The
LeGaye Law Firm P.C.
www.LeGayeLaw.com
Tel: (281) 367-2454
Fax: (866) 338-6353
2002 Timberloch Drive, Suite 200 ◇ The Woodlands, Texas 77380

March 14, 2011

Via E-Mail To: pubcom@finra.org

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

RE: FINRA Regulatory Notice 11-04, Proposed Amendment to FINRA Rule 5122 to Address Member Participation in Private Placement

Dear Ms. Asquith:

On January 11, 2011, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 11-04 (Regulatory Notice) seeking comments on its proposal to amend its rules governing member participation in private placements through a proposed amendment to FINRA Rule 5122 (Proposed Rule Amendment"). As stated by FINRA in the Regulatory Notice, the Proposed Rule Amendment is meant to provide investors with additional protection from fraud and abuse, by expanding Rule 5122 to reach all private placements in which a member firm participates—not just those in which the member firm (or its control entity) is the issuer.

While we believe that the intent of the rule as set forth in the Regulatory Notice is honorable, we also believe that the sponsors and issuers of private placements are already subject to federal and state regulations, and as a result, a number of our clients have expressed numerous concerns that are discussed below.

Participation in a Private Placement

The proposed amendments incorporates the definition of "participation" from Rule 5110 (Corporate Financing Rule), which corresponds to the types of services typically provided by a broker-dealer in a private placement. The definition includes participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis, furnishing of customer and/or broker lists for solicitation, or participation in any advisory or consulting capacity to the issuer related to the offering, but not the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEC Rule 13e-3..8.

By applying the definition to all broker-dealers, and not just those who were affiliated under the current rule, participation in a private placement in the Proposed Rule Amendment would appear to apply to broker-dealers engaged in mergers and acquisitions and investment banking firms. While historically, FINRA has focused on private placement investments that have been referred to as Direct Participation Programs (DPPs), and or "Pooled Investments" (such structures being referred to herein

as "Pooled Investments"). The Proposed Rule Amendment as currently drafted, will have a significant, adverse affect on broker-dealers that are not engaged in the typical "Pooled Investment" products, but are engaged in negotiated private placement transactions with both qualified purchasers and accredited investors, in conjunction with their legal and accounting professionals (such transactions being referred to herein as "Negotiated Transactions").

In Negotiated Transactions, there are typically a minimal number of investors. A transaction is proposed (generally in a short summary or term sheet), and once a proposed investor expresses an interest in the transaction conceptually, the sponsor/issuer and the investor negotiate the overall terms of the transaction. The result of such negotiations are the drafts of the closing documents which are prepared, and ultimately finalized. Generally, when the documentation is finalized, the transaction "closes." Funding of the investors' financial obligation then occurs as negotiated, with actual funding being made to the investment entity structured for the specific transaction. As a result of the transaction flow on a Negotiated Transaction, it is clear that the Proposed Rule Amendment does not address the business realities of Negotiated Transactions, both as to filing requirements, and the exemptions granted for investors.

The Proposed Rule in its current format appears to require the deal proposals, term sheets and each revision to be filed with FINRA. As the Proposed Rule's intent is presumably to address Pooled Investments (syndications, hedge fund offerings, and the like), we believe that it would be appropriate for an exemption to be made for Negotiated Transactions.

Furthermore, since market regulation issues related to private placement transaction transgressions appear to be limited to certain broker-dealers and individuals, it appears that it would be sound regulatory rule-making to only require filings for broker-dealers that are new to private placements, and to those firms that have a history of private placement transgressions. Such a precedent already exists in the form of the FINRA's advertising rule that requires all firms to file their advertising for the first year that such is utilized, but thereafter only requires future filings for certain products offered to the public or where FINRA has determined that a problem may exist. Perhaps all broker-dealers could be required to file their deals for the first year that they offer pooled private placements, unless FINRA exams or reviews of the filed documents indicate material problems. If problems were detected, a longer filing period could be imposed. This approach would provide for the protection of the investing market, while not overly burdening those firms that are currently in compliance with the intent of the Proposed Rule Amendment.

Finally, the Proposed Rule Amendment may result in having a "chilling effect" on the private placement market to the extent FINRA requires pre-filing on all private placements. Additionally, FINRA's right to "subsequently determine" if the disclosures are inadequate gives FINRA no information that is not currently available to it through its audit program, and it only has the potential to create additional confusion to those marketing Negotiated Investments. State laws and SEC rules and regulations provide ample guidance on this matter; additional rules only exacerbate the ability of a compliant firm to navigate the regulatory minefield regarding the offering of investments.

Disclosure Requirements

FINRA proposes that member firms participating in a private placement of securities issued by affiliates of the broker-dealer, alert investors to potential conflicts of interest. Specifically, the proposed amendments require that the offering document disclose if a participating member is an affiliate of the issuer and the nature of the affiliation. We believe that the anti-fraud provisions of section 10(b) of the Securities Exchange Act of 1934 and corresponding legislation as implemented by the various state

jurisdictions, currently address the disclosures discussed in the Regulatory Release. The conflict of interests discussed are in fact material, and the failure to include them in a disclosure document could subject the issuer and selling group to enforcement action from the respective states and the Securities and Exchange Commission ("SEC"). To this end, should it be determined that there was a violation of the anti-fraud provisions of state and or federal rules, FINRA clearly could implement an enforcement action under NASD Rule 2110 for a violation of just and equable standards.

Notwithstanding the above, to the extent the Proposed Rule Amendment is implemented, we believe that it is critical for FINRA to clearly set forth the disclosure standards so as to provide membership with clear guidance on what disclosures would be adequate.

Elimination of Wholesaling Exemption

The proposed amendments eliminate the existing exemption under Rule 5122(c) for offerings in which a member acts primarily in a wholesaling capacity. The basis for this exemption was that distribution of the private placement by independent retail broker-dealers would obviate the need for the rule, which focused on private placements in which the selling member or its control entity was the issuer. FINRA stated in the Regulatory Notice that due to enforcement action related to a private placement made by a broker-dealer who acted in a wholesaling capacity with an affiliated with an issuer demonstrated the need for more investor protection.

We respectfully believe that the elimination of the exemption should not be based on the assumption that the current rules do not work. In fact, the disclosure of the enforcement action implies that the rules do in fact work, and that given adequate resources, FINRA is able to locate and deal with fraud. Additionally, we would note that the elimination of the exemption will not stop those intent on committing fraud, it would only further impair the ability of those intent on complying with federal, state and FINRA rules and regulations to raise investment capital thorough the private placement of funds.

Conclusion

In summary, we believe that goals set forth in the Regulatory Notice regarding the Proposed Rule Amendment are important to investor protection, but we also believe that FINRA member firms do not need additional rulemaking to protect investor needs, and to the extent implemented, care needs to be taken to not have a material adverse impact on the capital markets by further restricting a broker-dealers ability to be complaint from a regulatory basis, while also engaging in its business. Thank you for your consideration of our comments. Should you have any questions, please contact the undersigned at 281-367-2454.

Respectfully submitted,

Daniel E. LeGaye
The LeGaye Law Firm, P.C.