SEC ADOPTS AMENDMENTS TO RULE 105 OF REGULATION M

On June 20, 2007, the Securities and Exchange Commission (the “SEC” or the “Commission”) voted to adopt amendments that significantly modify Rule 105 of Regulation M, which restricts purchases of securities in a public offering by persons who have made a short sale shortly before the offering price is determined.

The amendments will become effective 60 days after the Commission’s release is published in the Federal Register. While the principal change to the rule was clear from the discussion at the Commission meeting, the scope of two exceptions that will be included in the amended rule were less clear. There were indications that the final wording of the amendment is still being drafted. We will circulate an update when the Commission’s release is published.

Rule 105 currently prohibits a person from covering a short sale with securities purchased from an underwriter or a broker or dealer participating in a firm commitment offering, if such short sale occurred during the rule’s restricted period.1 In December 2006, the Commission proposed to amend Rule 105 to delete the “covering” element of the rule, and simply prohibit a person from purchasing securities in a firm commitment offering if that person had sold the same securities short during the restricted period.2 That change was approved at the June 20, 2007 Commission meeting. In response to comments on the proposal that this absolute prohibition would be too draconian and would impede capital formation, the SEC will include two exceptions in the amended rule, although the precise contours of the exceptions are not clear at this time.

First, a person who sold securities short during a restricted period may make a bona fide purchase of the same securities during the restricted period to cover that short sale, and would then be free to purchase in an offering of those shares. This exception appears to be addressed to situations where a person sold short at a time when the person had no knowledge that an offering was to be made, but would like to purchase shares in the offering. In other cases, a person may have been aware of an upcoming offering, but made a short sale of shares of that same issuer. If that person desired to make a purchase in the offering, he or she could effectively “cure” the

1 17 CFR 242.105. The restricted period is the shorter of (1) the period beginning five business days before the pricing of the offered securities and ending with the pricing, or (2) the period beginning with the initial filing of a registration statement or notification on Form 1-A and ending with the pricing.

short sale with a bona fide purchase of shares in the market. The release may contain guidance on what the SEC will consider a bona fide purchase, but it appears that the market purchase will have to be made at least one day before the pricing of the offering.

Second, the SEC determined to include an exception providing that securities positions and trading in accounts that are separately managed and that trade independently do not have to be aggregated for the purpose of applying the prohibition of the amended rule. This provision essentially focuses on the question of who is the “person” whose trading activity must be considered in applying the rule. The discussion at the Commission meeting indicated that the exception would be available with respect to a family of registered investment companies, as well as to a person that owned separately managed accounts with different advisers. It appears that each of the funds and accounts could be considered separate “persons.” For example, where an individual has multiple separately managed accounts, a short sale could be made during the restricted period by one account, and another account could purchase the same security in a firm commitment offering. While the SEC staff indicated that this exception is intended to provide “considerable structural flexibility,” the range of entities and accounts that will qualify for the exception is unclear.

As noted above, we will prepare an update after the Commission publishes its release adopting the amendments.

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