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Via e-mail: rule-comments@sec.gov

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: SR-NYSE-2004-12 and SR-NASD-2003-140
Prohibition of Abuses in Allocating Initial Public Offerings

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the American Bar Association's Section of Business Law (the "Committee")[1] with respect to the request for comments published by the Securities and Exchange Commission ("SEC") with respect to proposed rules of the New York Stock Exchange, Inc. ("NYSE") and the National Association of Securities Dealers, Inc. ("NASD") (together, the "SROs") relating to the prohibition of certain abuses in the allocation and distribution of shares in initial public offerings ("IPOs").[2] It was prepared by the Committee's NASD Corporate Financing Rules Subcommittee.

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[1] References herein to "we" and "our" refer to the Committee.

[2] Notice of Filing of Proposed Rule Changes by the New York Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. Relating to the Prohibition of Certain Abuses in the Allocation and Distribution of Shares in Initial Public Offerings, SEC Release No. 34-50896 (December 20, 2004); 69 F.R. 77804 (December 28, 2004) ("SEC Release").

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committee. This letter also does not represent the views of any other ABA Section.

The Committee shares the concerns of the SROs that the IPO process should operate effectively and fairly in light of "the importance of IPOs to the vitality of our capital markets . . . ."[3] In this connection, we commend the efforts of the NASD and NYSE, since 2002, to address issues of IPO abuses, including issuing NASD Notice to Members 02-55 (August 2002) (the "2002 NTM") and Notice to Members 03-72 (November 2003) (the "2003 NTM") and forming the NYSE/NASD IPO Advisory Committee (the "IPO Advisory Committee"), which resulted in the issuance of a Report and Recommendations in May 2003 (the "IPO Advisory Committee Report"). We believe that a number of the specific proposals made by the SROs that would regulate IPO allocation and distribution abuses (the "IPO Proposals") will contribute to public confidence in the IPO process. The Committee is concerned, however, that the proposed rules should operate effectively to prevent manipulative activity while not inhibiting legitimate allocation and distribution practices and without imposing unnecessary burdens on the broker/dealer industry. Thus, we make a number of recommendations for clarifications with respect to the application of the proposed rules. We request that such clarifications not be provided only in the SEC approval order or in an NASD Notice to Members or NYSE Information Memo. Instead, we ask that such clarifications be included in related interpretive material (as an Interpretive Memorandum to the NASD rule or Supplementary Material to the NYSE rule) adopted as a rule, in order to ensure that the SRO rules accurately reflect their intended scope and application.[4]

DISCUSSION

Quid Pro Quo Allocations

Proposed new NYSE Rule 470(A) and NASD Rule 2712(a) would prohibit a member and its associated persons from offering or threatening to withhold shares the member allocates in an IPO as a consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member. The *quid pro quo* regulations proposed by the SROs are intended to prohibit the abusive practice by broker/dealers of allocating IPO shares based on a potential investor's agreement to pay excessive commissions on trades of unrelated securities or based on the

[3] SEC Release, at 77806.

[4] *See*, discussion in connection with Footnote 6 in ABA Comment Letter on SR-NASD-2004-22, February 3, 2005, at 3.

investor's agreement to "kick back" to the broker/dealer, either through excessive commissions or otherwise, a portion of the profits anticipated by the investor.[5] We generally support the proposed *quid pro quo* prohibition, as it narrowly prohibits an abusive activity, without also affecting legitimate broker/dealer practices. However, we also believe that the rule would benefit from certain clarifications.

The discussion of the IPO Proposals in the SEC Release reiterates a statement made in Recommendation 11 of the IPO Advisory Committee Report that "[t]his prohibition is not intended to interfere with a member's or member organization's business relationship with its customers nor does it prohibit legitimate allocations of IPO shares to a customer of the member or member organization even when the customer has separately retained the member or member organization for other services when the customer has not paid excessive compensation in relation to those other services."[6] We recommend that this language be included in related interpretive material that is adopted as a rule, if not, indeed, in the rule itself, because it is a significant factor for member firms to consider in interpreting the rule.

The NASD also includes an explanation in the discussion of its proposal in the SEC Release that "trading activity that serves no economic purpose other than to generate compensation for the member (*e.g.,* wash sales) would be viewed as 'excessive' in relation to the services provided by the member, which is meaningless."[7] Although we do not object to the NASD's basic premise that fees for inherently uneconomic trading activity are presumptively "excessive," it is important to recognize that, under certain circumstances, a trade that may be designated a "wash sale" can be a legitimate and permitted transaction when it is not at the instigation of the member solely to generate trading fees.[8] Thus, we believe that related interpretive material adopted as a rule should clarify that determinations as to whether fees paid for a service are excessive in relation to that service will be based on all the facts and circumstances surrounding the services provided, including, among other things, the risk and effort involved in the transaction, usual and customary rates charged for similar services at broker/dealers in the same kind of business, regional norms in setting prices for financial services, and the historical trading strategies and trading patterns of the investor,[9] and that fees from wash sales will not be deemed excessive if they meet those standards and are entered into for a valid customer purpose.

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[5] SEC Release, at 77807.

[6] *See,* statement of the NYSE, SEC Release, at 77807 and similar discussion of the NASD, at 77810.

[7] SEC Release, at 77810.

[8] For example, a wash sale may be necessary to switch positions between accounts or for the purpose of "tax switching." *See*, NYSE IM-04-65 – Tax Switching Transactions Information Memo (December 27, 2004).

[9] This language is taken from the SEC Release, at 77815.

We believe that the IPO Proposals achieve the purpose of prohibiting *quid pro quo* arrangements in a clearer manner than new SEC Rule 106 under Regulation M recently proposed by the SEC,[10] because the SRO rules would link the coercive conduct of a member in conditioning or threatening to withhold an allocation to the receipt of excessive compensation for the services provided by the member. Further, we find proposed Rule 106 to be unduly complex and confusing in its application to both *quid pro quo* and tying arrangements. We urge that the SEC refrain from extending Regulation M to a new area of activities involving the payment of excessive fees or commissions in return for an IPO allocation and, instead, limit Rule 106 to clarifying the application of Regulation M to tying arrangements – an area traditionally within the scope of Regulation M.

Spinning Allocations

Proposed new NYSE Rule 470(B) and NASD Rule 2712(b) would prohibit the allocation of IPO shares to an executive officer or director of a company, or to persons materially supported by such an executive officer or director, if (1) the member previously received compensation from such company for investment banking services in the past 12 months (the "12-month restriction"); (2) the member expects to receive or intends to seek investment banking business from such company in the next six months (the "six-month restriction"); or (3) on the express or implied condition that such executive officer or director (on behalf of the company) will direct future investment banking business to the member (the "express or implied condition restriction"). The proposed spinning rule includes a presumption with respect to the six-month restriction that an allocation by a member to an executive officer or director of a company from which the member subsequently receives investment banking business within the next six months was made with the expectation or intent to receive such business. A member may rebut the presumption by demonstrating that the member's allocation of IPO shares was not made with the expectation or intent to receive investment banking business. The proposed rule is intended to address the abusive practice of "spinning," in which a member allocates IPO securities as a *quid pro quo* for the prior receipt or on condition of the future receipt of investment banking business.

General Comments - We are concerned that, without interpretive guidance, the spinning restrictions will have an overbroad application, and are likely to result in unfair discrimination against purchases by executive officers and directors of companies. The 12-month restriction is the result of a recommendation of the IPO Advisory Committee Report that the executive officers and directors of a member's investment banking clients should not receive IPO allocations in order to avoid the appearance of wrongdoing.[11] Although the express or implied condition restriction is a direct prohibition on the

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[10] Amendments to Regulation M: Anti-Manipulation Rules Concerning Securities Offerings, SEC Release No. 34-50831 (December 9, 2004); 69 F.R. 75774 (December 17, 2004) (the "Regulation M Proposal"). The Committee has submitted comments in a separate letter regarding these proposals.

[11] *See,* Recommendation 9, IPO Advisory Committee Report, at 11.

abusive practice of spinning, we are concerned that there will be uncertainty as to when the SROs will deem that an executive officer or director was allocated IPO shares on an "implied condition" that future investment banking business be directed to the member. We are also concerned that the six-month restriction presumes that a member has engaged in a spinning violation if the member subsequently obtains investment banking business from a company with which a recipient of IPO securities is an executive officer or director, even though the member had no expectation that such business would be forthcoming from the company at the time it made the IPO allocation. We believe that the presumption in the six-month restriction and the uncertainty about the meaning of the term "implied condition" may prevent members from selling IPO securities to executive officers and directors and others materially supported by such persons, thereby interfering with underwriters' legitimate business relationships with their customers and with the ability of brokers to allocate securities to good customers. We are concerned, moreover, that the provisions create a status prohibition that unfairly discriminates against executive officers and directors because it may frequently prevent executive officers and directors from purchasing IPO securities, although they may not have engaged in any abusive practices and are likely to have the kind of business sophistication and financial resources that would make them among the most qualified retail investors to assume the investment risk of an IPO.[12]

The NASD's discussion of its proposal[13] included a clarification that the presumption in the six-month restriction is considered to be rebutted if the member has procedures and information barriers that ensure that persons making allocations do not have information about the beneficial owners of retail accounts that receive allocations (the "information barriers"). We believe that the presence of such information barriers should not only serve to rebut the presumption but should also be considered evidence that demonstrates that a member has not made an allocation on the implied condition that the executive officer or director will direct future investment banking business to the member. We, therefore, recommend that the SROs add a new provision in the text of the proposed rule to provide that the presence of such information barriers, which would be at the option of the member, will rebut the six-month presumption and will be considered evidence that the member has not made an allocation on an implied condition of receiving future investment banking business. We believe that this approach is consistent with the SEC's Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial

[12] The purpose of the proposed spinning rule to prevent members from allocating IPO securities to executive officers and directors as a reward for prior or future investment banking business should be distinguished from the purpose of NASD Rule 2790, which is to ensure a bona fide public distribution by preventing persons that are associated with the investment banking and securities business from taking advantage of their position by purchasing new issues of securities to the detriment of the investing public.

[13] SEC Release, at 77811.

Public Offerings to Corporate Executives and Directors issued in 2003 (the "Voluntary Initiative").[14]

The comments set forth below address a number of the individual requirements of the proposed spinning rule. In certain cases, these comments will be satisfied if the SROs adopt the foregoing recommendations.

Scope of Companies/Accounts - The broad reach of the proposed rule to executive officers and directors of any company, no matter where located, adds significantly to the compliance burdens that are imposed by this rule on the broker/dealer industry. The logistics of tracking information on the relationship of retail customers to past and potential investment banking clients of the firm are so complex under the proposal that we believe that underwriters may, instead, determine not to sell IPO securities to any executive officer or director of any company or may refrain from selling IPOs to any retail customer. Consistent with the SEC's Voluntary Initiative, we recommend that the proposed rule be amended to apply only to the accounts of executive officers and directors of a U.S. company or a public company for which a U.S. market is the principal equity trading market. We also believe that the prohibition should apply only to accounts held at the member firm and should not apply to accounts that may be held offshore by affiliates of the member.[15]

Persons Materially Supported - In response to the SEC's specific request for comment, we believe that the proposed spinning prohibition should not be extended to members of the immediate family of an executive officer or director (*e.g.,* adult children and siblings, parents, father/mother-in-law, brother/sister-in-law, and son/daughter-in-law) who do not receive material support from the executive officer or director, other than those persons living in the same household. Such an extension would significantly add to the compliance burden and is unnecessary to achieve the purposes of the rule to prevent abusive spinning practices. Furthermore, we believe that the proposed spinning prohibition should be narrowed to apply only to sales of IPO securities to members of the immediate family of an executive officer or director who live in the same household.

We are concerned that it will be particularly difficult for broker/dealers to determine whether an adult customer is an immediate family member of or is materially supported by an executive officer or director of a company for which the member may have provided or may in the future provide investment banking services. The compliance

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[14] *See,* Item 4 in the SEC's Voluntary Initiative, which prohibits a member's investment banking personnel from participating in the member firm's allocation of IPO securities to specific individual customers. The SEC asks in the SEC Release whether a requirement for such a procedure should be adopted in addition to the spinning rule proposed by the SROs. SEC Release, at 77816. We believe that the proposed rule should not include a requirement for such a procedure. Instead, we believe that members should be given the option to establish information barriers, as set forth in the body of this letter. *See* http://www.sec.gov/news/press/globalvolinit.htm.

[15] *See,* discussion below of the definition of "person associated with a member."

problems inherent in determining the relationship (whether family or financial) of brokerage customers with an executive officer or director are exacerbated with respect to customers who are not members of the same household as an executive officer or director. We also believe that there is an issue of basic fairness to family members and other persons who do not live in the same household as an executive officer or director and who are not involved in the securities industry and not even associated with the issuing company, but would be barred in effect from purchasing IPO shares merely because they are related to an executive officer or director of a company.

The NASD's rationale for applying the spinning prohibition to the immediate family of an executive officer or director, including persons not living in the same household or materially supported by such person, is that Recommendation 9 of the IPO Advisory Committee Report stated that the spinning prohibition should be extended to the "immediate family" of executive officers and directors.[16] There is nothing in Recommendation 9 that indicates that the IPO Advisory Committee intended for the spinning prohibition to be extended beyond the immediate family living in the same household as the executive officer or director. Such an extension of the prohibition is also not justified by the SEC's and NASD's enforcement actions involving spinning violations,[17] which do not appear to have involved allocation of IPO shares to persons other than an executive officer or director. We also note that the SEC's Voluntary Initiative did not extend to the immediate family of executive officers and directors. Thus, we believe that it is unnecessary and unduly burdensome to extend the spinning prohibition to the immediate family and other persons living outside of the household of an executive officer or director.

Issuer-Directed Shares - Although the language of the proposed rule applies to allocations by broker/dealers, not the issuer, we are concerned that the proposed spinning rule would prohibit an issuer from directing IPO securities to its own executive officers and directors[18] and to executive officers and directors of other companies, and persons they materially support, as part of an issuer-directed share program to "friends and family." Issuer-directed shares do not give rise to the abuses that the proposed rule was intended to address. In light of the exception in the Voluntary Initiative,[19] we recommend that the proposed spinning prohibition be revised to expressly except any allocations by an issuer or its affiliates and selling shareholders pursuant to a directed share program in order to avoid any doubt as to the scope of the rule. We also think that the rule should except allocations by a separately organized investment adviser.

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[16] SEC Release, at 77810.

[17] *See, for example,* NASD Press Release, July 12, 2004, *NASD Fines Piper Jaffray for IPO Spinning* and SEC Litigation Release No. 18110 (April 28, 2003) re Credit Suisse First Boston LLC.

[18] A prohibition on sales to the issuer's executive officers and directors would also be inconsistent with the IPO Proposal in NYSE Rule 470(D)(2)(a) and NASD Rule 2712(e)(2)(A) that shares purchased by the issuers officers and directors shall be subject to any lock-up restriction imposed by the underwriter.

[19] Voluntary Initiative, Item 5.

NASD Rule 2790 - The SEC requested specific comment on whether the NASD's spinning prohibition should be included in NASD Rule 2790, which would treat executive officers and directors of any company, both onshore and offshore, as restricted persons in connection with "new issues" of securities in the U.S. or offshore. We are not in favor of including the NASD's spinning prohibition in Rule 2790 because such a change would create a very broad category of persons that, unlike the other categories of "restricted persons," have no connection to the investment banking and securities business. Moreover, designing questionnaires and procedures for hedge funds and other investment vehicles to identify restricted persons is already very difficult, particularly when the inclusion of executive officers and directors of different companies will vary from offering to offering and from day to day. As a category of "restricted person," executive officers and directors of companies that have received or might receive services from an underwriter are so numerous as to make it almost impossible for an investment fund to provide to the member the representation required for compliance with Rule 2790.

Compliance Procedures - We believe that the proposed rule should provide guidance on procedures that members can rely on in order to comply with the provisions of the proposed spinning rule. In order for members to avoid the necessity of obtaining updated information from its retail investors in connection with each IPO, [20] we recommend that the SROs permit members to rely on a representation from retail clients regarding their status, and the status of any person that the client materially supports, as an executive officer or director of a company if such representation was obtained no more than one year prior to the effective date of the offering. This recommendation is based on the model of procedures for representations relating to restricted persons under NASD Rule 2790.

The 12-month provision would require that a member, at the time of each IPO, have current information on the identity of the firm's clients from which it has received compensation for investment banking services in the prior 12 months. We believe that a similar compliance issue was addressed under the NYSE and NASD research analyst rules regarding disclosure in a research report as to whether a subject company is or, in the prior 12 months, was a client of the member.[21] Based on the procedures codified in the research analyst rules, unless the information is otherwise known to the member, we believe that a member should be permitted to rely on information regarding the identity of the firm's clients from which it has received compensation for investment banking services in the prior 12 months that is current as of the last day of the month immediately

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[20] The complexity of gathering this information and keeping it updated will be significant given that client information will need to reflect not only the client's relationship to a company, but also the relationship to companies of the client's spouse, other persons living in the same household, and persons that the client materially supports.

[21] *See,* NASD Rule 2711(h)(2)(A)(iii)b. and NYSE Rule 472(k)(1)(i)b.

preceding the effective date of the IPO or, if the effective date is less than 30 days after the end of the most recent month, as of the end of the second most recent month.

Definition of "Investment Banking Business" - The SROs have not proposed to define the term "investment banking business" as used in connection with the six-month restriction and the express or implied condition restriction in the proposed rule. We believe that this term should be interpreted or defined similarly to the term "investment banking business" as used in NYSE Rule 472(b)(4) and NASD Rule 2711(c)(1), which provisions prohibit a research analyst from participating in efforts to solicit investment banking business. The discussion related to those provisions indicates that the concept of "investment banking business" is limited to SEC-registered underwritten offerings, including IPOs, as well as follow-on and secondary offerings.[22] We believe that the narrower scope of this term, compared to the term "investment banking services" used in the 12-month restriction, is appropriate because of the greater difficulty of collecting information with respect to anticipated future events.

IPO Pricing Information

Proposed new NYSE Rule 470(D)(1) and NASD 2712(e)(1) would require that the book-running lead manager provide the issuer's pricing committee, board or other authorized group with a regular report of indications of interest, including the names of institutional investors and the number of shares indicated by each, as reflected in the book-running lead manager's book of potential institutional orders, and a report of aggregate demand from retail investors. The SROs have modified this provision from the original version proposed by the NASD in the 2003 NTM so that it only obligates the book-running lead manager to provide the type of information normally maintained with respect to institutional and aggregate retail orders. The same rule would also require that the book-running lead manager provide a report of the final allocation of shares to institutional investors and aggregate amount of sales to retail investors after the settlement date of the IPO. We appreciate the changes made to these provisions from the original version proposed in the 2003 NTM and support the proposed version of the rule.

Lock-Up Agreements

Proposed new NYSE Rule 470(D)(2)(b) and NASD Rule 2712(e)(2)(B) would require that, at least two business days before the book-running lead manager releases or waives any lock-up restriction on the transfer of the issuer's shares by an officer or director, the manager notify the issuer of the impending release or waiver and announce it through a national news service. Based on the text of the proposed rule, we believe that this obligation only applies to the release or waiver of lock-up restrictions on a transfer of

[22] SEC Release No. 34-48252 (July 29, 2003); 68 F.R. 45875 (August 4, 2003), at 45879.

the securities, which appears to include the restrictions on sale, transfer, pledge, or hypothecation.[23]

We do not support the portion of the SROs' proposed rule that would require that the book-running lead manager publicly announce such an impending release or waiver of any lock-up restriction on transfer by an officer or director. As we previously stated in our comment letter dated February 4, 2004 with respect to the 2003 NTM, even if the proposed disclosure is limited to sales, we believe that the proposed disclosure rule is likely to result in a flood of meaningless information regarding sales of immaterial amounts of securities. To the extent that the SROs nonetheless adopt a disclosure rule, we believe that the disclosure rule should apply only to sales of a significant amount of securities, i.e., an amount of securities that has the potential to impact the public market. We also believe that the issuer is the more appropriate party to make disclosures regarding potential sales of its securities by its officers and directors.

In terms of the category of the waivers that should be disclosed, we do not necessarily agree with the NASD that the purpose of the underwriter's lock-up restriction is to impose investment risk on the issuer's officers and directors[24] in the same manner as the NASD's lock-up restriction on underwriters in Rule 2710. Rather, we believe that the underwriter's lock-up restriction on the securities of the issuer and its officers and directors is for the purpose of ensuring that sales by the issuer's insiders do not depress the market during the first six months following an IPO in order that the market may fully develop. Thus, we believe that public disclosure should only be required with respect to the waiver of a lock-up restriction that results or could result in a sale into the public market of an amount of securities that has the potential to impact the public market.

We also believe that the date for public disclosure should be from the first date on which an officer or director may sell shares into the public market pursuant to a waiver, not from the date of the release or the waiver.[25] The agreement of the book running lead manager to waive or release a lock-up provision may occur many days before the first date that a sale may be made. The market requires the information about the impending

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[23] We believe that, because the lock-up notification and announcement requirements are only triggered in the case of a waiver of any "restriction on the transfer of the issuer's shares," the proposed rule would not require members to notify an issuer or announce a waiver that only permits the registration or assignment of locked-up securities of an officer or director. Moreover, we request confirmation from the SROs that the proposed rule would not apply to the expiration of any lock-up restriction, as the issuer and market are already aware of the expiration date of the lock-up restriction.

[24] In rejecting a similar comment on the proposal published in the NASD NTM, the NASD stated that "the fact that the shareholder or issuer no longer has accepted market risk with regard to those securities is information that should be available to the market." SEC Release, at 77813.

[25] We believe that the date of public disclosure should calculated using the same date that triggers the 15-day quiet periods under the research analyst rules of NYSE Rule 472(f)(4) and NASD 2711(f)(4). The NASD and NYSE have clarified that the 15-day quiet periods in the research analyst rules are triggered on the first date that a shareholder may first sell their shares pursuant to a waiver. *See*, NASD Notice to Members 04-18 (March 2004), at 236.

sale shortly before such sale may be made, not several days in advance. Moreover, we believe that a two-day advance disclosure is not needed for such information. It has long been deemed to be sufficient for market-impact information to be disclosed before the opening of the trading session that may be impacted by the information.

With respect to the means of public disclosure, we believe that it is more appropriate that the issuer control the release of information regarding sales of its securities by its officers and directors. We also recommend that the issuer not be limited to releasing information through a press release, but rather be permitted to release the information through any method permitted by SEC Regulation FD.[26] Therefore, if the SROs adopt a disclosure requirement at all, we recommend that the proposed lock-up restriction rule be amended to require that the underwriting agreement obligate the book-running lead manager to "notify the issuer at least two days before the impending sale of securities into the public market pursuant to any waiver or release of a restriction" and obligate the issuer to "announce through any SEC Regulation FD compliant method the waiver or release of a lock-up restriction before the opening of the first trading session in which such sale may occur."[27]

Allocation of Returned Shares

Proposed NYSE Rule 470(D)(3) and NASD Rule 2712(e)(3) would provide that the agreement among underwriters must require that any returned shares be used to offset any syndicate short position or, if no syndicate short position exists or has been covered, be offered at the public offering price to customers to fill their unfilled orders pursuant to a random allocation methodology. We are pleased that the SROs have modified this proposal from the original version published in the NASD's 2003 NTM to harmonize with NASD Rule 2790 and SEC Regulation M. There are, however, a number of difficulties attendant on the application of the proposed rule to the different situations under which securities are returned to the underwriters,[28] which are not addressed by the proposal. These include the requirement to allocate securities to unfilled indications of interest when the trading market is trading below the offering price, and the treatment of securities that are returned many days after the offering when it may no longer be appropriate to allocate securities to unfilled indications of interest. The proposed rule also does not provide members with the alternative, historically available under Regulation M, to place any returned shares in the member's investment account in order

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[26] In making this recommendation, we are not agreeing that information regarding the waiver or release of a lock-up restriction is necessarily material information subject to SEC Regulation FD, NASDAQ Marketplace Rule IM-4120-1, or NYSE Rule 202.05.

[27] The NASD has imposed obligations on issuers in other situations through its authority over a member's participation in a public offering. *See*, the NASD's regulation of rollup transactions in NASD Rule 2810(d).

[28] Securities sold in a public offering may be returned to the underwriters due to, *inter alia*, failure of the investor to pay for the securities, cancellation of a sale due to an error in allocation, or a failure of settlement of the transaction.

to ensure that the member meets the requirements of the definition of "completion of participation in a distribution," pursuant to Rule 100 of Regulation M. A number of these problems would be addressed by limiting the application of the proposed rule to situations where the aftermarket is trading at a premium to the IPO price.

We also believe that the proposed rule should not apply to securities that are the subject of a *bona fide* sale, *i.e.,* where the investor fails to pay for the security. Such securities should not be considered "securities returned by a purchaser" that are subject to the proposed rule, because the securities have been sold. In this case, the underwriter is bearing the market risk of the failure of the purchaser to pay for the securities and should be permitted to place the securities in the member's trading account and sell the securities at the current market price.[29]

In response to the SEC's request for comment,[30] we also recommend that the SEC amend the definition of "completion of participation in a distribution" in Rule 100 of Regulation M to provide that allocations of returned shares in compliance with the SRO rules would not be deemed to continue a distribution. We are concerned that, without this change to Regulation M, a member's allocation of securities to customers' unfilled indications of interest subsequent to the commencement of aftermarket trading may be considered to be new sales of securities that continue the distribution with the result that members' market-making purchases in the aftermarket may be deemed to be in violation of Regulation M.

Definition Of "Initial Public Offering"

NASD rules do not include a definition of "initial public offering." However, NYSE Rule 472.100 defines the term to apply to the initial registered equity offering by an issuer, regardless of whether such issuer was previously subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 ("1934 Act"). It is clear that the SROs intend that certain of the IPO Proposals apply only in the case of equity IPOs consistent with the NYSE definition.[31] We recommend that the NASD clarify the application of proposed Rule 2712 to IPOs by adopting the same definition of IPO as that contained in NYSE Rule 472.100. However, the definition must be further clarified in order to exclude offerings of types of equity securities that are not subject to the potential for aftermarket abuses that are associated with corporate IPOs because the aftermarket for such offerings have historically traded at a discount to the IPO price. Therefore, we believe that the term "IPO" should not include offerings by

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[29] If, as we have recommended, the SROs limit the proposed rule to IPOs when the aftermarket trades at a premium to the IPO price, there should be few occasions when an investor reneges on a purchase agreement.

[30] *See,* SEC Release, at 77816.

[31] Since the NYSE definition requires that the offering be "registered," an IPO would be limited to a U.S. registered IPO.

limited partnerships, limited liability companies, real estate investment trusts, and any other offering structured as a "direct participation program,"[32] and closed-end funds. Moreover, the term "IPO" should not include offerings of trust preferred, preferred and convertible preferred securities. In addition, the term "IPO" should not include any offering of a corporate equity security that would technically come within the definition because the company has not previously registered the security with the SEC under the Securities Act of 1933, if the security is already listed on a national securities exchange or The Nasdaq Stock Market.

Definition of "Person Associated With A Member"

The NYSE proposes to define the term "person associated with a member or member organization" in NYSE Rule 470(F)(1) by reference to Section 3(a)(21) of the 1934 Act. This definition incorporates the definition of "person" in Section 3(a)(9) of the 1934 Act and, therefore, would bring under the proposed rule corporations and other legal entities that have a control relationship with a member of the NYSE.[33] In comparison, the NASD's definition of "person associated with a member" in Article I, Section (dd) of the NASD By-Laws specifically limits its scope to those associated persons of NASD members who are natural persons, consistent with the historical limitations on SRO jurisdiction to SRO members and the natural persons who are associated with such members. Since the prohibitions of the IPO Proposals are clearly intended to apply only to members and their registered representatives that engage in sales of securities, we recommend that the NYSE either amend the proposed definition to clarify that it would apply only to natural persons or adopt the NASD definition.

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[32] *See*, definition of "direct participation program" in NASD Rule 2810(a)(4).

[33] We believe that this extension of "associated person" to entities that may be affiliates of members was unintended.

We hope that these comments will be helpful to the Commission. We would be pleased to discuss any aspects of these comments with the staffs of the NYSE, NASD or SEC. Questions may be directed to Peter W. LaVigne (212) 558-7042 or Suzanne E. Rothwell (202) 371-7216.

Respectfully submitted,

/s/ Dixie L. Johnson

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