37] The basis for the disclosure that we are proposing is the familiar Schedule 13G regime, under which certain passive investors that beneficially own more than 5% of a company's securities, report their ownership of a company's securities. We believe that using this well-understood system of disclosure should reduce compliance costs for companies and shareholders. In addition, because shareholders eligible to file under Schedule 13G must not have acquired or held their securities for the purpose of or with the effect of changing or influencing the control of the company, the opportunity to use Rule 14a-8 to inappropriately circumvent the disclosure and procedural regulations that are intended to apply in contested elections should be minimized.

Under the proposed amendments, if the proponents of a bylaw to establish a procedure for shareholder nominations of directors do not meet both the threshold for required filing on Schedule 13G, and the eligibility requirements to file on Schedule 13G, the proposal could then be excluded from the company's proxy materials under Rule 14a-8(i)(8). In this way, shareholders will be guaranteed the disclosure necessary to evaluate such proposals.

In light of the need for full disclosure where the possibility of control over a company is present, we believe that our decision to link the ability to include a bylaw proposal for director nominations in a company's proxy materials to the 5% threshold set by Section 13(d) of the Exchange Act addresses the basic policy concerns previously articulated by both Congress and the Commission. Moreover, because the proposed expansion of shareholders' ability to submit proposals under Rule 14a-8 would be limited

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37 See proposed revision to Exchange Act Rule 14a-8(i)(8).

to specific situations in which shareholders would be assured of appropriate disclosure and procedural protections, if the proposal did not meet the eligibility requirements of the amended rule, the Commission's staff would continue to interpret the rule to permit companies to exclude the proposal.

We believe that the amendments we are proposing today, including the amendments to the language of the election exclusion, will provide clarity and certainty in this area. We also believe they will facilitate shareholders' exercise of their state law rights to propose amendments to company bylaws concerning director nominations.

2. Proposed Amendment to Rule 14a-8(i)(8) Concerning Bylaw Amendments on Procedures for Shareholder Nominations of Directors

We are proposing an amendment to Rule 14a-8(i)(8)[38] that would enable shareholders to have their proposals for bylaw amendments regarding the procedures for nominating directors included in the company's proxy materials. Such a bylaw proposal would be required to be included in the company's proxy materials if:

- The shareholder (or group of shareholders) that submits the proposal is eligible to file a Schedule 13G and files a Schedule 13G that includes specified public disclosures regarding its background and its interactions with the company;[39]
- The proposal is submitted by a shareholder (or group of shareholders) that has

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[38] See proposed revision to paragraph (i)(8) of Exchange Act Rule 14a-8.

[39] The eligibility to file a Schedule 13G generally is available only for persons who have acquired and continue to hold the securities beneficially owned without "a purpose or effect of changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect." See Rule 13d-1(e). Although proposing a bylaw amendment pursuant to proposed Rule 14a-8(i)(8) would not on its own eliminate the ability to file a Schedule 13G, a determination of whether a proposing shareholder is eligible to file a Schedule 13G will continue to be based on the specific facts and circumstances accompanying the activities of the proposing shareholder. See Release No. 34-39538 (Jan. 12, 1998) [63 FR 2854].

continuously beneficially owned more than 5% of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date the shareholder submits the proposal;[40] and

- The proposal otherwise satisfies the requirements of Rule 14a-8.[41]

As amended, Rule 14a-8 would allow proponents of bylaw proposals to offer shareholder nomination procedures as they see fit. The only substantive limitations on such procedures would be those imposed by state law or the company's charter and bylaws. For example, the procedure could specify a minimum level of share ownership for those making director nominations that would be included in the company's proxy materials; it could specify the number of director slots subject to the procedure; or it could prescribe a method for the allocation of any costs – so long as both the form and substance of any such requirements were consistent with applicable state law and the company's charter and existing bylaw provisions. Likewise, the voting threshold required in order to adopt the bylaw would be determined by the thresholds set forth by state law or in the company's charter and bylaws with respect to the adoption of bylaws or bylaw amendments.[42]

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40 The one-year holding requirement would apply individually to each member of a group that is aggregating its security holdings to make a proposal.

41 To require a company to include the proposal in its proxy materials, the proposal would have to satisfy the procedural requirements of Exchange Act Rule 14a-8 and not fall within one of the other substantive bases for exclusion included in Exchange Act Rule 14a-8.

42 In the event the charter or bylaws are silent as to the voting threshold required, a company and its shareholders should look to the governing state corporation law. The staff of the Commission would not become involved in determining what this threshold is or whether it had been achieved. Interpretation and enforcement of any bylaw provision setting forth a procedure for shareholder director nominees to be included in the company's proxy materials would be the province of the appropriate state court since it would be a question of state law, not federal law. The staff of the Commission would not become involved in determining the correct interpretation or application of

The disclosure requirements and anti-fraud provisions of the federal proxy rules would, of course, apply to any solicitation of proxies conducted pursuant to a bylaw provision proposed and approved by shareholders. A shareholder proposal to establish bylaw procedures for shareholder nominations of directors would also be subject to any substantive bases for exclusion currently provided for in Rule 14a-8 that do not relate to an election for membership on the company's board of directors.

Shareholder proposals to amend the company's bylaws to establish a procedure for shareholder nominations of directors by proponents that do not meet the eligibility requirements of the proposed amendment to Rule 14a-8(i)(8) – including the requirements that the shareholder proponents have been more than 5% owners for at least one year and have filed a Schedule 13G – would be subject to exclusion.

We believe that the amendments we are proposing today will not only provide consistency and certainty in this area of Rule 14a-8, but also will provide shareholders the ability to have a greater voice in their company's corporate governance, consistent with their rights under state law.

Request for Comment

- As proposed, a bylaw proposal may be submitted by a shareholder (or group of shareholders) that is eligible to and has filed a Schedule 13G that includes specified public disclosures regarding its background and its interactions with the company, that has continuously held more than 5% of the company's securities for at least one year, and that otherwise satisfies the procedural requirements of Rule 14a-8 (e.g.,

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an adopted bylaw provision. In addition, the staff of the Commission would not become involved in determining whether a bylaw provision was properly adopted.

holding the securities through the date of the annual meeting). Are these disclosure-related requirements for who may submit a proposal, including eligibility to file on Schedule 13G, appropriate? If not, what eligibility requirements and what disclosure regime would be appropriate?

- For example, should the 5% ownership threshold be higher or lower, such as 1%, 3%, or 10%? Is the 5% level a significant barrier to shareholders making such proposals? Does the impediment imposed by this threshold depend on the size of the company? Should the ownership percentage depend on the size of the company? For example, should it be 1% for large accelerated filers, 3% for accelerated filers and 5% for all others? Should an ownership threshold be applicable at all?
- If the eligibility requirement should be different from 5%, should we nonetheless require the filing of a Schedule 13G or otherwise require disclosure equivalent to a Schedule 13G?
- The proposed one-year holding requirement is consistent with the existing holding period in Rule 14a-8(b)(1) to submit a shareholder proposal. Is it appropriate to limit use of the proposed rules to shareholder proponents that have held their securities for any length of time? If so, is the one-year period that we have proposed appropriate, or should the holding period be longer (e.g., two years or three years) or shorter than proposed (e.g., six months)? Why? With regard to the one-year holding requirement, is it appropriate to require that each member of a group of shareholders individually satisfy this holding requirement?

- Shareholders of some companies, e.g., open-end management investment companies, are not eligible to file Schedule 13G because the securities of those companies are not defined as "equity securities" for purposes of Rule 13d-1, which governs the filing of Schedule 13G by beneficial owners of equity securities. Should we permit security holders of such companies to file a Schedule 13G for the purpose of relying upon proposed Rule 14a-8(i)(8) if the holder otherwise would be eligible to file a Schedule 13G but for the exclusion of the company's securities from the definition of "eligible security?" If we were to do this, what, if any, amendments would be required to Schedule 13G? Should we instead use an eligibility requirement, other than eligibility to file Schedule 13G, in Rule 14a-8(i)(8) for shareholders of companies whose securities are not "equity securities?"

- If a shareholder acquires shares with the intent to propose a bylaw amendment, could that be deemed to constitute an intent to influence control of the company and thus potentially bar them from filing on 13G? If so, should the Commission provide an exemption that would enable such a shareholder to file on Schedule 13G?
- Proposals to establish a procedure for shareholder nominees would be subject to the existing limit under Rule 14a-8 of 500 words in total for the proposal and supporting statement. Is this existing word limit sufficient for such a proposal? If not, what increased word limit would be appropriate?
- In seeking to form a group of shareholders to satisfy the 5% threshold, shareholders may seek to communicate with one another, thereby triggering application of the

proxy rules. In order not to impose an undue burden on such shareholders, should such communications be exempt from the proxy rules? If so, what should the parameters of any such exemption be?

- Is there any tension between the requirement in Schedule 13G that the securities not be acquired or held for the purpose of changing or influencing control of the company and the desire of the holder of such shares to propose a bylaw amendment seeking to establish procedures for including shareholder-nominated candidates to the board? Does the answer to this question depend on the number of candidates sought to be included in the proposal? If there is tension, should we establish a safe harbor of some kind?

3. Proposed Disclosure Requirements Related to Shareholder Proponents and Nominating Shareholders

a. Overview of Requirements Applicable to Shareholder Proponents

Under the revisions to Rule 14a-8 that we are proposing today, a company would be required to include in its proxy materials bylaw proposals to establish procedures governing shareholder nominations for director so long as the bylaw is consistent with state law and the company's charter and bylaws. To trigger that requirement, an essential element is that the shareholder (or group of shareholders) proposing the bylaw provide disclosure about its own background, intentions, and course of dealings with the company to enable other shareholders to vote intelligently on the proposal. This disclosure requirement is being implemented through proposed amendments to existing Schedule 13G and a new reporting requirement under proposed Item 24 of Regulation 14A.

The already significant role that full disclosure plays in our proxy rules is rendered still more important when individual shareholders or groups of shareholders, who do not owe a fiduciary duty to the company or to other shareholders, use company assets and resources to propose changes in the company's governing documents. Our proposed amendments would require that certain information concerning proposals that could cause a fundamental change in the relationship between the company and its shareholders be placed before all shareholders entitled to vote. This information, in this context, includes background information on the shareholder proponent that other shareholders ordinarily would find to be important and relevant to a decision when asked to consider a proposed bylaw amendment setting forth procedures for director nominations. In addition, we believe that the use of such a proposal, or the possibility of such a proposal, to influence the company's management or board of directors to take or not to take other related or unrelated actions should be rendered transparent. It would be useful to the company's shareholders to know of any course of dealing between the shareholder proponent and the company when they are deciding how they will vote on the proposal. The additional Schedule 13G and Regulation 14A disclosure requirements that we are proposing address these concerns.

Therefore, we propose to require disclosure on Schedule 13G of significant background information regarding the shareholder proponent, as well as an extensive description of the course of dealing between the shareholder proponent and the company. In addition, we propose to require the company to disclose similar information with regard to the nature and extent of its relationships with the shareholder proponent. We believe that this additional disclosure will provide transparency to shareholders voting on such bylaw amendments.

Specifically, we are proposing that any shareholder (or group of shareholders) that forms any plans or proposals regarding an amendment to the company's bylaws[43] concerning shareholder director nominations, file or amend Schedule 13G to include the following information that would be required by new Item 8A, Item 8B, and Item 8C:

- the shareholder proponent's relationships with the company; and
- additional relevant background information on the shareholder proponent.

The shareholder proponent also would be required to amend its Schedule 13G to update this information as necessary.

To permit reliance on the existing disclosure scheme set forth in Regulation 13D, the proposed amendments to Rule 14a-8 will require shareholder bylaw proposals to be included in a company's proxy materials only if the shareholder proponent is subject to Regulation 13D and eligible to file on Schedule 13G.[44] Regulation 13D, which requires the disclosure of specified information in filings with the Commission on Schedule 13D, applies to persons that directly or indirectly beneficially own more than 5% of a class of voting equity securities registered pursuant to Section 12 of the Exchange Act.[45] Schedule 13G requires less disclosure than Schedule 13D and is available for use by

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43 In this regard, the formation of any plans or proposals regarding an amendment to the company's bylaws would include the submission of a proposal to amend the company's bylaws, and discussions in which the shareholder indicated to management an intent to submit such a proposal or indicated an intent to refrain from submitting such a proposal conditioned on the taking or not taking of an action by the company. See proposed Note to Item 8A of Schedule 13G. In the proposed disclosure requirements, and in the following discussion of those proposed requirements, the term "shareholder proponent" refers to a person that has formed any plans or proposals regarding an amendment to the company's bylaws for a shareholder director nomination procedure; any affiliate, executive officer or agent acting on behalf of that person with respect to the plans or proposals; and anyone acting in concert with, or who has agreed to act in concert with, that person with respect to the plans or proposals. See proposed Item 8A(a) of Schedule 13G.

44 See proposed revisions to paragraph (i)(8) of Rule 14a-8.

45 See 17 CFR 240.13d-1.

persons who beneficially own more than 5% of a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act and who meet the criteria for one of three types of Schedule 13G filers.[46] Generally, persons, including groups and others who file on Schedule 13G must certify that the securities have not been acquired with the purpose nor with the effect of changing or influencing control of the company.[47]

The proposed amendments to Rule 14a-8 and Schedule 13G, which would enable a shareholder that had provided specified disclosures to propose a bylaw amendment, would apply to a shareholder (or group of shareholders) that:

- has continuously held more than 5% of the company's shares entitled to be voted on the proposal for at least one year as of the date of submitting the proposal;
- was eligible to file a report of beneficial ownership on Schedule 13G; and
- has filed a report of beneficial ownership on Schedule 13G, or an amendment thereto, that includes information about the shareholder or group's background and relationships with the company.

The requirement that a shareholder or group of shareholders hold more than 5% of the company's shares entitled to be voted on the proposal corresponds with the filing requirement on Schedule 13G for beneficial owners of more than 5% of a company's

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46 Regulation 13D permits filing on Schedule 13G for a specified list of qualified institutional investors who have acquired the securities in the ordinary course of their business and not with the purpose nor the effect of changing or influencing control of the company. See Exchange Act Rule 13d-1(b) (17 CFR 240.13d-1(b)). In addition, persons who are beneficial owners of more than 5% of a class of equity securities may file Schedule 13G, if they have not acquired the securities with the purpose nor with the effect of changing or influencing control of the company, and if they are not directly or indirectly the beneficial owner of 20% or more of the class of securities. See Exchange Act Rule 13d-1(c) (17 CFR 240.13d-1(c)). Finally, certain persons may file a Schedule 13G, in lieu of Schedule 13D, if they qualify under Exchange Act Section 13(d)(6) or Rule 13d-1(d) (17 CFR 240.13d-1(d)).

47 Reports of beneficial ownership filed on Schedule 13G pursuant to Rule 13d-1(d) are not required to make this certification.

shares, and facilitates the provision of the additional disclosures concerning the shareholder proponent that the amendments to Rule 14a-8 would require. The proposed requirement that the shares be continuously held for at least one year as of the date of submitting the proposal has the additional benefit of ensuring that proposals are made by shareholders with a significant long-term stake in the company, and it is consistent with the current requirement in Rule 14a-8 that has worked well historically. The proposed requirement that the shareholder (or group of shareholders) be eligible to report on Schedule 13G would not only ensure that they are subject to the disclosure requirements of the Williams Act, but also that their shares were not acquired and are not held with the purpose or effect of changing or influencing control of the company.

b. Proposed New Item 8B of Schedule 13G

A shareholder proponent may have a variety of relationships with the company. Because these relationships will often be relevant to an informed decision by other shareholders as to whether to vote in favor of a proposed bylaw amendment, disclosure of information concerning the proposal should include information about such relationships. Accordingly, we are proposing to add a new Item 8B to Schedule 13G concerning the nature and extent of relationships between the shareholder proponent and the company.[48] As proposed, new Item 8B disclosure would include:

- any direct or indirect interest of the shareholder proponent in any contract with the company or any affiliate of the company (including any employment

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[48] In proposed Item 8A of Schedule 13G we define a shareholder proponent to include a person or group that has formed any plans or proposals with regard to the amendment, any affiliate, executive officer, or agent of such shareholder proponent, or anyone acting in concert with, or who has agreed to act in concert with such shareholder proponent with respect to the proposed bylaw amendment.

agreement, collective bargaining agreement, or consulting agreement);

- any pending or threatened litigation in which the shareholder proponent is a party or a material participant, involving the company, any of its officers or directors, or any affiliate of the company; and
- any other material relationship between the shareholder proponent and the company or any affiliate of the company not otherwise disclosed.[49]

Additionally, Item 8B would require a shareholder proponent to describe the following items that occurred during the 12 months prior to the formation of any plans or proposals, or during the pendency of any proposal or nomination:

- any material transaction of the shareholder proponent with the company or any affiliate of the company; and
- any discussion regarding the proposal between the shareholder proponent and a proxy advisory firm.

As proposed, new Item 8B also would require disclosure of any holdings of more than 5% of the securities of any competitor of the company, including the number and percentage of securities owned, as of the date the shareholder proponent first formed a plan or proposal regarding an amendment to the company bylaws in accordance with Rule 14a-8(i)(8).[50] The shareholder proponent also would be required to disclose any material relationship with any competitor other than as a security holder, as of the date the shareholder proponent first formed a plan or proposal regarding an amendment to the

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49 A material relationship between the proponent and the company or an affiliate of the company may include, but is not limited to, a current or prior employment relationship, including consulting arrangements.

50 For this purpose, a "competitor" of the company is proposed to include any enterprise with the same Standard Industrial Classification code.

company bylaws in accordance with Rule 14a-8(i)(8).

Finally, new Item 8B would require disclosure regarding any meetings or contacts, including direct or indirect communication by the shareholder proponent, with the management or directors of the company that occurred during the 12-month period prior to the formation of any plans or proposals, or during the pendency of any proposal. The proposed disclosure would provide:

- a description, in reasonable detail, of the content of such direct or indirect communication;
- a description of the action or actions sought to be taken or not taken;
- the date of the communication;
- the person or persons to whom the communication was made;
- whether that communication included any reference to the possibility of such a proposal; and
- any response by the company or its representatives to that communication prior to the date of filing the required disclosure.

To the extent that the shareholder proponent and management or the directors of the company have an ongoing dialogue, the shareholder proponent may describe the frequency of the meetings and the subjects covered at the meetings rather than providing the information separately for each meeting. However, if an event or discussion occurred at a specific meeting that is material to the shareholder proponent's decision to submit a proposal, that meeting would be required to be discussed in detail separately.

c. Proposed New Item 8C of Schedule 13G

When a shareholder (or group of shareholders) proposes a bylaw amendment regarding the procedures for nominating directors, background information regarding the proposing shareholder often will be relevant to an informed voting decision by the other shareholders. Accordingly, we are proposing to add a new Item 8C to Schedule 13G concerning the following information about the shareholder proponent:

- If the shareholder proponent is not a natural person:
  - The identity of the natural person or persons associated with the entity responsible for the formation of any plans or proposals;
  - The manner in which such person or persons were selected, including a discussion of whether or not the equity holders or other beneficiaries of the shareholder proponent entity played any role in the selection of such person or persons, and whether they played any role in connection with the formation of any plans or proposals;
  - Any fiduciary duty to the equity holders or other beneficiaries of the entity that the person or persons associated with the entity responsible for the formation of any plans or proposals have in forming such plans or proposals;
  - The qualifications and background of such person or persons relevant to the plans or proposals; and
  - Any interests or relationships of such person or persons, and of that entity, that are not shared generally by the other shareholders of the company and that could have influenced the decision by such person or persons and the entity to submit a proposal.
- If the shareholder proponent is a natural person:
  - The qualifications and background of such person or persons relevant to the

plans or proposals; and

- Any interests or relationships of such person or persons that are not shared generally by the other shareholders of the company and that could have influenced the decision by such person or persons to submit a proposal.

With regard to these disclosures, examples of any interests or relationships of the shareholder proponent not shared by other shareholders of the company may include, but are not limited to, contractual arrangements, current or previous employment with the company, employment agreements, consulting agreements, and supplier or customer relationships.

d. Proposed New Item 24 to Schedule 14A

Because a shareholder proponent's relationships with the company often will be relevant to an informed voting decision by other shareholders, background information regarding these relationships should be disclosed not only by the shareholder proponent, but also the company. Accordingly, we are proposing to add a new Item 24 to Schedule 14A to require the disclosure by the company of the nature and extent of the relationship between the shareholder proponent, any affiliate, executive officer or agent of the shareholder proponent, or anyone acting in concert with, or who has agreed to act in concert with, the shareholder proponent with respect to the proposed bylaw amendment submitted in accordance with Rule 14a-8(i)(8), on the one hand, and the company, on the other. Item 24 disclosures would include:

- any direct or indirect interest of the shareholder proponent in any contract with the company or any affiliate of the company (including any employment agreement, collective bargaining agreement, or consulting agreement);

- any pending or threatened litigation in which the shareholder proponent is a party or a material participant, involving the company, any of its officers or directors, or any affiliate of the company; and
- any other material relationship between the shareholder proponent and the company or any affiliate of the company not otherwise disclosed.

Additionally, Item 24 of Schedule 14A would require disclosure of the following with respect to the 12 months prior to the shareholder proponent forming any plans or proposals, or during the pendency of any proposal, regarding an amendment to the company bylaws in accordance with Rule 14a-8(i)(8):

- any material transaction of the shareholder proponent with the company or any affiliate of the company; and
- any meetings or contacts between the shareholder proponent and management or directors of the company.[51]

As with the shareholder proponent requirement, to the extent that the shareholder proponent and management or directors of the company have an ongoing dialogue, the company would be required to merely describe the frequency of and the subjects covered at the meetings, except where an event or discussion occurred that is material to the shareholder proponent's decision to submit a proposal.

For purposes of meeting these proposed disclosure requirements, the company

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51 As with the corresponding disclosure requirement for shareholder proponents, the proposed disclosures would include: a description, in reasonable detail, of the content of such direct or indirect communication; a description of the action or actions sought to be taken or not taken; the date of the communication; the person or persons to whom the communication was made; whether that communication included any reference to the possibility of such a proposal; and any response by the company or its representatives to that communication prior to the date of filing the required disclosure. See proposed Item 24(d)(2) of Schedule 14A.

would be entitled to rely on the Schedule 13G disclosures of the shareholder proponent concerning the date on which the shareholder proponent formed any plans or proposals regarding an amendment to the company bylaws in accordance with Rule 14a-8(i)(8).

Request for Comment

- The proposed disclosure standards relate to the qualifications of the shareholder proponent, any relationships between the shareholder proponent and the company, and any efforts to influence the decisions of the company's management or board of directors. To assure that the quality of disclosure is sufficient to provide information that is useful to shareholders in making their voting decisions and to limit the potential for boilerplate disclosure, we have proposed that the disclosure standards require specific information concerning these qualifications, relationships, and efforts to influence the company's management or board of directors. Is the proposed level of required disclosure appropriate? Are any of the proposed disclosure requirements unnecessary to shareholders' ability to make an informed voting decision? If so, which specific requirements are not necessary? Should we require substantially similar disclosure from both the proponent and the company as proposed or should the company be allowed to avoid duplicating disclosure relating to the proponent where the company agrees with the disclosure provided? Is any additional disclosure appropriate?
- We solicit comments with respect to any other types of background information regarding a shareholder proponent that should be disclosed in Schedule 13G or Item 24 of Schedule 14A. What other types of information do shareholders need to have about the shareholder proponent, or the shareholder proponent's course of dealing

with the company, when voting on a proposal?

- Would the proposed Schedule 13G disclosure requirements for shareholder proponents be useful to other shareholders in forming their voting decisions? Are the requirements practical? Is any aspect of the proposed disclosure overly burdensome for shareholder proponents to comply with?
- As proposed, shareholder proponents would be required to disclose discussions with a proxy advisory firm prior to submitting a proposal. Is this disclosure requirement appropriate? Why or why not?
- We also propose that companies would be responsible for disclosure regarding their relationships and course of dealing with the shareholder proponent in Item 24 of Schedule 14A. Is this proposed additional disclosure useful? Would any aspect of this disclosure requirement be impractical or overly burdensome?
- As proposed, the disclosures concerning the shareholder proponent and company's relationship must be provided for the 12 months prior to forming any plans or proposals, or during the pendency of any proposals, with regard to an amendment to the company bylaws. Is this the appropriate timeframe? If not, should the timeframe be shorter (e.g., 6 or 9 months) or longer (e.g.,18 or 24 months)? Is any federal holding period requirement appropriate?
- Is the proposed reliance on the existing Schedule 13G framework appropriate? Should we require the type of disclosure found in Schedule 13G, but nevertheless permit a shareholder who holds less than 5% of a company's shares to file a Schedule 13G and to submit bylaw proposals of the type described herein? Is there another

disclosure provision in the federal securities laws with a lesser ownership requirement that would more appropriate upon which to rely?

- Is it appropriate to require any additional disclosure by shareholders and/or the company, beyond what is currently required, in connection with a proposed amendment to the company's bylaws in accordance with proposed Rule 14a-8(i)(8)? Rather, should we require disclosure only when a shareholder actually seeks to nominate a director using a nominating procedure established pursuant to a company's bylaws?

e. Disclosure by Nominating Shareholders – Proposed New Rule 14a-17

One of our primary concerns with using Rule 14a-8 to nominate or establish a procedure for shareholders to nominate a candidate for director is that doing so could result in shareholders being asked to vote on a director nominee without the disclosure that otherwise would be required under the federal proxy rules applicable to elections involving solicitations in opposition to the company's nominees. To address this concern, we are proposing a new Rule 14a-17 that would provide that the existing disclosure requirements for solicitations in opposition (either for a short slate or for a majority of board seats) would apply to nominating shareholders and their nominees under any shareholder nomination procedure.[52] These disclosure requirements are found in Item 4(b), Item 5(b), Item 7, and Item 22(b) of Schedule 14A, and provide basic information regarding the nominating shareholder (or shareholder group) and nominee or nominees, including biography and shareholdings, other interests of the individuals (or

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[52] See proposed Exchange Act Rule 14a-17(c).

group), methods and costs of the solicitation, and other information to enable voting shareholders to make an informed decision.

Because the shareholder nominee would be included in the company's proxy materials, the company would be required to include the disclosure in its proxy statement or, in the Internet version of its proxy statement, to link to a website address where those disclosures would appear. The nominating shareholder would be responsible for providing the information to the company.[53] Further, the nominating shareholder would be required to provide a statement that the shareholder nominee consented to being named in the proxy materials and to serve if elected.[54] Finally, a company would not be required to include a nominating shareholder's nominee in its proxy materials if the shareholder fails to provide the information required by proposed Rule 14a-17(b)-(c).[55]

f. Liability for, and Incorporation by Reference of, Information Provided by the Nominating Shareholder

It is our intent that a shareholder who nominates a director under a bylaw provision concerning the nomination of directors would be liable for any materially false or misleading statements in the disclosure provided to the company and included by the company in its proxy materials. The proposed rules contain express language, modeled on Exchange Act Rule 14a-8(l)(2),[56] providing that the company would not be

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53 Id.

54 See Exchange Act Rule 14a-4(d)(4) (17 CFR 240.14a-4(d)(4)). The rule provides that such consent is required in order for a person to be named in the proxy statement as a bona fide nominee.

55 See proposed Exchange Act Rule 14a-17(d).

56 17 CFR 240.14a-8(l)(2). Exchange Act Rule 14a-8(l)(2) applies with respect to proposals and supporting statements that are submitted by shareholders and then required to be repeated in the company's proxy materials by Exchange Act Rule 14a-8. In this regard, Exchange Act Rule 14a-8

responsible for that disclosure.[57] In addition, it is our intention that any information that is provided to the company for inclusion in its proxy materials by the nominating shareholder and included in the company's proxy statement would not be incorporated by reference into any filing under the Securities Act or the Exchange Act unless the company determines to incorporate that information by reference specifically into that filing.[58] However, to the extent the company does so incorporate that information by reference, we would consider the company's disclosure of that information as the company's own statement for purposes of the anti-fraud and civil liability provisions of the Securities Act or the Exchange Act, as applicable.

g. Filing Requirements

When, in accordance with a shareholder nomination bylaw procedure, a shareholder nominates a candidate for director, the company would be required to file its proxy statement in preliminary rather than definitive form, in the same manner as under the existing proxy rules applicable to proxy contests.[59] This is the same result that would be obtained in a traditional contested election in which the shareholder nominees appeared in a separate proxy statement.

It is possible that either the company or a nominating shareholder (or group of shareholders) may wish to solicit in favor of their nominee or nominees outside the company proxy materials. As in a traditional contested election, it is important that any

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states that "the company is not responsible for the contents of [the shareholder proponent's] proposal or supporting statement."

57 See proposed Exchange Act Rule 14a-17(e).

58 See proposed Exchange Act Rule 14a-17(f).

59 See proposed amendment to Exchange Act Rule 14a-6.

soliciting materials in addition to the proxy statement be filed publicly with the Commission so that such materials are available to all shareholders, to the company, and to the Commission staff for review. Accordingly, where a shareholder or company chooses to solicit outside the company proxy materials, we intend that the existing filing requirements applicable to definitive additional soliciting materials would apply.[60] Under these requirements, all soliciting materials are required to be filed with the Commission in the same form as the materials sent to shareholders no later than the date they are first sent or given to shareholders.[61]

h. Proposed New Rule 14a-17(b)-(c) and Item 25 of Schedule 14A

As noted above, one of the primary concerns with using Rule 14a-8 to establish a procedure for shareholders to nominate directors is that doing so would not provide shareholders with disclosure they otherwise would be given in a proxy contest. In this regard, we note that it is of substantial importance to provide shareholders with clear, transparent disclosure regarding any shareholder or group of shareholders using a nominating procedure established pursuant to a company's bylaws to nominate a candidate for director. Therefore, the additional disclosures that are proposed to be added to Schedule 13G for shareholder proponents of a bylaw amendment concerning shareholder director nominations also would apply to a nominating shareholder under an adopted bylaw. In this regard, we are proposing to add new Rule 14a-17(b), which would require any nominating shareholder to provide to the company the disclosures required by

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60 See Exchange Act Rule 14a-6(b) (17 CFR 240.14a-6(b)) and Exchange Act Rule 14a-12 (17 CFR 240.14a-12).

61 Id.

Item 8A, Item 8B, and Item 8C of Schedule 13G.[62] These disclosures would be required at the time the shareholder forms any plans or proposals with respect to submission of a nominee for director to the company for inclusion in the proxy materials.[63] Immediately after the nominating shareholder provides the company with the disclosure, under Rule 14a-17(c), the company would be required to provide the information on its website or provide a link on its website to a website address where the disclosure would appear. In addition, pursuant to Item 25 of Schedule 14A, the company would be required to include the disclosure in its proxy statement or provide a link to a website address where the disclosure would appear in the Internet version of its proxy statement. Under Rule 14a-17(d), if a nominating shareholder fails to provide the required information, the shareholder's nominee will not be required to be included in the company's proxy materials.

Request for Comment

- As proposed, a nominating shareholder would be required to provide to the company, for inclusion in the company's proxy materials, disclosure responsive to Item 8A, Item 8B, and Item 8C of Schedule 13G, as well as Item 4(b), Item 5(b), Item 7, and Item 22(b) of Schedule 14A, as applicable. Is this the appropriate type and amount of disclosure for a nomination under a shareholder nomination procedure? If not, what

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62 In this regard, it is important to note that a shareholder director nomination bylaw may establish any ownership threshold for nominating a director. Because we believe that the disclosure required by these items is important for an informed voting decision by shareholders, we are proposing new Item 25 of Schedule 14A in order to provide complete disclosure regarding nominating shareholders utilizing procedures established in bylaw amendments that allow for nominations by shareholders.

63 We have proposed a Note to Exchange Act Rule 14a-17(a) stating that the formation of any plans or proposals includes instances where the shareholder has indicated an intent to management to submit a nomination or has indicated an intent to management to refrain from submitting a nomination conditioned on the taking or not taking of a corporate action.

disclosure requirement would be appropriate? Is the timing requirement for providing this disclosure appropriate? If not, when should such disclosures be provided?

- Is it appropriate for the disclosure to be provided to the company for inclusion on its website and in its proxy materials, or should the shareholder instead be responsible for filing the information provided that they beneficially own more than 5% of the company's securities entitled to be voted and are eligible to file on Schedule 13G?
- Does the proposal make sufficiently clear that the nominating shareholder would be responsible for the information submitted to the company? Should the proposal include language addressing a company's responsibility for including statements made by the shareholder that it knows are not accurate?
- Should information provided by a nominating shareholder be deemed incorporated by reference into Securities Act or Exchange Act filings? If so, why?
- Should companies that receive a nomination for director from a shareholder be required to file their proxy statement in preliminary form, as is proposed? If not, why would it be appropriate for companies to file directly in definitive form?
- Should solicitations in favor of or against a nominee for director, by either the company or the shareholder, be filed as definitive additional soliciting materials on the date of first use, as is proposed? If not, how should such materials be filed?
- As proposed, a nominating shareholder would be required to provide the information required by Item 8A, Item 8B and Item 8C of Schedule 13G to the company for inclusion on the company's website and in its proxy. Would it be appropriate to add a disclosure requirement on Form 8-K that would apply where a company does not

maintain a website? Would it be appropriate to allow a company to choose between website disclosure and Form 8-K disclosure even where a company maintains a website? Why or why not?

- Is there disclosure other than that proposed concerning shareholder nominees that would be material to investors? If so, what are those disclosures and why would they be material? For example, should we require disclosure regarding the relationship between the nominating shareholder and shareholder nominee? If so, what disclosures would be appropriate and useful to shareholders?

B. Electronic Shareholder Forums

1. Background

The Commission's recent series of roundtables on the proxy process considered, among other issues, the role of technology in facilitating communications not only between shareholders and companies, but also among shareholders. Given the opportunities for collaborative discussion afforded by the Internet and related technological innovations, the proxy mechanism by comparison offers limited opportunities – usually only the annual meeting – for shareholders to provide advice to management. Accordingly, the proxy system may not be the only, or the most efficient, means of shareholder communication with management on purely advisory matters.

Alternatives or supplements to the proxy machinery that exploit the advantages of telecommunications technology have been suggested that could offer shareholders other means to communicate, including with regard to resolutions such as those typically submitted as non-binding proposals under Rule 14a-8. For example, an online forum, restricted to shareholders of the company whose anonymity is protected through encrypted unique identifiers, could offer the opportunity for shareholders to discuss among themselves the subjects that most concern them, and which today are considered – if at all – only indirectly through the proxy process. Shareholder expressions of interest on particular suggested actions, tabulated based on their ownership interest, could be determined on a real-time basis. The company could use the form to provide information, such as a copy of press release information regarding record dates and expression of views by the company. Moreover, the opportunity for this enhanced level of shareholder participation could be extended throughout the year, rather than only at annual meetings. From the company's standpoint, such a shareholder forum could provide more frequent information about the interests and concerns of investors.

We are not seeking, through the proxy rules or otherwise, to devise an approved regulatory version of an electronic shareholder forum. Myriad uses of the Internet to facilitate shareholder communication are already well under way, and as technology continues to develop, individuals and entities will find increasingly creative ways to address the challenges they face in presenting proposals to companies, determining support for proposals among other shareholders, conducting referenda on non-binding proposals, and organizing online petitions to management, among other potential activities. The Commission strongly encourages these developments. Rather than prescribe any specific approach to an online shareholder forum in the proxy rules, the proposed amendment is designed to remove any unnecessary real and perceived impediments to continued private sector experimentation and use of the Internet for communication among shareholders, and between shareholders and their company.

2. Proposed Amendment to Facilitate the Use of Electronic Shareholder Forums

We propose to facilitate greater online interaction among shareholders by removing obstacles in the current rules to the use of an electronic shareholder forum. To facilitate the establishment of such forums, which can be conducted and maintained in any number of ways, we propose to clarify that a company is not liable for independent statements by shareholders on a company's electronic shareholder forum. In addition, in order to enhance the efficacy of the forum, we propose to address any ambiguity concerning whether use of an electronic shareholder forum could constitute a proxy solicitation.

Proposed Rule 14a-18(a) would make clear that both companies and shareholders are entitled to establish and maintain an electronic shareholder forum under the federal securities laws, provided that the forum is conducted in compliance with the federal securities laws, applicable state law, and the company's charter and bylaws. While the proxy rules currently do not prohibit or delimit such activities, neither were they written in contemplation of the wide-ranging communications potential of the Internet. By addressing specific concerns relating to the use of the electronic shareholder forum in the proposed rule, we are seeking to remove legal ambiguity that might inhibit shareholders and companies from energetic exploitation of the potential of communications technology, and to encourage shareholders and companies to take advantage of this technology to facilitate better communication among shareholders and between shareholders and companies.

Liability for statements made on an electronic shareholder forum is one area of concern for companies and shareholders when making the decision whether to establish such a forum. To alleviate this concern, we propose to clarify in Rule 14a-18(b) that, for simply establishing, maintaining, or operating the electronic shareholder forum, a company or shareholder would not be liable under the federal securities laws for any statement or information provided by another person to the forum. The intent is for the person establishing, maintaining, or operating an electronic shareholder forum to be protected from liability in a similar way as the federal telecommunications laws protect an interactive computer service.[64]

Persons providing information to or making statements on the electronic shareholder forum would remain liable for the content of those communications under traditional liability theories in the federal securities laws, such as those in Section 17(a) of the Securities Act and Section 10(b), Rule 10b-5, and Section 20(e) of the Exchange Act. The prohibitions in the anti-fraud laws against primary or secondary participation in fraud, deception, or manipulation would continue to apply to those supplying information to the site, and claims would not face any additional obstacle because of the new rule. Any other applicable federal or state law would also continue to apply to a person providing information or statements to an electronic shareholder forum.

An additional concern regarding the use of an electronic shareholder forum relates to the broad general application of our proxy rules under Section 14(a) of the Exchange Act. Under the proxy rules, a solicitation encompasses any request for a proxy, any request to execute or revoke a proxy, and the furnishing of a form of proxy or other communication under circumstances reasonably calculated to result in the procurement,

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64 See Section 230(c)(1) of the Telecommunications Act of 1996 (47 U.S.C. § 230(c)(1)) ("No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.").

withholding, or revocation of a proxy.[65] This broad definition of solicitation limits the kinds of activities that a shareholder or the company may undertake in a public forum when discussing issues that may be voted on at the company's annual or special meeting.

To facilitate greater use of the electronic shareholder forum concept and to encourage more robust communication with the company and among shareholders, we propose to exempt any solicitation in an electronic shareholder forum by or on behalf of any person who does not seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a shareholder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form or revocation, abstention, consent or authorization.[66] The solicitation would be exempt so long as it occurs more than 60 days prior to the date announced by the company for its annual or special meeting of shareholders or if the company announces the meeting less than 60 days before the meeting date the solicitation may not occur more than two days following the company's announcement.[67] We further propose to clarify in proposed Rule 14a-18(c) that a person who participates in an electronic shareholder forum and makes solicitations in reliance on the proposed exemption would continue to be eligible to solicit proxies outside of Rule 14a-2(b)(6) provided that any such solicitation complies with Regulation 14A.

The purpose of these amendments is to encourage the free flow of information, ideas, and opinions in an electronic shareholder forum. It is not the purpose of these

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65 See Exchange Act Rule 14a-1(l) (17 CFR 240.14a-1(l)).

66 See proposed Exchange Act Rule 14a-2(b)(6).

67 The proposal would not affect the application of any other exemptions under Regulation 14A. For example, a person could rely on the other applicable exemptions in Exchange Act Rule 14a-2 (17 CFR 240.14a-2).

amendments to allow such a forum to be used to circumvent the proxy or anti-fraud rules. We believe that there is less risk of an electronic shareholder forum being used for proxy solicitation more than 60 days prior to an annual or special meeting and therefore have proposed a 60-day limitation.[68] Communications within an electronic shareholder forum that occur less than 60 days prior to the annual or special meeting, or more than two days after the announcement of the meeting, would continue to be treated as any other communication would be treated today, and would be required to comply with our proxy rules if they are a solicitation unless they fall within an existing exemption. In addition, we propose to limit the exemption to persons who do not seek to act as a proxy for a shareholder or request a form of proxy from them.

We propose limitations to the exemption because, though we believe that an electronic shareholder forum should provide a medium for, among other things, open discussion, debate, and the conduct of referenda, we believe that the solicitation of proxies for an upcoming meeting is more appropriate under the protections of our proxy rules. Any proxies obtained prior to the application of our proxy rules would not benefit from the full and fair disclosure required under the regulations.

Request for Comment

- Our proposals are intended to provide a company or its shareholders with the flexibility under the federal securities laws to establish an electronic shareholder forum that permits interaction among shareholders and between shareholders and the

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[68] 60 days corresponds with the maximum amount of time prior to a scheduled meeting that the company may fix the record date for determining the stockholders entitled to notice of or to vote at a meeting under the Delaware Code. See Del. Code title 8, §213 (2007).

company's management or board of directors, and permits the operator of the electronic shareholder forum to provide for non-binding referenda votes of forum participants. Do our proposals provide this flexibility? Are there additional steps that are necessary to assure that the federal securities laws do not hinder the development of these electronic shareholder forums?

- We propose to amend Regulation 14A to encourage the development of electronic shareholder forums that could be used by companies to better communicate with shareholders and by shareholders to better communicate both with their companies and among themselves. In addition, the electronic shareholder forum concept could offer shareholders a means of advancing referenda that might otherwise be proposed as non-binding shareholder proposals under Rule 14a-8. Is this appropriate and, if so, how can we further encourage the development of electronic shareholder forums?
- As proposed, the new rules would allow companies and shareholders to develop electronic shareholder forums as they see fit, as long as the forums are conducted in compliance with Section 14(a) of the Exchange Act, other federal laws, applicable state law, and the company's charter and bylaw provisions. Should we be more prescriptive in our approach, such as by providing direction or guidance relating to whether a forum is available for non-binding referenda, whether access is limited to shareholders, the frequency with which shareholder records are updated for purposes of enabling participation, or whether the forum assures the anonymity of shareholders who access it?
- As proposed, we make clear that a company or shareholder that establishes, maintains, or operates a forum is not liable for any statements or information

provided by another person. Does the proposed rule adequately address the liability concerns that might face sponsors of and participants in an electronic shareholder forum?

- In order to encourage use of electronic shareholder forums, we are proposing an exemption for solicitations on an electronic shareholder forum. As proposed, solicitations that do not seek to act as a proxy for a shareholder or request a form of proxy from them and occur more than 60 days prior to an annual or special meeting (or within two days of the announcement of the meeting) are exempt under the proxy rules. Is it appropriate to provide this exemption from regulation for communications on an electronic shareholder forum? Should the exemption apply more broadly to all communications? Would it be possible to conduct an effective proxy solicitation on the forum despite the limitations? Is the 60-day limitation sufficiently long to protect shareholders from unregulated solicitations? Should the time period be shortened (e.g., 30 or 35 days) or lengthened (e.g., 75 or 90 days)? Is there a better alternative that would encourage free and open communication on electronic shareholder forums, but limit the use of the forums as a way to solicit proxies without providing the full and fair disclosure required in our proxy rules?
- As proposed, we have provided no guidance on what should happen to the communications and data on the forum within the 60-day period prior to the annual or special meeting. Solicitations that remain posted on the forum that were exempt under proposed Rule 14a-2(b)(6) may no longer be exempt. Should we require that the electronic shareholder forums be taken down within 60 days of a scheduled meeting? Alternatively, if the forum continues to run, should shareholders who

continue making communications on the forum file any communications that are solicitations in compliance with Regulation 14A? Should those shareholders be required to file any solicitations on the forum that occurred more than 60 days prior to the meeting? How would the forums be policed to ensure that the responsible parties are properly filing?

- What would be the appropriate use of an electronic shareholder forum with regard to a bylaw proposal, as contemplated in this release? For example, should shareholders be able to use a forum to solicit other shareholders to form a 5% group in order to submit a bylaw proposal?

C. Request for Comment on Proposals Generally

1. Bylaw Amendments Concerning Non-Binding Shareholder Proposals

Several participants in the Commission's recent proxy roundtables expressed concern that by requiring the inclusion of non-binding shareholder proposals in company proxy materials, Rule 14a-8 expands rather than vindicates the framework of shareholder rights in state corporate law.[69] A number of other participants in the roundtables indicated, however, that non-binding shareholder proposals have a useful role in the proxy process and in corporate governance.[70] Based, in part, on these and other views expressed by participants at the roundtables, we are requesting comment as to whether

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69 See, e.g., Leo E. Strine, Jr., Vice Chancellor, Court of Chancery of the State of Delaware, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 18-23.

70 See, e.g., Ted White, Strategic Advisor, Knight Vinke Asset Management, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 94-95; Damon A. Silvers, Associate General Counsel, AFL-CIO, Transcript of Roundtable on Proposals of Shareholders, May 25, 2007, at 8-11. See also Form Letters B and C, available on the Commission's Web site at www.sec.gov.

the Commission should adopt rules that would enable shareholders, if they choose to do so, to determine the particular approach they wish to follow with regard to non-binding proposals. Such an approach was proposed once before by the Commission but ultimately was not adopted;[71] however, in light of developments in the last 25 years that may have diminished the concerns about shareholders' ability to act as a group, which formed the basis of arguments for a mandated federal approach, we are again requesting comment on this approach. These developments include the increasing importance of institutional investors in contemporary capital markets, the significant role of private organizations that collect and disseminate information to institutional investors concerning corporate governance issues, the prevalence of widely published voting guidelines for market participants of all sizes, and the significantly enhanced opportunities for collaborative discussion and decision-making afforded by the Internet and related technological innovations.

We therefore are requesting comment on whether a company or its shareholders should have the ability to propose and adopt bylaws that would establish the procedures

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71 In 1982, during a comprehensive review of the shareholder proposal process, the Commission proposed permitting companies and shareholders to formulate and adopt procedures for including shareholder proposals in the company's proxy materials. See Release No. 34-19135 (Oct. 14, 1982) [47 FR 47420]. Under the proposed approach, the Commission would have continued to have a rule that specified the procedures governing the submission and inclusion of shareholder proposals, but would have adopted a supplemental rule to permit a company and its shareholders to adopt a plan providing their own procedures to govern the process. The proposed approach would have allowed a company's board of directors and shareholders, rather than the Commission or its staff, to make judgments as to what proposals should be included in the company's proxy materials at the company's expense. The plan could have been proposed by either the company's board of directors or shareholders, and subject to certain minimum requirements, the provisions of the plan could have been as liberal or restrictive as shareholders were willing to approve. In 1983, the Commission adopted final rules amending Exchange Act Rule 14a-8, but left the Exchange Act Rule 14a-8 framework intact, concluding that, at that time, a federal framework for including shareholder proposals in company proxy materials was in the best interests of shareholders and issuers. See Release No. 34-20091 (Aug. 16, 1983) [48 FR 38218].

that the company will follow for including non-binding proposals in the company's proxy materials. In addition to general comment, we encourage commenters to address the following specific questions:

- Would it be appropriate to require the shareholder (or group of shareholders) that submits the proposal to file a Schedule 13G that includes specified public disclosures regarding its background and its interactions with the company, that corresponds to the proposed disclosure requirements for shareholder proponents of bylaw amendments concerning shareholder director nominations?
- Should a shareholder (or group of shareholders) proposing such a bylaw amendment be required to have continuously held a certain percentage of the company's securities entitled to be voted on the proposal at the meeting? What would the appropriate percentage be? Should a holding period be required? If so, how long should the holding period be?
- Should a proposal be required to otherwise satisfy the requirements of Rule 14a-8 (e.g., the proposal would have to satisfy the procedural requirements of Rule 14a-8 and not fall within one of the other substantive bases for exclusion included in Rule 14a-8)?
- Under current Rule 14a-8, all shareholder proposals and supporting statements are limited to 500 words in total. Should the word limit be different for shareholder submissions of proposed bylaw amendments to establish procedures for non-binding proposals? If so, should the word limit be increased to 3,000 words in order to permit a more thorough description of the proposed procedural framework and in accordance with the approximate word count in current Rule 14a-8? If not 3,000, should the

word limit be higher or lower than 3,000 (e.g., 1,000, 2,000, 4,000)?

- Should the proxy statement for the shareholder vote be required to explain that approval of the bylaw would establish procedures that would govern in all circumstances with regard to shareholder requests for the inclusion of non-binding proposals? Should the bylaw itself be required to provide this explanation?
- Would it be appropriate for the Commission to provide that the substance of the procedure for non-binding proposals contained in a bylaw amendment would not be defined or limited by Rule 14a-8, but rather by the applicable provisions of state law and the company's charter and bylaws? For example, the Commission could provide that the framework could be more permissive or more restrictive than the requirements of existing Rule 14a-8 (e.g., the framework could specify different eligibility requirements than provided in current Rule 14a-8, different subject-matter criteria, different time periods for submitting non-binding proposals to the company, or different resubmission thresholds; or it could specify that non-binding proposals would not be eligible for inclusion in the company's proxy materials, or alternatively that all non-binding proposals would be included in the company's proxy materials without restriction, if these approaches were consistent with state law and the company's charter and bylaws).
- To ensure that any new rule is consistent with the principle that the federal proxy rules should facilitate shareholders' exercise of state law rights, and not alter those rights, should any rule adopted include a specific requirement that, to be included in a company's proxy materials, a shareholder proposal establishing bylaw procedures for non-binding proposals would have to be binding on the company under state law if

approved by shareholders?

- Would it be appropriate for the Commission to provide that, if shareholders approve a bylaw procedure for non-binding proposals, interpretation and enforcement of that procedure would be the province of the appropriate state court? Under such an approach, the Commission and its staff would not resolve such questions. Should the Commission or its staff instead become involved in interpreting or enforcing the company's bylaws? Is there any reasonably foreseeable situation where intervention by the Commission or its staff would be critical to the proper functioning of bylaw procedures for non-binding proposals? In addition, we solicit comments with respect to the practicality and feasibility of relying on state courts as the arbiter of disagreements between companies and shareholder proponents over the company's bylaws as they apply to non-binding shareholder resolutions.
- Should the Commission encourage the proponent of any bylaw procedure governing non-binding proposals to include in the procedure a fair and efficient mechanism for resolving any disagreements between the company and the shareholder as to the bases for inclusion or exclusion of a proposal?
- Should the Commission specify that, even after the shareholders approve a bylaw procedure for non-binding shareholder proposals, a shareholder meeting the proposed eligibility requirements could later submit another bylaw procedure that removes or amends the previously-adopted non-binding procedure and that bylaw would not generally be excludable by a company under Rule 14a-8(i)(2) or Rule 14a-8(i)(3)?
- How might shareholders' overall ability to communicate with management and other shareholders be improved or diminished if shareholders were able to choose different

procedures for non-binding proposals than those currently in Rule 14a-8? Are there additional or different procedures that the Commission should require, encourage or seek to prevent?

With respect to subjects and procedures for shareholder votes that are specified by the corporation's governing documents, most state corporation laws provide that a corporation's charter or bylaws can specify the types of binding or non-binding proposals that are permitted to be brought before the shareholders for a vote at an annual or special meeting. Further, most state corporation laws permit a company's board of directors to adopt, amend, or repeal bylaws without a shareholder vote. Because a company's board of directors could adopt a bylaw establishing procedures for the consideration of non-binding proposals at meetings of shareholders, we have not included in the above request for comment any discussion of a board of directors adopting bylaws that would limit the ability of shareholders to raise non-binding proposals for a vote at meetings of shareholders. To the extent a company had in place a bylaw under which non-binding shareholder proposals were not permitted to be raised at meetings of shareholders, a company may be able to look to Rule 14a-8(i)(1) with regard to the exclusion of such proposals. Such ability to exclude the proposals would, of course, be reliant on the bylaw's compliance with applicable state law and the company's governing documents. In light of the board's power to adopt such a bylaw under state law, please consider the following specific requests for comment:

- Should the board of directors be able to adopt a bylaw setting up a separate procedure for non-binding shareholder proposals and be able, under our proxy rules, to follow that procedure in lieu of Rule 14a-8 with regard to non-binding proposals? Should such procedures be deemed to comply with Rule 14a-8 if the bylaw is not approved by a shareholder vote, provided that state law authorizes the adoption of such a bylaw without a shareholder vote?

- Should a bylaw proposed and adopted by a company prior to becoming subject to Exchange Act Section 14(a) be deemed to comply with Rule 14a-8 once the company became subject to Exchange Act Section 14(a)? If so, should such companies be required to provide disclosure regarding the rights of shareholders with respect to the submission of non-binding shareholder proposals for inclusion in the company's proxy materials as part of the description of its equity securities in its Securities Act and Exchange Act registration statements. If not, should companies instead be required to submit the bylaw to a shareholder vote once the company becomes public and subject to Section 14(a) of the Exchange Act, either at a special meeting or an annual meeting?
- Is there a concern that affiliates of a company could obtain a sufficient number of votes to adopt a bylaw without obtaining a vote of the non-affiliates? Should the federal proxy rules further restrict the operation of bylaw provisions that are otherwise permissible under state law by requiring, for example, that once a company is subject to Section 14(a), the shareholders who are not affiliates of the company ratify the bylaw, or that the bylaw procedure be periodically re-approved by shareholders after its initial approval? Does the fact that the company's bylaws can generally be revised or repealed at any time after adoption mitigate the need for such extraordinary procedures?

- Should the Commission adopt a provision to enable companies to follow an electronic petition model for non-binding shareholder proposals in lieu of Rule 14a-8? Such a model could include some or all of the following parameters:
  - Electronic petitions would be submitted by shareholders and posted by the company on the electronic proxy notice and access website;
  - Only shareholders as of the record date could sign the electronic petition through the close of the applicable shareholder meeting;
  - Execution of the electronic petition would occur through the same control numbers used to vote under electronic proxy;
  - Communications would be subject to Rule 14a-9, but otherwise would be minimally restricted by the proxy rules;
  - Results of petitions would be reported as a percentage of total outstanding shares;
  - The decision to sign or not to sign an electronic petition would not be considered a shareholder vote;
  - Petitions would follow current Rule 14a-8 guidelines (e.g., would be limited to 500 words) and require the identification of the shareholder-sponsor;
  - Companies would be permitted to post a response to each petition; and
  - Petition sponsors could use an "electronic-only" solicitation approach with no obligation to send paper copies.
- Are there additional changes to Rule 14a-8 that would improve operation of the rule? If so, what changes would be appropriate and why? For example, should the Commission amend the rule to change the existing ownership threshold to submit

other kinds of shareholder proposals? If so, what should the threshold be? Would a higher ownership threshold, such as \$4,000 or \$10,000, be appropriate? Should the Commission amend the rule to alter the resubmission thresholds for proposals that deal with substantially the same subject matter as another proposal that previously has been included in the company's proxy materials? If so, what should the resubmission thresholds be – 10%, 15%, 20%? Are there any areas of Rule 14a-8 in which changes or clarifications should be made (e.g., Rule 14a-8(i)(7) and its application with respect to proposals that may involve significant social policy issues)? If so, what changes or clarifications are necessary?

- Currently, Item 4 in Part I of Form 10-K and Form 10-KSB and Item 4 in Part II of Form 10-Q and 10-QSB require a company to disclose information regarding the submission of matters to a vote of security holders. The required disclosure includes a description of each matter voted upon at the meeting and the number of votes cast for, against, or withheld, as well as the number of abstentions and broker non-votes as to each such matter. In the interest of increased transparency, should additional disclosure be provided with regard to the voting results for non-binding shareholder proposals? For example, should the company be required to disclose votes for non-binding shareholder proposals as a percentage of the total outstanding securities entitled to vote on the proposal? Or as a percentage of the total votes cast? Would shareholders benefit from receiving this type of information?

2. Other Requests for Comment

- Would adoption of the proposed rules conflict with any state law, federal law, or rule of a national securities exchange or national securities association? To the extent you indicate that the proposed rules would conflict with any of these provisions, please be specific in your discussion of those provisions that you believe would be violated.

- As the Commission staff noted in its July 15, 2003 Staff Report entitled "Review of the Proxy Process Regarding the Nomination and Election of Directors,"[72] the cost to shareholders of soliciting proxies in opposition to the company's solicitation has been considered to be prohibitive and, as such, has been a key component of arguments in favor of increasing the opportunity for the inclusion of shareholder nominees for director in the company's proxy materials. Significant recent technological advances appear to have the potential to substantially reduce the costs of such a proxy solicitation, including the Commission's recently adopted "E-Proxy" rules[73] and the electronic shareholder forum discussed in this release. Will these technological advances reduce the costs of proxy solicitations for both companies and those that solicit in opposition to a company?
- Should bylaw proposals establishing a shareholder director nomination procedure be subject to a different resubmission standard than other Rule 14a-8 proposals? If so, what standard would be appropriate and why?
- As proposed, the federal proxy rules would not establish a threshold for the votes required to adopt a bylaw procedure. This is because the voting thresholds for the adoption of bylaw amendments are established by state law and a company's governing documents. Is this reliance on state law and the company's governing

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72 See Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, Appendix A (Summary of Comments in Response to the Commission's Solicitation of Public Views Regarding Possible Changes to the Proxy Rules) (July 15, 2003).

73 Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148].

documents appropriate? Should the proxy rules establish a different federal standard for the required vote to adopt a bylaw procedure, such as the majority of shares present in person or represented by proxy and entitled to vote on the proposal, or a supermajority vote?

- Our proposals assume that the existing exemptions for solicitations are sufficient to include soliciting activities of shareholders that are seeking to form a more than 5% group. Accordingly, the release does not address any such soliciting activities or propose any new rules in this regard. Is our assumption that the existing exemptions are sufficient for the purpose of forming a shareholder group to submit a bylaw proposal correct? If not, what would be the appropriate scope of any new exemption or amendment to an existing exemption?
- Is there an alternative to the proposal regarding shareholder director nomination bylaws that would provide a preferable method by which shareholders could establish procedures to place their candidates for director in the company proxy materials? For example, should shareholders be able to propose a bylaw amendment only where there has been a majority withhold vote for a specified director or directors, and the director or directors do not resign? If so, what ownership threshold would be appropriate in those circumstances?
- In light of developments that reduce the costs of proxy solicitations by shareholder proponents, such as the adoption of "E-proxy," general advances in communication technology, the proposals concerning electronic shareholder forums, and, in some instances the ability of shareholders to request and receive reimbursement for election contest expenses, is there an alternative to the proposal regarding shareholder director

nomination bylaws that would enable shareholders to conduct election contests without incurring the expense of a traditional contest and without being placed on the company ballot? For example, should our proxy rules be amended to permit pure electronic solicitation? Should we amend Rule 14a-2(b)(1) to enable shareholders to solicit a greater number of other shareholders than currently is permitted under the rule (the rule limits the number solicited to ten) without being required to furnish a proxy statement?

- Would additional amendments to the system for reporting beneficial and other ownership interests in securities be appropriate? If so, what additional amendments would be appropriate and why? Are there areas where additional disclosures would be appropriate (e.g., with regard to the exercise of voting rights without an economic interest in the underlying security)? Are there ways in which the system could be simplified (e.g., by combining the reports required to report beneficial and other ownership interests)?

III. General Request for Comment

We request and encourage any interested person to submit comments regarding:

- the proposed amendments that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors and other market participants. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

IV. Paperwork Reduction Act

A. Background

The proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995, the PRA.[74] We are submitting the proposal to the Office of Management and Budget for review in accordance with the PRA.[75] The titles for the collections of information are:

(1) "Proxy Statements - Regulation 14A (Commission Rules 14a-1 through 14a-15 and Schedule 14A)" (OMB Control No. 3235-0059); and

(2) "Securities Ownership - Regulation 13D and 13G (Commission Rules 13d-1 through 13d-7 and Schedules 13D and 13G)" (OMB Control No. 3235-0145).

These regulations were adopted pursuant to the Exchange Act and the Investment Company Act of 1940 and set forth the disclosure requirements for securities ownership reports filed by investors and proxy statements filed by companies to help investors make informed voting or investing decisions.

The hours and costs associated with preparing and filing the disclosure, filing the forms and schedules and retaining records required by these regulations constitute reporting and cost burdens imposed by each collection of information. An agency may

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[74] 44 U.S.C. 3501 et seq.

[75] 44 U.S.C. 3507(d); 5 CFR 1320.11.

not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

B. Summary of Proposals

The proposed amendments would establish a new procedure by which shareholders could use Rule 14a-8 to propose bylaw amendments establishing procedures that would permit eligible shareholders to nominate candidates for the board of directors in the company's proxy materials.[76] As proposed, Rule 14a-8 would be amended to require inclusion of such proposals, provided that the proposals comply with the procedural requirements of Rule 14a-8 and the additional proposed disclosure requirements. To be included, the bylaw amendments would be required to be submitted by a shareholder proponent that is eligible to, and has, filed a Schedule 13G including all required disclosures and has continuously held more than 5% of the company's securities entitled to be voted on the proposal for at least one year. We also propose to amend Schedule 13G and add Item 24 and Item 25 of Schedule 14A to require disclosure regarding the shareholder proponent's background and relationships with the company. This disclosure would be provided by the shareholder proponent and the company, respectively.

In addition to the proposed amendments concerning shareholder proposals to amend company bylaws, we propose several amendments to require disclosure about shareholder nominees for director and nominating shareholders when shareholder

[76] Proposed Rule 14a-18 would establish special provisions in the proxy rules applicable to electronic shareholder forums in order to encourage shareholders and companies to take advantage of these forums. These rules are intended to allow issuers and shareholders broad latitude with regard to the forums and do not impose any new paperwork burdens.

nominees are included in the company's proxy material. Proposed Rule 14a-17 would require nominating shareholders to provide the company with certain Schedule 14A information regarding each director nominee for inclusion in the proxy statement or on a website to which the proxy statement refers. In addition, proposed Rule 14a-17 would require a nominating shareholder to provide information regarding the background of the nominating shareholder and its relationships with the company that would be required by proposed Items 8A, 8B and 8C of Schedule 13G to the company.

The proposed information collection requirements would be mandatory and responses would not be confidential. The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number.

C. Paperwork Reduction Act Burden Estimates

The proposed amendments would, if adopted, require additional disclosure on Schedule 14A and Schedule 13G, as well as in a company's registration statements.

1. Proposed Amendments to Rule 14a-8 Concerning Bylaw Proposals for Shareholder Nominations of Directors

Schedule 14A prescribes the information that a company must include in its proxy statements to provide security holders with material information relating to voting decisions. For purposes of the PRA, we currently estimate that compliance with Regulation 14A, including preparation of Schedule 14A, requires 475,781 hours of company personnel time (approximately 66 hours per company) and costs $63,437,000 for the services of outside professionals (approximately $8,750 per company).[77] The proposed amendment to Rule 14a-8 would require the company to include shareholder proposed bylaw amendments that provide procedures for shareholder nominations of directors unless the shareholder has failed to comply with the procedural requirements of Rule 14a-8.

Historically shareholders have made relatively few binding proposals. In the 2006-2007 proxy season, companies received 1,250 shareholder proposals, of which only 100 were binding proposals.[78] Of those 100, only three related to bylaw amendments providing for shareholder nominees to appear in the company's proxy materials.[79] These three proposals were not subject to the additional disclosure requirements that would apply to shareholders under the proposed rules. In light of this historical data and given the proposed eligibility requirements to submit such proposals, we estimate that there would be a limited number of shareholder proposals to amend the bylaws to provide for shareholder nominees to be included in the company's proxy materials. We note, however, that by establishing procedures for submission of theses types of proposals, we are likely to encourage more bylaw amendment proposals than we currently receive. We

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77 These figures assume 7,250 respondents that file Schedule 14A under Regulation 14A with the Commission. We estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of $400 per hour. The hourly cost estimate is based on our consultations with several registrants and law firms and other persons who regularly assist registrants in preparing and filing with the Commission.

78 Rachel McTague, 39 Securities Regulation & Law Report 911 (June 11, 2007) (stating that, according to data complied by the Institutional Shareholder Services, nearly 1,250 shareholder proposals were submitted to companies during the 2006 proxy season).

79 Tomoeh Murakami Tse, The Washington Post, March 15, 2007, at D2 (stating that three proxy access proposals were submitted by shareholders during the 2006 proxy season).

therefore assume some increase in such proposals and estimate that the number would be 30 per year.[80]

For purposes of the PRA, we estimate that the proposed amendments to Rule 14a-8 would create an incremental burden of six hours of company personnel time and costs of $800 for the services of outside professionals. In sum, we estimate that the amendments to Regulation 14A will increase the annual paperwork burden by approximately 180 hours of company personnel time and a cost of approximately $24,000 for the services of outside professionals. These burdens and costs would include the additional disclosure in proposed Item 24 and Item 25 of Schedule 14A as well as the burdens and costs associated with including the proposal in the company's proxy materials.

2. Proposed Amendments to Schedule 13G Requiring Disclosure from Shareholder Proponents

Exchange Act Schedule 13G is a short-form filing for persons to report ownership of more than 5% of a class of voting equity securities registered under Section 12 of the Exchange Act. Generally, the filer must certify that the securities have not been acquired and are not held for the purpose of, or with the effect of, changing or influencing the control of the issuer of the securities. For purposes of the PRA, we currently estimate that compliance with the Schedule 13G requirements under Regulation 13D requires 98,800 burden hours, broken down into 24,700 hours (or 2.6 hours per respondent) of

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80 We estimate that the number of proposals for bylaw amendments to allow shareholder nominations of directors received last proxy season (3) would increase tenfold (30).

respondent personnel time and costs of $22,230,000 (or $2,340 per respondent) for the services of outside professionals.[81]

The proposed amendment to Rule 14a-8 would require the company to include certain shareholder proposed bylaw amendments only if they are submitted by a shareholder proponent that is eligible to, and has, filed a Schedule 13G that complies with proposed Schedule 13G Items 8A, 8B, and 8C. As explained above, we estimate that the number of shareholder proponents submitting such proposals under Rule 14a-8 would be 30. Rather than presume that any of the shareholder proponents previously filed a Schedule 13G on an individual or group basis, we assume for purposes of the PRA that each person or group will be a new Schedule 13G filer. This would increase the number of Schedule 13G filers. In addition, the proposed disclosure of each shareholder proponent's background and relationships with the company would be different and more detailed than the disclosure currently required by Schedule 13G, increasing the reporting burden associated with this schedule.

For purposes of the PRA, we estimate that the proposed amendments to Schedule 13G would create an incremental burden of 4.1 hours per response, which we would add to the existing Schedule 13G burden resulting in a total burden of 14.5 hours.[82] Each of the 30 additional filers would incur a burden of approximately 3.6 hours of respondent

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81 These figures assume 9,500 respondents that file Schedule 13G with the Commission. We estimate that 25% of the burden of preparation is carried by the company internally and that 75% of the burden of preparation is carried by outside professionals retained by the issuer. These figures assume an average cost of $300 per hour. The Commission has increased the cost estimate $100 since our last estimate provided to OMB based on our consultations with several registrants and law firms and other persons who regularly assist registrants in preparing and filing with the Commission. In our PRA submission, we will increase the cost of outside professionals to meet the new $400 per hour estimate.

82 We currently estimate the burden for preparing a Schedule 13G filing to be 10.4 hours.

personnel time (25% of the total burden) and costs of $4,350 for the services of outside professionals (75% of the total burden). In sum, we estimate that the amendments to Schedule 13G will increase the annual paperwork burden by approximately 108 hours of respondent personnel time and a cost of approximately $130,000 for the services of outside professionals.

3. Proposed Rule 14a-17 to Require Disclosure from Nominating Shareholders and Shareholder Nominees

Proposed Rule 14a-17 would require nominating shareholders and their nominees to provide disclosure relating to their backgrounds and relationships with the company for inclusion in a Schedule 14A. As explained above, we estimate that there will be 30 proposals for bylaw amendments to allow shareholder nominations of directors annually. Of these, for purposes of this analysis we estimate that 50% will be successful. If we assume that in every case where a bylaw amendment is successful a shareholder nominee is proposed, the additional disclosure would be required 15 times annually.

For purposes of the PRA, we estimate that proposed Rule 14a-17 would create an incremental burden of six hours of company personnel time and costs of $800 for the services of outside professionals for each shareholder nominee included in a Schedule 14A. In sum, we estimate that the amendments will increase the annual paperwork burden of Regulation 14A by approximately 90 hours of company personnel time and a cost of approximately $12,000 for the services of outside professionals.

D. Solicitation of Comments

We request comment on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-16-07. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-16-07, and be submitted to the Securities and Exchange Commission, Office of the Secretary - Records Management Branch, 100 F Street, NE, Office of Filings and Information Services, Washington, DC 20549. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

V. Cost-Benefit Analysis

We propose to revise and update the proxy rules to more effectively serve their essential purpose of facilitating the exercise of shareholders' rights under state law. We request any relevant data from commenters that would be helpful in quantifying these costs and benefits.

A. Benefits

The proposed amendments to Rule 14a-8 concerning binding bylaw proposals relating to shareholder nominations of directors on the company's proxy would help shareholders to exercise rights under state law to nominate and elect directors of their choosing. A bylaw amendment that allowed shareholder nominees to be included in the company's proxy materials would reduce the cost for a shareholder to nominate candidates for election on the board since the nominating shareholder would not need to incur the cost of preparing separate proxy materials and mailing those materials to other shareholders. Allowing shareholders to propose bylaw amendments that would enable them to include shareholder nominees on the company's proxy may provide shareholders a more effective voice than simply being able to recommend candidates to the nominating committee or being able to nominate candidates in person at a shareholder meeting.

The proposed amendment would require additional disclosure on Schedule 13G and Schedule 14A by shareholder proponents, nominating shareholders and shareholder nominees about their background and relationships with the company. This additional information provided by such disclosures would help provide transparency to shareholders in voting on bylaw amendments and shareholder nominees.

Finally, the proposed amendments to Regulation 14A regarding the electronic shareholder forum seek to remove unnecessary barriers to the use of technology to increase constructive communication between shareholders and between shareholders and the company. The exemption for communications more than 60 days prior to the announced meeting date would allow for more open and unfettered communication between parties. The enhanced communication may result in better coordination among the views of shareholders, more effective exercise of state law rights, and a better alignment between the interests of shareholders and the company.

B. Costs

The proposed amendments would impose some direct costs on companies and shareholders who are subject to the new rules. For purposes of the PRA, we estimate that the annual additional burden to companies of preparing the required proxy disclosure would be approximately 270 hours of company personnel time and a cost of approximately $36,000 for the services of outside professionals. In addition, for purposes of the PRA, we estimate that the annual incremental burden to prepare the required disclosure for shareholder proponents, nominating shareholders and nominees would be approximately 108 hours of personnel time and a cost of approximately $130,000 for the services of outside professionals.

The bulk of the additional disclosure required by the amendments to Regulation 14A would be provided to the company by shareholder proponents and nominating shareholders. The proposed amendments would add costs to the preparation and dissemination of this information in the company's proxy statement where shareholders have chosen to make proposals or put forth nominees.

If shareholders have adopted a shareholder nomination bylaw amendment and chose to allocate company resources to facilitate shareholder nominations, the cost of preparing the company's proxy materials would be increased by the need to prepare and include information relating to the shareholder nominees. In addition, the company could incur increased costs relating to the solicitation of proxies in support of the board's candidates and against the shareholder nominees.

The proposed amendments to Regulation 14A and Schedule 13G would impose costs on shareholder proponents. Shareholder proponents would be required to provide extensive background information and information on their relationships with the issuer on Schedule 13G. Under the proposed amendments, a company would also incur preparation and filing costs associated with disclosing the nature and extent of its relationships with a shareholder proponent. In addition, companies may incur costs for procedures to monitor its relationships with shareholder proponents.

If a shareholder nomination bylaw amendment were adopted, shareholder nominees and nominating shareholders would also incur costs associated with the Rule 14a-17 disclosure requirements. Nominating shareholders and their nominees might also bear solicitation costs in seeking support for the nominee's election. However, these disclosure and solicitation costs are not expected to exceed the costs that would be incurred from a separate proxy contest.

Under the proposed rules, companies may choose to incur additional costs to establish more responsive policies and procedures in an attempt to avoid having shareholders seek bylaw amendments or propose shareholder nominees. The company and the board may spend more time on shareholder relations instead of the business of the company. In addition, it is possible that electing a shareholder nominee to the board could have a disruptive effect on boardroom dynamics.

Request for Comment

We are sensitive to the costs and benefits imposed by our rules, and have identified certain costs and benefits related to these proposals. We request comment on all aspects of this cost-benefit analysis, including identification of any additional costs and benefits. We encourage commenters to identify and supply relevant data concerning the costs and benefits of the proposed amendments.

- What are the costs and benefits of a 5% threshold as opposed to alternative thresholds? How would the private costs of assembling a 5% coalition vary across different types or sizes of companies?
- What are the potential costs and benefits of facilitating an increase in the variation of nomination rules across companies?
- What are the costs and benefits of potentially moving away from a dual-slate structure in which voting shareholders choose between the management card and the dissident card toward a unitary slate voting system in which voters choose among items on a single proxy card?

VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act[83] requires us, when adopting rules under the

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83 15 U.S.C. 78w(a)(2).

Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act[84] and Section 2(c) of the Investment Company Act[85] require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

The proposed rules are intended to promote the exercise of shareholder rights under state law and provide shareholders with information about shareholder proponents of, and shareholder nominees under, shareholder nomination bylaw amendments. The proposed rules, if adopted, would establish a fair and transparent mechanism for shareholders to propose and adopt bylaw amendments to establish procedures relating to shareholder director nominations inclusion in the company proxy materials.

The disclosure requirements in the proposed rules would require detailed information regarding the background and relationships of shareholder proponents of the bylaw amendments to be disclosed by the shareholder proponents and the company. This disclosure would provide shareholders a better informed basis for deciding whether to approve the bylaw amendments. Changes to the company's bylaws should therefore better reflect shareholders' preferences regarding director nomination procedures. Investors may value the information about whether companies have subjected these

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84 15 U.S.C. 78c(f).

85 15 U.S.C. 80a-2(c).

preferences to a vote and provided a specified alternative procedure for inclusion of shareholder nominees in the company's proxy materials. This may promote the efficiency of the exercise of shareholder rights under state law.

If the shareholders adopt a bylaw amendment and the company is required to include shareholder nominees in its proxy materials, there may be increased competition for board positions, which might encourage or discourage qualified candidates from running. The proposed rules focus on improving and streamlining information flow between investors and with the company, which we believe would give more direct effect to shareholder preferences regarding shareholder director nominees. We believe these changes are likely to have a limited effect on efficiency, competition and capital formation. The effects of the proposed rules could be positive or negative depending on what shareholders deem is best for them given the additional information. We request comment on whether the proposals, if adopted, would promote efficiency, competition and capital formation or have an impact or burden on competition. Commenters are requested to provide empirical data and other factual support for their view, if possible.

VII. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed revisions to the rules and forms under the Exchange Act that would permit shareholders to propose bylaw amendments to establish procedures relating to shareholder director nominations for inclusion in the company's proxy materials. The proposed revisions would also facilitate the use of an electronic shareholder forum by companies and shareholders.

A. Reasons for, and Objectives of, Proposed Action

The proposed rules are intended to open up communication between the company and its shareholders, promote the exercise of shareholder rights under state law, and provide shareholders with better information to make an informed voting decision by requiring disclosure about shareholder proponents and shareholder nominees under any shareholder nomination bylaw amendments.

The proposals, if adopted would facilitate the exercise of shareholders' rights under state law. As proposed, shareholders who have held more than 5% of the company's securities entitled to be voted at the meeting for at least one year by the date of their submission may submit binding proposals to amend the company bylaws to establish procedures for shareholder nominations of directors. Enabling shareholders to establish the company's procedures for inclusion of shareholder nominees on the company's proxy would provide shareholders with greater control over the use of the company's proxy process.

In addition, encouraging the use of electronic shareholder forums and the Internet may have the effect of improving shareholder communication. Any electronic shareholder forum may enhance shareholders' ability to communicate not only with management, but also with each other. Such direct access may improve shareholder relations to the extent shareholders have improved access to management.

B. Legal Basis

We are proposing amendments to the forms and rules under the authority set forth in Sections 13, 14, and 23(a) of the Exchange Act, as amended and Section 20(a) and 38 of the Investment Company Act, as amended.

C. Small Entities Subject to the Proposed Rules

The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[86] The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission.[87] A "small business" and "small organization," when used with reference to an issuer other than an investment company, generally means an issuer with total assets of $5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,100 issuers, other than investment companies, that may be considered reporting small entities.[88] For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[89] Approximately 215 investment companies meet this definition.[90] The proposed rules may affect each of the approximately 1,315 issuers that may be considered reporting small entities, to the extent companies and shareholders take advantage of the proposed procedures.[91] We request comment on the number of small

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86 5 U.S.C. 601(6).

87 Securities Act Rule 157 (17 CFR 230.157) and Exchange Act Rule 0-10 (17 CFR 240.0-10) contain the applicable definitions.

88 The estimated number of reporting small entities is based on 2007 data, including the Commission's EDGAR database and Thomson Financial's Worldscope database.

89 Rule 0-10 under the Investment Company Act [17 CFR 270.0-10] contains the applicable definition.

90 The estimated number of reporting investment companies that may be considered small entities is based on December 2006 data from the Commission's EDGAR database and a third-party data provider.

91 The proposed amendments to Rule 14a-8 would not impact open-end investment companies that may be small entities because shareholders of those entities are not eligible to file Schedule 13G,

entities that would be impacted by our proposals, including any available empirical data.

D. Reporting, Recordkeeping and Other Compliance Requirements

The proposals would require all companies, including small entities, to permit certain shareholders to submit the specified binding proposals to amend the company bylaws. Shareholder proponents, including proponents that are small entities, would be required to provide the proposed Schedule 13G disclosure regarding background and relationships with the company and companies would be required to include similar disclosure provided by the shareholder proponent with the company's proxy.

If a bylaw amendment with an alternate shareholder nomination procedure is adopted, issuers would be required to meet the new procedural requirements and provide disclosure relating to the shareholder nominee in the proxy and the nominating shareholders and shareholder nominees would be required to provide additional information regarding their background and relationships with the company.

E. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no rules that conflict with or duplicate the proposed rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective of our proposals, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments and rules, we considered the following alternatives:

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which must be filed in order to rely upon the proposed rule. Of the 215 investment companies that may be considered small entities, 131 are open-end investment companies.

- the establishment of different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- the clarification, consolidation, or simplification of the rule's compliance and reporting requirements for small entities;
- the use of performance rather than design standards; and
- an exemption from coverage of the proposed rules, or any part thereof, for small entities.

The Commission has considered a variety of reforms to achieve its regulatory objectives. The proposed amendments, if adopted, would require companies to include binding bylaw amendments relating to procedures for shareholder nominations of directors. The proposals are being made in order to more effectively serve the essential purpose of the proxy rules to facilitate the exercise of shareholders' rights under state law. The proposed amendments also would require additional disclosure by the shareholder proponent (or any subsequent nominating shareholder or shareholder nominee) and the company of the background of the proponent and its relationships with the issuer.[92] We believe this additional disclosure will assist investors in making an informed voting decision. It is not clear how applying separate compliance or reporting standards to small entities would further encourage facilitation of the exercise of these rights. However, we are considering what level of disclosure would be appropriate for shareholder proponents, nominating shareholders and shareholder nominees regarding their background and relationships with the company. If we require less disclosure from

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92 The proposed ability for shareholder proponents to propose bylaw amendments to be included in the company's proxy material is linked to their filing on Schedule 13G. A lower ownership threshold for small entities would not be appropriate due to the loss of the additional disclosure and safeguards provided by Schedule 13G.

smaller issuers we are concerned that shareholders may not receive sufficient information with which to make an informed decision.

We considered the use of performance standards rather than design standards in the proposed rules. The proposal contains both performance standards and design standards. We are proposing design standards to the extent that we believe that compliance with particular requirements are necessary. However, to the extent possible, we are proposing rules that impose performance standards. By allowing companies to establish their own procedures relating to shareholder nominations, we seek to provide companies, shareholder proponents and nominating shareholders with the flexibility to devise the means through which they can comply with the standards.

We request comment on whether separate requirements for small entities would be appropriate. The purpose of the amendments is to provide certain shareholders with the ability to amend the bylaws to establish their own procedures for shareholder nominations of directors and to improve shareholder communications. Exempting small entities would not appear to be consistent with these goals. The establishment of any differing compliance or reporting requirements or timetables or any exemptions for small business issuers may not be in keeping with the objective of the proposed rules.

G. Solicitation of Comment

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposals;
- The existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and

- How to quantify the impact of the proposed rules.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the final regulatory flexibility analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VIII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[93] a rule is "major" if it has resulted, or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment or innovation.

IX. Statutory Basis and Text of Proposed Amendments

We are proposing amendments to rules pursuant to Sections 13, 14, and 23(a) of the Exchange Act, as amended, and Sections 20(a) and 38 of the Investment Company Act, as amended.

List of Subjects

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[93] Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996)(codified in various sections of 50 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. §601).

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations as follows:

PART 240 – GENERAL RULES AND REGULATION, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. §240.13d-102 Schedule 13G is amended by:

a. Removing the authority citation following the section; and

b. Adding Items 8A, 8B and 8C.

The additions are to read as follows:

§ 240.13d-102 Schedule 13G - Information to be included in statements filed pursuant to §240.13d–1(b), (c), and (d) and amendments thereto filed pursuant to §240.13d–2.

* * * * *

Item 8A. Shareholder Proponents

(a) Definition of shareholder proponent: In this item, the term "shareholder proponent" means:

(1) A person or group that has formed any plans or proposals regarding an amendment to a company's bylaws, in accordance with § 240.14a-8(i)(8);

(2) A nominating shareholder as defined in § 240.14a-17(a);

(3) Any affiliate, executive officer or agent acting on behalf of the person (or group) described above in Item 8A(a)(1)-(2) with respect to the plans or proposals; and

(4) Anyone acting in concert with, or who has agreed to act in concert with, the person (or group) described above in Item 8A(a)(1)-(2) with respect to the plans or proposals.

(b) A shareholder proponent, as defined in section (a), shall provide the additional disclosure required by Items 8B and 8C.

Note to Item 8A. For purposes of this Item 8A and for the disclosures required by Item 8B and Item 8C, the term "plans or proposals" shall include, but not be limited to, the submission of a proposal to amend a company's bylaws, and instances where a shareholder proponent has indicated an intent to management to submit such a proposal or has indicated an intent to management to refrain from submitting such a proposal conditioned on the taking or not taking of a corporate action. The term also shall include a shareholder nomination for director pursuant to a bylaw procedure established pursuant to Rule 14a-8(i)(8), and instances where a shareholder proponent has indicated an intent to management to submit such a nomination or has indicated an intent to management to refrain from submitting such a nomination conditioned on the taking or not taking of a corporate action.

Item 8B. Relationships with the Company of Shareholder Proponents

(a) A shareholder proponent, as defined in Item 8A, must describe the following:

(1) Any direct or indirect interest in any contract between the shareholder proponent and the company or any affiliate of the company (including any employment agreement, collective bargaining agreement, or consulting agreement);

(2) Any pending or threatened litigation in which the shareholder proponent is a party or a material participant, involving the company, any of its officers or directors, or any affiliate of the company; and

(3) Any other material relationship between the shareholder proponent and the company or any affiliate of the company not otherwise disclosed.

Note to Item 8B(a)(3). Any other material relationship of the shareholder proponent with the company or any affiliate of the company may include, but is not limited to, whether the shareholder proponent currently has, or has had in the past, an employment relationship with the company or any affiliate of the company (including consulting arrangements).

(b) A shareholder proponent must describe the following items where they occurred during the 12 months prior to the formation of any plans or proposals, or during the pendency of any proposal or nomination:

(1) Any material transaction of the shareholder proponent with the company or any affiliate of the company; and

(2) Any discussion regarding the proposal or nomination between the shareholder proponent and a proxy advisory firm.

(c) If the shareholder proponent holds more than 5% of any enterprise with the same Standard Industrial Classification code as the company, the shareholder proponent must describe the number and percentage of securities held in the competitor, as of the date the shareholder proponent first formed any plans or proposals.

(d) Describe any material relationship of the shareholder proponent with any enterprise with the same Standard Industrial Classification code as the company other than as a shareholder, as of the date the shareholder proponent first formed any plans or proposals.

(e) Disclose any meetings or contacts, including direct or indirect communication by the shareholder proponent, with the management or directors of the company that occurred during the 12 months prior to the formation of any plans or proposals or during the pendency of any proposal or nomination, including:

(1) Reasonable detail of the content of such direct or indirect communication;

(2) A description of the action or actions sought to be taken or not taken;

(3) The date of the communication;

(4) The person or persons to whom the communication was made;

(5) Whether that communication included any reference to the possibility of such a proposal or nomination; and

(6) Any response by the company or its representatives to that communication prior to the date of filing the required disclosure.

Note to Item 8B(e). To the extent that a shareholder proponent conducts regularly scheduled meetings or contacts with management or directors of a company, the shareholder proponent may describe the frequency of the meetings and the subjects covered at the meetings rather than providing information separately for each meeting. However, if an event or discussion occurred at a specific meeting that is material to the shareholder proponent's decision to submit a proposal or nomination, that meeting should be discussed in detail separately.

Item 8C. Background Information Regarding Shareholder Proponents

(a) If the shareholder proponent is not a natural person, provide:

(1) The identity of the natural person or persons associated with the entity responsible for the formation of any plans or proposals;

(2) The manner in which such person or persons were selected, including a discussion of whether or not the equity holders or other beneficiaries of the shareholder proponent entity played any role in the selection of such person or persons or otherwise played any role in connection with any plans or proposals;

(3) Whether the person or persons associated with the entity responsible for the formation of any plans or proposals have, in forming such plans or proposals, a fiduciary duty to the equity holders or other beneficiaries of the entity;

(4) The qualifications and background of such person or persons relevant to the plans or proposals; and

(5) Any interests or relationships of such person or persons, and of that entity, that are not shared generally by the other shareholders of the company and that could have influenced the decision by such person or persons and the entity to submit a proposal or nomination.

(b) If the shareholder proponent is a natural person, disclose:

(1) The qualifications and background of such person or persons relevant to the plans or proposals; and

(2) Any interests or relationships of such person or persons that are not shared

generally by the other shareholders of the company and that could have influenced the decision by such person or persons to submit a proposal or nomination.

Note to Item 8C(a)(5) and Item 8C(b)(2). Examples of interests or relationships of the shareholder proponent not shared by other shareholders of the company include, but are not limited to, contractual arrangements, current or previous employment with the company, employment agreements, consulting agreements, and supplier or customer relationships.

3. § 240.14a-2 is amended by adding paragraph (b)(6) to read as follows:

§ 240.14a-2 Solicitations to which § 240.14a-3 to § 240.14a-15 apply.

* * * * *

(b) * * *

(6) Any solicitation in an electronic shareholder forum established pursuant to the provisions of Rule 14a-18 by or on behalf of any person who does not seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization provided that the solicitation is made more than 60 days prior to the date announced by a registrant for its next annual or special meeting of shareholders or if the registrant announces the date of its next annual or special meeting of shareholders less than 60 days before the meeting date, then the solicitation may not be made more than two days following the date of the registrant's announcement of the meeting date.

4. § 240.14a-6 is amended by:

a. Removing the period at the end of the undesignated paragraph following paragraph (a)(6), prior to Note 1, and adding a comma in its place; and

b. Adding "or where the proxy materials include a shareholder nominee submitted pursuant to a bylaw adopted in accordance with § 240.14a-8(i)(8)." after that new comma.

5. § 240.14a-8 is amended by:

a. Revising paragraph (b)(1); and

b. Revising paragraph (i)(8);

The revisions read as follows:

§ 240.14a-8 Shareholder proposals.

* * * * *

(b) ***

(1) In order to be eligible to submit a proposal, you must have continuously held at least $2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date you submit the proposal; except where additional eligibility requirements are specified in this rule. You must continue to hold those securities through the date of the meeting.

* * * * *

(i) * * *

(8) <u>Relates to election</u>: If the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election, except for a proposal to establish a procedure by which shareholder nominees for election of director would be included in the company's proxy materials, where that proposal:

(i) Relates to a change in the company's bylaws that would be binding on the company if approved by the shareholders; and

(ii) Is submitted by a shareholder (or group of shareholders) that:

(A) Has continuously held more than 5% of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date the shareholder submits the proposal;

(B) Is eligible to file a Schedule 13G (§ 240.13d-102) as an institutional investor or a passive investor, including pursuant to Rule 13d-1(l) (§ 240.13d-1(l)); and

(C) Has filed a statement of beneficial ownership on Schedule 13G (§ 240.13d-102), or an amendment thereto, that contains all required information;

* * * * *

6. Add § 240.14a-17 and § 240.14a-18 to read as follows:

§ 240.14a-17 Shareholder nominations for election as director.

(a) A nominating shareholder is any shareholder (or group of shareholders) that forms any plans or proposals regarding the submission of a nominee or nominees for director to the company for inclusion in the company proxy materials, in accordance with a company bylaw that has been adopted by shareholders, as provided in § 240.14a-8(i)(8).

Note to Rule 14a-17(a). The formation of any plans or proposals includes instances where the shareholder has indicated an intent to management to submit a nomination or has indicated an intent to management to refrain from submitting a nomination conditioned on the taking or not taking of a corporate action.

(b) A nominating shareholder shall provide the information required by Item 8A, Item 8B, and Item 8C of Schedule 13G (§ 240.13d-102) to the company at the time the shareholder forms any plans or proposals with regard to submission of a nominee or nominees for director. Immediately after receiving the information from the nominating shareholder, the company shall provide the information on its website, or provide a link to a website address where the information would appear. The company also shall include the information provided by the nominating shareholder pursuant to this section in its proxy statement or on a website to which the proxy statement refers.

(c) At the time that a nominating shareholder submits to the company for inclusion in the company proxy materials a nominee or nominees, in accordance with a company bylaw that has been adopted by shareholders, as provided in § 240.14a-8(i)(8), the nominating shareholder must provide to the company, for inclusion in the company proxy statement or on a website to which the proxy statement refers, the following:

(1) Information meeting the disclosure requirements of Item 4(b) of Schedule 14A, as applicable;

(2) Information meeting the disclosure requirements of Item 5(b) of Schedule 14A, as applicable;

(3) Information meeting the disclosure requirements of Item 7 of Schedule 14A, as applicable;

(4) Information meeting the disclosure requirements of Item 22(b) of Schedule 14A, as applicable; and

(5) The consent of the nominee or nominees to be named in the company's proxy statement and to serve if elected.

(d) Where a nominating shareholder fails to provide any of the information required under paragraphs (b) and (c) of this rule, the shareholder's nominee will not be required to be included in the company's proxy materials.

(e) The company will not be responsible for the information provided to the company by the nominating shareholder and included in the company's proxy statement or on a website to which the proxy statement refers, in satisfaction of the company's disclosure obligations under Regulation 14A.

(f) Information about a shareholder nominee or nominees that has been provided to the company by a nominating shareholder, and which is disclosed in the company's proxy statement or on a website to which the proxy statement refers, in satisfaction of the company's disclosure obligations under Regulation 14A, will not be deemed incorporated by reference into any filing under the Securities Act of 1933 or the Act, except to the extent that the registrant specifically incorporates that information by reference.

§ 240.14a-18 Electronic Shareholder Forums.

(a) A company or shareholder may establish, maintain, or operate an electronic shareholder forum to facilitate interaction among shareholders and between the company and its shareholders as the company or shareholder deems appropriate. Subject to (b) and (c) of this Rule, the forum must comply with the federal securities laws, including Section 14(a) of the Act and its associated regulations, other applicable federal laws, applicable state law, and the company's charter and bylaw provisions.

(b) No company or shareholder because of establishing, maintaining, or operating an electronic shareholder forum is liable under the federal securities laws for any statement or information provided by another person to the electronic shareholder forum.

Nothing in this Rule 14a-18 prevents or alters the application of other provisions of the federal securities laws, including the provisions for liability for fraud, deception, or manipulation, or other applicable federal and state laws to a person or persons providing a statement or information to an electronic shareholder forum.

(c) Reliance on the exemption in Rule 14a-2(b)(6) to construct, maintain, support, or participate in an electronic shareholder forum does not eliminate a person's eligibility to solicit proxies after the date that the exemption in Rule 14a-2(b)(6) is available, provided that any such solicitation is conducted in accordance with this regulation.

7. § 240.14a-101 is amended by adding Item 24 and Item 25 to read as follows:

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

Schedule 14A Information

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Item 24. Relationships with Shareholder Proponents. Disclose the nature and extent of relationships between the shareholder proponent, any affiliate, executive officer or agent of such shareholder proponent, or anyone acting in concert with, or who has agreed to act in concert with, such shareholder proponent with respect to the proposed bylaw amendment submitted in accordance with § 240.14a-8(i)(8), on the one hand, and the company, on the other, including:

(a) Any direct or indirect interest of the shareholder proponent in any contract with the company or any affiliate of the company (including any employment agreement, collective bargaining agreement, or consulting agreement);

(b) Any pending or threatened litigation in which the shareholder proponent is a party or a material participant, involving the company, any of its officers or directors, or any affiliate of the company; and

(c) Any other material relationship between the shareholder proponent, the company, or any affiliate of the company not otherwise disclosed.

Note to Paragraph (c): Any other material relationship between the shareholder proponent and the company or any affiliate of the company may include, but is not limited to, whether the shareholder proponent currently has, or has had in the past, an employment relationship with the company (including consulting arrangements).

(d) With respect to the 12 months prior to a shareholder proponent forming any plans or proposals, or during the pendency of any proposal, regarding an amendment to a company's bylaws in accordance with § 240.14a-8(i)(8):

(1) Any material transaction of the shareholder proponent with the company or any affiliate of the company; and

(2) Any meeting or contact, including direct or indirect communication by the shareholder proponent, with the management or directors of the company, including:

(i) Reasonable detail of the content of such direct or indirect communication;

(ii) A description of the action or actions sought to be taken or not taken;

(iii) The date of the communication;

(iv) The person or persons to whom the communication was made;

(v) Whether that communication included any reference to the possibility of such a proposal; and

(vi) Any response by the company or its representatives to that communication prior to the date of filing the required disclosure.

Note to Paragraph (d)(2): To the extent that a shareholder proponent conducts regularly scheduled meetings or contacts with management or directors of a company, the company may describe the frequency of the meetings and the subjects covered at the meetings rather than providing information separately for each meeting. However, if to the company's knowledge, an event or discussion occurred at a specific meeting that is material to the shareholder proponent's decision to submit a proposal, that meeting should be discussed in detail separately.

Note to Item 24. For purposes of the disclosures required by this item, the company will be entitled to rely upon the Schedule 13G disclosures of the shareholder proponent concerning the date upon which the shareholder proponent formed any plans or proposals with regard to the submission of a proposal to amend a company's bylaws.

Item 25. Relationships with Nominating Shareholders. (a) Provide the information submitted to the company by any nominating shareholder as required by §240.14a-17(b) and (c).

(b) Disclose the nature and extent of relationships between the nominating shareholder, any affiliate, executive officer or agent of such nominating shareholder, or anyone acting in concert with, or who has agreed to act in concert with, such nominating shareholder with respect to a nomination pursuant to a bylaw adopted in accordance with Rule 14a-8(i)(8), on the one hand, and the company, on the other, including:

(1) Any direct or indirect interest of the nominating shareholder in any contract with the company or any affiliate of the company (including any employment agreement, collective bargaining agreement, or consulting agreement);

(2) Any pending or threatened litigation in which the nominating shareholder is a party or a material participant, involving the company, any of its officers or directors, or

any affiliate of the company; and

(3) Any other material relationship between the nominating shareholder, the company, or any affiliate of the company not otherwise disclosed.

Note to Paragraph (b)(3): Any other material relationship between the nominating shareholder and the company or any affiliate of the company may include, but is not limited to, whether the nominating shareholder currently has, or has had in the past, an employment relationship with the company (including consulting arrangements).

(c) With respect to the 12 months prior to a nominating shareholder forming any plans or proposals to submit a nomination for director for inclusion in the company's proxy statement, or during the pendency of any nomination:

(1) Any material transaction of the nominating shareholder with the company or any affiliate of the company; and

(2) Any meeting or contact, including direct or indirect communication by the nominating shareholder, with the management or directors of the company, including:

(i) Reasonable detail of the content of such direct or indirect communication;

(ii) A description of the action or actions sought to be taken or not taken;

(iii) The date of the communication;

(iv) The person or persons to whom the communication was made;

(v) Whether that communication included any reference to the possibility of such a nomination; and

(vi) Any response by the company or its representatives to that communication prior to the date of submitting the nomination.

Note to Paragraph (c)(2): To the extent that a nominating shareholder conducts regularly scheduled meetings or contacts with management or directors of a company, the company may describe the frequency of the meetings and the subjects covered at the meetings rather than providing information separately for each meeting. However, if to the company's knowledge, an event or discussion occurred at a specific meeting that is material to the nominating shareholder's decision to submit a nomination, that meeting should be discussed in detail separately.

Note to Item 25. For purposes of the disclosures required by this item, the company will be entitled to rely upon the disclosures of the nominating shareholder submitted to the company as required by Rule 14a-17(c) concerning the date upon which the nominating shareholder formed any plans or proposals with regard to the submission of a nominee or nominees to be included in the company's proxy materials.

* * * * *

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: July 27, 2007

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56168 / July 30, 2007

INVESTMENT ADVISERS ACT OF 1940
Release No. 2625 / July 30, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12717

In the Matter of **WILLIAM M. STICKNEY,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against William M. Stickney ("Stickney" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Stickney's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Stickney be, and hereby is suspended from association with any broker, dealer, or investment adviser for a period of twelve (12) months, effective on the second Monday following the entry of this Order.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 56163 / July 30, 2007

INVESTMENT ADVISERS ACT OF 1940
Release No. 2623 / July 30, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12715

In the Matter of **MICHAEL J. RICE,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Michael J. Rice ("Rice" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Making Findings, and Imposing Remedial

Document 57 of 59

Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940 (the "Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Respondent

1. Rice, age 40, is a resident of New York, New York. Rice was employed as the chief administrative officer of the Private Client Group of Prudential Securities, Inc. ("PSI") from January 1999 to October 2000, as executive director of PSI's domestic retail branch system from November 2000 to December 2002, and as president of PSI's Private Client Group ("PCG") from December 2002 to July 2003. On July 1, 2003, Prudential Financial, Inc. ("Prudential Financial"), the parent of PSI, transferred the assets relating to PSI's domestic retail securities brokerage operations to a newly formed joint venture created by Prudential Financial and Wachovia Corporation. Rice was employed by the Prudential/ Wachovia joint venture until October 2003, and by Prudential Insurance Company of America from November 2003 to April 2004. During the Relevant Period (as defined below), Rice was one of the most senior executives of the Private Client Group, and once he became President of the PCG he was also one of the most senior executives at PSI, and during the Relevant Period he had supervisory responsibility for PSI's retail registered representatives. Rice was registered with PSI as a general securities representative, general securities principal, general securities sales supervisor, and registered options principal.

Other Relevant Entity

2. Prudential Securities, Inc. Prior to July 1, 2003, PSI was an indirect wholly owned broker-dealer and investment adviser subsidiary of Prudential Financial, a publicly-owned financial holding company traded on the New York Stock Exchange. Prior to July 1, 2003, PSI was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and as an investment adviser pursuant to Section 203(c) of the Advisers Act and was a member of NASD and the New York Stock Exchange. On July 1, 2003, PSI converted from a stock corporation into a limited liability company and was renamed Prudential Equity Group, LLC.

Summary

3. This matter concerns Rice's failure reasonably to supervise certain PSI registered representatives whose business involved market timing in mutual fund

shares for their hedge fund customers. From at least November 2000 until at least June 2003 (the "Relevant Period"), the registered representatives used fraudulent and deceptive trading practices to evade restrictions on market timing imposed by the mutual fund companies whose funds they traded. The practices, which included the use of multiple customer accounts and multiple broker identification numbers (known at PSI as "Financial Advisor" or "FA" numbers), concealed the registered representatives' identities and those of their customers, made it more difficult for mutual fund companies to detect and prevent their market timing activity, and deceived mutual fund companies into processing transactions from customers and registered representatives whose business they wanted to reject.

4. Rice failed reasonably to supervise the registered representatives with a view to preventing their violations of the federal securities laws. As executive director and president of PSI's Private Client Group, Rice was one of the most senior executives in PSI with responsibility for PSI retail registered representatives' compliance with applicable regulatory and legal requirements. He knew that some PSI registered representatives derived a substantial portion of their revenues from market timing in mutual fund shares, and he became aware of numerous "red flags" which indicated that certain of the registered representatives were using deceptive practices to engage in market timing. Despite this knowledge, Rice failed to take effective steps to respond to these red flags. On several occasions, Rice participated in or directed the issuance of policies and procedures that ostensibly set limits on market timing by PSI registered representatives, but none of the policies adequately addressed their use of multiple accounts and FA numbers to evade detection. Moreover, even when Rice learned that specific registered representatives may have used fraudulent and deceptive practices to engage in market timing, he failed to recommend any discipline or sanctions against them. Due in part to Rice's failure to take effective action, the registered representatives' widespread use of fraudulent and deceptive practices continued until at least June 2003. Rice, therefore, failed reasonably to supervise the registered representatives, persons subject to his supervision, with a view to preventing or detecting their violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Market Timing in Mutual Fund Shares

5. Market timing in mutual fund shares involves the frequent buying and selling of shares of the same mutual fund, or the frequent exchanging of mutual fund shares within the same fund complex, in order to exploit inefficiencies in mutual fund pricing. Though not illegal *per se*, market timing can harm mutual fund shareholders in several respects, including: (a) it can dilute the value of the shareholders' shares; (b) it can disrupt the management of the mutual fund's investment portfolio; and (c) it can impose significant administrative costs for the fund.

6. Beginning in the late 1990s, many mutual fund companies determined that market timing harmed their long-term shareholders. As a result, they began to monitor market timing in their funds' shares and imposed restrictions on excessive trading. Such restrictions limited the number of trades that an account holder could place in a fund's shares and often were set forth in the funds' prospectuses. Many mutual funds monitored trading activity to detect any violations of these prospectus limitations.

7. Most PSI registered representatives submitted mutual fund transactions through the National Securities Clearing Corporation ("NSCC"), which is a centralized trade clearance and settlement system that linked the registered representatives, PSI's Mutual Fund Operations division, and virtually all mutual fund companies. To place trades through NSCC, a PSI registered representative was required to identify himself by FA number and to provide the number of the customer account for which the trade was placed. The FA number and account number typically included a prefix for the PSI branch that submitted the trade.

8. Some mutual funds screened for excessive short-term trading by reviewing FA and customer account numbers that the registered representatives transmitted to them via NSCC. Some also monitored for excessive short-term trading by trade size and principal amount and by the branch code attached to a trade. Typically, if a fund concluded that a shareholder had violated its exchange limitations, the fund would attempt to prevent, or "block" additional trades in a fund or fund family by that shareholder. If a fund determined that a particular PSI registered representative or shareholder had violated its exchange limitations, the fund would send a "block letter" to PSI. Block letters varied but generally notified PSI of the mutual fund's intention to reject the registered representative's or customer's transaction and often asked PSI to take steps to preclude a particular registered representative or customer account from engaging in additional trades in a particular fund or fund family. Some block letters specifically identified the PSI registered representatives' use of deceptive practices to avoid detection.

The PSI Registered Representatives' Deceptive Conduct

9. During the Relevant Period, certain PSI registered representatives engaged in a fraudulent scheme to avoid or evade blocks imposed by mutual funds on their trading privileges. Their scheme worked as follows. These registered representatives' customers, typically hedge funds, asked the registered representatives to purchase and sell mutual funds on a short-term basis on their behalf. The registered representatives, however, knew that mutual funds tracked their trades by FA number and customer account number, and they further knew that if they placed short-term mutual fund trades for their customers using a single FA or account number, the mutual funds would likely determine the number of trades was excessive and would block any further trades by them.

10. The registered representatives, therefore, devised a scheme to conduct their customers' trading using dozens of customer accounts, often established under fictitious names, and multiple FA numbers to make it difficult for mutual funds to identify their customers' market timing. When the mutual funds succeeded in blocking certain FA numbers or customer accounts from further trading, the registered representatives then used other FA numbers and customer accounts that had not yet been blocked to evade the funds' restrictions and continue to trade.

Rice Failed Reasonably to Supervise the Registered Representatives

Rice's Positions and Responsibilities

11. In October 1997, Rice joined PSI as the director of strategic initiatives, reporting to the president of the PSI's Private Client Group. In January 1999, Rice became chief administrative officer of the PCG, and he reported to the president of the PCG. As chief administrative officer, Rice was responsible for the PCG's administration, finance, real estate, and risk management functions, and the heads of those functions reported to him.

12. In November 2000, Rice became executive director of the PCG. As executive director, Rice retained his previous responsibilities and also assumed supervisory responsibilities concerning PSI's retail registered representatives.

13. In December 2002, Rice became president of the PCG. As president of the PCG, Rice was one of the most senior executives responsible for oversight of the PCG and certain other PSI business divisions, and one of the most senior executives with responsibility for supervision of the firm's retail registered representatives. As such, he participated in or directed the establishment of procedures and a system for implementing such procedures that could have reasonably been expected to prevent and detect violations of the federal securities laws.

As Early as 1998, Rice Was Warned about Risks from Market Timing

14. In October 1998, one of the PCG president's assistants forwarded to Rice an email from PSI's Mutual Fund Operations ("MFO") division staff warning that market timing activity in several PSI branches presented potentially serious risks. The problem resulted in part from the enormous volume of transactions, often submitted late in the trading day, which put substantial pressure on the back-office staff and created the risk of processing errors for which a customer might seek reimbursement from PSI. The email warned, "Because of the lack of time to edit or validate we are taking a substantial financial risk by entering the exchanges in this manner."

15. After he became chief administrative officer for the PCG in January 1999, Rice became actively involved in discussions about how to reduce the operational risk for PSI from market timing by its registered representatives. Much of the discussion concerned the fact that a purchase of mutual fund shares had not been fully processed before a sale or exchange of the same shares was submitted.

By Late 1999, Rice Was Aware of Red Flags Concerning Some PSI Registered Representatives' Use of Multiple Accounts to Market Time

16. On November 21, 1999, a senior executive in PSI's MFO division forwarded to Rice a string of emails concerning a complaint from a mutual fund company that a PSI registered representative had evaded a block on two of his accounts by opening new accounts:

> It appears [that the registered representative] circumvented this restriction by requesting new BIN [account] #s and fund accounts be established, funded by transferring shares into these new accounts on 11/8/99. Subsequently on 11/10/99, an exchange out of the money fund into our stock funds was processed, beginning market timing again.

The cover email commented, "[T]his seems to be a serious matter that will only get worse."

17. On January 19, 2000, the manager of the MFO division forwarded to Rice an email from another mutual fund company complaining that another PSI registered representative had likewise evaded a trading restriction by opening a new account:

> It appears that [the registered representative] set up another account in December for the same client we restricted on 11/22[.]

18. Thus, even before Rice assumed supervisory responsibilities concerning PSI's retail registered representatives, Rice understood that market timing presented operational risks to PSI and that some mutual fund companies were imposing restrictions on market timing by PSI registered representatives. At the time, he had also received indications that some PSI registered representatives were opening new customer accounts in order to evade the restrictions and continue trading in the same mutual funds.

Throughout 2001, Rice Became Aware of Red Flags Concerning
<u>Certain Registered Representatives' Use of Deceptive Practices to Market Time</u>

19. Throughout 2001, Rice was personally involved in several matters concerning market timing by leading PSI registered representatives. He received a series of notices that indicated quite clearly that certain PSI registered representatives were engaged in market timing on a significant basis and, more importantly, that some of them were using multiple accounts and FA numbers to avoid detection by the fund companies and to continue market timing despite restrictions on their trading.

20. On March 30, 2001, the head of PCG's risk management group copied Rice on an email attaching a letter from a mutual fund company complaining that "excessive trading activity" by PSI registered representatives in its mutual funds "has become detrimental to both the funds and shareholders of the funds involved." The email, which responded to the concerns raised in the attached letter, described the steps Prudential would take to address these concerns. The letter described the tactics used by some PSI registered representatives to avoid having their trades canceled as follows:

> Since trade cancellation began on February 26th, 2001, we have noticed several types of reactions by Prudential Financial Advisors in order to circumvent our attempts to terminate excessive trading. Originally, your Financial Advisors established new identification numbers so that they would not be recognized as a repeat offender.
>
> Secondly, Financial Advisors would transfer a fund(s) position from account to account, in order to disguise their identity. Lastly, your Financial Advisors have attempted to reduce the dollar amount of the exchange orders while simultaneously increasing the number of exchanges (in the same fund and account) in the hopes of not being identified.

21. On April 18, 2001, the head of PCG's risk management group sent Rice a string of emails concerning complaints from another mutual fund company about market timing. These emails indicated that the excessive trading was taking place in two accounts belonging to a PSI registered representative, four accounts belonging to the registered representative's wife, and six "duplicate accounts." The head of risk management added this comment for Rice: "Looks like we can add [this mutual fund company] to the list of fund companies who are strictly monitoring market timing activity."

22. On June 28, 2001, Rice was copied on an email from a PSI branch manager warning him that some PSI registered representatives in his branch office were obtaining multiple FA numbers in order to avoid restrictions on their market timing:

> We will have an issue soon with joint FA numbers: in order to get around the MF [mutual fund] timing issue they are starting to request 99/01 split numbers with their junior partners to help them get around being shut down by some MF companies on timing. I will not be approving these.

23. Between February and June 2001, Rice thus received several specific warnings indicating that some PSI registered representatives were engaged in market timing on a scale that presented significant operational and legal risks for PSI and, more importantly, that certain specific registered representatives were using multiple customer accounts and FA numbers to evade detection by the mutual fund companies and to continue market timing despite being blocked. Despite this knowledge, Rice failed to take effective steps to investigate the registered representatives' improper conduct or to ensure that PSI adopted reasonable policies and procedures to prevent and detect such conduct.

Throughout 2002, Rice Continued to Become Aware of Red Flags Concerning Some PSI Registered Representatives' Use of Deceptive Practices to Market Time

24. On April 4, 2002, the MFO manager sent an email to the head of PCG risk management, who reported to Rice, and to the director of compliance at PSI, attaching a letter from a mutual fund company complaining that identified PSI registered representatives were using multiple accounts and FA numbers to evade restrictions on their market timing:

> What we have seen [s]cares us. It appears certain representatives are changing account registrations, tax id numbers, and branch and rep numbers in an effort to time [the mutual funds]. All of these accounts have been stopped, but each day "new" ones pop up.

This mutual fund company's complaint thus concerned the same kind of deceptive practices about which another mutual fund company had complained in March 2001 one year earlier. Shortly after the PSI chief compliance officer saw this complaint, he discussed it with Rice in a meeting. The head of PCG risk management also discussed the complaint with Rice.

25. On April 29, 2002, Rice met with a PSI working group that had been analyzing market timing issues. The meeting included representatives of PSI's compliance department, PCG's risk management group, the PSI law department, a PSI divisional officer, and PSI's manager of the New York metropolitan region. The group described for Rice the mutual fund companies' restrictions on excessive trading, their block letters to PSI, and the evasive tactics used by certain PSI registered representatives, including the use of multiple accounts and FA numbers. Rice stated that any misuse of FA numbers should stop at once, directed the group to develop a new policy prohibiting their misuse, and encouraged that work continue on a draft of a policy prohibiting market timing.

26. While the head of PCG risk management was on maternity leave, the interim head of risk management notified Rice on two occasions of the New York registered representative's attempts to evade detection by mutual fund companies. First, on May 8, 2002, in connection with a request by a registered representative in PSI's Boston branch office to charge his customers a service fee similar to that charged by the New York registered representative to his market timing customers, the interim head of risk management sent Rice a chart indicating that between April 1, 2002 and May 7, 2002, the New York registered representative had 19 different mutual fund companies request that accounts under his control be blocked from their funds, but he had circumvented these requests using "also" or joint FA numbers or journaling funds between accounts, which in some instances caused sizable (7 figure) deficits, as exchanges continued to be processed in the old account. On May 29, 2002, the interim head of PCG risk management forwarded a draft market timing policy, and included a cover email reiterating the same concerns about deceptive practices by the New York registered representative as described in the chart she circulated on May 8, 2002.

27. Shortly after receiving this information, Rice held a meeting with the New York registered representative and representatives of legal, compliance, risk management, the divisional and regional officers, and regional business and divisional managers to review the New York registered representative's business. Rice knew at the time of this meeting that some mutual fund companies had complained to PSI that the New York registered representative used deceptive practices to market time. After the meeting, the head of compliance, the divisional officer and the regional officer agreed to follow up with the New York registered representative. Rice took no further steps at that time, and failed to follow up with any of the meeting's attendees to ensure the New York registered representative's conduct had been addressed.

28. From April to early June 2002, Rice thus received detailed information indicating that some PSI registered representatives, including several of the firm's largest business producers, were apparently using deceptive practices, primarily multiple customer accounts and FA numbers, to evade fund company restrictions on market timing and to continue trading despite being blocked. Despite

this knowledge, Rice failed to take effective steps to curtail the registered representatives' conduct.

<u>Rice Approved An Ineffective Policy Concerning New FA Numbers</u>

29. Rice responded to these red flags by directing and approving the issuance of a PCG policy, dated June 21, 2002, requiring regional business managers to approve the issuance of new FA numbers. Under the policy, a registered representative seeking a new FA number was supposed to identify a business reason for the request. Responsibility for enforcing the policy rested with the branch and regional managers, who reported up through the divisional officers to Rice.

30. Even though the analysis by PCG risk management and compliance had revealed that some PSI registered representatives were using multiple FA numbers to evade blocks on their trading, PSI took no steps to identify their current FA numbers, and the policy did nothing to restrict the use of these existing FA numbers for market timing. Although Rice told the working group on April 29, 2002 that the misuse of FA numbers should stop at once, the June 2002 policy did nothing to identify and prevent the registered representatives' continuing misuse of existing FA numbers to market time.

31. Further, the June 2002 policy did not even address the registered representatives' deceptive use of multiple customer accounts to evade restrictions on market timing – even though the analysis by PCG risk management and compliance had clearly identified this problem for Rice. Indeed, as of June 2002, PSI's most active market timing registered representatives had already opened dozens of accounts for their handful of customers.

Rice Approved An Ineffective Policy Concerning
<u>Market Timing in Non-Prudential Funds</u>

32. During the summer and early fall of 2002, a PCG working group continued to discuss a draft policy concerning market timing by PSI registered representatives in non-Prudential mutual funds. Members of the working group periodically briefed Rice on the group's progress. At the time, the working group's proposed policy, which Rice supported, would have prohibited PSI registered representatives from placing more than one trade per quarter or four trades per year.

33. By late 2002, Rice continued to be informed of discussions leading to PCG's issuance on January 8, 2003 of a policy concerning market timing by PSI registered representatives in non-Prudential funds (the "Market Timing Policy"). The Market Timing Policy simply told PSI registered representatives to abide by whatever trading restrictions were imposed by a particular mutual fund company:

> Financial Advisors must adhere to the restrictions placed on the frequency of trading as set forth in a particular product's disclosure document or prospectus (*e.g.*, limitations on exchanges set forth in a mutual fund prospectus). Inappropriate timing activities <u>will continue to be monitored by the product manufacturer</u> [emphasis in original].

34. The Market Timing Policy also warned PSI registered representatives against "attempts to circumvent this policy through the use of manipulative techniques" such as opening new customer accounts and obtaining new FA numbers. However, beyond stating that customer accounts and FA numbers should not be used to conceal the identity of the FA or customer, the Market Timing Policy failed to address the number of accounts and FA numbers already in use for market timing. Indeed, by early 2003, PSI's most active market timing registered representatives had opened dozens or, in some cases, hundreds of accounts for their market timing customers and were using dozens of FA numbers to place their mutual fund trades.

35. Further, the Market Timing Policy stated that upon receipt of a fund company block letter, PCG would comply with the manufacturer's requested restrictions, and that the restrictions would be applied to "<u>all</u> associated FA numbers (including joint and also numbers)" [emphasis in original]. If enforced, the Market Timing Policy would have entailed a more effective response to mutual fund company block letters because if a fund company blocked one of a registered representative's FA numbers, PSI would have applied the block to all the registered representative's FA numbers. Although interim drafts of the policy had provided that mutual fund company blocks "may be applied" to all associated FA numbers, the Market Timing Policy as issued clearly stated that fund company blocks "will be applied" to all associated FA numbers. Notwithstanding, Rice told the director of strategic planning at PCG (whom he had put in charge of risk management issues) that the Market Timing Policy should be implemented strictly in accordance with the instructions from the mutual fund company. Although this was consistent with interim drafts of the Market Timing Policy that he reviewed, it was not consistent with the policy as issued. Thus, the policy was implemented more narrowly than suggested by its plain language, which required that restrictions be implemented on "all associated FA numbers." As a result, the Market Timing Policy did not improve on the firm's ineffective practice of adhering to the strict letter of mutual fund company block letters.

Even After PSI Issued the Market Timing Policy, Rice Continued To Become Aware of Red Flags Concerning Some Registered Representatives' <u>Continuing Use of Deceptive Practices</u>

36. On February 5, 2003, the director of strategic planning at PCG forwarded to Rice a string of emails from a mutual fund company complaining that

certain PSI registered representatives were using multiple customer accounts and FA numbers for market timing. One email indicated that the registered representatives had been asked to stop the activity a few times over the past several months and the mutual fund company placed stops on 325 of their accounts, only to see new accounts and "rep id combinations" added daily. Another recounted similar conduct, and noted that the offending registered representatives created almost $3 billion in exchanges the prior year, during which time the mutual fund company placed stops on 350 of their accounts.

37. On February 7, 2003, the director of strategic planning at PCG forwarded to Rice another string of emails from a mutual fund company complaining about market timing by certain PSI registered representatives through multiple FA numbers and seeking PSI's assistance to identify the registered representatives involved, all but one of whom belonged to the office of the New York registered representative. The director of strategic planning informed Rice that the "noose is tightening" on market timers.

38. On February 11, 2003, a PCG risk officer forwarded to Rice an email from a PSI branch manager about the New York registered representative's market timing practices. The branch manager questioned the effectiveness of the MFO's internal blocking system and raised several other concerns about the registered representative's activities:

> Blocking of individual accounts by fund companies is extremely short-sighted in consideration of the fact that each entity maintains multiple accounts with our Firm.
>
> There have been repeat offenses, at least in spirit, in [two mutual fund companies].
>
> Fund companies have been misled as to the identity of the FA's of record... Recently, [another mutual fund company] was provided with information which was at best misleading to effect the removal of a block.
>
> [T]here is frequent journaling of funds between accounts.
>
> At the present time, [the New York registered representative and another PSI registered representative] either have or have had a total of 48 FA #s including single, joint and also numbers.

The branch manager's email thus informed Rice that the New York registered representative continued to use multiple customer accounts and FA numbers to evade restrictions on his market timing – the same deceptive practices by the registered representative about which Rice had been warned on prior occasions, including in May 2002. Although the branch manager's email prompted a review of the New York registered representative's business practices by PSI's Legal, Compliance, and Risk Management divisions, and by several PSI line supervisors, and resulted in a consensus that the New York registered representative should be disciplined for some of his business practices, the New York registered representative never was disciplined for his use of deceptive practices to market time – even though the Market Timing Policy explicitly threatened sanctions for registered representatives who engaged in such activities.

Conclusion

39. As executive director and president of PSI's Private Client Group, Rice was one of the most senior executives in the Private Client Group and had responsibility for PSI retail registered representatives' compliance with applicable regulatory requirements. Among other things, Rice participated in or directed the issuance of policies and procedures concerning the registered representatives' business practices and had the authority to sanction, discipline or terminate registered representatives who used fraudulent and deceptive practices to market time.

40. Even before Rice assumed any supervisory responsibilities concerning PSI's retail registered representatives, he understood that market timing presented potentially serious risks to PSI, that some mutual fund companies were imposing restrictions on market timing by PSI registered representatives, and that some PSI registered representatives opened new customer accounts in order to evade the restrictions and continue trading in the same mutual funds. After Rice assumed the position of executive director, and, later, president of PSI's Private Client Group, he received numerous "red flags" indicating that some PSI registered representatives, including some of the largest business producers at the firm, continued to use fraudulent and deceptive practices – most notably multiple customer accounts and FA numbers – to market time, despite the mutual fund companies' efforts to monitor and curtail their trading.

41. In June 2002 and in January 2003, Rice participated in or directed the issuance of policies ostensibly designed to respond to the use of fraudulent and deceptive practices by PSI registered representatives. These policies were substantially ineffective, however, and did little to identify, let alone prevent, the registered representatives' continuing deceptive use of multiple accounts and FA numbers for market timing.

42. Rice failed reasonably to supervise the PSI registered representatives to prevent or detect their fraudulent and deceptive conduct, which continued largely unabated until at least June 2003.

43. As a result of the conduct described above, Rice failed reasonably to supervise certain PSI registered representatives, persons subject to his supervision, with a view to preventing or detecting the registered representatives' violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act provide for imposition of sanctions against, respectively, (i) a person associated with a broker or dealer; and (ii) a person associated with an investment adviser, who has failed reasonably to supervise, with a view to preventing or detecting violations of the securities laws, another person who commits such a violation, if such other person is subject to his supervision.

Undertakings

44. Ongoing Cooperation by Rice. Rice undertakes to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Rice has undertaken:

A. To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff;

B. To be interviewed by the Commission's staff at such times as the staff reasonably may request and to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

C. That in connection with any testimony of Rice to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Rice:

i. Agrees that any such notice or subpoena for his appearance and testimony may be served by regular mail on his counsel, Lee S. Richards III, Esq., Richards, Kibbe & Orbe LLP, One World Financial Center, New York, NY 10281; and

ii. Agrees that any such notice or subpoena for his appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure or the Commission's Rules of Practice.

45. Respondent shall provide to the Commission, within 30 days after the end of the 12 month suspension period described in this Order, an affidavit that he has complied fully with the sanctions described in Section IV below.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Rice's Offer.

Accordingly, pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Rice be, and hereby is suspended from association in a supervisory capacity with any broker, dealer, or investment adviser for a period of twelve months, effective on the second Monday following the entry of this Order.

B. Respondent Rice shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the United States Treasury. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) wired, hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Rice as a Respondent in these proceedings, the file number of these proceedings, a copy of which wire transfer instruction, money order, or check shall be sent to David P. Bergers, Regional Director, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110.

C. Respondent shall comply with the undertaking enumerated in Section 45 above.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56176]

July 31, 2007

Order Granting The NASDAQ Stock Market LLC's Application for an Exemption Pursuant to Section 36 of the Securities Exchange Act of 1934

I. Introduction

On June 28, 2007, the Commission received an application from The NASDAQ Stock Market LLC ("Nasdaq") for an exemption pursuant to Section 36[1] of the Securities Exchange Act of 1934 (the "Exchange Act"),[2] in accordance with the procedures set forth in Exchange Act Rule 0-12.[3] Nasdaq has requested exemptive relief from Section 12(a) of the Exchange Act[4] to permit certain qualified members, brokers, and dealers to trade certain securities that are not registered under Section 12[5] of the Exchange Act on The PORTAL® Market (the "PORTAL Market"). On April 25, 2007, the Commission issued a notice of a proposed rule change submitted by Nasdaq and a proposed exemption order that would reestablish an indicative quotation and trading system for securities that are designated by the PORTAL Market as PORTAL securities under Nasdaq's rules.[6] This order grants Nasdaq's application for an exemption.

In conjunction with its request for an exemption, Nasdaq also proposed a rule change, SR-NASDAQ-2006-065, to establish rules for the trading of securities pursuant to Securities Act of

[1] 15 U.S.C. 78mm. Section 36 of the Exchange Act gives the Commission the authority to exempt any person, security or transaction from any Exchange Act provision by rule, regulation or order, to the extent that the exemption is necessary or appropriate in the public interest and consistent with the protection of investors.

[2] 15 U.S.C. 78a et seq.

[3] 17 CFR 240.0-12. Exchange Act Rule 0-12 sets forth procedures for filing applications for orders for exemptive relief pursuant to Section 36.

[4] 15 U.S.C. 78l(a).

[5] 15 U.S.C. 78l(b).

[6] Release No. 34-55669 (April 25, 2007) (SR-NASDAQ-2006-065).

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1933 Rule 144A[7] on the PORTAL Market.[8] The Commission, via authority delegated to the Division of Market Regulation, is also approving that rule change.[9]

II. Order Granting The NASDAQ Stock Market LLC's Application for an Exemption Pursuant to Section 36 of the Exchange Act

Section 12(a) of the Exchange Act provides in relevant part that "[i]t shall be unlawful for any member, broker or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security for such exchange."[10] Section 12(b) of the Exchange Act[11] dictates how the registration referred to in Section 12(a) must be accomplished. Accordingly, all equity and debt securities that are not "exempted securities" or are not otherwise exempt from Exchange Act registration must be registered by the issuer under the Exchange Act before a member, broker, or dealer may trade that class of securities on a national securities exchange.

Brokers or dealers who trade securities (other than certain equity securities) otherwise than on a national securities exchange may trade securities regardless of whether the issuer registered that class of securities under the Exchange Act. Exchange Act registration for securities traded other than on a national securities exchange is required only for certain equity securities. In

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[7] 17 CFR 230.144A.

[8] See Release No. 34-55669 (April 25, 2007).

[9] See Release No. 34-56172 (July 31, 2007).

[10] 15 U.S.C. 78l(a).

[11] 15 U.S.C. 78l(b).

particular, Section 12(g) of the Exchange Act,[12] the only Exchange Act provision other than Section 12(a) to impose an affirmative Exchange Act registration requirement, requires the registration of equity securities only.

As the Commission has stated in the past, we believe that steps should be taken to achieve a more efficient institutional resale market for unregistered securities.[13] In 1990, in an attempt to reach this goal, we approved a series of rules similar to those before us today.[14] Despite those efforts, the vast majority of secondary trading of Rule 144A securities by institutional investors continued to occur in the OTC market, and those rules were partially withdrawn by the NASD.[15]

We view the exemptive relief requested by Nasdaq as another step to improve the institutional resale markets for unregistered securities. The Commission believes that granting Nasdaq's application will serve the public interest by providing a central (but not an exclusive) location for the quotation, trade negotiation, and trade reporting of Rule 144A securities.[16] Currently, unlike on a national securities exchange, broker-dealers may trade securities pursuant to Rule 144A in the OTC market, but there is no established framework for quotation or trade reporting in Rule 144A securities. This exemption order is designed to allow increased liquidity in the institutional resale market without discouraging participation by holders of the securities of

[12] 15 U.S.C. 78l(g). Section 12(g)(1) of the Exchange Act and Rule 12g-1 [17 CFR 240.12g-1] promulgated thereunder require an issuer to register a class of equity securities if the issuer of the securities, at the end of its fiscal year, has more than $10,000,000 in total assets and a class of equity securities held by 500 or more recordholders.

[13] Release No. 34-27956 (April 27, 1990) 55 FR 18781 (May 4, 1990).

[14] Id.

[15] Release No. 34-44042 (March 6, 2001) 66 FR 14969 (March 14, 2001).

[16] As indicated in Nasdaq's application, trade reporting in PORTAL Market-designated securities currently is submitted to the NASD's OTC Reporting Facility and trade reports in most PORTAL Market-designated debt securities are submitted to the Trade Reporting and Comparison Entry Service ("TRACE") system. Under the proposed rules related to this exemption request, dealers and brokers qualified to participate in the PORTAL Market will be permitted to negotiate and execute trades in PORTAL Market securities, and submit trade reports in PORTAL Market-negotiated trades that will be forwarded to TRACE and the NASD's OTC Reporting Facility for comparison, confirmation, and forwarding of confirmed trades to The Depository Trust Company for settlement.

certain issuers that would accompany a change in the information requirements for issuers from those established in Rule 144A.

The rules that would govern the PORTAL Market serve to protect public investors by limiting the nature of the participants in the PORTAL Market to those that may otherwise purchase securities pursuant to Rule 144A as a result of the exemption.[17] Further, such rules are designed to have no adverse effect on the rights of institutional investors in the Rule 144A market to receive certain information about an issuer, consistent with Rule 144A(d)(4).[18]

We received seven comment letters on the proposed rule change by Nasdaq. Three commenters supported the proposed rule change.[19] Another comment was a single sentence seeking "to know more information about the findings and possible 144A portal" that neither supported nor criticized the proposals.[20] Another commenter raised concerns regarding the access of and impact on QIBs not yet approved by Nasdaq as PORTAL-eligible and Accredited Investors, as well as liability concerns for brokers and dealers.[21] The final comment sought clarification on a number of matters including trade reporting, dissemination of information, the regulatory jurisdiction over parties to the market, the nature of subscriber agreements, Exchange Act compliance of brokers, dealers and issuers that participate in the PORTAL Market, and other mechanical and technical

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[17] See Release No. 34-56172 (July 31, 2007).

[18] 17 CFR 230.144A(d)(4).

[19] See letters to Nancy M. Morris, Secretary, Commission, from Deborah L. Wince-Smith, Council on Competitiveness, dated May 25, 2007; Lezlee Westine, President and CEO, TechNet, dated May 22, 2007; NYPPEX, dated May 18, 2007.

[20] Submission via SEC WebForm from John J. McGuire, Jr., who is affiliated with Morgan Stanley, dated May 9, 2007.

[21] See letters to Nancy M. Morris, Secretary, Commission, from William J. Ginivan, Friedman, Billings, Ramsey Co., Inc. ("FBR"), dated May 22, 2007; William J. Ginivan, FBR, dated July 18, 2007.

concerns.[22] None of the comments objected explicitly to the proposed exemption from Section 12(a).

The vast majority of the concerns raised in the comments noted above are addressed in Release No. 34-56172 (July 31, 2007) and the comments do not raise issues relevant to the requested exemption under Section 12(a) from registration pursuant to Section 12(b).

In granting this exemptive relief, we expect that Nasdaq will design and implement all rules related to the relief in a manner that protects investors and the public interest and limits participants in the PORTAL Market to those parties eligible to rely on Rule 144A under the Securities Act of 1933. We view the exemptive relief requested by Nasdaq as another step to improve the institutional resale markets for unregistered securities. Further, we believe that granting Nasdaq's application will increase transparency regarding prices and sales in that market.

For the reasons discussed above, the Commission finds that the exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

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[22] See letter to Nancy M. Morris, Secretary, Commission, from Mary Kuan, Managing Director and Assistant General Counsel, SIFMA (Securities Industry and Financial Markets Association), dated May 30, 2007.

Accordingly, IT IS ORDERED pursuant to Section 36 of the Exchange Act that a Nasdaq member, broker, or dealer may effect a transaction on the PORTAL Market, and any successor trading facility that maintains compliance for sales under Rule 144A, in a security that has not been registered under Section 12(b) of the Exchange Act without violating Section 12(a) of the Exchange Act.[23] This exemption does not extend to any other section or provision of the Exchange Act.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

[23] Nasdaq members will be able to effect transactions on the PORTAL Market in accordance with the terms of this exemption without violating Nasdaq rules only after SR-NASDAQ-2006-065 becomes effective.

Chairman Cox
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8827 / July 31, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 56170 / July 31, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2660 / July 31, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12718

In the Matter of **ASPEN TECHNOLOGY, INC.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Aspen Technology, Inc. ("Aspen" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-

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and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

1. From at least 1999 through 2002, Aspen -- often acting through its Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Chief Operating Officer (COO) -- engaged in a scheme to fraudulently inflate revenues by improperly recognizing revenue on at least nineteen different software license transactions involving at least fifteen different customers world-wide. Motivated by a desire to boost revenues and meet securities analyst earnings expectations, Aspen's CEO, CFO and COO were directly involved in negotiating and improperly recognizing revenue on certain of these transactions. The scheme involved premature recognition of revenue where revenue was not recognizable under generally accepted accounting principles ("GAAP") in the quarters claimed by Aspen either because contracts were not signed within the appropriate quarter or because the earnings process was incomplete due to side letters or other contingency arrangements. In several reporting periods, Aspen would not have met analysts' earnings expectations without the improperly recognized revenue.[2]

2. On March 15, 2005, Aspen restated its financial statements for fiscal years ended June 30, 2000 through June 30, 2004. Among other things, the restatement revealed that Aspen had overstated previously reported license revenue for the fiscal year ended June 30, 2000 by 5.5% and for the fiscal year ended June 30, 2001 by 9.3%, resulting in net income dropping from $5.4 million to a loss of $3.2 million for fiscal 2000 and increasing the previously reported loss for fiscal 2001 by $16 million.

B. RESPONDENT

3. Aspen, a Delaware corporation based in Cambridge, Massachusetts, sells computer software used in chemical, petroleum and other industrial operations. Aspen's stock is registered with the Commission under Section 12(g) of the Exchange Act and trades on the NASDAQ National Market System. Aspen reports its results of operations on a fiscal year basis ending on June 30.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] From June 1, 2000 through May 9, 2002, Aspen financed six acquisitions through private placements of common stock exempt from registration under Section 4(2) of the Securities Act. In addition, Aspen filed Forms S-8 with the Commission to register shares in each of the years 2000, 2001 and 2004; those registration statements incorporated by reference the periodic reports discussed herein.

construction firm ("the Korean company"). For the quarter ended March 31, 2000, Aspen recorded in its books and records and recognized $1.1 million in license revenue pursuant to a software license agreement dated March 31, 2000 with the Korean company. The revenue should not have been recognized because an Aspen salesman entered into two contemporaneous side letter agreements with the Korean company which obligated Aspen to provide $300,000 in cash and $800,000 in services to the Korean company. Under GAAP, because the total amount of software license revenue was offset by Aspen's obligations under the side letters, Aspen should not have recorded or recognized revenue on the transaction. On May 15, 2000, Aspen filed its Form 10-Q for the quarter ended March 31, 2000; the financial statements in the Form 10-Q improperly included approximately $1.1 million in software license revenue from the transaction.

8. The second transaction involved a software license agreement dated March 31, 2000 with a French company ("the French company"). For the quarter ended June 30, 2000, Aspen fraudulently recorded in its books and records and recognized license revenue of $1.5 million relating to that agreement. The revenue should not have been recognized because an Aspen salesman entered into a contemporaneous side letter agreement which created contingencies to the French company's obligations. Under GAAP, the existence of those contingencies prohibited up-front recognition of the license revenue. On September 28, 2000, Aspen filed its Form 10-K for the year ended June 30; the financial statements in the Form 10-K improperly included approximately $1.5 million in software license revenue from the transaction.

<u>License Revenue Fraudulently Recognized in the Fiscal Year Ended June 30, 2001</u>

<u>Second Quarter 2001 Revenue</u>

9. On February 14, 2001, Aspen filed its Form 10-Q for the quarter ended December 31, 2000. In the financial statements included in that filing, Aspen's software license revenue for the quarter was fraudulently inflated by 18.6% as a result of the improper recognition of revenue from five software transactions. As described below, Aspen's CEO, CFO and COO were all aware that the recognition was improper in at least two of those transactions.

10. Aspen's CEO, motivated by a desire to increase revenue at the end of a quarter, was the architect of a fraudulent revenue transaction with an information technology company based in New York ("the New York company"). For the quarter ended December 31, 2000, Aspen improperly recorded in its books and records and recognized $2.8 million in license revenue pursuant to a software license agreement with the New York company. Under GAAP, the revenue from the transaction with the New York company should not have been recognized for two independent reasons: (i) the transaction was still being negotiated after quarter end; and (ii) the New York company's payment to Aspen was contingent on Aspen finding end users to which the New York company could resell the software.

11. Just before the close of the second quarter, around December 25, 2000, the CEO asked the New York company to buy approximately $3 million worth of software. In order to induce the New York company to make the deal, the CEO promised that Aspen would arrange for end-users to purchase the software from the New York company. The CEO further promised that

the New York company would not be required to pay for the licenses until Aspen arranged for those end-users to purchase the software, and that if the New York company was unable to resell all $3 million in licenses, Aspen would arrange financing for the transaction until the licenses were sold through to end-users. On or about January 6, 2001, an employee of the New York company observed to a coworker in an email that: "AspenTech needs to realize the $3M sale in Dec. 2000 business, and they are willing to make some extraordinary concessions for this." Aspen's CEO, CFO, and COO all knew that Aspen and the New York company were still negotiating the terms of the license sale through mid-January 2001, and also knew that, in order to legitimately recognize the revenue in the quarter ended December 31, the deal had to have been signed before December 31, 2000. In an attempt to make it appear that the deal was signed before the close of the quarter, an Aspen salesman asked the New York company representative in January 2001 to sign the software license agreement and to back date it December 29, 2000. The CEO, CFO and COO were motivated to prematurely recognize the revenue by a desire to increase revenues in the quarter and to meet analyst earnings expectations. Including the revenue from the New York company allowed Aspen to exceed analyst earnings expectations for the quarter; without that revenue, Aspen would have missed analyst earnings expectations.

12. Similarly, in a transaction with a British software company ("the British company"), Aspen's CEO, CFO and COO all participated in a deal which resulted in Aspen fraudulently recording in its books and records and recognizing $1.75 million in license revenue for the quarter ended December 31, 2000. Under GAAP, the revenue should not have been recorded or recognized for two independent reasons: (1) the transaction was still being negotiated after quarter end; and (2) the British company's payment for the licenses was contingent on Aspen finding customers who would purchase a minimum amount of software implementation services from the British company. Aspen's CEO was aware that the transaction was being negotiated after quarter end, and both Aspen's CFO and COO knew that the British company's payment was contingent on Aspen finding customers to purchase services from the British company. Despite this, all three caused Aspen to improperly recognize revenue on the transaction in the quarter ended December 31, 2000. Including the revenue from the British company allowed Aspen to exceed analyst earnings expectations for the quarter.

13. In addition, for the quarter ended December 31, 2000, Aspen also fraudulently recorded in its books and records and recognized license revenue of $1.2 million pursuant to a software license agreement dated December 29, 2000 with a South African construction company that was a reseller of Aspen products in Africa, $824,000 pursuant to an agreement dated December 29, 2000 with an Indian reseller of Aspen's software, and $978,000 pursuant to a software license agreement dated December 30, 2000 with a Thailand chemical company. Aspen should not have recognized the revenue up-front on each of these transactions due to the existence of contingencies that, among other reasons, under GAAP made collectibility not probable.

Fourth Quarter 2001 Revenue

14. On September 26, 2001, Aspen filed with the Commission its Form 10-K for the year ended June 30, 2001. Aspen's quarterly and yearly financial results for fiscal 2001 were also reported in a Form 8-K filed with the Commission on August 8, 2001. As a result of fraudulent

revenue recognition from three software license transactions, Aspen's software license revenue for the fourth quarter of 2001 was inflated by 15.8%. Aspen's CEO, CFO and COO knew that the recognition of revenue from at least one of those transactions was improper.

15. Among the fourth quarter 2001 transactions, Aspen fraudulently recorded in its books and records and recognized $4.3 million in license revenue pursuant to a software license agreement with a large petroleum company in Russia ("the Russian company"). Aspen's CEO, CFO and COO all participated in the scheme to improperly recognize revenue from the deal. Under GAAP, the revenue from the transaction with the Russian company should not have been recorded or recognized for two independent reasons: (1) the transaction was still being negotiated after quarter end; and (2) a separate side agreement signed by Aspen's COO created significant contingencies to the Russian company's obligations under the license agreement.

16. Aspen's CEO, COO, and CFO all knew that the deal with the Russian company was not completed within the quarter ended June 30, 2001. The COO, with the knowledge of Aspen's CEO and CFO, had the Russian company sign the software license agreement in July 2001 but back date it June 2001 so that Aspen could fraudulently recognize the revenue in the 2001 fiscal year. On or about July 5, 2001, the COO sent an e-mail, marked "destroy after reading," to the CEO and CFO attaching a draft letter to the Russian company's president. The attached letter to the Russian company's president proposed, in part, that the Russian company sign the contemplated software agreement by July 10, 2001 and stated that "[a]s a quarterly driven software company, our business model requires that we book significant software license revenue. ... By [the Russian company] committing to the software license agreement [by July 10, 2001] ... we can recognize the revenue for our fiscal year ending June 30, 2001 . . . ." In addition, in mid-July 2001, Aspen's COO entered into a side agreement with the Russian company which created significant contingencies. The side agreement gave the Russian company the "unconditional right[]" to withdraw from the software agreement if the parties failed to reach any one of three additional agreements by August 1, 2001. Because the parties failed to enter into any of the additional agreements referenced in the side agreement, the Russian company had no obligation to purchase any software pursuant to the software agreement. Aspen's CEO, CFO and COO were all motivated to prematurely recognize the revenue from the Russian company transaction by a desire to meet consensus analysts' earnings expectations. Without the revenue from the Russian company transaction, Aspen would not have met quarterly analysts' earning expectations.

17. In addition, on or about August 7, 2001, Aspen's CEO, CFO and COO signed a letter to Aspen's outside auditors which falsely represented that "there are no contingencies, amendments or modifications to the original agreement, side agreements (verbal or written) or expected future concessions under [the software agreement] between Aspen and [the Russian company]."

18. Aspen also fraudulently recorded in its books and records and recognized $1.8 million in license revenue pursuant to software license agreements dated June 8, 2001 with a large petroleum refining company in Asia and $225,000 pursuant to a software license agreement dated June 30, 2001 with a Canadian systems integrator. Aspen should not have recognized revenue in

the quarter ended June 30, 2001 on either of these transactions due to contingencies that, among other reasons, under GAAP, caused the fees not to be fixed or determinable.

License Revenue Fraudulently Recognized in the Fiscal Year Ended June 30, 2002

19. On September 30, 2002, Aspen filed with the Commission its Form 10-K for the year ended June 30, 2002. The financial statements in the filing overstated revenue as a result of fraudulent revenue recognition from at least three software license transactions. As described below, Aspen's CFO and COO, again motivated by a desire to increase revenues for the quarter, were directly involved in the improper revenue recognition on at least one of the transactions.

20. In a second instance of improper revenue recognition involving the New York company referenced above, Aspen's CFO and COO caused revenue to be recognized despite knowing that the New York company's obligations were contingent and that revenue could not be recognized. As a result, for the quarter ended March 30, 2002, Aspen fraudulently recorded in its books and records and recognized $1.7 million in license revenue pursuant to a software license agreement with the New York company dated March 28, 2002. This transaction totaled approximately 4.5% of Aspen's license revenue for the quarter and was reported on Aspen's Form 10-Q/A for the quarter ended March 31, 2002, filed with the Commission on September 6, 2002.

21. The revenue from the second New York company deal should not have been recognized up-front because, similar to the prior deal, the New York company's obligation to pay Aspen was contingent upon resale to an end-user, and thus, the license fee did not meet the requirements for up-front revenue recognition. Aspen's CFO and COO were aware of this contingency at the time the revenue was fraudulently recognized. For example, in early March 2002, an Aspen salesman copied Aspen's CFO on an email, stating in part that "We are in the closing stages of completing a deal with [an Italian company]. . . . The deal is most likely to be sold through [the New York company] as they have an existing agreement with [the Italian company] . . . . The timing of [the Italian company] deal will mean we run close to the end of Q3. My question is, if [the New York company] sign [sic] up the deal with us in March but the [Italian company] deal with [the New York company] completes in early April, would we be able to recognize the deal in Q3? [The New York company] would purchase the software on behalf of [the Italian company] as part of the larger project. Let me know asap, as this has a bearing on how much pressure we put on [the Italian company]." Aspen's CFO responded to this email by stating "We have tried this several times with [the New York company] and it hasn't worked as they always want the end customer to be committed before they are committed - SO I am willing to give it a try but don't count on it!!" The CFO then forwarded the email string to, among others, the COO, with a note stating: "THis [sic] is risky!!" Despite the CFO and COO's knowledge that the New York company's commitment was contingent upon resale to a third party, Aspen fraudulently recognized the revenue from the transaction. Recognizing the revenue from the New York deal allowed Aspen to exceed analyst earnings expectations; without the revenue, Aspen would have missed expectations.

22. In a second transaction with the South African company referenced above, for the fiscal quarter ended June 30, 2002, Aspen recorded in its books and records and fraudulently recognized $440,000 in license revenue pursuant to a software license agreement dated June 30, 2002. In mid-2002, an Aspen salesman offered the South African company a $45,000 payment to simply sign a software license agreement to buy $450,000 in software licenses and then transfer the software on to an end-user that Aspen had previously lined-up. The Aspen salesman entered into a letter agreement with the South African company on July 1, 2002 confirming that Aspen, in recognition of the South African company's signing of the license agreement, would sell the software to an end user and pay the South African company a commission of $45,000. Under GAAP, this transaction was not a bona fide sale and thus the revenue should not have been recognized.

23. Lastly, Aspen's COO, motivated by a desire to partially offset a large revenue shortfall in the final days of the quarter, entered into contemporaneous side agreements with a Kuwait company ("the Kuwait company") which affected delivery and caused the fee under the license agreement not to be fixed or determinable. As a result, for the quarter ended June 30, 2002, Aspen fraudulently recorded in its books and records and recognized $1.9 million in license revenue pursuant to a software license agreement with the Kuwait company. Had the revenue from the Kuwait company transaction not been recorded in this period, Aspen would have missed consensus analyst expectations by a greater margin.

The Restatement

24. On October 27, 2004, Aspen announced that its board of directors' audit committee began an investigation of accounting for software license and service agreements entered into during fiscal years 2000 through 2002. On November 24, 2004, Aspen announced that it would file a restatement of its financial statements due to certain accounting improprieties. On March 15, 2005, Aspen restated its financial statements for fiscal years 2000 through 2004. The restatement revealed that Aspen had overstated previously reported license revenue for fiscal 2000 by 5.5% and for fiscal 2001 by 9.3%, resulting in net income dropping from $5.4 million to a loss of $3.2 million in 2000 and increasing the previously reported loss for fiscal 2001 by $16 million. License revenue for the years ended June 30, 2002, 2003, and 2004 was understated by 1.8%, 13.9%, and 4.0% respectively. As a result of prematurely recognized revenue from several transactions in fiscal 2001 and prior, the revenue was moved to these later periods.

D. VIOLATIONS

25. As a result of the conduct described above, Aspen violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale or in connection with the purchase or sale of securities.

26. Also as a result of the conduct described above, Aspen violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 and 12b-20 thereunder.

27. Because Aspen improperly recorded revenue, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

28. In addition, Aspen failed to implement internal accounting controls relating to its revenue accounts sufficient to provide reasonable assurances that these accounts were accurately stated in accordance with GAAP.

29. As a result of the conduct described above, Aspen violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

30. Lastly, as a result of the conduct described above, Aspen violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

E. <u>ONGOING COOPERATION</u>

31. In determining to accept the Offer, the Commission has considered the following undertaking by the Respondent – Aspen shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. Aspen shall: (i) produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission staff; (ii) use its best efforts to cause its employees to be interviewed by the Commission staff at such times as the staff reasonably may direct; and (iii) use its best efforts to cause its employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be reasonably requested by the Commission staff.

F. <u>UNDERTAKINGS</u>

Respondent undertakes to:

a. Retain, through its Board of Directors, within thirty days after the entry of this Order, an Independent Consultant ("Independent Consultant"), not unacceptable to the staff of the Commission, to review Aspen's financial and accounting policies and procedures relating to: (i) revenue recognition on software licensing agreements, including the consideration of SOP 97-2 and documentation of that consideration; (ii) the signing and dating of material sales contracts and purchase orders and the retention by Aspen's corporate finance organization of all such contracts and purchase orders; (iii) written documentation that all sales contingencies have been met in material revenue transactions; (iv) the generation and issuance to customers of sales invoices; and (v) the preparation and review of accounts receivable confirmations. Aspen shall require the Independent Consultant to also consider, based on his/her review, the nature and extent of Aspen's Board of Directors training required to minimize the possibility of future violations of the federal securities laws by Aspen, acting through its finance and accounting employees. At the conclusion of the review, which in no event shall be more than 90 days after the Independent Consultant's retention, Aspen shall require the Independent Consultant to submit a Report to Aspen and to the Boston Regional Office of the Commission. The Report shall address the issues described above and shall include a description of the review performed, the conclusions reached and the Independent Consultant's recommendations for changes in or improvements to policies and procedures, including recommendations as to the nature and extent of Board of Directors' training.

b. Respondent shall adopt all of the Independent Consultant's recommendations for changes in or improvements to policies and procedures as set forth below; provided however, that within 45 days from the date of submission of the Independent Consultant's report, Respondent shall in writing advise the Independent Consultant and the staff of the Commission's Boston Regional Office of any recommendation that Respondent considers to be unnecessary, inappropriate, unreasonable, impractical or infeasible. Respondent need not adopt any such recommendation at that time but shall propose in writing an alternative policy or procedure designed to achieve the same objective.

c. As to any recommendation with respect to Respondent's policies and procedures on which Respondent and the Independent Consultant do not agree, they shall make a good faith attempt to reach agreement within 60 days from the date of submission of the Independent Consultant's report. In the event the Respondent and the Independent Consultant are unable to agree on an alternative proposal, Respondent will follow the recommendation of the Independent Consultant. To the extent the Independent Consultant proposes, in his/her report, alternative recommendations, any one of which is intended to address a given matter, Respondent may adopt one of the proposed alternatives and need not notify the Independent Consultant or the staff of the Commission's Boston Regional Office of alternative recommendations not adopted.

d. Aspen (i) shall not have the authority to terminate the Independent Consultant, without the prior written approval of the Commission's Boston Regional Office; (ii) shall compensate the Consultant, and persons engaged to assist the Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; and, (iii) shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Consultant from transmitting any information, reports, or documents to the staff of the Commission; and

e. Aspen shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Aspen, or any of its present or former affiliates, directors, officers, employees, or agents, respectively, acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Commission's Boston Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Aspen, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Aspen's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Aspen cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent shall comply with the undertakings enumerated in Section III.F, above.

C. Deadlines: For good cause shown, the Commission staff may extend any of the procedural deadlines set forth herein.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary