RECORD OF PROCEEDINGS

SECURITIES AND EXCHANGE COMMISSION

ADVISORY COMMITTEE
on
SMALLER PUBLIC COMPANIES

First Day of Meeting
October 24, 2005

9:30 a.m.

Securities and Exchange Commission
Multi-Purpose Room L006
100 F Street, N.E.
Washington, D.C.

TABLE OF CONTENTS

P R O C E E D I N G S

The following Members were present in person:

Patrick C. Barry

Stephen E. Bochner

Richard D. Brounstein

Pastora S.J. Cafferty

James A. “Drew” Connolly, III

E. David Coolidge, III

Alex Davern

Joseph "Leroy" Dennis

Janet Dolan

Richard M. Jaffee

Mark Jensen

Richard M. Leisner

Robert E. Robotti

Kurt Schacht

Ted Schlein

James C. Thyen

John B. Veihmeyer

Herbert S. Wander

The following Members were absent:

C.R. "Rusty" Cloutier

Deborah D. Lambert

Scott R. Royster

The following Official Observers were present in person:

Daniel L. Goelzer

Jack E. Herstein

The following Official Observer was absent:

George J. Batavick

The following SEC personnel were present in person:

Anthony G. Barone

Alan L. Beller

Chairman Christopher Cox

Mark W. Green

William A. Hines

Gerald J. Laporte

Kevin M. O’Neill

****

MR. WANDER: Why don’t we begin our meeting and we'll call the meeting to order. This is a meeting of the Securities and Exchange Commission advisory committee on smaller businesses, and as you will notice from our program, it says, "Opening Remarks," but it doesn't say from whom, so we are fortunate this morning to have Chairman Cox here to start with some introductory and opening remarks. It is our pleasure and Jim and my pleasure to introduce him to all of you.

CHAIRMAN COX: Thank you very much.

First of all, thank you for being here. Thanks for what you are doing -- members, observers, everybody here, and I am getting the front end of what will be two more days on top of the nine months that you have already put in, so I just want you to know how deeply appreciative not only am I as Chairman, but all of the Commissioners and the professional staff of the Securities and Exchange Commission for what you are doing.

This advisory committee was established even before I became Chairman, but I have been a supporter of what you have been doing even before the President nominated me. This is a wonderful purpose and the SEC is very, very much in need of the information and the guidance that you are going to provide, and as Chairman I will be very interested in receiving your work product at the beginning of next year. So I want to state that at the outset.

Second, since I haven't had a chance personally to meet with many of you, just a little bit about my background that perhaps you didn't know. In addition to serving in Congress and serving as a securities practitioner, I actually started a small business at one point and it was smaller, I hope, than most of yours. I hope you have grown, all of you, a little bit bigger than Context Corporation, which I started out with my dad in the 1980s. It had an interesting business. It translated in real-time Pravda, which was the Soviet Union's major newspaper, if one can call it that, and we distributed this product, which was a complete replica of the Russian original except in English, graphically identical in every respect, typefaces matched from cyrillic to roman and so on, radio and TV listings, editorial cartoons -- as if the rest of the newspaper were not an editorial -- in 26 countries around the world.

It was a fascinating thing to be involved in something that was brand new. Nobody had ever tried to and nobody has since attempted to translate in real-time an entire newspaper, a daily, and reproduce it this way. It took a team of 50 full-time translators to do that. But it was an impressive thing for me to watch this organism, to watch the way a small business develops.

I had perhaps more realistic, in terms of scale, experience as a lawyer working with small companies, venture capital financed companies -- in fact, some venture capital firms out in California, mezzanine level companies and early stage public companies.

What I discovered as a result of all of that animated a lot of what I did in Congress over 17 years. I came to the firm conviction that small business is the critical engine of growth in the United States of America, that small business really does drive innovation. It really is the genius of our system and albeit a great many enormous multinational companies have acquired the successes of smaller businesses along the path of their growth. Without the small business engine America and indeed the world wouldn't be what it is.

We are critically dependent as a nation and as a global economy on small business, and so from the standpoint of the Securities and Exchange Commission, it's going to be very, very important for us to keep this alive, to make sure that we are focused on what is necessary for capital formation, a key part of the SEC's mission and also one of the principles that you have adopted here, to make sure that we are doing everything necessary for investor protection, because if investors don't have confidence they won't continue to put their money into small business and the investor protection is also one of the critical missions of the Securities and Exchange Commission.

The entirety of the principles that you have adopted, beginning with investor protection, is a perfect fit, I think, with what the Commission has in mind for this advisory committee and for ultimately what our aim has to be as regulators. Investor protection, balancing costs and benefits, we really need your guidance in this area because we want to make sure that we are spending essentially the economy's money wisely in achieving the benefits that Congress intended when they passed Sarbanes-Oxley, for example.

Maintenance of our culture of entrepreneurship I think refers directly to what I just remarked upon --

encouraging capital formation, as I mentioned, is what we need to be all about and lastly keeping it simple, perhaps that is the rabbit in the hat of this whole exercise, because it is very easy to be for all the above, but doing it and not missing our stride is going to be much, much more difficult.

Godspeed in this mission. It is very, very important. I want to thank you for what you are doing and I want you to know, since you are all such busy people, I am pretty sure that we picked the right people. As Alan Beller's fond of saying, "If you want a job done right, pick a busy person to do it." We have a grouping of people that fit that description to a T, and I am extremely impressed that notwithstanding how busy you are and how much time you put into this already, you want to have even more meetings perhaps than we could immediately pay for.

I want you to know we are going to finance as many meetings as you need to have because we want to get this job done right. We are behind you to the hilt.

Thank you very much for what you are doing. Good luck. I had a chance to meet with Jim and Herb for the second time this morning. I am very much, as you know, looking forward to receiving your final recommendations early next year, and I hope that we can move on them with alacrity here at the Securities and Exchange Commission. Thanks very much.

MR. WANDER: Thank you.

(Applause.)

CHAIRMAN COX: Thanks.

MR. WANDER: We are also fortunate to have Alan Beller with us this morning, who is also going to provide us with some opening remarks.

MR. BELLER: I'm really not going to attempt to follow up on that. I think Chairman Cox said essentially everything that I would say. I have been speaking with him. I have been speaking with other members of the Commission. They continue to be very, very strong supporters of the idea of this committee, and more importantly, they continue to be very, very strong supporters of the work that this committee is doing. They look forward to seeing the recommendations. Given the work that has been done, I am confident that those recommendations are going to be taken very seriously.

The Chairman has indicated that. I think the Chairman and I are committed to getting those recommendations the prominence they deserve and getting them considered on an expeditious basis. I know some of the things you have been talking about have been around for -- not quite as long as I have, but, you know, 20 years, and they are entitled to serious consideration by the Commission, and that is what you will get and what your recommendations will get.

Beyond that, I know you have a lot of work to do over the next two days, and I am not going to take up any more of your time. Jim, the meeting and Herb, the meeting and the floor are yours. I thank you for your work today, and I wish you Godspeed as you continue it over the next couple of days and thereafter. Thanks very much for being here and thanks for doing this.

(Applause.)

MR. WANDER: Good morning, everybody. I hope you are satisfied with the arrangement, the way we have set up the tables. We have each of the subcommittees together, and I think this room is quite appropriate for our meetings today and tomorrow.

You'll notice on the agenda for today that after the opening remarks we are going to have a discussion and evaluation of witness presentations at recent meetings and written statements received.

I will provide a short introduction to that, but I am going to alert all of you that we would like to have this discussion to be quite thorough, quite interactive, and we are going to call on all of you to give us your views because we think it is important that the committee members express themselves and we find out where we are in agreement, and frankly, if we are not in agreement to note that and to see if we can bridge some gaps.

When we finish that, we will go into reports from the subcommittees, and what we have produced for everybody is a list of items where there appears to be alignment among the subcommittees, in the individual subcommittees, and -- away from the mike? Oh, okay. How's that? Usually they say move closer.

And so we will discuss those, not I hope in any great depth, and then we will adjourn for the day. The subcommittees will meet during the rest of today, so that when we open our meeting tomorrow morning at 9 o'clock, we will have consideration of subcommittee reports and recommendations and at least narrow the recommendations so that at least we can begin fresh to start putting together our final recommendations in due course, so that we can present them to the Commission, and then at the end of tomorrow's session we will really look at next steps and the timetable and outline how we will prepare our final report and recommendations.

Jim, did you have any comments that you would like to make?

Before we go into the discussion of what we have learned, I would like to mention a couple of things that have happened that you should be aware of, in case you haven't seen or heard of them yet.

First is that the COSO report will be published I think tomorrow. Some of us received an advance copy over the weekend. It is going to be voted upon, I think, today, if that is correct, and will be out tomorrow. It is about this thick (indicating) and all of you will get a copy. Don't do what I did. I printed it out at home on my home printer, which took over an hour and a half, so do it in your offices. But that will be a document that we will want to review, particularly Janet's subcommittee.

The other thing that I would like actually to mention to Dave -- your subcommittee. There are two things that have happened on the analyst front. One is that the SEC has published some interpretations of the soft dollar rule 28(e), and it is actually quite a lengthy release. Your committee may want to look at that, and if appropriate, actually recommend to the whole committee that we provide comments to the SEC on that, since that is one of topics that you are supporting and I think unanimously.

In addition to that, it has been reported, although I haven't seen the official word, that a group of regulators in NASDAQ, et cetera, have also supported some rules that would permit third -- paid for by issuers third party research, and I can't go much beyond that, other than what I sent out to everybody, but actually maybe Kurt will help us later on and discuss that, since I know he is very familiar with that.

So those are two developments that have happened just in the last two days or last week.

Now I am going to move on to the topic that I would like to devote some attention to today.

We have essentially finished our fact-finding process, and are moving onto considering our recommendations.

Our fact-finding has been quite extensive, and Jim and I believe that before moving on we should as a full committee review what we have learned, share our observations with each other, and assess the need, if any, for developing recommendations to be made to the Commission.

When we started on this journey last April we adopted five overarching principles. Let's repeat them, so that they are at the forefront of our thinking, and Chairman Cox mentioned them.

They are: further the Commission's investor protection mandate; seek cost choice benefit inputs; keep it simple; maintain the culture of entrepreneurship; and capital formation should be encouraged.

We should also keep in mind the SEC's mission, which, as you notice from the plaque up in the lobby, is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.

We have learned a lot, and not all we have heard has been consistent. That was, in my view, to be expected. It is our job now to evaluate all this mix of information, assess it, and use it as the foundation for our recommendations. Each of you committee members were selected because of your knowledge base and experience. Now is the time to utilize your skills to sift through all the information presented to us, and to help form our committee's recommendations.

Let me briefly review what we have learned.

First, we received approximately 110 written submissions in response to our request for public comment. We also received seven written comments regarding our first public meeting. We received approximately 270 on-line responses to our 29 questions and 20 written answers to those questions.

In terms of oral presentations, we had 12 in New York City in June, 8 in Chicago in August. We had 11 presenters in San Francisco in September. In addition, at that meeting we had five presenters from the Small Business Forum and we were fortunate enough to have Larry Rittenberg, the head of COSO, also make a major presentation to us.

Finally, a week or so ago we had seven more presenters in New York City.

These written and oral submissions cover the waterfront. We had accounting firms, large and small, investors, big institutions, smaller, small cap investors, buy-out firms, venture capital firms. We had company representatives, CEOs, CFOs, comptrollers.

We had organizations such as the FEI, the Society of Corporate Secretaries and Governance Professionals, the Center for Public Audit Firms.

We had many people from the analyst community. We had some attorneys. We had a lot of community bankers. We had the NASDAQ, the AMEX, and the Pink Sheets, and we had some professors.

In addition, I want to particularly acknowledge the work of the SEC staff. We have received a wealth of information from not only Gerry's staff, but also from the Office of Economic Analysis, and from the Office of the Chief Accountant.

We want to thank each of those who has helped us along this way for their splendid contribution to us.

(Applause.)

MR. WANDER: Now it is up to us to bring all this information together and use our experiences and knowledge to form a coherent set of recommendations for the Commission.

So that is my brief introduction this morning. I would, rather than start calling on people to give their views, would anyone like to volunteer to go first?

Well -- Richie?

MR. LEISNER: Well, this is the capital formation subcommittee and I pinch-hit a little bit for Dave Coolidge, who is to my left as he was making his own investigations of the capital formation in other areas during a couple of our meetings, and so with Dave's permission I am going to report briefly on I think what the sense of our committee's findings are.

You know, we did get direct testimony in San Francisco from Jerry Niesar, who was one of the founders of the ABA private placement broker dealer study group, and I think Jerry did an excellent job of encapsulating the problem there, which is how do people seeking capital tell the good guys from the bad guys in a place where lots and lots of capital is needed and lots and lots of capital is being raised by people who are not licensed as broker dealers.

The essence of that testimony I think is a request that leadership be provided to take the next step. There is a very good scholarly background in the Business Lawyer article that has been distributed and this is an idea that has been percolating through the bar and with the assistance and participation of certain of the regulators for a number of years, so the next step is for somebody to come forward and lead a project and because there are multiple agencies involved and there are lots of difficult challenges associated with this project, I think our sense is that the SEC would be the ideal agency to move that forward.

Now that is the only direct testimony that I think we experienced dealing with capital formation for smaller public companies and for private companies, but I think everybody who listened to the testimony would agree that you can learn a lot about the capital formation world by listening to what full-blown public companies and smaller public companies have experienced in the post-Sarbanes-Oxley world and from the perspective of capital formation sort of lower down in the totem pole, I think we would agree that you now need to be larger to qualify to go public than would have been the case a decade ago. It is more expensive to get to that threshold. It's more expensive to cross the threshold, and of course we have been hearing lots of testimony and the other subcommittees will talk about the nuts and bolts of life as a public company.

So the conclusion is inescapable, that lots and lots of companies that a decade ago might have been thinking about going public are thinking about something else, but they don't have less of a need for capital.

The other things they are thinking about are private capital or getting sold, and if they are continuing down their plans, maybe more so than a decade ago, something in the capital formation arena that addresses the need for capital growing companies is as important as ever, and we think our proposals, starting with the private placement broker dealer and probably the other largest proposal is doing something to relax the current prohibitions against advertising and general solicitation in the private offering area. Those are sort of the two that I guess would be at the top of our list.

Unlike some of the other committees I think our in absorbing all this testimony we kind of turned internally and I’ll let the subcommittee members disagree, but mostly we had agreement on the items that we recommended thus far.

Our challenge wasn't setting priorities and also in limiting the number of proposals we got something that's sneaking up on looking a little bit like a laundry list but we didn't have places where we had arguments that somebody didn't think the ideas were good ones.

MR. WANDER: Okay, any comments on Richie's comments? Dave?

MR. COOLIDGE: Let me just add to what Richie talked about. With respect to companies that are contemplating a public offering, clearly the landscape has changed, a lot of it due to regulatory requirements that they are facing -- the expense of complying -- and as a result there are fewer companies perhaps that have been willing to go that route, go public.

I think at the same time, though, you can't say it is strictly a regulatory environmental issue. It is also a market environmental issue. The markets have changed.

Investors are demanding I think bigger companies, greater public float that is created at the time of an initial public offering and this would be for the larger institutional investors, so even in the absence of the regulatory change you would probably have seen the bar raised for companies that were contemplating a public offering just to meet those minimums that institutional investors require from a liquidity standpoint and a market cap standpoint.

So that is sort of what has happened. Companies that are private today do have alternatives to raise capital. We have had testimony to that effect and perhaps, as Richie suggested, our committee is focused on making it a little bit easier to raise capital in the private markets because the public markets are not as available as they once were.

I think there is a whole other group of companies that sort of have found that the game has changed on them. They went public at a time when being really small wasn't as big an issue from a regulatory compliance and cost standpoint and also perhaps wasn't as big an issue from an investor standpoint, so there's lots of companies out there, the small public companies, that are being pressured on the cost side because of the regulatory environment and also being pressured on the investor's side because there is a lack of investment research for these companies.

There is a lack of interest in a lot of

institutional investors for these companies and they are feeling orphaned, I mean, and I think there's lots and lots and lots of public companies out there that don't feel that they have the support they need or the interest that they need to continue as a public company, and again it was both the market changing situation and a regulatory changing situation that created a situation where more of these companies felt orphaned.

Investment research is a topic that we discussed. It's been testimony from several people. Clearly research budgets at the Wall Street firms have been cut pretty dramatically. Lots of companies have been dropped. There's many, many companies out there that are public, so, as Richie said, this creates a dilemma and one of the things that we have addressed in our committee is this going private issue.

If you are caught as a company in a position where it's not attractive to be public, it's not interesting to be public, one of the options is to go private, and the rules for going private are quite difficult, and the smaller you are again the more expensive it is to jump through all those hoops and accomplish what you may think is good for your company, which is getting out of the public market.

So we want to encourage capital formation. We want to make it attractive to go public and not too burdensome to go public. At the same time, if the public markets are not the right place for companies, we don't want to make it terribly burdensome to go in reverse, because the rules of the game have changed, so I think that is an area that we are interested in creating some additional relief for smaller public companies.

On the other hand, there is one thing going on. We didn't have a lot of testimony from venture capitalists, but Ted Schlein, who is not here at the moment, is in the venture business. The amount of capital that has been raised in private equity funds has grown very, very, very dramatically, so there is a viable private alternative for many companies.

It is not easy to get money from some of these sources, so you have to be a very well-qualified company, but fortunately offsetting this lesser access I think to public capital, there is substantial private capital that's been put together to provide investment capital for companies that need it and want it.

So it is a curious situation I find that we are dealing with, which is lots and lots and lots and lots of smaller public companies and they don't really know if it's a great place to be because of the cost of the regulatory environment and the potential, you know, orphanage or lack of interest on the part of the investment community, and again on the research side we have talked about that and you noted at the beginning that there's some movement at the SEC and with other regulators that are going to encourage the continuation of research, facilitate the flow of dollars to pay for that research for those companies that want it to stay public. That is a very critical thing that they need to have in order to get their story out and be an attractive investment for lots of investors.

So I think we have kind of focused on the right issues, but we are dealing with a market and a regulatory environment that is different than it was five and ten years ago and it's -- you know, I don't think we can turn the clock back and say it's going to be just like it was ten years ago and practically anybody could go public -- and did.

But I think many of the recommendations that we are contemplating making do try and make it easier for those smaller public companies to either stay in the market, get research coverage, lessen the burden, or if they want to opt out, make it a little easier for them to opt out.

So anyway, those are my general remarks.

MR. WANDER: Thanks, Dave. I just would add one other thing to this analyst coverage. The SEC, as you know, has adopted some rules recently for larger public companies, particularly in the securities offering area, and it's very clear that the existence of analyst coverage, the "eyeballs," as Alan Beller called it, is a real plus in the regulator's eye because it means somebody else is looking at the company so that the enforcement division isn't as active in that area, so it is another reason for that.

Drew? I saw you move the microphone.

MR. CONNOLLY: That was your first clue.

Well, thank you, and I most assuredly want to echo Dave Coolidge's and predecessor to that Richie Leisner's remarks because they do sum up, almost leaving nothing for me to add, but there are several interesting footnotes to our activities that hopefully we can take some credit for already.

I am looking at an NASD notice to members that came out in September where they are soliciting from their members and presumably the public as well commentary on enhanced short interest reporting. As you can recall from our last hearing, that was a big issue for me. It doesn't specifically address the bulletin board of the Pink Sheets but obviously we're early days.

It seems to me at least at the micro-cap tier of the marketplace and the individual investor portion of the marketplace there is an untoward focus on whether or not short selling has been either naked or covered short selling has been in somehow a manipulative market practice. I think that one of the hallmarks of this committee, when we finally tender our report, should be that we have examined this issue so as to give confidence on a go forward basis.

The other part that I would like to comment about Mr. Coolidge's presentation is the whole focus of research, both brokerage firm, investment banking firm sponsored research on the buy side, and then quite frankly the resurrection of issuer paid research as a model to attract qualified -- whether they be CFAs, whether they be members of the National Institute of Investor Relations, whether they be other standards credentialed organizations. Companies are going to be given an opportunity to tell their story and expose their company, warts and all, to the investor public, and I think that clearly in the internet age and the immediate ability to do research, do a wider and broader audience, that is a very, very good thing.

Then finally, just in terms of the issue of going private and how we make that simpler, or propose to make that simpler, one of the things I hope we focus on, and this really was part of the testimony I gave last year, on the House Financial Services Committee, is the focus on investors who were already in.

One of the concerns I guess on a proactive, going forward basis is the investor protection side of things, one part of that investor protection has to be protecting the folks who are already invested, as opposed to preventing folks from bad choices going forward, so I hope we focus there as well, and once again second the prior comments from the capital formation committee.

MR. WANDER: Dave?

MR. COOLIDGE: I just remembered there is one item I didn't mention that I think I want to keep everybody informed, and it has to do with the trading markets, the NASDAQ and I think one of our main focuses has been the over-the-counter bulletin board market and the fact that the NASDAQ in effect transferred that over to the NASD and, you know, we did have some testimony that was very concerned about whether that was going to be a successful transition and going forward the bulletin board market was going to be a well maintained and viable market.

Our committee has the same concern, not that we have any reason to believe it won't be maintained as a viable market, but just that the focus, the emphasis, the energy, the dollars to support it were quite focused on making sure that that occurs, that it doesn't become -- you know, not only do our companies that are traded there become orphans but the market itself becomes an orphan.

Somebody with a real desire to make that a good place for a lot of these smaller public companies to trade and the resources and the energy to make sure that it is maintained as a good market -- I mean promoting a market like that or maybe promoting is not the right word, but keep it as a market that investors like to deal in and have confidence in is very, very important to these smaller public companies.

If that market were to deteriorate, it would not be good news for capital formation. It would not be good news for these companies, and so, you know, that is really in the NASD and the NASDAQ's control at this point in time, but whatever this committee can do to make sure that the pressure is on or the heat is on to make that a very viable market and put the necessary resources into it to continue it is another focused topic of our committee.

MR. SCHACHT: Can I ask one question of this group? I don't care who answers it, but just on this notion of lesser access to capital or is the access the same, there is just a higher cost related to the integrity of the numbers?

What comes to mind is the testimony we heard in San Francisco from one of the underwriter folks, and I forget who it was, but mentioning that in their view people are still going public, the ones that want to go public are going public. They are making that decision to do so, so there is not really a lesser access to public capital.

MR. COOLIDGE: Well, I guess the way I describe it is that it is up to the owners to decide whether they want the company public or not and what you without question see in today's markets is private equity sponsors being the owners, the decisionmakers on that go-forward to a public market, and they are doing it because they feel it is in their best economic interest to do that.

Ted is not here, but he mentioned, you know, one of his portfolio companies, they did the work, they figured that this was a viable public offering candidate and they went to the management and said, "Come on, this is what we want to do," and the management said, "We don't want to go public. I mean it's just going to create a whole series of issues for us -- time distractions, expenses to the bottom line, et cetera, et cetera, et cetera."

And in this particular case Ted's firm had control of the situation and they said, "You are going public," you know, and so that was the end of the story, but some of these, say, family-owned companies or management-controlled companies, the willingness or the interest in being public has definitely declined because of the regulatory hurdles and so the capital is out there. I think that's probably what the testimony said, for those companies that do meet the minimum standards, and as I said in my earlier remarks, the standards have clearly gone up.

There's just not the same level of interest in the really small public company, and I don't know how you want to define it, but the way that we define it at our firm is minimum $50 million to do an IPO, minimum $150 million market cap to go public. I mean that is where we draw the line.

Now others may draw the line lower. Other bigger firms probably draw the line higher, but that is what is going on in the marketplace. Underwriters are setting their standards at a level, and that is -- you know, when a company goes in and talks to a very major underwriting firm, you know that those numbers are going to be higher. When he talks to our firm, which specializes in small to mid-size companies, you know, that is what we consider the minimum.

Now there are others that will do smaller deals, but I would say that the intermediaries, the underwriting community, has clearly raised the bar so the access is not as ready as it was historically for smaller companies, for smaller deals.

So, you know, it can get done, and maybe it gets done in a public mode, but it isn't really a full-blown public offering and you don't get to the NASDAQ daily quotes, et cetera, et cetera, unless you meet a lot of these minimums, and you certainly don't attract the kind of investors that most companies want to have if you don't get to these minimums.

A lot of it has had to do, as I said, with the marketplace. You have seen a good example of a T. Rowe Price that used to have, you know, a few billion under management, and we would sell them $20 million IPOs all day long. Well, now they have got a hundred billion under management and they are just not going to play at that really small company level. They've got to see bigger companies, bigger deals, so the consolidation on the buy side has created some of this.

As I said, it's a marketplace phenomenon as well as a regulatory issue, so, you know, the capital is out there, but clearly the rules I think and the minimums for going public have changed pretty dramatically in the last five to ten years.

MR. JENSEN: Can I follow up? I'm sorry. Go ahead.

PARTICIPANT: I’ll yield.

MR. JENSEN: Well, I think that is an interesting point. I think we ought to drill down on that a little bit, because it seems like the notion of the aggregation of capital into larger and larger funds is a marketplace dynamic that is undeniable, and I think as a result of that it has caused IPO candidates to actually have to raise a lot of capital because it takes as much time to invest $5 million as it does to take to invest $50 million.

So the question is is it -- what is really the driving force? Is it the capital aggregation that is going on in the centers of that capital, or is it the burden of being a public company and cost, the regulatory cost, of being a public company, because that about -- it's not the same necessarily but it is -- there's a lot of cost you have regardless of what size you are.

MR. COOLIDGE: I think there are both dynamics going on at the same time. In my opinion, it raised the bar.

MR. WANDER: Anybody else have any comments?

MR. BOCHNER: I guess this is a little bit between the 404 subcommittee and the capital formation subcommittee, but talking about public offerings, I think we would hopefully all agree that 404 seems to be the biggest cost area that people have addressed concerns about in our testimony or written responses, and so I'm wondering about the Capital Formation Subcommittee's thoughts about the impact of 404, in particular, on the IPO process and whether the existing -- or maybe I ought to broaden it to all of governance reform.

You know, we've got this huge new set of rules in the governance disclosure, internal controls and other areas, that apply to companies going public, although we do have some phase-in periods. We have phase-in periods for board independence. We have some phase-in for 404.

And I'm wondering whether we have evaluated enough the -- whether those timelines, that relief is appropriate for a company going public, particularly in the 404 context. In other words, is that creating a chilling effect, that huge cost?

And I think that's sort of a classic investor protection versus cost kind of an issue. Because, on the one hand, you'd like to have the best internal controls possible for a company going public. On the other hand, we've got to get companies public. We need to encourage capital formation.

And as we've seen, until we solve this issue for smaller public companies, it's just such a large cost, a large component for a small company trying to get public and raise money.

MR. CONNOLLY: I'm going to take a first crack at that, Dave, if I may?

David is obviously still a major bulge bracket investment banking firm. I come out of.

MR. COOLIDGE: I wish.

MR. CONNOLLY: I got your annual report. Certainly bigger capital than I used to play with.

But I have a background on the street as well, most recently late '90s, with a smaller New York member firm, and our efforts in those days, pre-SOX, to go through the due diligence presentation material and pull together what we legally needed and what we, from the standpoint of our attorneys, needed to be a sponsoring underwriter was significant then. I can only imagine that it has gotten substantially stronger.

And, clearly, I don't think I'd want to be in

Goldman Sachs' shoes right now with having taken Refco public a couple of months ago.

My sense of it is that the information gathered and the costs attendant to pulling that capital together, almost by definition, at the smaller end is going to require bridge financing just obviously to get to the IPO.

My hope is -- and there's certainly an interesting statistic -- there's something like 5163 NASD member firms. I'm going to be looking for a number of those who will specifically state that they will reach out for a lower minimum than Blair.

Because, you know, quite frankly, the costs and the time investment are not -- if not exactly -- they are similar. So there needs to be an economic rationale for the lower tier. But, clearly, those front end expenses are a real detriment.

MR. COOLIDGE: Steve, managements are fearful. So there's just -- that's not a monetary or a financial issue. It's just, gee, do I want to be signing, you know, all those financial statements, you know, exposing myself financially and, you know, to potential lawsuits and criminal whatever.

So that's just a psychological barrier you've got to get over.

I'd say that the costs of 404 are factored into what is it going to cost for us to do this? That's going to deduct from my net income. My valuation is going to be a multiple of that net income out two years or one year. That's how these deals get put together. You look at the forward numbers. You put a multiplier.

So if that number is lower, and you multiply it, you know, and it doesn't get to the kind of minimum market cap, well, yeah, okay, that can be a show-stopper, say, that's too expensive. It's going to hit our net income too hard. We can't go public until it's a less material item.

MR. BOCHNER: Well, yeah. I think there's an additional issue which I had in mind, which is, you know, not all public offerings succeed, and I suppose the smaller the company, the less likely success. Markets can change, companies can change.

So there's a certain capital commitment that a small company makes, and it's, you know, in the order of several million dollars of lawyer fees, accounting fees, internal control consulting help. And so part of what I was thinking about was your issue, that calculus of being public.

But the other part of my issue was that up front cost and that risk you take with the up front cost. For example, if we said you ought to be fully 404 compliant on day one when you're public, because that's important to investors, you know, that's a large amount of capital and it takes a lot of maturity for a company to do that.

On the other hand, maybe we split the baby, and we say, you know, the underwriters will hopefully do due diligence on this issue. They'll look at the controls and the accounting staff and so on. And we think to encourage capital formation, let's not make the owners take that up front business risk right away, but let them phase into it over a period of time.

So that was really more the debate that was going through my mind.

MR. COOLIDGE: I think the way underwriters have dealt with that in general is, you may get a representation for the company that they will be, you know, compliant with 404 when they are required to be, after going public.

And at least I'm not aware of one where they said we don't want to go forward until you are 404 compliant, and spend all the money now before we even file the registration statement. It's been more of a forward-looking commitment on the part of companies.

And then they've got to do the numbers to figure out how much it's going to cost and whether that's going to really impact the valuation or not.

MR. CONNOLLY: Steve, there's one other issue here at the lower tier. I don't believe -- I haven't heard for years of any such thing as a firm commitment underwriting. So the underwriters are all doing best efforts underwritings, which in effect means if they can't find customers to place the offering, that offering will fail.

It's no longer an issue of a firm, an underwriting firm committing their own capital. They may on some of the larger deals, but certainly the small deals are, you know, subject to market demand immediately.

MR. JAFFEE: This is a wonderfully interesting discussion for me, and I started out thinking retrospectively because Dave and I worked on my public offering a long time ago, and certainly at the size my company was at the time we went public, we would never consider, and never could go public in the environment that we're in.

But I was really -- besides telling old stories, I was thinking about -- one of the areas I think we haven't focused on enough is looking forward rather than looking backward.

And what I mean by that is that this committee is probably unique and probably won't be reconvened or a committee like it for a long time in the future. So maybe it would be worth thinking about what's the world going to look like 5, 10, 15 years from now in terms of these kinds of issues.

And I don't see regulation being reduced, in general. And I think that's another issue that I'm focused on, because our company is an extractive industry. We mine clay out of the ground, and so we have a large number of environmental regulations which maybe other companies do or don't have.

So I see the landscape as increasing regulation, increasing cost and burden of regulation. And so this piece, this 404, or Sarbanes-Oxley, is just one more nail in the coffin of a small company that's attempting to do the right thing, as we understand the right thing to be done.

The other thing that I don't see getting any better -- maybe I'm too pessimistic, because we've certainly talked about it -- is tort reform. We got a legal system that seems to be continuously -- whether or not the -- you know, the settlements get knocked off at appeal or not, but there's -- out there there's constant threat of having your business taken away because of the legal system.

And a number of us here from Chicago are involved in the medical area, and we're the poster child for medical malpractice settlements. We just had one from the county hospital for $35 million. One individual in the hospital that Dave and Pastora and I are associated spent $60 million a year just to take care of the trial lawyers and the malpractice issue.

So, again, I'm looking at it in a broader context.

I don't think it's going to get any easier. I think that this regulation is very burdensome, and whether or not we can come up with specific examples of how it inhibits capital formation in any one individual case is not the whole thing.

The other thing that bothers me, and we have had -- we have one -- I believe an attorney who took a company public on the London market, and I forget what you call that market --

MR. WANDER: AIM.

MR. JAFFEE: AIM, yeah. You know, if you think about it -- I haven't even read his book yet, but Friedman's got this book out about the world is flat, and I heard him being interviewed by Russert on TV the other day. And I got a bunch of grandchildren, and he was making the point that they're going to have to compete with kids from Shanghai and Bombay and various places. And I'm sure that's probably true.

If you think about it going forward on a competitive basis with other areas of the world where capital may be available or where markets for trading securities may be available, I think that's an area that we shouldn't lose sight of.

I mean, if I wasn't public, and I knew all that I know now when I was thinking of going public, I'd sure pick up the phone and call the guy from this London market.

Because I'd say to myself, why do I want to expose myself to a legal system and to this 404 stuff -- and I come from a point of view which I don't believe 404 is really protecting the investor to any significant extent, so I look at it mainly just as a bunch of sunk non-useful costs.

And so if I were going public today, and I were talking to you as I did 35 years ago, I would say, hey, Coolidge, can we take this thing on the London market rather than worrying about NASDAQ or the NYSE and so forth.

I don't know whether that's -- because we're in this category -- like Dave describes, I mean, we're happy, we're public, we got a market, we got investors, and paying a dividend. Everybody is -- nobody's too unhappy. But if I could throw a switch and get private, I'd do it. But I can't. It's just too tough.

So -- I don't know if that helps, but it seemed to me -- and the subject here was to evaluate the testimony. It seemed to me that those people who are really in the trenches, dealing with the problem -- and I would characterize those people as being the CFOs that we heard, particularly in Chicago. They were crying out for help. There's a lost of cost, and they're having great trouble.

If I put it at the other end of the spectrum, the regulator who we heard in San Francisco, oh, it's easy, and every CFO can fill out the form in a day and solve the problem in a week, and the costs that we're hearing about are really over-exaggerated, and they're all going to go down in a year or two, it's real easy.

I think that the truth is closer to the practitioners of the CFOs that we heard from, that this regulation is really quite burdensome.

So I don't know if that's helpful. It's more general than --

MR. WANDER: No, we'd like to hear everybody's views. I'm going to call on Steve and then -- is there somebody over here? Or you, Mark.

MR. BOCHNER: I'll be quick here, since I kind of led down this alleyway to begin with. I guess I'd like to request, since we're -- the 404 work is still ongoing, that perhaps the capital formation subcommittee, and maybe the 404 sort of put a little note in areas to consider.

Once we figure out what the right balance is in terms of the implementation of 404 with respect to smaller public companies, we ask ourselves as a group, did we get it right for the companies going IPO for the first time?

So come back to this issue once we figure out where our 404 decisions land.

MR. WANDER: Mark?

MR. JENSEN: Yeah, I just wanted to go back. First of all, I agree with what was said. But what I wanted to do is take it back to some of the testimony we heard, and not give my own point of view, but, rather, what I heard other people say.

And, interestingly, I bring up the community banks again because we heard a lot from those guys. But there was a reoccurring theme there that that I think we may have missed. And the theme that I heard was the burden of regulation on top of regulation. It was, nothing ever got taken away, more just got added.

And you kind of get to the point after you heard that for a while, it's like, well, maybe what we've got is a system that is becoming so top heavy and so complex -- because there was also a reoccurring theme from Irwin Federman, who blasted 404, if you recall -- or Sarbanes-Oxley generally, and got an ovation for doing it. But I think he had the same theme, which was -- and he talked about competitiveness, and he's an old semiconductor guy, and he talked about how the United States was losing its semiconductor business in the '80s being beat by the Japanese because they knew how to build quality into a product, and they didn't inspect it in. They didn't have inspectors running around, they just built quality into it, and then didn't have to look at it at the end.

And he was using that and analogizing that to a regulatory system, what companies should be able to -- or should bake this into what they do, build quality into what they do, and not have to regulate it or inspect it in later.

And I think -- as a committee, I think those are some things that I took away from it. I did hear -- we did ask Bill Hambrecht -- back on your question -- if you remember, I asked him about underwriter liability, and, you know, 404 or lack of 404 certifications in registration statements, whether that gave him any problem, and he said no, and that because he had his own 33 Act liability, he had to do his own due diligence.

So now we're going to see -- because in the case of Refco there were two material weaknesses identified by the auditor. They were put into the prospectus. So you got two material internal control weaknesses identified in the prospectus, and underwriters took them public anyway, some quality underwriters, and people invested, seemingly not caring about it at the time.

And so, as an auditor, I look at it and I go, well, is disclosure enough? And no amount of regulation solves those kinds of things. The only thing that solves those kinds of things are what Irwin Federman said, which is having things baked in and built into companies that enable them to control themselves.

MR. WANDER: I'm not sure, but I think there were significant deficiencies.

MR. JENSEN: Well, okay. Well, I stand corrected.

MR. WANDER: But I've been too busy on committee work. I haven't had a chance to go read the Refco prospectus –- Janet?

MS. DOLAN: Well, I was just going to suggest a format here since maybe it would be better. Why don't I give my comments on behalf -- as the chair of the 404, and then maybe invite the rest of our subcommittee to make their comments? And we'll have perhaps a little more cohesive, and then maybe move it on to the next committee.

MR. ROBOTTI: I'm sorry. I really feel as if I've got -- one more thing that has to be disclosed on that.

MR. WANDER: Go ahead, Bob.

MR. ROBOTTI: I'm sorry. A lot of what we talked about, I want to kind of echo from the point of view -- of course, I'm an after-market participant, not a pre-market participant. So I'm not interested in necessarily as much the capital raising function, and there are alternatives to the public market.

But, you know, I think there is too much regulation. I think 404 really has to be reevaluated for the small companies, because if you change the rules to make it easier for them to exit the marketplace, and you increase their cost of regulation and the amount of regulation over time, you're going to increase the pool of companies that no longer see the public market as a place in which it makes sense for them to be.

And if you're going to ease them leaving the markets -- and one of the reasons they're going to ease the market is because of the cost of regulation. And I think, you know, therefore, that's why you really have a tradeoff here.

The cost of the regulation -- and I think specifically 404 is one of them -- is too burdensome, and you're going to encourage more companies that then go away. And from a company point of view, I am sympathetic to the company, but I also have to think about -- you know, the number one rule we all have here is investor protection.

And there's a huge number of investors. Those investors are not institutional because the institutions don't invest in this market. It is a bifurcated market. Like the small cap, microcap market is very different.

We have the institutions who become larger. Even the small cap investors become larger and larger, therefore, less willing to commit capital to this market. So because of that, you've created a huge amount of companies, with a huge number of investors that potentially we're taking away investor protections for.

The alternative is, you have to reduce the cost of it. You have to reduce the cost of it. Otherwise, I think we lose one of the objectives that we have, kind of core and fundamental.

So it's a repeated concept. We've got too much cost, probably. How do we do something? But it's from a different point of view. It's the after-market point of view, as opposed to pre-marked point of view, capital raising point of view.

Sorry, excuse me, Janet.

MR. WANDER: Before we move on to you, Janet, I just thought we haven't heard from this side of the room, Leroy's group, and I'm sort of trying to get just general views. You don't have to speak only about your own area, but I think it's worthwhile so that everybody knows what everybody else's thought process has been, and where we may have agreement or disagreement.

So any comments on a general nature?

MR. DENNIS: I wrote down some things as I was listening to everybody, and what I heard from the testimony -- and I'll just rattle some of these off, the testimony and also some of the things that we received in written comments.

We clearly heard from our -- I'm on the accounting standards committee that -- two separate sets of standards is not appropriate for the market.

We heard a lot of discussions about relationship between auditors and their clients, although I would tell you we heard a lot more of it early in the process and a lot less later in the process so at least from my standpoint tends to make me think that maybe the guidance from the PCAOB is working. We heard a lot about the ability of smaller public accounting firms to audit smaller firms, and I think we heard some of the testimony in San Francisco that that is a way to potentially broaden your competition and potentially reduce cost, although, you know, the fact is that 404, as currently written, is probably not going to -- we're never going to go back to the 1990s as to what things cost.

We heard some comments on COSO, and, really, the surprise to me was that how -- as I thought about it, how involved COSO really is in setting standards now, given that most companies in the United States use their framework to set controls, and that they really are a fairly informal organization in how it's funded and the processes they go through, although doing some very important work.

Heard a lot of companies about delisting, going dark, and I think we all agree that's probably not the best thing for the market when there's no information being presented to people.

And then probably -- I think Jim said it best, when we had the tastes great, less filling comments on 404. It seems like you're either on one side of a camp or the other, and not much in the middle.

I do believe it's real important that for the smallest companies, that we be very aggressive in what we recommend on 404, keeping in mind the investor mandate protections that we have in place.

But I would tell you the other thing I heard a lot of was that a lot of thing in Sarbanes are working very well. Tone at the top, the board involvement, the audit committee involvement, all that stuff working very well at some cost, but certainly a lesser cost than the 404 transactional side of testing.

And then the last thing I wrote down was, you know, that -- I think Larry testified to the number of errors in restatements in the smaller public companies, and that the SEC spends a lot of time in that area with smaller companies, although the dollars are obviously not the size of an Enron or a Worldcom or something like that, but that there are a lot of numbers involved in the number of restatements and the number of errors that are uncovered in smaller public companies.

And those are -- as I reflected back, those are some of the things that I remember from the testimony that stood out. I guess I'd ask John or Patrick for any other comments or thoughts.

MR. VEIHMEYER: I would just add. I think one of the things that surprised us from an accounting subcommittee standpoint in terms of the testimony is, we heard less about big GAAP, little GAAP than I think any of us anticipated when we began this endeavor.

There really didn't seem to be a strong view about needing a little GAAP for little companies or smaller public companies. We didn't hear any of that to speak of.

And the more we talked about the concepts that I think led us into that big GAAP, little GAAP initial agenda item, I think the more it becomes clear that the issues that I think lead people to think we need a little GAAP for smaller public companies are just as true for large companies as they are for small companies in terms of problems with standards as they're currently written and the complexity and everything else, that that's a problem being experienced by the largest companies as well as the small companies.

I think you'll see that reflected in some of the recommendations that we have. So I think that was surprising from the testimony standpoint for us.

And then I think -- you know, Herb, back on your comments, I think, you know, if there's one thing that the testimony proved it's where you stand depends on where you sit, I guess.

And there wasn't a lot of consensus, but I agree with you that what we really need to do is not rely too heavily, I think, on any one individual or any one set of testimony, because everyone comes to the table biased by their perspective and where they sit in the capital market system.

And what we really have to do is, I think, resist the temptation to rally around maybe the most persuasive, or the loudest of the folks providing testimony, and really be reflective and balance everything that we've heard and everything we bring to the table in terms of our respective backgrounds as we move forward with recommendations.

MR. DENNIS: Patrick, given you're the only one in the real world, in our group, anyway, do you want to say anything?

MR. BARRY: Yeah, I mean, for me, a lot of the testimony was still sort of geared towards the larger companies than the companies my size. I really represent the smaller, microcap size company.

The thing that struck me the most was sort of the testimony in New York. There was sort of a back and forth, and they were talking about, you know, not really investment in smaller cap funds. They were really talking about investing in companies you know and using the information, and they were basically talking about Enrons.

And if you look at the information, you know, one, you shouldn’t have invested based upon what was there, or if you didn't know it, you shouldn't invest in it. Someone would get lost with, you know, putting the onus on the shareholder to understand what they're invested in.

I mean, I deal with a lot of companies probably that Bob deals with, and the investors are largely very unsophisticated, and I think we do a good job presenting the financial information, the Q's and the K's, et cetera, and they're not looking at them.

Where does sort of our burden as a practitioner end and where do you say, hey, we've got to run a business, and push the burden back on the investor to say, you've got to do your due diligence, and you've got to start using the information.

And it's sort of -- I feel like something's lost, where I think some of the things that Dave was talking about, the economies are going to take care of themselves.

You know, there's -- I'm in the after-market for public capital, and three years ago I might have talked to David's firm because we were doing $30 million, you know, secondaries, and people were interested in doing that. And now I'm in the PIPE market, and there's not necessarily anything wrong with the market. It's sort of -- you know, the big guys don't want to touch it for their own economic reasons. So there is access to capital for me. It's just in a different format.

And I think we're sort of -- you know, everybody's sort of looking at how do you protect against the Enrons? I don't think you ever protect against that. I think, you know, you have to do enough to give an informed investor information and assume they're informed on the other side.

I'm not sure that any of the testimony really focused on the burden that the investor has to do their due diligence.

That's sort of what strikes me as -- you know, I deal with these guys every day, and they're just -- they're not sophisticated, they're not informed, and I just don't know where my burden stops and theirs starts.

MR. WANDER: That's an interesting comment. Pastora?

MS. CAFFERTY: Let me say that my experience is very different from most of the people in the room. I know a lot more about mid-cap and large cap companies than I do about smaller public companies.

But nothing I have heard here or in testimony is something that I haven't heard from large cap and mid-cap companies. And that is, that no one likes the costs and everyone's a little bit nervous about new regulations.

But reflecting on testimony and on the data, I think the issue that's very persuasive is the disproportionate cost of 404 to the smaller companies.

This is very persuasive. Whatever we do, not -- well, yes, whatever we do is going to be done in a political climate, and I think the fact that the same relief that is wished for by smaller public companies is being wished for by large and mid-cap companies.

I think the strongest argument here is the disproportionate costs, and the disproportionate costs is very persuasive.

Going beyond that, I have heard nothing or read nothing in the testimony except occasionally or in discussions that really would persuade me that anything but the 404 cost is really seen as onerous.

There's a lot of positive testimony that was given on the impact of Sarbanes-Oxley, and I would argue that the change in tone in the top and the change in tone in the board room is the greatest impact of Sarbanes-Oxley, that the culture has changed, and in my view and my experience, it is nothing but a change for the better.

To do that in a way -- and I think your points about baking it in are excellent -- to do that in a way that basically builds the controls better into the process, rather than make it an attestation of those controls, which is an added burden, may make a great deal of sense.

I do not think that looking forward, as Dick Jaffee suggested, takes us away from regulation. If anything, you know, we look at Refco in the last couple of weeks, the fact that a very reputable firm took them public -- and, indeed, I would not like to be in their shoes. But, on the other hand, where were the investors who were investing in this, and what did they read?

We will not be able to come up with any regulation, I think, that guards against fraud. That is impossible. The Enrons will go on. That's not the job, I think, of the regulators. The job of the regulators obviously is to catch it and then enforce it and put the right people necessarily fined or punished.

But hopefully what we can do -- and I think Sarbanes-Oxley does that -- is set a tone which makes the likelihood of fraud lesser, simply by -- and I think baking in is a point, but it's also the penalties of the regulations.

I think for this committee to be most effective, given the testimony, given the data that the SEC staff has pulled together for us, is to focus on financial costs, and particularly -- and any other cost that's disproportionate. I think when we look at this proportionality, I think we can be very persuasive.

I think if we go beyond that, just complaining that this is a highly litigious environment with a great deal of regulation, again, listening very careful to Dick Jaffee, that's not the world going forward. Part of it is the complexity of the world.

And I must say, the European markets are increasingly regulated. They're different regulations, but in a way the London market, in particular, has had much more tone at the top regulations for the last 15 years. We're very behind the European markets. So globalization, if anything, argues for greater, not less, clarity of regulations.

MR. WANDER: Okay, thank you. Is there anyone who hasn't spoken that would like to? Otherwise, I'm going to go back to the agenda. Yeah, Jim?

MR. THYEN: I'd like to make some comments on proportionality just to give some context, and respecting that viewpoint is determined by where you sit.

It's the cost choice that is forced or driven upon a small public company that is causing the greatest amount of pain because it changes the cost structure, the internal cost structure of the company, and it changes it rather abruptly.

In my world, in the electronics side, we are in a global value chain. We have customers all around the world, customer value chain. We also have a global supply chain. Our supply stretches around the world.

On the furniture side, we're primarily domestic on the customer side, although I don't know that any customer is truly domestic anymore, and we are global on the supply side.

Now, material costs, when you look at the cost structure of a company -- and I'm coming to burden and the burden of regulation in general and how the way this was implemented really disproportionately changed the whole cost structure.

The world is getting flatter, and the Internet, the communication, it's moving a lot quicker, a lot faster. To serve a customer globally you have to have pretty accurate inventories, pretty accurate record-keeping, or it will break down and you won't even serve that customer.

So it is important that we bake it in in a preventive, up front way.

Material costs generally are moving the world prices. They're generally the same price wherever you are in the world. Logistics, it's the cost of moving of time and distance, moving to and from.

And so that brings you to burden. And burden, if you want to define it as perhaps the cost of one hour, labor and overhead, including cost of capital, to convert your materials to a package of value that your customer appreciates and is willing to pay for.

When I look at information from The Economist magazine, when I hear us talk, one of the things that I didn't hear said in terms of the disproportionate costs of this burden -- and, Dick, I think you started -- you hit upon it. In Western Europe the cost of one hour of burden, labor, overhead, whether it's social cost, whether it's government regulations, whether it's market regulations, is about -- in U.S. dollars, it's about $110 to $120 in Western Europe per hour.

So if you had made this pencil in Western Europe, your material would be about the same. Now, you would pay more in logistics, depending on where you're going to ship it to, who you're going to sell it to, and where you're buying your components, time and distance. But if you assembled and manufactured it, $110 to $120 in Western Europe.

In the United States, $50 to $60 per hour, fully loaded burden of one manufacturing hour. In Eastern Europe -- Poland, Romania, Czechoslovakia, the Slovakian countries -- $20 to $25, one hour burden to make this same pencil. In Mexico, $20 to $25, some range there. In Asia -- Thailand, China, Vietnam, Malaysia -- $10 to $12.

Now, when you're a manufacturing company trying to compete, the disproportionate cost, the amount that is added to the burden, is a big deal, especially if you're smaller, because if you're a smaller public company, we compete on skill, not on scale. So we don't really have the leverage in procuring material to change that cost structure to offset that burden that comes from the cost of a manufacturing -- one fully loaded manufacturing hour.

If we are going to remain competitive in the global market, I don't know that it's a choice of getting rid of regulation, because all of us support the need to restore confidence of the investor in the marketplace.

I don't know any of us that disagree with the need -- we all support the need for good internal controls. But it must be done in a way that the overhead burden, the one hour of burden -- and it's not the labor, it's not the employee. Because when you start comparing productivity, in the United States we have a 2000, 2100 man-year -- or hour-year. Europe, sometimes 1300, 1400 hours a year.

It really is the rest of that cost structure -- and I believe as we go through our debate here, one of our big challenges is -- certainly, if we can keep regulation from being added to move us into European cost structures of $110, $120, that's going to be good news.

But we really have to find a way, given the regulations we've got, how we get that cost structure down, because that skill set from Asia, from Mexico, is world class. And that is our competition. And the more we move our cost of burden above that $50 to $60 per hour, the less competitive we become in the world.

I would just like to share that with you so you kind of calibrate it as we go through the two days.

MR. WANDER: Dick, and then Janet.

MR. JAFFEE: Jim, I thought that was brilliant, frankly, I think, because I think you put numbers on what I was conceptually attempting to communicate, that in real cents, we are putting ourselves in a position of becoming less competitive on the world market.

And I would like to also follow up on a couple points that Pastora made. To me, most of Sarbanes-Oxley has been positive and has been implemented, and I'm glad we have it, and I don't have a problem with it at all. It really -- for me -- and I don't have the issues about, you know, that Drew understands or that Dave does in the markets because I'm not involved in that.

But for me, the whole thing revolves around 404. And it's not just only what is 404 costing me, and the accounting fees are up, it is really the issue, is 404 accomplishing what we would all say would be a good outcome?

And it seems to me very questionable that the answer is yes. Because it seems to me that the way it's been implemented, the way it's been focused on -- and maybe the PCAOB briefing is going to help it to some degree -- but up to what I've heard to this point, it has been so much at the transactional level, so much a focus in energy and cost, on documentation, which is, again, if you analogize to quality control, the wrong way to go. That's all about the check and checking the checkers rather than starting at the tone at the top and really understanding what the outcomes are supposed to be.

So I'm having trouble with 404 because of two things. I think it's making us less competitive, it's raising the burden cost, as Jim said. I don't see it having the desired outcome that it was supposed to have.

And in terms of the political environment, the one thing that I found that was -- I'm sure you're all aware -- but there was a piece in The Wall Street Journal co-authored by Bob Dole and Tom Daschle on this subject, which I thought was amazing, that -- first of all, that they wrote something together, and, secondly, that they picked this subject together.

So there may be a political environment where a recommendation that would be bold in 404 might be received better than we think it might be.

MR. WANDER: Janet?

MS. DOLAN: I just want to make a couple comments that perhaps haven't been mentioned so far, although it does build a lot on what Dick just said.

If the real question to us is how do we evaluate the testimony we've heard, and what haven't we heard, and do we need any more. I presume that's what we're trying to get at.

MR. WANDER: Sure.

MS. DOLAN: I have three areas. But one is, I think we appreciate very much having a sort of ad hoc hearing a couple weeks ago from investors.

That helped a lot, because at the end of the day, what we're really trying to find out, and this is building on what Dick said, which is we heard a lot of testimony about the cost. The real question is, does it make a difference?

I would say one of the things we heard from the testimony is there's no alignment among investors as to whether this really makes a difference. I thought that was the most startling conclusion to come out of the New York testimony two weeks ago.

We had a number of investors, as somebody has already said, many of them don't invest in micro-caps, that's one category, but many of them said, "It hasn't changed my behavior. It's nice to have, but I do my own research. My job is to go in and meet with the leadership of the company. I form my judgment about the caliber of the company based on the people who run it."

I found that quite disturbing that, you know, we have an opportunity to bring investors in to say, "I would invest only in companies that do get a 404 certification and I wouldn't in others," and we didn't get any indication of that, and when pressed, we asked investors, "Do you invest in companies outside the United States who don't have this burden," and they said, "Yes, we feel the need to diversify and do you ask a higher premium."

They couldn't answer that in terms of, "How do you actually calculate the value of this?"

So in terms of what we have heard and what we haven't got in front of us to work with, we do not have a monolothic view from investors that, for all the expense that went into this, that it really is making a difference.

The second is, I think we've heard nothing, and perhaps we couldn't expect to, but we have heard nothing on what happened here. Is this really what was intended?

We've certainly gotten innuendoes, but we certainly know from outside documents that the expectation was that this was going to cost a company $90,000 a year.

I think when you roll out this kind of huge regulatory burden as fast as we did, we owe it to both the regulated and the investment public to do some sort of reflection on if we knew then what we knew now, would we do it this way, and if we wouldn't, how would we calibrate it? And I think calibration is the word we heard.

So we didn't hear any testimony on that, but I think all of us are taking that as our charge.

The last point is, and I think it was touched on over in Leroy's table there, but we can sort of laugh and chuckle a little bit about this sort of combination of regulatory and legal liability, but that is the 800-pound gorilla in the middle of the room here, and we can't ignore it.

I would compare it, I would compare the process to when we were naming our first child before he was born. Every name I came up with, my husband would say, "Oh, no, you know what nickname they're going to put on that. They'll call him da da da da."

And I said, "What, did you do this when you were a child?"

It's the same process here.

Every time we come up with any kind of reform, we go right down the road of, "Oh, but what kind of legal exposure will this expose somebody to?" We right away run all the scenarios on what kind of possible malpractice or some other exposure is somebody going to be exposed to, and therefore, we can't have that reform.

So it is a big thread here, and we've had very little testimony on it, so in terms of the testimony, those would be the three areas that I would say we didn't get uniformity from investors, and we certainly didn't get an overwhelming burden of evidence from investors that this really does make a difference, this changes their behavior, this drives their investment decisions, it really makes U.S. capital markets much more attractive than other markets they could invest in.

We didn't hear anything on is this really what the regulatory climate was expected to be, or did we somehow get off-track and how do we get it back; and we didn't hear enough on what is this regulatory and legal liability exposure that is so threatening that kind of stands in the way of sort of stepping back from the precipice and sort of right-sizing this to fit what the market can bear?

MR. WANDER: Leroy?

MR. DENNIS: I just want to echo Janet's comments, because I think in everything we talked about in our group, it does come back to legal liability, and the question from the auditor's standpoint is, "Well, if I'm going to be held responsible for something regardless, then I'm going to do it."

I think what I take from all that is if we are going to recommend less regulation or less steps or however we want to call our recommendations, there's a corresponding expectation of the courts and the legal system that there's less being done, so we can't, if we walk out of this with less regulation under 404 for micro-cap companies, we can't also go to the courts and expect the same level that we have today in liability for all the participants -- the company management, the auditors, the underwriters, everybody.

MR. WANDER: And the lawyers.

MR. DENNIS: And the lawyers. I was going to exclude them, but --

(Laughter.)

MR. DENNIS: -- but we can't have the same expectation of them if we require less regulation on the other side.

MR. WANDER: I think that actually was -- Janet's point and your follow-up is something that I don't think we have discussed.

I think the big public policy issue is, we tend to think of our court system as being a safety valve -- higher quality, people have a chance to have these class action lawsuits.

But, you know, in the end, is it right? I mean, they're blaming all that on why we don't have vaccine, for example, and so we're without vaccine.

In any event, that's my little editorial on that.

Rich?

MR. BROUNSTEIN: Hi. Rick Brounstein.

Again, I'm going to speak just basically from my role on the 404 Committee. And I don't disagree with anything Janet said, I agree with it all.

A couple points I have that kind of jumped out at me, and not all-inclusive.

Everyone seemed to be, you know, whether they were for on the yes 404, on the no 404 side, they all seemed to have what I'll call the spirit of 404.

Everyone, you know, if they were down in the trenches, it was too expensive, but everyone sort of, you know, from a 30,000-foot level, said it builds investor confidence.

I think the people down in the trenches understand the cost of it more, and it struck me as amusing that, you know, one of our speakers, who admitted to being an author of SOX, you know, talked about it in terms of, you know, well, the CFO ought to be able to do his work in a day and they ought to be able to audit it in a week.

Well, I think we know that that's not the case, but if you could do that, it would come back to if everyone was spending 90 or 91 thousand dollars, I think was the number that the SEC predicted, we wouldn't be having this discussion.

So in many ways, I saw a lot of convergence, maybe not a lot of understanding about what's involved, but a lot of convergence about, you know, 404. The theory behind this was that it improves investor confidence, and that's a good goal.

Secondly, virtually nobody presenting was willing or did invest in the smallest of these companies that this committee has defined as the micro-caps, and I heard some shock when we talked about the proportionality that's come out a little bit today, that, "Well, it can't possibly cost that much, or if it does, something is very wrong."

But, quite indeed, when you take a look at the markets for what is half of the companies in our environment, if you are a fund manager, they're probably too small for you to invest in, and we tried to get small-cap fund managers, and I think I recall one person in the entire group of 44 presenters that said they actually have any investments in what we call a micro-cap.

My last point is everybody, on the other hand, admitted that good corporate governance, you know, is a major deterrent of fraud, and my take-away there is, as we take a look at what we're going to do, we have to make sure that the requirement for good corporate governance is something that's important to all the companies that we're considering.

MR. WANDER: Kurt?

MR. SCHACHT: I'm just glad we have a committee hearing today, because I think we have some discussion to do about what we heard the investors' viewpoint was at some of these hearings, because I actually came away thinking that we gleaned at least a couple things from investors.

That is that, by and large, the professional institutional investors that we talked to felt that internal controls were important, and I think by and large, all investors feel that internal controls are important, it's just a question of what the level, what's the proper level of independent outside verification we need to have as part of that process.

I think everybody that's been a part of this discussion can stipulate to the fact that the costs are high and disproportionate. I think we knew that coming in. I don't think we learned anything new in that regard.

But I think it's important to understand investors do care about this.

You know, whether they're actually asking about it, whether they -- I think one of the comments was that there's a lot of information that's out there and available for investors, and what's their responsibility?

Well, I would certainly agree that investors have a responsibility to be competent to understand what they're investing in, but to suggest, if the suggestion is that investors aren't paying attention to this and that that somehow mitigates the responsibility of the issuer to provide clear and concise and consistent information, I would argue with that.

So we get down to this question about what is the level of proper independent external review of the internal control structure, and the question we're going to be struggling with, is it none for some public companies, or is it a matter of a more cost-conscious, a more focused and direct implementation of 404.

Thanks.

MR. WANDER: A couple people haven't made comments.

Before we take a short break and then go into our committee presentations, Alex, did you have something you'd like to share with us?

MR. DAVERN: Yeah. Just in the vein of everybody being heard, I guess, I appreciate the opportunity to be heard.

Alex Davern.

I'd first off like to say I think we got very good testimony overall. I think we heard obviously from companies, auditors, regulators, investors, COSO, so I think we got a lot of good input.

I like what Kurt said, that we all came, most people came here with the perception that there was a large, disproportionate cost for smaller companies, and I think we all had that confirmed for ourselves.

I'd echo Janet's comment that the biggest cause of that problem I personally believe is the whole legal liability system we operate under, and that really is the 800-pound gorilla she said. I would echo that completely.

I do believe very strongly, personally, that what's happened has and continues to do significant damage to small public companies in America, and I do personally passionately believe that it's very bad for the country and that we have a great opportunity to try to find a way to do what's right.

I take my guidance on what I think is right going back to what I think was originally intended.

We've heard reference today to SEC's role and the expectation it would cost $90,000, and I go back to what Rick said about the testimony we heard from Lynn Turner, that it should take a week to execute this requirement of 404, and I think it probably should, and that was, I believe, what was probably intended.

Unfortunately, what happened I believe is certainly not cost-effective, not productive, not what was intended, I think, by the SEC, and therefore I assume not what was intended by Congress, and I think it's our job to try to find a way to right-size that.

My conclusion I've also formed from listening to all this testimony is that tweaking around the edges of the procedures and process of executing 404 will not achieve the goal of right-sizing. I just don't believe that will work.

As Janet said, we've gone down multiple paths, and we always end up it creates too much liability for somebody.

So I'd also echo what Leroy said. As long as auditors have the responsibility, they're going to protect themselves, as they should. It's a rational, economic decision for them to make.

I personally believe the only way we will effectively right-size this is we've got to specifically eliminate some of those responsibilities for certain classes of companies, to make any substantive forward progress on it; and I believe from the testimony we've heard that investors in general will support that, and as long as the emphasis on management is clear, that they continue to have a requirement to have strong internal controls, they continue to certify against those controls.

And I think all the other provisions of SOX, absent 404, I believe are very, very effective in helping promote what the investor wants, which is a management team who is focused on running the business as honestly and presenting those results as honestly as possible.

So I believe we need to look at fundamental change and we need to be bold, and that tweaking won't make any difference.

Thank you.

MR. WANDER: Would either of our two observers like to make a couple comments?

Jack or Dan?

Dan?

MR. GOELZER: Dan Goelzer.

Yeah. Of course, my attention has been primarily to the comments about 404, as I guess is true of many of the other people in the room.

I thought I heard six things.

First, surely from the perspective of the preparers, particularly the CFOs, the point was very clearly made that the cost of 404 compliance, documenting controls, testing controls for purposes of an assessment, was disproportionately high relative to the resources available to the company, that unlike the situation with much larger companies, you could be talking about a significant proportion of the company's revenues, for example, that had to be devoted to this activity, and at the same time, they felt that the benefits were not significant, for, people suggested a variety of reasons, but primarily because, in a smaller enterprise, the CFO, for example, is much closer to the day-to-day operation of the controls than in other companies.

With respect to the second, with respect to the perspective of the investors, I guess I would largely agree with what Janet and Kurt said.

I think what I took away was that investors generally, institutional and perhaps individual to the extent they think about it, do have an expectation that public companies have effective controls in place.

That doesn't quite answer the question about what they need to see and how they would act on it in terms of external verifications of that, like management assessments or auditor attestations, but I thought that there was a fundamental expectation that companies will have effective controls, as has been required, well, since 1977, at least, long before the Sarbanes-Oxley Act was passed.

The third thing I was kind of struck by was that I thought the managements felt that there was a surprising lack of guidance available to them about how a smaller company ought to structure its controls and how it ought to assess their effectiveness if they're going to have to do that.

Obviously, as we've heard at great length, there are pages and pages and pages of stuff available from the PCAOB about how the auditor ought to do the attestation process, but that guidance, which is really just aimed at the auditor part of the process, has sort of I guess bled over into what management has to do because there isn't much practical guidance available to management.

There is obviously the COSO framework and we know that COSO is going to be coming out with something soon that at least has the purpose of trying to help smaller companies understand how to apply the framework to smaller companies, but I thought that suggested that however people come out on 404, that there was a need to be filled in terms of guidance for smaller company managements on structuring controls.

The fourth thing that seemed to be a pretty common theme was that what's been referred to by the shorthand of "tone at the top" is the most important single factor in terms of the integrity of the company's financial reporting -- the integrity of management, the quality of the people on the board of directors, particularly the outsiders, and other kinds of corporate governance measures that are in place.

Fifth, and others have certainly made this point, I thought there was a pretty general agreement that at some company level the costs of an auditor attestation are not worth the benefits.

What I had difficulty hearing was how that line should be drawn, and we're in a situation now where companies down to approximately 75 million in market cap, accelerated filers, are already in the system.

There's been some suggestion based on the companies' definitions that everybody above 700 or 750 million ought to be taken out of the system again.

At least from what I heard, it's all just opinion. Nobody was really able to point to much tangible guidance as to how that line ought to be drawn if a new line is going to be drawn in that area.

Finally, the sixth thing, the final thing I thought I heard was that while people I think pretty uniformly acknowledge that the SEC and the PCAOB had done a good job of trying to redirect the process to a risk-oriented approach in the May 16th statements that were put out that the PCAOB had a lot more to do in terms of making sure that auditors really brought that to bear in the course of their work and felt, I guess, to put it directly, that the risks of an adverse inspection report from the PCAOB were equally on the side of doing the work inefficiently versus not doing enough work.

Thank you.

MR. WANDER: Jack, did you have any comments?

MR. HERSTEIN: This whole process, being from a small state, this whole process has been a shock to my system, starting with the definition of a small company, which from a state regulator, I very seldom see cross my desk.

But the observations of all the advisors and the other observer has been excellent.

Definitely, cost seemed to be one of the major problems. Capital Formation, the committee I'm on, is also trying to do our best to help with this process.

I believe what Richie said in San Francisco, the finders should be number one or two on the list, that that would definitely help the small companies achieve the goal of raising capital formation.

Tweaking the trading markets, some of the trading market rules would be helpful.

Also, I noticed that what the commissioner said, just in my final closing remarks, the commissioner said is that -- chairman, excuse me -- that, you know, keep it simple and always remember investor protection.

From a state standpoint, for a lot of the states, it's, for talking about fraud, it's easier to stop the frauds before the investors lose their money.

MR. WANDER: Thanks.

We're going to take a short break, it's 20 after 11:00, to 11:30. Then we'll come back to our agenda, and Leroy, you'll be the first that we'll call on.

(A brief recess was taken.)

MR. WANDER: We're missing a few people.

I know Alex went to get coffee, because I asked him for some.

(Laughter.)

MR. WANDER: Kevin. Where's Kevin? We've lost him. Mark and Alex and Richie. Richie is probably on the phone.

Let me just talk about what we're going to be doing the next two days.

We're now going to have reports of the subcommittees, and these are really reports telling us where you're at, where you're in alignment, where you're not in alignment, and we'll go through all four subcommittees.

Then we're going to adjourn for the day.

Kevin, I've already asked him, Gerry, to tell us where to go eat, and then we will return for subcommittee meetings the rest of the afternoon, so that you can really work in depth now that we've finished our fact-finding.

By the way, if anybody needs more information, don't hesitate to ask us. We'll see if we can find it or accumulate it.

Then my next question is, we would like to begin tomorrow morning in full committee where we would have the subcommittees come back and, in effect, give us their latest thinking after their afternoon meetings, and recommendations.

I just wonder whether you all need the rest of the afternoon and maybe you'd want an hour tomorrow morning and then we'd begin at 10:00, or whether we should begin with a full committee deliberation at 9:00.

Dave?

MR. COOLIDGE: Do we have all afternoon for the subcommittees?

MR. WANDER: Yes. Yes.

MR. COOLIDGE: I think we'll need tomorrow morning.

MR. WANDER: You would. Okay, that's fine. No, that's fine.

I think we made this two days so that we don't get rushed through something, because we really becoming the important part of it.

Steve, I guess we're going to have an hour tomorrow morning, so we will begin tomorrow morning at 10 o'clock. Hopefully, we will be through by 3 o'clock, and I say that because Don Nicholiason's farewell reception is in the same room we're meeting in.

(Laughter.)

MR. WANDER: Okay. Yes, Steve.

MR. BOCHNER: For the subcommittee meetings, will we, should we meet here at 9:00 and then somebody will divide us up? What's the --

MR. WANDER: I think you could -- Gerry, do you know the room numbers?

MR. LAPORTE: Yeah. When Kevin gets back, he'll tell you this afternoon.

We've got some rooms reserved in the building, and he'll assign you a room this afternoon. I think it'll be the same room tomorrow morning.

MR. WANDER: It's on the third floor. That's all I know.

But Kevin I think is looking for a power point projector.

Oh, here comes the coffee. Now we can begin.

See, you didn't realize what you were signing on for.

MR. DAVERN: I've got an opportunity for a small business.

(Laughter.)

MR. WANDER: Okay.

MR. CONNOLLY: Can I just --

MR. WANDER: Oh, sure, Drew.

MR. CONNOLLY: This is Drew Connolly.

I have asked Deal Flow Media, who is the publisher of something called the PIPEs Report as well as the Small Cap Report, for their copyright permission to distribute parts of the September PIPEs Report to this committee, and they were kind enough and gracious enough to give it.

I've distributed two sets here, one of which talks about there's a story about Regulation SHO and how it has not in fact impacted the marketplaces perhaps the way it was intended to, the back of which quotes rather directly from our friend the president of the Pink Sheets Club, Cromwell Coulson, talking about what I think appears to be happening, which is additional enhanced short entrance reporting.

So all of that is background information.

But the real guts of this issue which comes out monthly, both in specificity and in aggregate, is what is the activity in the marketplace having to do with PIPEs, and as I think we've talked about before without any specific information, PIPEs or private investments in public equity, have become the de facto IPOs for micro-cap and small cap companies, not by themselves, but largely Pink Sheets, Bulletin Board, and other securities, in the absence of being able to attract investment banking support, there's an entire industry now both of bankers and the attorneys that service these things, that are doing PIPEs.

I guess one of the pages here will outline both the firms that are issuing and the firms that are underwriting, if you will, a PIPE transaction.

The one negative, and I think for my friends and colleagues on this committee who don't have the market timing or the market specific access background, the one concern that continues to resonate is that, in large measure, most of or many of these PIPE investors will make a PIPE investment and often require relatively short-term liquidity such that it's almost required that a micro-cap company go out and do a lot of promotion, create some enthusiasm and some additional market side buying, so that that PIPE investor can sell into the buying, and therein that has created, I suspect, a fair amount of enforcement issues and folks should kind of be aware of that.

So anyway, there's the data. Hopefully, it's helpful.

MR. WANDER: Does anybody not know what a PIPE is? If you don't, somebody here will tell you, or ask us. Ask us, if you -- ask one of the lawyers. I suspect we can tell you.

Leroy?

MR. DENNIS: I was just going to say I thought a PIPE was something you used to pump out Louisiana, but -- Herb, are we going to debate each one of these as we go through this?

MR. WANDER: No.

I really think that we'd like to really have you tell us where you're at and where you have some disagreement, and not necessarily debate, but rather, you know, any comments before, so that you can consider them this afternoon and then come back tomorrow morning and --

MR. DENNIS: Okay.

MR. WANDER: -- and give us some real recommendations, and then we'll all slug it out.

MR. DENNIS: I guess I would ask, as people have comments, you don't have to wait 'til the end to give me these.

We've had several discussions over the past few weeks and months, and I would say as we come together as a group there tends to be little other issues that come up, and I'll include those as we go through here.

Some of the things that we have a lot of alignment on is, like we've said before, big GAAP/little GAAP does not work and that we will not be recommending anything in that area, that GAAP is GAAP and there should be one set of standards for all the companies in the United States.

We do agree, though, that the implementation dates for new standards, especially more complicated standards, should be extended for micro-cap companies.

Our recommendations really center around the fact that they don't have the resources of the larger companies and that if we allow another year for them to adopt new accounting standards, that gives time for the bigger companies to sort them out and you kind of get some flavor in the market for how the standards are being implemented.

We did have some debate around SAB 74.

MR. WANDER: Dick, can I interrupt?

I just want to emphasize, I think that's a very good recommendation for the reason that the FASB standards don't go through a beta test, and they spring to life all of a sudden, and no one has ever done a scenario planning of what the problems will be with them.

And so it's very useful if the larger companies, for example, work through those bugs or kinks, and we just saw one with the option pricing, where the FASB said, "Well, it's the day you have an agreement with your option holder as to how you start pricing these," and they hadn't realized the technical problems that that was going to cause, and so that was, fortunately, that was changed before adopted.

So I think this is an excellent recommendation for that additional --

MR. DENNIS: Yeah.

And our thought is that, if you can just sort those out, let the market sort those out and deal with the FASB on a Q&A basis before the smaller companies have to go through the cost to implement those, that that's a good thing.

Now, we also would say to the FASB, there may be some standards that are fairly simple that we should just do, and so it ought to be up to their judgment as they're implementing those.

And traditionally, the FASB has required implementation by public companies on a quicker basis than private companies, and we would just suggest that the micro-companies probably be aligned with the private

companies as opposed to being aligning with the public companies as it comes to implementation.

One of the areas we're still having some discussion on, although I think John and I got closer to this today and with some input from the SEC, is whether or not SAB 74 needs revision.

For those of you who don't know, SAB 74 requires a company to disclose what the effect is going to be on its financial statements of pending but yet unadopted financial accounting standards, and that requires them to disclose what they know about.

I think we're now pretty much in alignment that that standard is fine as written and probably doesn't need to be revised.

Moving on, the second recommendation centers around the areas of independence with auditors.

We found that specifically, companies that do have some overseas operations, but even companies in the United States, there could be some pretty severe consequences for a company should its auditor have either an insignificant or an inadvertent violation of the independence rules.

The poster child example might be, you know, somebody in Sri Lanka doing some bookkeeping for a registrant that's affiliated with the accounting firm, and technically the accounting firm is not independent.

The consequences of that could be that that company's prior filings are invalid and certainly would have to be -- potentially have to change auditors.

We think the SEC, for the most part, has been pretty, I don't want to say lenient, but understanding of when those situations exist; but having more of a de minimis rule inside the regulations that would allow the Audit Committee, in conjunction with the auditor, to make those decisions might be appropriate.

The next item has to do with accounting standards.

And certainly we all want to move towards a principles based standard -- oh, by the way, you guys, please chime in as I say something that you don't necessarily agree with -- that principles based is the way to go.

We see a lot of problems with that with, and we've outlined that in a paper as we're pulling our recommendations together, but there are, you know, there is -- part of this is the legal liability issue that Janet mentioned, and when you have -- when you're faced with that environment, people want rules, they want bright lines, and those are not what you get with principles based accounting.

And they also -- I think it requires efforts on all parts to do the right thing, regardless of what the rules say.

The example I also use is the 123-R calculation or

argument on stock options.

The first thing that happened after that got issued was the market figured out that if they accelerate some options, that they will never have to take a compensation charge.

That's not, in my mind, in agreement with the principles of that standard, and if we are going to continue to have those kind of things, I don't think we'll ever get to a principles based standard.

However, having said that, we do think that we are going to make a recommendation to the FASB that they consider the ease of implementation and simplicity just as important as theoretical correctness when they're evaluating a new standard.

I'm less concerned about whether a lease is capitalized or not, as long as I know that everybody is treating it the same way, and because it goes to comparability of the financial statements, and when I'm an investor, in my mind, anyway, I seem to -- I would be more concerned about comparability than I would about theoretical correctness.

The next thing we talked about had to do with, also with accounting standards, and we noted that even when GAAP -- you know, there's a lot of pronouncements in GAAP and a lot of interpretations, but we still have emerging

transactions that there may not be on point guidance relating to that.

And so is there some sort of protocol for accounting and terming the accounting for that that the auditor along with the registrant can use that would protect them if they follow that process correctly?

Now, I'm not saying they get to the wrong answer and just because they follow the process that would absolve them of any liability. That's clearly not the case.

But if there is an emerging issue where there isn't clear guidance, if they follow a correct process, do some appropriate disclosure and disclose the alternatives and why they considered what they considered to be the right accounting, is there a way we can protect them from being second-guessed down the road?

The next item has to do with promotion of competition among audit firms for smaller public companies.

You know, I think we heard a lot of testimony about some other non-Big Four firms that are qualified to do public company audits, especially of the smaller companies.

Certainly, the Big Four are very qualified in that area.

If there's a way that the SEC can promote that competition and promote the ability of those firms by including them on committees like this, including them on

other -- more involvement in the profession and the accounting for those entities might get more promotion of those entities and allow them to be perceived as a viable alternative to the Big Four.

Along Dan's lines with the PCAOB guidance. We think that that guidance is working between the auditor and his clients.

I've interviewed all of the Big Four and a lot of the other middle tier firms, and it does seem to be having an impact. I think we'll know after we go through this busy season, and our recommendation is going to be that the PCAOB monitor that through their next inspection season.

If it's not working as they determine, then we recommend further guidance, but at this point, we believe that it is going to work as hoped.

I talked earlier about COSO, and we are going to recommend that the SEC study the structure of COSO and whether or not it needs to be more formalized with funding and a more formalized standard-setting process, because it does seem to be issuing standards, especially in light of very little guidance on the structures of internal controls that is available out to companies.

Lastly, the things we are aligned with is we'd like to have some more enhanced technical assistance for smaller public companies.

There's a lot of these companies out there, and if they had a place that was more actively funded, either independent of the SEC or with the SEC that they could call.

You have usually smaller auditors doing a lot of these smaller companies, and if they had a place they could call where they could get some advice and some help, that would be a good thing.

Some of the things that we have not reached alignment on, and probably more controversial:

We had some recent discussions on the cost to change auditors and how do we make that less costly, to promote competition.

As we thought through that, and I've thought through it, I don't see us being able to change the education process required for a new auditor. They're obviously going to come in, they're going to spend a lot of time and effort getting to know the company, getting to know the systems. I don't see that being reduced to any large extent.

The question does come in as to whether or not we could reduce the involvement of the predecessor auditor in 10-Ks, 10-Qs, and those kinds of things.

I think it also goes to if we're going to reduce the involvement of those auditors in that process, they would also have to -- we have to reduce the liability associated with that, because they're not going to continue to want to

be associated with a statement that they're held responsible for.

But they would have, for example, if I had a 2004 report out there, and the predecessor, or the successor auditor came in and issued 2005, I still have my 2004 report. I just got to make sure that what -- right now I make sure what's said in the 2005 10-K is consistent with that. Can that be someone else's responsibility, rather than the predecessor auditor?

MR. WANDER: Isn't there also the possibility of, at least for some or all smaller companies, lessening the number of years you have to go back?

MR. DENNIS: Well, right now we're at two, anyway. I think I'd be hard pressed to say you shouldn't issue some kind of comparative financial statements --

MR. WANDER: So you go to two?

MR. DENNIS: -- but you could put that onus on the investor to say, "We're going to issue single-year statements, and you got to go back and pull up the prior 10-K," would be an option, too.

I think it's something we're still debating on what the answer would be, but the premise is, can we reduce that prior auditor involvement so as to reduce the cost to change?

MR. BROUNSTEIN: Can I add one more on this?

MR. WANDER: Sure.

MR. BROUNSTEIN: On the same subject.

So there indeed is a lesser role for the SB clients today --

MR. DENNIS: Yes.

MR. BROUNSTEIN: And I don't know if you've addressed it, but to sort of follow up on that, it would seem to me that as we've now, as a committee, gone ahead and looked at micro-cap and smaller definitions, that you ought to look at those definitions and see if that kind of -- if some of the SB rules should apply to that level standard, because it makes -- you know, and you can issue a two-year balance sheet without three years of income statement, and it allows you, from a predecessor auditor point of view, one less year, and that can be significant.

MR. DENNIS: I think that's something Steve's group is looking at as the regulations of SB; is that correct, Steve?

MR. BOCHNER: Yes.

MR. BROUNSTEIN: Because it seems to tie into this predecessor auditor relationship.

MR. DENNIS: We can look at whether or not, in conjunction with Steve, whether or not the requirements for filers under our smaller definition should be two years versus three, and that's certainly a point we can take a look at.

One that Steve asked me to take a look at, that we haven't really talked about much yet in our committee, is materiality in financial statements.

We've seen a large increase in the number of restatements has happened. My sense is that there is more of a quarterly analysis for materiality as opposed to an annual analysis in the past.

What the right answer is, I don't know. Is there a different way to deal with immaterial errors in financial statements that are possibly material to quarters?

I am planning to meet with some of the staff of the SEC later on this afternoon and get their views on that, but that's something we've just really sorted out here or just really got put on our list of items to look at in the last two weeks, so we'll be sorting through that and --

MR. DAVERN: Can I comment on that?

MR. DENNIS: Yes.

MR. DAVERN: It's Alex Davern.

I'd like to encourage you guys to take a hard look at that question, because I think that is an area that does cause a lot of problems, and that some form of reevaluation of what are slicing these things up into ever smaller slices makes sense.

MR. DENNIS: Yeah, my sense is --

MR. DAVERN: I think it really should be examined,

its practical impact, because there is a de minimis stage we reach that I think we can have a lot of wasted effort around if we don't have some form of review of that.

Thank you.

MR. DENNIS: Yeah, and, you know, I think there are several things contributing to the number of restatements. One is 404, and the increased auditor involvement in a lot of areas is uncovering more issues.

I think when you change auditors, there's probably a bigger risk that other issues are uncovered.

You know, I think we're on a quarterly materiality level now, which effectively reduces everything by a quarter, and I think you run into situations where, an immaterial effect on each quarter is uncovered. It's probably immaterial on an annual financial statement, but when you go to correct it, because you have an accumulation of several quarters, possibly it becomes material in any one quarter.

Is there a better way to deal with that than restating the past eight quarters? And that's, I think, the question on the table that we need to sort out.

The last one I would say is -- and we got to be careful how we explain this.

This really is a thought, and we do not have alignment on this in our committee. In fact, I would say I'm in the minority on this, but because I'm the chair, I keep

putting it on the agenda.

MR. VEIHMEYER: Since there's only three of us, and you're in the minority, that kind of nails down who feels what way on this issue.

(Laughter.)

MR. DENNIS: But I got some statistics on the number of registered CPA firms in the United States, and I might not say these correctly, but there's something like 900 registered firms in the U.S. of which 200 or 300 don't audit a public entity and another 400 audit somewhere between one and five.

In our firm, whenever a person comes in and wants to do an SEC account, we will say, "You don't do any right now, we don't think we should allow you to do that on your own, but if you make a commitment to get involved in the industry and get some education and we'll monitor you along the way, then we'll allow them to go forward.

And I'm wondering whether there is something that would be appropriate for the PCAOB to have with firms that audit a smaller number of companies that maybe don't have the right experience that would require them to make a bigger commitment to the SEC business, and I think that ultimately would help in competition, because if I had a smaller number of registered CPA firms out there that did more public entities, I think it possibly could help in the competition.

It certainly would assist in the amount of regulatory burden that the PCAOB is saddled with, and the amount of people that they have to hire to accomplish their task at hand.

I think this also will sort itself out over a period of years. It's just a question of how long that will take.

I don't know exactly how the recommendation would get formulated or even if there's a recommendation there, but it's something I believe would be correct. I have a lot of people to convince.

MR. COOLIDGE: Only two.

MR. DENNIS: Pardon?

MR. COOLIDGE: Only two.

MR. DENNIS: Only two here.

(Laughter.)

MR. DENNIS: But, you know, it's just something that seems to make some common sense to me, and I want to emphasize I'm not trying to decrease the number of -- if a firm wants to be in the business, that's fine.

I think they would be required, if they only do one account, they probably need to have some kind of plan with the PCAOB that says, "Here's some additional education I'm going to do."

I mean, the SEC and the AICPA put on a great

training here in December every year, and it's very, very good.

They ought to have some kind of commitment to increase the number of public companies they do -- something that gets them more involved in the industry.

Because as I've learned over my career, whether it be in industry or whether it be in SEC or banking, you can't do one, because if you do one, you don't do it very well.

So that's one of the things we're exploring.

The other thing I would -- that I heard today, Herb, that's not on our committee agenda, but I think it needs to be somewhere, is the issue that Janet brought up on tort reform.

And we've not talked about it in our group, but it seems like something that we need to deal with somewhere in our group.

And with that, I would open it up for questions or comments.

Yes.

MR. JAFFEE: Leroy, Dick.

Did you at all think about how the accounting standards are formulated, I mean, what the deliberative process is and who they reach out to and how much input they get from users and that sort of thing?

Because there's one being formulated now on prepaid

mining costs and reserve calculations, which I haven't read and thought about except my people tell me it doesn't make any -- they don't think it makes sense in the real world.

And I just wondered whether you stepped back from that and talked about that.

MR. DENNIS: We didn't go through a lot of the process that they go through in evaluating that.

Our big thing that when we looked at the standards was simplicity and ease of implementation.

It just seems like we get so theoretical in the standards, and then we try to make sure that -- and this is not faulting the FASB. I think they got a very difficult job.

But everyone has an exception, and if you're going to have uniformity and ease, you can't have 15 different exceptions, and so it has to -- there needs to be less of those kind of things going on.

But we did not go through the actual process that they go through to draft a statement or anything like that.

MR. WANDER: Janet?

MS. DOLAN: Leroy, I have a question about -- this is Janet Dolan. I have question about your principle based recommendation.

One question is, what action would it take to do that? What do you -- I mean, what would it actually take to make that happen?

But then my second question is more of a context, which is, we certainly hear that outside the United States, especially in the U.K., with the Turnbull approach to corporate governance, it is more principle based.

It's less, you know, prescriptive and it's more principle based, and it leaves it -- puts it more in the hands of the board and the audit committee to manage risks.

And so my question is, did the accounting standards used to be more principle based but we got into a more sort of regulatory, litigious environment and so they become more prescriptive, or have we just had no history in the United States accounting environment of principle based?

I mean, would you be recommending something really different, or would you say we've kind of gotten way too prescriptive, let's kind of move back to the center and become what we used to be?

MR. DENNIS: I'll, John, maybe ask for your comments on this, also, but I think it’s going to be very difficult for us to ever get to an effective principles base, because -- and I think the litigation is one of those things, because you have more and more ability to be second guessed in a principles based environment, and you've got to have people that do the right thing right out of the chute, so we can't have designing accounting transactions or designing transactions for accounting purposes as opposed to designing transactions for business purposes.

We've seen that evolve over the last 15 years or so, where those things have come into play, you know, the number and complicated nature of the financial transactions that are going on.

I think it's going to make it very, very difficult to get to a principles based type environment, and my guess is that -- and this is just Leroy Dennis's prediction, so that's worth what it's worth -- that the Europeans will eventually get to a more rules based environment than they are right now, because what will happen is the same thing that happened in our environment over the last 20, 30 years, is that somebody abused the system, just like 404, someone abused the system, and so we fix the system by requiring everybody to do 404.

And someone will abuse the system over there, and then a rule will be established on how you account for a certain transaction, and then the next rule will be established.

I think there's where we've gotten to over the years, is every time someone abuses the system, regulations respond by creating a rule for everybody.

I think we've yet to figure out a way to identify the bad people up front and just prohibit them from ever

being involved in a public company. If we could ever figure that out, then I think we can go to a principles based standard and be fine.

John?

MR. VEIHMEYER: Yeah.

You know, I think it has gotten more -- you know, to your question about did this evolve, yeah, I think it did evolve over the last 20 to 30 years.

If you just look at the volume of the accounting literature today versus 25 years ago, I think that's an indication of how we have evolved.

You know, the prediction of where we can go, I agree with Leroy. It's not going to be easy. I do think, as we look to convergence to a global and international financial reporting system, there are going to have to be compromises on both sides of the pond, and I expect we will have to make some compromises that would move us to a more objectives based or principles based kind of model.

And we've got some specific thoughts, you know. We've kind of hit it at 30,000 feet. I think we've got some specific recommendations that, even if you don't wholesale throw out what we've got, which I think is very unlikely, I think there are some recommendations that, you know, we're going to put forward around if the standard setter, for example, envisions that there is a bright line test embodied

in a particular standard being adopted, make that very clear in the standard, because there are a lot of standards that I think, initially issued, appeared to provide grey area for judgment, practitioners and auditors make reasonable judgments around implementation of that, and then are second guessed and find out that someone else looking at it after the fact believes that was a bright line test and not an area of reasonable judgment based on your facts and circumstances.

So I think without just making a recommendation that standards ought to be more objectives based, I think we can try and make some specific recommendations that would move us close to that, but I think it's going to be a huge challenge. It won't happen overnight, and I think this is our view of some prodding and yet another voice, you know, in this direction that might be helpful.

MR. DENNIS: Alex?

MR. DAVERN: Yeah.

Just as you bring up the issue, Leroy, of international accounting standards and the whole notion that we will come together and have one set of international standards, I'd just like to raise -- I guess being the one European in the crowd, perhaps I can do this without fear of too much recrimination.

I personally have a lot of concern with the notion that the U.S. would, I won't say blindly, I don't want to overstate it, but I think we need to be very careful with the idea that a body of people who are unelected and unappointed by anybody in the U.K. or based in the U.K. become the de facto regulators and standard setters for the U.S. capital markets. I think that's a notion that scares me a little bit.

And I know it's way beyond the purview of our group here, but I think having a national standards body that has preeminence should remain the intent, and I think that would be much better for the U.S. capital markets than delegating that to a committee of unappointed people based in the U.K.

MR. DENNIS: I've heard nobody say that we should delegate accounting standards to anybody outside of the FASB, and I'd be -- I wholeheartedly agree with you.

I do believe that, to the extent we can get those two groups thinking together -- which they are doing. You know, when new statements are issued, they usually float one to the other, and so they are trying to converge together, but -- and hopefully, great minds think alike, so that you don't have somebody on an opposite side of the pond, so to speak, coming up with a completely different answer.

I think the key to all that is the politics out to stay out of the accounting standards process. We saw that attempted to be done here in the United States, and whether or not you agree with the stock option accounting or not, the prospect for having a political agenda in setting accounting standards would be a really, in my mind, would be a really scary process.

MR. CONNOLLY: Spoken like a true Irishman.

MR. DAVERN: And I agree with that, and I would also say that the process is already highly politicized in Europe already, especially relative to regulations around banks, et cetera, and this is one that's already very politicized within the EU.

So I just, I urge a little bit of caution. I support your remarks. And I think everybody would agree the preeminence of FASB should continue.

MR. JENSEN: I just had --

I just had a couple of ideas.

First of all, there's a lot of people who would say our accounting system is principles based, but most of the rules that we have today are just how you interpret those principles in certain industries.

So you might get a little bit of argument about that.

But I do think the body of literature has become unbelievably complicated for anybody, including auditors and accountants, companies, everybody to understand.

So I was curious whether you've taken a position on this project I think the AICPA has been looking at in terms

of reorganizing all the literature so that it's more comprehensible and somewhat understandable.

That was one.

And two, I wondered if you had thought at all about is there a recommendation that would encourage the SEC, through -- because that's who our recommendations are going to go to -- to encourage the SEC to encourage the FASB to have better representation from smaller companies along these lines that, you know, maybe the theory would be that they could help keep some of the stuff a little simpler, because they tend to think, you know, a little more rationally than somebody that's dealing with, you know, complex derivatives.

MR. DENNIS: To your second point, we have not talked about whether or not to have representation from smaller businesses on the FASB. That's something that we can put down and discuss. That's a good point.

Certainly we would support, or I would support any kind of effort to make the standards easier to read.

You know, I think part of it comes to trying to get all of these exceptions handled somewhere inside the standards, and so you take a document where maybe the principles piece of it is five pages long, and when you tack on all the possible different exceptions that someone is trying to get into there, it becomes a 150-page document, you know, and unreadable.

One of our recommendations that John alluded to in our more formal discussions have been whether we can exclude those type of interpretations and put them in just that, in some kind of other document where, you know, if you're a real estate company or a mining company, you can go to that piece of it for an interpretation of a standard as opposed to everyone having to read and understand those, relates to all the different exceptions that are out there.

So if we could, in the actual standards themselves, be more principles based with the interpretations, maybe dealing with the one off type situations or the industry situations, it would hopefully make it a little bit easier to understand.

MR. JENSEN: Have you thought at all about asking the SEC to make it easier for small companies to consult with them directly --

MR. DENNIS: Well, that is one of our recommendations, is that they have some -- you know, they've got a help desk right now, I believe, but some more funding into that that would provide an ability for smaller companies to call.

I think you question whether or not that needs to be outside of the SEC, because whether a small company would want to call the SEC and bare their soul, so to speak --

MR. JENSEN: Well, I think also, if you're going to

-- and your interest in smaller accounting firms, having smaller accounting firms have access to some help at the SEC would be helpful, as well.

MR. DENNIS: Right.

MR. JENSEN: They may or may not want it, but I mean, I think having it available to them --

MR. DENNIS: I think having some kind of help desk that could assist with those issues for smaller companies -- you know, and I think a lot of them are basic questions, and hopefully try to ward off some comments that are made later on in the process of whether it's an annual 10-K review or review of an S-1 or something like that would -- that's just heading it off before it becomes an issue.

MR. WANDER: Rick?

MR. BROUNSTEIN: Let me just kind of follow on with what Mark was saying.

I really think, you know, we've talked all about 404 and the proportionality. You know, I sit at a micro-cap company, and if you took that out, the next most unproportional thing is all these new accounting standards, whether -- you know, I'll pick on 123-R.

But all of a sudden, I'm out there, you know, having to hire people to do independent valuations of stock options or warrants that are happening in financing, and all these, you know, non-cash things, and I've got to update them

every quarter, and we're spending -- you know, I guess I'm --

you know, my thought is, if you peeled away 404 from a cost/benefit basis, the complexity that is hitting the accounting standards and the cost that is hitting smaller companies is probably the next biggest thing that is starting to get more and more out of line for, you know, I guess, you know, to play off what Mark was saying, if FASB had more smaller companies involved in the decision process, maybe it wouldn't -- maybe you'd get some more balanced, you know, assessments of what's going on.

But there are a lot of things that we're being asked to do that I don't think anyone who looks at my financial statements, you know, cares about, but it's costing, you know, significant dollars compared to our revenues.

MR. DENNIS: I agree completely, and I think in my mind it goes -- and I think the smaller company representation on the FASB is a good idea to think about.

But, you know, I think it goes to there's no doubt in my mind that 123-R or 133 or pick any of the standards that we all like to pick on, they're theoretically correct. They're difficult to implement. And any time you get into fair value accounting, it's a very difficult concept to implement.

Is there a way to make sure that we get 80 percent of the theoretical correctness there and 85 percent of the simplicity and comparability in? Because the simpler a standard is to implement, the easier it is for companies to get done, the less costly it is for companies to get done, and the more comparability you're going to have between companies.

I really don't care whether you have $2.47 per share of net income. What I really care about is how you compare to your competition and which one -- in my mind, that makes the decision of which company I'm going to invest in.

MR. BROUNSTEIN: So is that on the agenda?

MR. DENNIS: Yes.

MR. BROUNSTEIN: Okay.

MR. WANDER: Could I just suggest, since we're being web cast, that you state your name before you --

MR. BARRY: This is Pat Barry.

I'd just say, as a way of process, when we began looking at this, remember one of the first things on our agenda was should there be a big GAAP/little GAAP, so we sort of headed down the path of, you know, do we look at individual FASBs and ask the FASB to go back and revisit them.

And pretty quickly, from the testimony and the questionnaires and things we were hearing is, you know, GAAP is GAAP. We can't really segment the big guys from the little guys, and that's where you sort of have to draw the line.

And then when talking to the FASB, they basically said, "Look, take a prospective approach. Our docket is, you know, so long for the next five years. Don't bother going back and having revisionist history. Let's try to make this prospective."

So I think our guides are sort of geared to how do we, you know, get them as they move forward and put in new pronouncements to look prospectively versus going back and looking at, you know, should we have 123-R, should it be different for smaller companies, big companies, et cetera. We said, let's look forward on this.

MR. WANDER: All right.

Steve, why don't we move on to the Governance and Disclosure Subcommittee?

MR. BOCHNER: Great. Steve Bochner.

Well, I think I'd like to start with talking about some of the things that we think are working well in Governance and Disclosure, based on our discussion, the answers to our questions, the testimony.

And we think that there's a lot that's going right in this area, the CEO-CFO certifications, and in particular, the processes that have been put in place to support those I think are serving corporate America and the investing public well.

The whistleblower protections we think are important. The Audit Committee reforms and responsibilities and charter amendments. Board independence, I think is very important. And more frequent SEC review of periodic reports, I think.

And I think we all think all those things have had a positive impact, although I will get to couple of suggestions, or at least one suggestion in the independence area in a moment that one of our members has suggested, and that's an area still under consideration.

But I think that we looked at a lot of areas of current disclosure.

Are the 8-Ks being burdensome, the four business days? Is there something magic about quarterly reports? Board independence.

And what really came back, I think, to all of us, and perhaps a big part of this is just that 404 so dominates the landscape, but we did not get a lot of concerns raised out there in these other areas.

So I would say that the corporate governance changes and the disclosure rules seem to be working pretty well, and putting aside 404 and perhaps some of the auditor relationship issues, not to be a cause of consternation at least among those who have responded for the most part to our questions and those who have given us testimony, with some exception.

So where are we aligned?

Our first recommendation, which was no further acceleration of periodic reports for smaller public companies beyond 75/40, was voted on by the Commission to propose this for comment on September 21, so we're pleased to see that moving forward.

Secondly, in the S-B area, we've got Regulation S-B applicable to a very small -- the smallest companies, 25 million in market cap and lower, and we think that having two sets of almost parallel regulation -- there's a lot of overlap between those two -- causes complexity with the rules, it causes a bit of a stigma.

And so we've suggested, and I think we've got some signs of support for this, that, and certainly our subcommittee has supported this, that why don't we just have one set of rules with a new SK item which provides whatever accommodations the committee proposes and the SEC agrees to with respect to small businesses.

And we're recommending that threshold get raised to our micro-cap company size, at 100 million in market cap, so the two years financials versus three years accommodation afforded SB filers today, we would propose making that accommodation available to micro-cap companies, it's time to raise that threshold, and then perhaps taking a look at other accommodations for micro-cap companies that could be similarly put into this new SK item or items such as whatever the 404 Committee comes up with, and we're recommending that as possibly a context in which to make this recommendation.

Another one. I describe this as modest, because I wouldn't say that we received a huge outcry here, either.

But the SEC, as Herb noted, did approve a securities reform release, did issue a securities reform release, and that's final now, and they did move forward with this access equals delivery concept, noting that 70 percent of Americans have Internet access and so saying that the final prospectus doesn't need to be physically delivered.

And so our subcommittee supports that, and suggests that the SEC continue to look at other ways to bring similar efficiencies to smaller public companies, such as the electronic delivery of proxy statements and annual reports, so that as Internet usage increases, do smaller companies who bear these costs disproportionately really need to print paper copies and disseminate them and proxy statements.

That would have to be paired with appropriate protections for investors still wishing to receive paper copies. That might require more time and certainly require access by those investors who need paper copies to get those at no additional cost.

I think a similar suggestion is, again assuming that Internet accessibility is growing and pretty widespread, particularly among the investing public, to consider extending S-3 availability and forward incorporation by reference privileges to smaller public companies.

These smaller companies again disproportionately bear the costs of having to do an S-1 and repeat information that's already on file in 34 Act reports, so once we assume that those reports are available, then these accommodations and efficiencies ought to be made available to smaller public companies.

So we support that.

I'd say one of the areas that we did hear a lot of concern was -- and I think this was highlighted by comments from the smaller banks, and we heard this loud and clear, and I'm sorry Rusty Cloutier, one of our committee members from the banking community, couldn't be here, but it was sort of an outcry with respect to the overlap in regulation.

Duplicate governmental filings, such as financial statements, having multiple regulators filing -- you know, the filing burdens associated with those overlapping requirements were very burdensome, we heard, and so we've made a couple of recommendations in those areas, and those are fairly general, but that the SEC consider synchronizing filings with other governmental agencies, perhaps extending incorporation by reference privileges to other filings when they're already on file with a primary regulator, for example.

We looked at the loan prohibition under Sarbanes-Oxley. There's only a limited amount that can be done there, since it's in the statute, and the subcommittee strongly supports that prohibition.

We noted that there is a lot of confusion about what is a loan out there, particularly in the -- and even in the legal community.

And so we urge some clarification of the following areas: cashless exercise of stock options, indemnity advances, and relocation accommodations.

I think there's a different of opinion out there, and at least some confusion as to whether those types of transactions constitute prohibited loans.

And finally, we did hear from a couple of responders about the costs associated with EDGAR, and so we have a recommendation, we have alignment on a recommendation that seeks to reduce costs associated with SEC filings which again are higher proportionately for smaller public companies, and to explore new technologies for filing SEC documents perhaps in more widely available formats.

Areas still under consideration that we hope to get some resolution on over the next day or two:

We decided to put on the list this beneficial record holder issue under Section 12(g). That is the 500 shareholder limit and the idea that street name was really not in existence, not recognized when the statute was enacted, and whether we should look at a beneficial holder test.

I think we need a lot more data on that, and I might ask the SEC for some help there in figuring out, if we were to make a move to what would be a more widely common standard such as beneficial holders, sort of where those cutoffs might be appropriate and what kind of transition rules might be appropriate.

There was, and this came from the ABA, but we also have under consideration the idea of excluding holders of unexercised stock options that are issued in compensatory transactions from the determination of holders of record for purposes of Section 12(g) under the theory that those option holders have not made an economic decision to invest yet and so therefore shouldn't be counted for purposes of figuring out whether 34 Act registration should occur.

We're going to kick over the materiality issue to the Accounting Subcommittee here, and I guess I would just add that, and I know some of my lawyer friends on the committee think I'm crazy to wade into this materiality swamp continually, but I think it is a little broken out there, because now that SAB-99 throws us back into this reasonable investor test, which is basically case law -- you know, go talk to your lawyer about whether a reasonable investor would consider this important -- when you have a penny a share difference making a swing in your stock price, you're going to get very, very conservative calls on that.

If the street is expecting $1.55 and you come in at $1.54, and that impacts stock price, you're going to have a lawyer being conservative tell you, well, that reasonable investors consider a penny a share a difference.

And so that's the kind of problem we've got, is that these small changes result in very conservative calls there, and as a result, we've seen restatements where investors are saying, "Well, why did you restate? That seems immaterial."

MR. COOLIDGE: I would say those are not reasonable investors.

MR. DENNIS: I guess I would also ask the question, Steve, you know, if the market does react to a penny a share, then that sounds like it's material, then.

MR. BOCHNER: Well, it is material as we apply that standard today.

I guess the question is, should you -- should any errors that could conceivably move stock price trigger a restatement when it's, you know, happened, you know, three quarters, two years ago. I think that's the question.

But I mean, it's under -- it's an area under consideration, and I think we're kicking it over to you to resolve, Leroy, so good luck with that.

MR. WANDER: Guess what the answer is?

Any --

MR. BOCHNER: Well, one more, and Dick may want to comment on this, but I think there's a split on the committee on this.

I think some of us think the independence rules are working well, and I have to admit, as being on the NASDAQ Listing Council while these definitions were enacted, I may have the parent problem of thinking, you know, your children are beautiful.

But I think Dick at least views the independence standards as confusing and thinks we might want to think about more of a uniform safe harbor.

So those are the areas under consideration.

MR. WANDER: Any questions for Steve, comments?

Rick?

MR. BROUNSTEIN: Yeah. It's Rick Brounstein.

One comment, and then maybe one question on the last point, that maybe it's a decision of which the committee needs to look at it.

But the first comment is, I really support, putting on my hat as a small business user, the idea of the S-3 rules, the incorporation by reference.

It is a huge burden. Not only are you, when you're filing these documents, they become much longer, that's probably the least of the problem, because it's pretty easy just to go take what was in other documents and cut and paste them in.

But you go stale, and so if you've got outstanding registration statements, you have a very short period between the time you finish your audit a following year and you have to refile a brand new registration statement.

If they happen to be looked at for any reason by the SEC, then you're going to trigger all kinds of violations in your agreements, you're going to have -- your investors will not be able to trade on those, and there's all kinds of penalties associated.

So it seems to be something that is very burdensome for smaller companies, and being in the middle and watching it happen, you know, I guess that just has my vote.

The other piece, and maybe it relates a little bit to the independence rules, but when we talk about corporate governance and how good it is, and how we've been looking in 404 at what to do with the smallest, the micro-caps, one of the things that is clear to me is that the corporate governance standards that apply to companies trading on the exchanges do not apply to what is today most of all the micro-caps, and that's if you're trading on the Bulletin Board or the Pink Sheets, you don't have those same kind of rules.

And I don't know that, you know, the rules are -- you know, should be equal, but clearly, one of the things that we've been looking at is, if you're going to lessen the cost burden on the smallest of the companies, and everyone talks about tone at the top, just to use it, you know, what is -- you know, what makes sense from corporate governance standards, and I think we should decide whether it's, you know, our committee or your committee, but I think somebody should tackle, you know, is there reasonable corporate governance standards for the smallest of the companies.

MR. BOCHNER: Yeah, you've got to -- you know, traditionally, the SEC and the federal government really was not in the corporate governance business. You know, that was something left to the states, Delaware corporate law, as it's evolved principally, and the listing standards of the stock exchanges.

So, you know, and there's a question as to whether everybody should continue to stay in their lane, I think in the words of Justice Strine.

So I guess I am a little reluctant, but would be interested in hearing from others, I am reluctant to expand or recommend an expansion of the role of the SEC and the federal government in the area of corporate governance beyond what we've got today, but others may have different views.

MR. WANDER: Well, but maybe the compromise or the solution is you don't have to change, but if you want to take advantage of anything that you would do under 404, you have to voluntarily somehow commit to the governance standards.

Because I don't think you're going to get a reduction in 404 for the small companies without that, so it's a problem we have to solve and you might want to put it on your agenda, Steve.

MR. BROUNSTEIN: And let me just add to that.

So I think if you follow that to the next conclusion, I think then it takes a fair look as to what makes sense from a corporate governance standard.

I've seen early drafts of COSO, and we'll see what the final one is, but there when the COSO small business report talks about some aspects of corporate governance, and it isn't necessarily that you need a fully independent audit committee, that you need, you know, a majority of independent directors, but there's some reasonableness that makes sense.

I think it was the -- I don't know if it was the ABA presentation, but I think it was one of our speakers that, maybe from Wilson, that talked about the ABA paper, and that was one of our submissions, and made some -- you know, talked about the idea that in smaller companies they are -- you know, the people that sit on their board are oftentimes, their consultants are a lot more involved than maybe what we define as independent and not independent for the purpose of the smaller company needs a look -- so I guess there's a -- you know, I agree with Herb that if we want to give on one side, we need to take away, and especially since everyone goes, you know, if you got the right tone at the top, you've solved a lot of the problem, you know, to simply hand off and force the smallest companies into what today the exchanges require, you know, may be too burdensome.

And so I'm thinking it's fair to look at that.

MR. WANDER: I hope all of you are strong enough to carry the COSO report. You need a gorilla to carry it.

Any other comments for Steve?

Yes, Leroy.

MR. DENNIS: Steve, I just had one question on the ability to exclude unexercised options and the purposes of 12(g).

Are you thinking all option holders or just the top management or management option holders?

It seems to me like you'd have a different answer if you had a company that gave options to everybody versus maybe one that targets them towards certain management or certain holders.

MR. BOCHNER: We were -- I think we were thinking about options issued in compensatory transaction.

There's an exemption that looks at sort of the compensatory intent on the books today, so we sort of aligned our views on this with that exemption and said, if they're options and the intent is compensatory when they're issued, why have that be part of the count?

You know, I think you might need that if we can resolve this beneficial record holder thing in a more palatable manner, but I think we're struggling.

It's hard to have something that everybody has relied on for some period of time and then to sort of stick a new stake in the ground and say, you know, all of a sudden we're going to require a whole 'nother large category of companies to go public.

So it's a tricky issue, but, you know, it's been raised and there's a perception out there that what we have today isn't fair because it can be gamed simply by aggregating beneficial holders and street name and calling him a record holder, calling one record holder.

MR. WANDER: There's actually, I guess, a couple of petitions to the SEC to change the rule, which the Commission has been sitting on for some time.

Right, Gerry?

MR. LAPORTE: The first petition was filed a while ago. I don't agree that the Commission has necessarily been sitting on them.

(Laughter.)

MR. WANDER: That's all right. It wasn't one of my priority issues.

Any other comments? We'll move right along to --

MR. CONNOLLY: I have one quick one.

MR. WANDER: Yes.

MR. CONNOLLY: And this is Drew Connolly.

Coming from the specific baseline of capital formation, which is finding investors, and we've spoken, I think, on several levels about -- hopefully, the end result of our work product not only makes more effective, efficient public company interactions with the government and their investors, but I can't help but think that this committee can take some steps to encourage or in some way promote financial literacy among investors.

We are in the internet age. We are in a highly sophisticated financial era. And whether or not we're encouraging this at a college level or tying, somehow, into -- the Treasury Department has a link on their website, for example, and it talks about financial literacy. And it is a linkage of all the federal agencies and the work -- it's far more complex and cumbersome than necessary.

But I'd like to point out that there are some major companies that have interests in this area that are taking it very seriously. Charles Schwab, for example, embraced the Boys & Girls Clubs and committed X numbers of people and dollars to bringing some level of financial literacy.

Now, I don't think they're teaching little kids about stocks and bonds, per se, but they're bringing that along. Merrill Lynch is committed to the Girl Scouts in certain jurisdictions.

So, I don't know how to address this specifically, but if we don't increase the pool of investors, and I mean individual investors who are prepared to assume some of the risk in these little companies, I think we're likely going to shrink the market cap of many more going forward.

MR. WANDER: Okay. Dave, would you like to take center stage, please?

MR. COOLIDGE: Sure. Are we going to have lunch, Mr. Chairman?

MR. WANDER: No, we're going to -- well, we can -- it's 20 till 1:00. We have two more subcommittees to do. Would you -- I'm interested in your views. Would you like to break for an hour and then come back for the next two or would you like to move ahead?

MR. COOLIDGE: (Nodding.)

MR. WANDER: Move ahead. Dick, you're from Chicago. It's only 11:20.

(Laughter.)

MR. COOLIDGE: Okay. Capital Formation Subcommittee; we've mentioned a few of these in our previous remarks, but let me just go over the list.

Item 1, end prohibition against general solicitation and advertising for transactions with certain purchasers. The idea here is potentially to make private offerings a little more robust, be it a new class of private offering transactions limited to purchasers who do not require the protections afforded by the securities registration process.

This is tricky, because it has to do with definition of your investor base in making sure that you're only soliciting or advertising to those highly sophisticated investors. And it doesn't leak over into less sophisticated investors, which the Commission, I think, generally wants to protect from these kinds of promotional activities in the private placement arena, but it's a subject worthy of some more discussion, I think.

Secondly, going to the intermediaries that do function in the private placement market, I thought, and this would really be an action on the NASD's part, to qualify finders, M&A advisors, and other institutional private placement practitioners in a streamlined way. There is an ABA task force proposal out there on this subject, which we are thinking of supporting.

Then there's a number of other private placement exemption adjustments that we are thinking about recommending. Again, the relaxation of the solicitation in advertising rules, Rule 152 safe harbor issue, shortening periods that -- in between offerings so that there's a safe harbor after a much shorter period of time from the conclusion of one offering to the initiation of another, et cetera.

I mentioned earlier item 4 in our list, Going Private. I mentioned that before, perhaps looking at the issue of making it easier for small companies to go private; Bob's comments, you know, about -- is this good for the investors. I guess my reaction to that is -- you know, it really depends on the price.

You know, it's good for investors if the price is good. It's bad for investors if the price is not good. But the process and the expense of that process really doesn't have much to do with the price and I don't know whether there's a way of getting to the right price with a more streamlined process, but that's really the gut issue.

And making it easier, at least in my mind, is making it less costly, making it a more efficient thing to execute. It doesn't really speak to the price issue as to whether it's a fair price or not.

Trading Markets; we talked about this, trying to maintain robust trading markets for smaller companies and especially the bulletin board market.

Another issue is information on public companies that broker/dealers need to have in order to trade and make a trading market, Rule 15c2-11. This is information that is not now publicly available, but it is in -- as I understand it, in the broker's possession and also in the SEC's possession -- or the NASD's possession, excuse me.

And the question is whether that should all be made public. It seems like a fairly easy thing to do and if -- you know, full disclosure is the mantra of the SEC and the NASD, why don't they fully disclose what they have with respect to information on these companies.

Potentially making S-3 available for bulletin board companies is another idea and there's a few other items that we're discussing. We're also looking at the PIPE. Drew brought up and distributed this PIPE report.

We're looking at the PIPE process to make sure that that process, because it has become a very significant capital-raising tool for smaller public companies; make sure that there aren't things that we can't do to improve that process and make it a more viable option for smaller public companies without creating problems from an investor protection standpoint.

Research; we've already commented on that. You opened the meeting talking about those two items. I noticed those myself and it looks like the SEC is definitely concerned about the diminution of research in the marketplace and doing things to stem that tide or maybe reverse it.

Let's see. We had an item on Regulation S-B, Steve, that we fully hand off to you. It sounds like you've got the same thoughts that we have in terms of kind of getting rid of S-B, just making it a correction of S-K.

And I guess that's it. We have Rule 701 issues that we're discussing about stock options and whether they're voting securities type -- it's the same issue that you had talked about, Steve. Maybe you and I can talk briefly about what our deliberations were, but that's it.

MR. WANDER: Thanks, Dave. Any other questions or comments?

(No response.)

MR. WANDER: We move -- save the best for the last. Janet Dolan?

MS. DOLAN: And maybe even the shortest. Always -- being the only thing standing between us and lunch encourages simplicity and speed.

So, I would refer everybody to our areas of agreement and areas still under consideration and I will say that I'm going to somewhat merge them by simply painting a picture for you of where we are and I think from comments earlier this morning, you can see some of the dynamics that are going on.

And that is, I think it's very clear that everyone following -- as Kurt indicates, everyone believes that good internal controls are important and important to the integrity of the financial statement. And we are all in agreement that the 302 Certification and the role of management in continuing to certify for the integrity of the controls is a great addition and we all support it.

The area that we are most -- we are struggling with or that we have the greatest dichotomy within the committee in which we will work to resolve today, or as quickly as we can, is all around what's the role of the auditor; what auditor role should there be for small companies.

And we are ranging from -- as we indicated, I think, from our very first meeting, the very easiest and more straightforward is to simply exempt all small companies. A more complex way of approaching it, which may add greater investor confidence, however, is, is there something less than the full auditor testing and attestation; is there a still a role for the auditor, but something short of the full auditor testing and attestation.

For instance, we are looking at the possibility that as you move from the micros, which we, in all likelihood, are likely to exempt, up through to the larger, as you move up closer to that $700 million market cap, can we have stages of involvement so that we -- closer and closer to the full 404 auditor involvement by the time a company reaches that level, so that you don't have all or nothing can you have kind of a graduated approach.

And that would mean, as you get larger, can we add an auditor role such as -- as part of the audit of the financial statement, the auditors would also opine on the design and implementation.

In other words, sort of assuring that there is a good internal control system in place. They don't have to test it and attest to its operation themselves, but they would opine on the fact that there's a good design and implementation in place, understanding, of course, that the CEO and CFO themselves would be doing the attesting.

And from our conversation this morning, you can imagine some of the tradeoffs we're looking at, which is, if the auditor has to have any role at all, does that do anything to reduce either their exposure or the cost. Both of those are major factors that we're looking at.

And we also are looking at -- while we have -- the size committee did make two cuts of small companies and that may fit for every other committee, but might we look at more gradation when it comes to 404, just as we said, which is, you might move from the micro up through a couple of layers. And in each layer, you would have more auditor involvement.

And the tradeoff there is, we think that anything less than either full exemption or living with the current standards that we have may be that it would require new rulemaking by either the PCAOB or the SEC.

And there is a level of debate within our committee as to, is that something you want to engage in. I mean, do we want to look for some new rulemaking which might be around this lesser involvement of the auditor, knowing that the tradeoff there is, you now have a brand-new rule that you may or may not know what it's going to look like when it comes out and you'll have a new level of learning curve, a new learning curve that everybody's got to go through, even though many of the accelerated reporting companies have at least already been through one round of the 404.

So, while our list of areas under consideration where we do not have alignment is short, it is very substantive. It goes right to the heart of the matter of, do we have any -- do we recommend any auditor involvement at all and if so, can we recommend something less than what it currently is and if we do, what would that take and how would it help relieve the cost burden impact that we've certainly all this morning agreed is the number-one concern.

So, those are the areas that we're considering. I also put on a couple of areas that we did discuss. I would call them parking lot issues at this point. They’re off to the side.

We had pretty much discussed and sort of decided that there wasn't enough committee -- subcommittee endorsement for having, basically, say, a full 404 but maybe every three years or every five years, with the idea being that if you went -- if you were a small company and you went through your first 404 and you got your certification, then you wouldn't have to go through it for a few more years. If you didn't, obviously, you might have to go through it again.

And we had debate around, again, would investors accept that; wouldn't there be, sort of, the full expectation of accountability for the audit firms, even if they didn't do it. So, that was kind of side -- put on the side. I will say the investors that testified in New York two weeks ago -- there were several of them that said that would be fine, that they would endorse or certainly support something like that.

We have looked at whether this should be a shareholder decision; that's for the investors, ultimately let the shareholders decide. Again, I would say that's a parking lot issue at this point until we really get the substance of our bigger issues resolved.

And then there has been some discussion about if accelerated filers fall within our definition of small but they've already gone through the process and gotten their certification already, are they going to be within -- are we going to provide an exemption or a reduced burden on them or is the idea that they've already gone through that and they aren't going to get the benefit of this.

These are kind of side issues that we've been debating, but put on the side for now.

MR. WANDER: Steve?

MR. BOCHNER: Janet, have you -- and thanks for doing this. You guys clearly have the toughest job here and we all know that.

Have you thought about, to the extent -- you know, it sounds like there's a lot of agreement that the 404 costs are way higher than anybody expected, causing a lot of problems.

Have you thought about -- to the extent we decide there is -- there should be some exempt status, whether it's micro cap companies or smaller public companies, have you thought about the idea of enhanced disclosure to make up for the absence of an auditor attestation, for example, if we decided, "Look, we just can't get the cost thing right, too expensive, hurting smaller public companies, so what we're going to suggest is much more robust disclosure," maybe significant deficiencies get disclosed, maybe there's a new section on internal controls where management really has to go through what is the control structure.

So, the idea is use full and fair disclosure and beef that up as an alternative to paring back the requirements which seem so burdensome today.

MS. DOLAN: Yes. That is -- I guess when we say in our -- what we're in agreement with, the importance of the financial statement audit. And it's always a question of, do you start with the floor and build up or do you start with the ceiling and peel away. And maybe you end up at the same place, maybe you don't, but that's exactly what we've been thinking about.

Can we take the financial audit and do more with it if we do, in fact, exempt a 404 audit or can we -- do we start with the 404 audit, but then try to peel away some parts of it. I mean, so it's -- we're looking at both of those.

MR. WANDER: Yes, Mark?

MR. JENSEN: Can I -- I just wanted to add a couple of things that --

MR. WANDER: This is Mark Jensen.

MR. JENSEN: I'm sorry, it's Mark Jensen. I have to tell you, I appreciate all the attention the auditors get in these conversations. In 30 years, I've always felt I wasn't that important, but --

MR. DENNIS: Wouldn't you love to go back to those days?

(Laughter.)

MR. JENSEN: Yeah, the relative obscurity was good. A couple of things that I think we're struggling with or at least I struggle with is, first of all, if the audit was free, if it didn't cost anything for the auditor to do a 404 attestation, there's still a significant cost in the company.

So, you know, I think we have to keep that in mind. I mean, all of the recommendations being laid at the audit, as if somehow, the auditors have driven this cost north, there may be some truth in that, but I think you have to remember if the audit was free, management still has a lot of stuff to do.

And I also worry about another thing that's going on and the lawyers in the room can talk about this better than I, but there -- every state has a standard of due care, even in the private companies, even for private companies, that if you -- you know, so there are lots of laws on the books that aren't necessarily Securities and Exchange laws.

My concern is that the way we are documenting internal controls today, the way they're being tested, the way they're being implemented, this notion of management -- or not notion, but management's assertion under 404 that the internal control environment is proper and working proper, those are best practices today. Those are becoming the standards of corporate governance in this country and they're going to impact all companies.

And so, I think that to some extent, a little bit about what we're doing here isn't going to really get to the real heart of this matter. I think what does get to the heart of the matter is, as I said earlier today, when Irwin Federman talked about building processes into companies from the ground up.

And that's the piece that -- where I still think we need a strong recommendation. Who is that body? There is no body in the country today who has that as their charge or their responsibility. COSO is a volunteer organization. It's a virtual company. You heard the guy say that. They don't even have -- I don't think they have any employees. I think even he's part time, isn't he?

Gerry, do you know? I think he's part-time.

MR. BROUNSTEIN: He's a law professor, right.

MR. JENSEN: Yeah, he's a law professor. He's part-time.

MR. WANDER: No, he's an accounting professor.

MR. BROUNSTEIN: Accounting, sorry.

MR. JENSEN: And so, somehow or another --

MR. WANDER: You're getting the award for that --

(Laughter.)

MR. JENSEN: So what's happened is, is all of the internal control stuff has been put back at the accounting firms because they're the only people that had any of that expertise. And we've got to figure out how to get better processes, best practices out there, get better information in people's hands and get the problem corrected that way. That's the only way it's going to get corrected, in my mind, my speech of the morning.

MS. DOLAN: So you can see some of the debate we have.

(Laughter.)

MR. WANDER: Leroy?

MR. DENNIS: Leroy Dennis. Janet, I just have a couple questions. Following up on Steve's comment on disclosure, if we do go down the road of exempting or requiring a lesser standard, is there going to be something that's real apparent to investors, like a ticker symbol or -- you know, something that's right on the 10-K?

Are you -- have you had those kind of discussions as to how we would inform investors there's a difference?

And my other question is, when you talk about possible outcomes for the micro cap companies and you threw out the word, exemption, are you talking about both management's assertion of controls, tying into Mark's comment, or just the auditors' attestation on that?

MS. DOLAN: Generally, we are not talking about exempting the management certification. We're talking about the auditor.

MR. DENNIS: I guess I just point out Mark's comment that --

MS. DOLAN: Oh, for micro caps, I'm sorry.

MR. DENNIS: Yeah, for micro caps.

MS. DOLAN: Yes -- no, we're talking about total exemption, right.

MR. DENNIS: So, management's assertion and -- okay, for the --

MS. DOLAN: But it is -- I want to say that it's premature at this point to assume -- when I say that we're aligned around that, we don't want to yet say that we've got a framework ready for disclosure, because we're certainly working on a lot of issues.

So, I just -- the purpose of this is to tell you the kinds of issues that we're dealing with and -- you know, where some of the alignment is, but I want to -- I don't want to suggest that we've taken a position and -- you know, voted through a particular exemption or not. Nothing has been voted through yet or anything of the subcommittee. We're working with the --

MR. DENNIS: I agree and I would emphasize also that -- you know, for the micro cap companies listening out there, that any recommendation this committee makes is just a recommendation and ultimately, it's the commissioners, so they can't go celebrate in the streets just because somebody used the word, exemption, so --

(Laughter.)

MR. WANDER: Yes, Drew?

MR. CONNOLLY: I'm sorry that you took the wind out of my sails there a little bit, Leroy, because we were going to salute the work of the committee in drafting that recommendation.

My concern is twofold, sir. I certainly would object vehemently to a scarlet letter being appended to a company that is a micro cap company. I think that the marketplace will know, by virtue of a company being defined as a micro cap, that if these exemptions are, in fact, applied to a micro cap, that -- you know, the buyer beware if that's the concern.

But I do salute you, Janet, because I think that frankly, when I heard you say that, I didn't really know what to do. But it is also fairly clear to me that -- you know, and Leroy, this is really true, inside every micro cap CEO's heart is a smaller public company CEO waiting to break free.

So, because there is a momentary period in a public company's life where it is a micro cap, I want to assure you that everyone that I've talked to doesn't want to stay a micro cap to the extent that the American dream and their business model allows them to move forward into a more heavily regulated segment of the public company marketplace.

MS. DOLAN: Well, I would just conclude, on behalf of our subcommittee, two comments and I'm sure Herb and Jim will say the same thing when they close.

The first is, we assume that companies do have an evolutionary aspiration to them and that's why we're looking at staging and suggesting stages that companies would go through in their maturity, from a micro up through actually moving out of our definition of small.

That's exactly why we do it. This is not so much about exempting. It's about laying out a road map and helping companies understand what they're going to need as they get bigger and bigger in order to meet the expectations of the marketplace.

But the second is, we just finished taking testimony two weeks ago, so this comment's for everybody, which is, we want to also balance our need to share with the public some status report. And yet, the reservation that we are just now in the stage where we're debating and developing our recommendations.

And so, it's premature for anybody, either around this table or listening, to take anything as a conclusion at this point.

MR. WANDER: That's for sure. Let me make a comment. We discussed whether shareholders should be able to vote on this. Well, a number of people have said that really isn't -- shareholders shouldn't do that; management should make that decision.

If the ultimate conclusion that we recommend is that for some group of companies, let's say micro cap, they don't have to do a 404 with auditor attestation -- you know, the companies could opt into that. So, don't forget that that is a possibility, that if you think that the -- you would -- your goods, your securities would be more dear in the marketplace, you can obviously opt into that.

And in that regard, I will tell you one very quick story. I was on a program at the Corporate Secretaries Group in Chicago a couple of weeks ago and an investment banker from Milwaukee that does non-profit investment banking, a well-known company, Ziegler & Company, had less than 300 shareholders and decided to deregister. They were very upset when I said, "Go dark, so deregister."

And they actually went through a very lengthy study, hired experts, they actually had Cromwell Coulson come out and visit with them because they're on the Pink Sheets. They decided that they would provide everything but 404 going forward; proxy statements, 10-K type information, everything else.

And they found that their market was not harmed.

In fact, their stock price has gone up because they claim, in any event, that they saved the $800,000 which adds to the bottom line. That's a vignette. It shows you can opt in or opt out. Maybe we ought to think of it on both sides of the coin.

There is one final thing that I should mention, that our friend Joe Grundfest, who is a former SEC Commissioner and joined us for dinner out in San Francisco, has drafted a paper. It isn't published yet, but I did send it to Janet's committee.

I don't know if you got it in time to read it, but very interesting; his suggestion is -- he has two and I'll just give you the first one -- is that -- and this would require a PCAOB amendment -- that we do away with significant deficiencies and that you define material weakness as a reasonable possibility or probable likelihood that a material misstatement will not be prevented or detected, which is a different standard. And he argues in here that that would be good.

He has another standard, which is procedural that you can all read and I'll circulate his article to all of you. So, there are still a number of solutions out there looking for a home.

(Whereupon, at 1:00 p.m., the meeting was adjourned until 10:00 a.m. the next day.)

CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the SEC Advisory Committee on Smaller Public Companies.

11/12/08

Herbert S. Wander Date
Committee Co-Chair

Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its meetings of October 14, 2005 and October 25, 2005 and the dates of receipt.

Oct. 25, 2005
Gerald G. Morgan, Jr., Burdett, Morgan, Willlamson & Boykin, LLP on behalf of Church Loans and Investments Trust
See also:
* M. Kelly Archer
* Jack R. Vincent
* Steve Rogers
* Bill R. McMorries
* Michael A. Bahn
* Larry G. Brown
* Michael W. Borger
* Alfred J. Smith

Oct. 21, 2005
A. John Knapp, Jr., President and CEO, ICO, Inc.

Oct. 17, 2005
Edmund M. Ruffin, Executive Vice President, Capital Formation Sector and Business Development, Biotechnology Industry Organization

APPENDIX A

THE PIPEs REPORT

NEWS, INFORMATION, AND ANALYSIS OF PRIVATE INVESTMENTS IN PUBLIC EQUITY

Vol. III, No. 16 September 15, 2005

THE MID-MONTH REPORT

THE KATRINA QUESTION

Hurricane's Impact on PIPE Issuers Anticipated

by Joe Gose

Hurricane Katrina's decimation of communities along the Gulf of Mexico has affected recent PIPE issuers, particularly in the energy industry, and her impact will likely spread farther. Thus far, drilling, pipeline, and exploration and production issuers that operate in the area have generally reported minor damage and little business interruption.

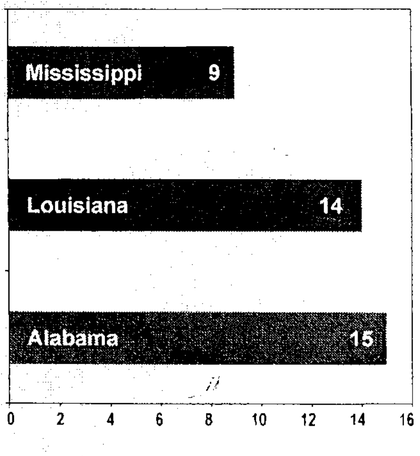
But the storm's wake ultimately could lead to more PIPE financings as energy companies raise capital to repair the havoc wreaked by one of the largest natural calamities in U.S. history. Additionally, environmental remediation companies, home builders, communication firms, commercial contractors and other companies may turn to PIPEs to ramp up for what is sure to become tens of billions of dollars worth of recovery work in Louisiana, Mississippi, and Alabama.

While refinery behemoths such as **Valero Energy** in all likelihood won't tap the PIPE market to raise funds for major refinery or platform repairs, the large companies likely will hire smaller engineering, consulting, and construction firms that focus on energy assets. The increased awareness of the country's flagging refining capacity, which was an issue even before Katrina made landfall, may also spur new refinery construction and spark work for third-party firms.

"There are a lot of public companies that provide services to the energy industry, and they may have the need to staff up to take on these kinds of projects," says Keith Behrens, managing director of **Energy Capital Solutions**, which has facilitated four energy placements this year valued at $58 million. "That could be a reason for many of those companies to do a PIPE."

Continued on page 17

PIPE ISSUERS IN KATRINA DAMAGED STATES



Source: PrivateRaise. Includes PIPE Issuers since 2001.

TREND *Watch*

SHO FAILS TO DELIVER

Reg Has Had Little Effect on Stock Kiting

by Brett Goetschius

Analysis of settlement data recently obtained from the SEC indicates that Regulation SHO has had little effect on reducing the level of extended settlement failures in heavily shorted small cap stocks. The data, obtained exclusively by *TPR* through Freedom of Information Act requests, show that there has been little change in the amount of "failures-to-deliver" (FTDs) resulting from naked short sales in stocks quoted on the OTC Bulletin Board, American Stock Exchange, and Pink Sheets.

The data includes the total number of shares on a daily basis from April 2004 through July 2005 which have not been delivered to buyers from short sellers of stocks which already have settlement failures exceeding 10,000 shares. Reg SHO incorporates the 10,000 share FTD threshold in its criteria for triggering the mandatory short sale pre-borrowing and

Continued on page 19

PrivateRaise.com's
DEAL FLOW

TRANSACTION ACTIVITY

ACTIVITY FOR THE PERIOD AUGUST 15 THROUGH SEPTEMBER 15, 2005

During the period August 15 through September 15, deal activity comprising 137 corporate issuers included 106 closed transactions, 22 definitive agreements, 22 announced placements, and two cancellations.

Status*	C/A Date**	Issuer	Ticker	Exchange	Amount	Security Type
C	9/15/05	Allen-Vanguard Corporation	ALNVF	OTC	$10,377,260	Prepaid Warrant
C	9/15/05	Antrim Energy Inc.	ATGYF	OTC	$9,315,778	Prepaid Warrant
C	9/15/05	Cano Petroleum, Inc.	CFW	AMEX	$10,779,997	Common Stock
C	9/15/05	China Evergreen Environmental Corp.	CEEC	OTC BB	$4,830,000	Common Stock
C	9/15/05	Genaera Corporation	GENR	NASDAQ-SC	$24,475,800	Common Stock
A	9/15/05	Nevada Geothermal Power Inc.	NGLPF	OTC BB	$8,468,889	Common Stock
C	9/15/05	Regalito Copper Corp.	RLO	AMEX	$4,600,000	Common Stock
C	9/15/05	Viragen, Inc.	VRA	AMEX	$1,430,000	Debt: Conv
DA	9/14/05	Ascentia Biomedical Corporation	ASCE	OTC	$1,000,000	Debt: Conv
DA	9/14/05	China BAK Battery, Inc.	CBBT	OTC BB	$43,450,000	Common Stock
DA	9/14/05	Spectrum Pharmaceuticals Inc.	SPPI	NASDAQ-NMS	$42,000,000	Common Stock
DA	9/14/05	Toreador Resources Corporation	TRGL	NASDAQ-NMS	$25,000,000	Common Stock
C	9/14/05	Valkyries Petroleum Corp.	VYPCF	OTC	$55,856,900	Common Stock
C	9/13/05	GeoGlobal Resources Inc.	GGR	AMEX	$27,640,600	Common Stock
A	9/13/05	HyperSpace Communications, Inc.	HCO	AMEX	$30,000,000	Debt: Conv
A	9/13/05	InforMedix Holdings, Inc.	IFMX	OTC BB	$4,000,000	Unknown
C	9/13/05	Smart Online, Inc.	SOLN	OTC BB	$3,461,535	Common Stock
C	9/12/05	Nara Bancorp, Inc.	NARA	NASDAQ-NMS	$19,999,997	Common Stock
C	9/12/05	National Storm Management, Inc.	NLST	OTC	$1,000,000	Unknown
DA	9/12/05	NUR Macroprinters Ltd.	NURM	OTC	$12,000,000	Common Stock
C	9/12/05	Smith & Wesson Holding Corporation	SWB	AMEX	$26,160,000	Common Stock
DA	9/12/05	Terax Energy Inc.	TERX	OTC BB	$7,380,000	Common Stock
C	9/12/05	ViRexx Medical Corp.	VIRFF	OTC	$3,425,472	Common Stock
C	9/9/05	Cord Blood America, Inc.	CBAI	OTC BB	$3,500,000	Debt: Conv
C	9/9/05	Deep Field Technologies, Inc.	DPFD	OTC BB	$10,000,000	Equity Line
DA	9/9/05	FC Banc Corp.	FCBQ	OTC BB	$2,108,288	Common Stock
C	9/9/05	PolyMet Mining Corporation	POMGF	OTC BB	$7,066,883	Common Stock
A	9/9/05	Resin Systems Inc.	RSSYF	OTC BB	$21,157,753	Debt: Conv
C	9/8/05	Turinco, Inc.	TURI	OTC BB	$1,490,000	Common Stock
C	9/7/05	American Technologies Group, Inc.	ATEG	OTC BB	$7,000,000	Debt: Conv
C	9/7/05	American Technologies Group, Inc.	ATEG	OTC BB	$3,000,000	Debt: Conv
C	9/7/05	American Technologies Group, Inc.	ATEG	OTC BB	$2,000,000	Debt: Conv
C	9/7/05	Boston Life Sciences, Inc.	BLSI	NASDAQ-SC	$12,780,000	Common Stock
C	9/7/05	In Veritas Medical Diagnostics	IVME	OTC BB	$10,000,000	Equity Line
A	9/7/05	Kirkland Lake Gold Inc.	KGILF	OTC	$3,363,600	Common Stock
A	9/7/05	Kirkland Lake Gold Inc.	KGILF	OTC	$2,102,068	Common Stock

* Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date

PrivateRaise.com's
DEAL FLOW

TRANSACTION ACTIVITY

Status*	C/A Date**	Issuer	Ticker	Exchange	Amount	Security Type
C	9/7/05	Sutura, Inc.	SUTU	OTC BB	$7,000,000	Debt: Conv
DA	9/6/05	Alnylam Pharmaceuticals Inc.	ALNY	NASDAQ-NMS	$58,517,292	Common Stock
A	9/6/05	Laramide Resources Ltd.	LMRXF	OTC	$8,410,400	Common Stock
A	9/6/05	Miranda Gold Corp.	MRDDF	OTC BB	$1,513,800	Common Stock
DA	9/6/05	Oxford Ventures, Inc.	OXFV	OTC BB	$30,000,000	Equity Line
A	9/6/05	Oxford Ventures, Inc.	OXFV	OTC BB	$15,000,000	Debt: Conv
DA	9/6/05	Rand Acquisition Corporation	RAQC	OTC BB	$15,000,000	Pref: Conv
C	9/2/05	Bulldog Technologies Inc.	BLLD	OTC BB	$2,100,000	Debt: Conv
C	9/2/05	Crew Gold Corporation	CRUGF	OTC	$32,627,375	Common Stock
C	9/2/05	Cyber Digital, Inc.	CYBD	OTC BB	$10,000,000	Equity Line
C	9/2/05	CYOP Systems International Inc.	CYOS	OTC BB	$15,000,000	Equity Line
C	9/2/05	NewGen Technologies, Inc.	NWGN	OTC BB	$1,386,000	Common Stock
C	9/2/05	Telular Corporation	WRLS	NASDAQ-NMS	$9,275,000	Common Stock
C	9/1/05	Catuity Inc.	CTTY	NASDAQ-SC	$5,250,000	Common Stock
C	9/1/05	GlobeTel Communications Corp.	GTE	AMEX	$4,500,000	Debt: Conv
C	9/1/05	Goldstrike Inc.	GDSK	OTC BB	$8,337,916	Common Stock
C	9/1/05	Innofone.com, Inc.	INFN	OTC BB	$1,500,000	Debt: Conv
C	9/1/05	PolyMet Mining Corporation	POMGF	OTC BB	$5,055,540	Common Stock
C	9/1/05	Streicher Mobile Fueling, Inc.	FUEL	NASDAQ-SC	$3,000,000	Debt: non-Conv
A	9/1/05	TAG Oil Ltd.	TAGOF	OTC BB	$10,103,111	Common Stock
A	9/1/05	TAG Oil Ltd.	TAGOF	OTC BB	$2,525,778	Common Stock
C	8/31/05	Access Worldwide Communications, Inc.	AWWC	OTC BB	$2,255,000	Debt: Conv
DA	8/31/05	Harbin Electric, Inc.	HRBN	OTC BB	$4,800,000	Common Stock
C	8/31/05	Intraop Medical Corporation	IOPM	OTC BB	$2,500,000	Debt: Conv
C	8/31/05	Intraop Medical Corporation	IOPM	OTC BB	$2,000,000	Debt: non-Conv
C	8/31/05	Invisa, Inc.	INSA	OTC BB	$1,000,000	Pref: Conv
C	8/31/05	Microvision, Inc.	MVIS	NASDAQ-NMS	$1,500,000	Common Stock
C	8/31/05	Optigenex, Inc.	OPGX	OTC BB	$1,300,000	Debt: Conv
A	8/31/05	Silvercorp Metals Inc.	SVMFF	OTC	$5,371,000	Common Stock
C	8/31/05	SmartServ Online, Inc.	SSRV	OTC BB	$2,500,000	Debt: Conv
C	8/31/05	SpeechSwitch, Inc.	SSWC	OTC BB	$10,000,000	Equity Line
C	8/31/05	Stonepath Group, Inc.	STG	AMEX	$25,000,000	Debt: Conv
C	8/31/05	Viper Powersports Inc.	VPWS	OTC	$15,000,000	Equity Line
C	8/31/05	Viper Powersports Inc.	VPWS	OTC	$3,900,000	Common Stock
C	8/30/05	Bear Creek Mining Corporation	BCEKF	OTC	$9,767,880	Common Stock
C	8/30/05	Brinx Resources Ltd.	BNXR	OTC BB	$1,000,000	Common Stock
C	8/30/05	IMI International Medical Innovations Inc.	IME	AMEX	$8,210,000	Debt: Conv
C	8/30/05	Savannah Bancorp, Inc. (The)	SAVB	NASDAQ-NMS	$12,199,619	Common Stock
DA	8/30/05	Tanger Factory Outlet Centers, Inc.	SKT	NYSE	$81,270,000	Common Stock

* Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date

TRANSACTION ACTIVITY

Status*	C/A Date**	Issuer	Ticker	Exchange	Amount	Security Type
C	8/29/05	Aberdene Mines Limited	ABRM	OTC BB	$1,250,000	Common Stock
DA	8/29/05	Celerity Systems, Inc.	CESY	OTC BB	$50,000,000	Equity Line
A	8/29/05	Celerity Systems, Inc.	CESY	OTC BB	$1,000,000	Pref: Conv
C	8/29/05	Grant Life Sciences, Inc.	GLIF	OTC BB	$2,000,000	Debt: Conv
DA	8/29/05	OMNI Energy Services Corp.	OMNI	NASDAQ-NMS	$25,000,000	Equity Line
C	8/29/05	Regeneration Technologies, Inc.	RTIX	NASDAQ-NMS	$23,940,000	Common Stock
C	8/28/05	Cardima, Inc.	CRDM	OTC	$1,000,000	Debt: non-Conv
A	8/26/05	Energy Exploration Technologies, Inc.	ENXTF	OTC BB	$2,000,000	Debt: Conv
C	8/26/05	Gener8Xion Entertainment Inc.	GNXE	OTC BB	$1,525,000	Common Stock
C	8/26/05	Kimber Resources Inc.	KBRRF	OTC	$4,194,333	Common Stock
C	8/26/05	Manhattan Pharmaceuticals, Inc.	MHTT	OTC BB	$13,178,625	Common Stock
C	8/26/05	Ophthalmic Imaging Systems	OISI	OTC BB	$9,000,000	Equity Line
C	8/26/05	Poseidis Inc.	PSED	OTC BB	$8,000,000	Equity Line
A	8/26/05	Vista Gold Corp.	VGZ	AMEX	$7,776,000	Common Stock
C	8/25/05	Eden Energy Corporation	EDNE	OTC BB	$9,075,000	Debt: Conv
C	8/25/05	Flotek Industries, Inc.	FTK	AMEX	$21,190,000	Common Stock
C	8/25/05	IWT Tesoro Corporation	IWTT	OTC BB	$5,000,000	Debt: Conv
C	8/25/05	Kirkland Lake Gold Inc.	KGILF	OTC	$4,199,250	Common Stock
C	8/25/05	Med Gen, Inc.	MDGN	OTC BB	$1,540,000	Debt: Conv
C	8/25/05	Raptor Networks Technology, Inc.	RPTN	OTC BB	$3,558,500	Common Stock
C	8/25/05	Sky Petroleum, Inc.	SKPI	OTC BB	$4,094,438	Common Stock
A	8/24/05	Alberta Star Development Corp.	ASXSF	OTC BB	$5,011,500	Common Stock
A	8/24/05	Alberta Star Development Corp.	ASXSF	OTC BB	$3,758,000	Common Stock
DA	8/24/05	Azure Dynamics Corporation	AZDDF	OTC	$11,216,646	Common Stock
C	8/24/05	Big Sky Energy Corporation	BSKO	OTC BB	$15,487,500	Common Stock
DA	8/24/05	Big Sky Energy Corporation	BSKO	OTC BB	$11,025,000	Prepaid Warrant
C	8/24/05	Isis Pharmaceuticals, Inc.	ISIS	NASDAQ-NMS	$51,000,000	Common Stock
C	8/24/05	pSivida Limited	PSDV	NASDAQ-NMS	$4,225,000	Common Stock
A	8/24/05	Sense Technologies Inc.	SNSG	OTC BB	$1,000,000	Common Stock
X	8/24/05	Xtreme Companies Inc.	XTME	OTC BB	$5,000,000	Equity Line
C	8/24/05	Xtreme Companies Inc.	XTME	OTC BB	$5,000,000	Equity Line
X	8/23/05	Bravo! Foods International Corp.	BRVO	OTC BB	$13,163,324	Common Stock
C	8/23/05	Datigen.com, Inc.	DTGN	OTC BB	$1,735,500	Common Stock
C	8/23/05	ProEx Energy Ltd.	PXEYF	OTC	$25,781,770	Common Stock
C	8/23/05	ROO Group Inc.	ROOG	OTC BB	$5,750,000	Common Stock
C	8/22/05	Callisto Pharmaceuticals, Inc.	KAL	AMEX	$1,813,127	Common Stock
C	8/22/05	Gaiam, Inc.	GAIA	NASDAQ-NMS	$20,000,000	Common Stock
C	8/22/05	HearUSA, Inc.	EAR	AMEX	$5,500,000	Debt: non-Conv
C	8/22/05	iMedia International, Inc.	IMNL	OTC BB	$4,920,000	Pref: Conv

* Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date

PrivateRaise.com's
DEALFLOW

TRANSACTION ACTIVITY

Status*	C/A Date**	Issuer	Ticker	Exchange	Amount	Security Type
C	8/22/05	Inhibitex Inc.	INHX	NASDAQ-NMS	$41,250,000	Common Stock
C	8/22/05	Santarus Inc.	SNTS	NASDAQ-NMS	$31,237,500	Common Stock
A	8/22/05	Storm Cat Energy Corporation	SMEFF	OTC	$2,476,715	Common Stock
A	8/22/05	Storm Cat Energy Corporation	SMEFF	OTC	$2,476,625	Common Stock
C	8/22/05	Viseon, Inc.	VSNI	OTC BB	$9,400,000	Pref: Conv
C	8/19/05	ACT Teleconferencing, Inc.	ACTT	NASDAQ-NMS	$8,040,000	Pref: Conv
C	8/19/05	Astralis Ltd.	ASTR	OTC BB	$2,000,000	Common Stock
C	8/19/05	Fashion House, Inc. (The)	TDIH	OTC BB	$2,500,000	Common Stock
C	8/19/05	Medicure Inc.	MCU	AMEX	$3,852,040	Common Stock
DA	8/19/05	MTI Technology Corporation	MTIC	NASDAQ-SC	$20,000,000	Pref: Conv
A	8/19/05	Starwin Media Holdings Inc.	SWMD	OTC	$200,000,000	Unknown
C	8/19/05	Vyteris Holdings (Nevada), Inc.	VYHN	OTC BB	$10,000,000	Debt: Conv
C	8/19/05	Xponential, Inc.	XPOI	OTC BB	$8,811,000	Debt: Conv
DA	8/18/05	Creative Computer Applications, Inc.	CAP	AMEX	$3,000,000	Common Stock
C	8/17/05	Chartered Semiconductor Manufacturing	CHRT	NASDAQ-NMS	$300,000,000	Pref: Conv
DA	8/17/05	Global Alumina Corporation	GBAMF	OTC	$50,000,000	Common Stock
DA	8/17/05	Global Alumina Corporation	GBAMF	OTC	$50,000,000	Debt: Conv
C	8/17/05	Nektar Therapeutics	NKTR	NASDAQ-NMS	$24,000,005	Common Stock
A	8/17/05	Response Biomedical Corporation	RPBIF	OTC BB	$2,081,040	Common Stock
DA	8/17/05	Secure Computing Corporation	SCUR	NASDAQ-NMS	$70,000,000	Pref: Conv
C	8/17/05	SoftBrands, Inc.	SFBD	OTC	$18,000,000	Pref: Conv
C	8/17/05	Union Dental Holdings, Inc.	UDHI	OTC BB	$5,000,000	Equity Line
C	8/16/05	FermaVir Pharmaceuticals, Inc.	VSBS	OTC BB	$2,118,390	Common Stock
C	8/16/05	Gander Mountain Company	GMTN	NASDAQ-NMS	$20,000,000	Debt: Conv
C	8/16/05	Mediscience Technology Corp.	MDSC	OTC BB	$1,525,000	Common Stock
C	8/16/05	Nutra Pharma Corp.	NPHC	OTC BB	$9,600,000	Equity Line
C	8/16/05	Rubicon Minerals Corp.	RBY	AMEX	$5,001,898	Common Stock
C	8/16/05	Superconductor Technologies Inc.	SCON	NASDAQ-NMS	$12,500,000	Common Stock
C	8/16/05	Vaso Active Pharmaceuticals, Inc.	VAPH	OTC	$2,500,000	Debt: Conv
C	8/16/05	Verticalnet, Inc.	VERT	NASDAQ-SC	$6,600,000	Debt: Conv
C	8/15/05	China Mobility Solutions, Inc.	CHMS	OTC BB	$3,350,000	Debt: Conv
C	8/15/05	Coley Pharmaceutical Group	COLY	NASDAQ-NMS	$10,000,000	Common Stock
DA	8/15/05	Grifco International Inc.	GFCI	OTC	$3,000,000	Common Stock
C	8/15/05	Nexia Holdings Inc.	NEXH	OTC BB	$10,000,000	Equity Line
C	8/15/05	Patriot Motorcycles Corporation	PMCY	OTC	$2,286,400	Common Stock
C	8/15/05	SatCon Technology Corporation	SATC	NASDAQ-NMS	$5,798,427	Common Stock
C	8/15/05	SONUS Pharmaceuticals, Inc.	SNUS	NASDAQ-NMS	$17,537,550	Common Stock
C	8/15/05	Xenogen Corporation	XGEN	NASDAQ-NMS	$15,000,000	Common Stock

* Status: C = Closed, DA = Definitive Agreement, A = Announced, I = Intended, P = Postponed, X = Cancelled
** C/A Date: Best available of (i) Closing Date, (ii) Definitive Agreement Date or (iii) Announced Date

INDUSTRY RANKINGS FOR 2005 YEAR-TO-DATE

PIPE Activity

PIPEs ISSUER BY SECURITY TYPE

Security Type	#	Total $m	Avg. $
Common Stock	563	$7,049,595,922	$12,521,485
Preferred Stock: Conv	153	$3,372,484,926	$22,042,385
Preferred Stock: non-Conv	2	$9,830,900	$4,915,450
Debt: Conv	250	$2,737,835,933	$10,951,344
Debt: non-Conv	27	$442,297,188	$16,381,377
Other: Conv	3	$210,502,762	$70,167,587
Prepaid Warrant	8	$105,312,114	$13,164,014
Equity Line	90	$1,988,600,000	$22,095,556
Unknown	6	$12,500,000	$2,083,333
Totals	**1,102**	**$15,928,959,745**	**$14,454,591**

PIPEs BY ISSUER MARKET CAPITALIZATION

Issuer Market Capitalization	#	Total $m	Avg. $
Less than $50 m	649	$4,221,480,256	$6,504,592
$50 m - $99 m	188	$2,023,000,912	$10,760,643
$100 m - $249 m	152	$2,872,081,313	$18,895,272
$250 m - $499 m	61	$2,126,904,588	$34,867,288
$500 m - $999 m	19	$1,297,657,109	$68,297,743
$1 b - $4.9 b	18	$3,016,742,823	$167,596,824
Greater than $5 b	1	$300,000,000	$300,000,000
Totals	**1,088**	**$15,857,867,001**	**$14,575,245**

TOTAL PLACEMENTS (ISSUER MARKET CAPITALIZATION & SECURITY TYPE)

Security Type	Less $50 m	$50 m - $99 m	$100 m - $249 m	$250 m - $499 m	$500 m - $999 m	$1 b - $4.9 b	Greater $5 b
Common Stock	251	129	109	48	11	8	-
Pref: Conv	104	23	12	1	2	8	1
Pref: non-Conv	2	-	-	-	-	-	-
Debt: Conv	187	28	24	6	2	2	-
Debt: non-Conv	21	3	1	1	1	-	-
Other: Conv	-	-	-	2	1	-	-
Prepaid Warrant	4	1	1	1	1	-	-
Equity Line	77	4	5	2	1	-	-
Unknown	3	-	-	-	-	-	-

TOTAL DOLLARS RAISED/SECURED (ISSUER MARKET CAPITALIZATION & SECURITY TYPE)

Security Type	Less $50 m	$50 m - $99 m	$100 m - $249 m	$250 m - $499 m	$500 m - $999 m	$1 b - $4.9 b	Greater $5 b
Common Stock	$1,112	$1,269	$2,013	$1,492	$651	$484	-
Pref: Conv	$690	$284	$279	$70	$130	$1,613	$300
Pref: non-Conv	$10	-	-	-	-	-	-
Debt: Conv	$781	$215	$335	$206	$280	$920	-
Debt: non-Conv	$113	$200	$5	$63	$61	-	-
Other: Conv	-	-	-	$186	$25	-	-
Prepaid Warrant	$24	$9	$11	$10	$51	-	-
Equity Line	$1,485	$45	$229	$100	$100	-	-
Unknown	$8	-	-	-	-	-	-

PIPE ACTIVITY - BY PRICE TYPE

	Fixed-Price			Reset-Price			Variable-Price		
Security Type	#	Total $m	Avg. $m	#	Total $m	Avg. $m	#	Total $m	Avg. $m
Common Stock	559	$7,045.43	$12.60	3	$3.10	$1.03	-	-	-
Preferred Stock: Conv	131	$3,219.15	$24.57	11	$109.01	$9.91	10	$41.82	$4.18
Debt: Conv	199	$2,602.89	$13.08	13	$60.23	$4.63	38	$74.72	$1.97
Other: Conv	3	$210.50	$70.17	-	-	-	-	-	-
Prepaid Warrant	8	$105.31	$13.16	-	-	-	-	-	-
Equity Line	1	$9.60	$9.60	-	-	-	89	$1,979.00	$22.24
Unknown	-	-	-	-	-	-	-	-	-
Totals	**901**	**$13,192.88**	**$14.64**	**27**	**$172.34**	**$6.38**	**137**	**$2,095.54**	**$15.30**

*Data shown in millions

Unless otherwise noted, PIPEs data based on PrivateRaise.com's proprietary EPP Database (TM). EPP Database includes only PIPEs that are at least US $1.0 million and have been executed by public corporations domiciled in the U.S. or by public, foreign companies that have a primary listing or a consistent/significant trading presence on any of the U.S. stock exchanges or markets. EPP Database is maintained and updated based on availability and timing of public disclosures (e.g. press releases and SEC filings). Information contained in the EPP Database has been obtained from sources deemed reliable. However, PrivateRaise.com cannot guarantee the accuracy and completeness of this information. The opinions expressed herein do not necessarily reflect those of PrivateRaise LLC. Rankings EXCLUDE Equity Lines and Corporate Investors.

PrivateRaise.com's

PIPEs SCORECARD

INDUSTRY RANKINGS

INDUSTRY RANKINGS FOR 2005 YEAR-TO-DATE

Investment Managers

RANKED BY TOTAL DOLLARS INVESTED

Rank	Investment Manager	Total $m	Avg. $	#
1	Warburg Pincus LLC	$545.00	$77.86	7
2	Southeastern Asset Management	$400.00	$400.00	1
3	Credit Suisse First Boston	$264.28	$37.75	7
4	Laurus Capital Management, L.L.C.	$244.05	$4.98	49
5	Texas Pacific Group	$200.00	$200.00	1
7	Legg Mason, Inc. (NYSE: LM)	$195.00	$65.00	3
8	Highbridge Capital Management, LLC	$191.37	$4.45	43
9	Nomura Holdings, Inc.	$165.00	$165.00	1
10	Yucaipa Companies, LLC (The)	$150.00	$150.00	1
11	Silver Lake Partners	$145.00	$145.00	1
12	Kayne Anderson Rudnick	$140.76 *	$46.92 *	6
13	Tortoise Capital Advisors, LLC	$114.73 *	$28.68 *	6
14	HBK Investments	$112.84	$8.68	13
15	Emirates International Investment	$100.00	$50.00	2
15	Davis Funds	$100.00	$100.00	1
15	Fairfax Financial Holdings Limited	$100.00	$100.00	1
15	General Atlantic Partners, LLC	$100.00	$100.00	1
15	MSD Capital, LP	$100.00	$100.00	1
15	Security Capital Research & Mgmt.	$100.00	$100.00	1
22	Highland Capital Management, LP	$90.00	$90.00	1
23	Yorkville Advisors Management, LLC	$82.26	$3.92	21
24	Cohen & Steers Capital Mgmt.	$81.27 *	$81.27 *	2
25	Fidelity Management & Research	$80.74	$20.18	4
26	Goldman Sachs Group, Inc.	$80.70 *	$16.14 *	7
27	Government of Singapore Investment	$77.44	$77.44	1

* EXCLUDES transactions where Investment Amount has not yet been disclosed

Investment Managers

RANKED BY # OF INVESTMENTS

Rank	Investment Manager	Total $m	Avg. $	#
1	Iroquois Capital L.P.	$58.95 *	$1.11 *	54
2	Nite Capital, L.P.	$14.85	$0.30	50
3	Laurus Capital Management, L.L.C.	$244.05	$4.98	49
4	Omicron Capital, L.P.	$42.52 *	$0.97 *	45
5	Highbridge Capital Management, LLC	$191.37	$4.45	43
6	LH Financial Services Corp.	$13.29	$0.38	35
7	Crestview Capital Funds	$61.08 *	$1.91 *	33
8	Atoll Asset Management, LLC	$29.47	$0.95	31
9	Downsview Capital, Inc.	$29.45	$0.98	30
9	Enable Capital Management	$13.92	$0.46	30
11	Whalehaven Fund Ltd.	$7.85 *	$0.28 *	29
12	SF Capital Partners Ltd.	$55.47	$2.13	26
12	N.I.R. Group (The), LLC	$40.04	$1.54	26
12	Bristol Capital Advisors, LLC	$17.63	$0.68	26
15	Gryphon Partners, LP	$36.34	$1.58	23
15	Ramius Capital Group, LLC	$29.66	$1.29	23
17	Beacon Capital Management	$15.77 *	$0.79 *	22
18	Yorkville Advisors Management, LLC	$82.26	$3.92	21
18	DKR Management Company, Inc.	$25.37 *	$1.34 *	21
20	Titan Capital Management	$2.92	$0.15	20
21	Special Situations Funds	$73.99 *	$4.35 *	19
21	Basso Capital Management	$23.66	$1.25	19
21	GreenLight (Switzerland) SA	$8.20	$0.43	19
24	Duncan Capital Group, LLC	$18.46 *	$1.23 *	17
25	Heights Capital Management, Inc.	$21.12	$1.32	16

* EXCLUDES transactions where Investment Amount has not yet been disclosed

Placement Agents

RANKED BY TOTAL DOLLARS PLACED

Rank	Placement Agent	Total $m	Avg. $	#
1	Citigroup Global Markets Inc.	$890.00	$445.00	2
2	Deutsche Bank AG	$528.66	$132.16	4
3	Tejas Securities Group Inc.	$426.50	$213.25	2
4	RBC Capital Markets	$321.07	$32.11	10
5	Leerink Swann & Company	$300.85	$42.98	7
6	Goldman, Sachs & Co.	$300.00	$300.00	1
7	Raymond James & Associates, Inc.	$292.39	$32.49	9
8	Lehman Brothers Inc.	$282.49	$56.50	5
9	SG Cowen & Co., LLC	$277.68	$23.14	12
10	Banc of America Securities LLC	$276.00	$55.20	5
11	UBS Securities LLC	$230.74	$76.91	3
12	FirstEnergy Capital Corp.	$225.46	$56.36	4
13	Roth Capital Partners, LLC	$217.02	$18.08	12
14	BMO Financial Group	$210.17	$26.27	8
15	Sprott Securities Limited	$206.92	$20.69	10
16	A.G. Edwards & Sons, Inc.	$203.42	$50.85	4
17	National Bank Financial Inc.	$197.06	$49.27	4
18	Tristone Capital Inc.	$192.05	$64.02	3
19	Rodman & Renshaw, LLC	$185.90	$10.94	17
20	Merriman Curhan Ford & Co.	$185.29	$18.53	10
21	Canaccord Capital Corp.	$183.35	$12.22	15
22	Wachovia Securities, Inc.	$182.00	$91.00	2
23	Scotia Capital Inc.	$181.31	$90.65	2
24	C.E. Unterberg, Towbin	$166.56	$16.66	10
25	TD Securities Inc.	$166.26	$83.13	2

Placement Agents

RANKED BY # OF PLACEMENTS

Rank	Placement Agent	Total $m	Avg. $	#
1	Rodman & Renshaw, LLC	$185.90	$10.94	17
2	Canaccord Capital Corp.	$183.35	$12.22	15
3	SG Cowen & Co., LLC	$277.68	$23.14	12
3	Roth Capital Partners, LLC	$217.02	$18.08	12
5	RBC Capital Markets	$321.07	$32.11	10
5	Sprott Securities Limited	$206.92	$20.69	10
5	Merriman Curhan Ford & Co.	$185.29	$18.53	10
5	C.E. Unterberg, Towbin	$166.56	$16.66	10
5	Haywood Securities Inc.	$88.43	$8.84	10
5	Laidlaw & Company (UK) Ltd.	$41.67	$4.17	10
11	Raymond James & Associates, Inc.	$292.39	$32.49	9
11	HPC Capital Management	$44.56	$4.95	9
13	BMO Financial Group	$210.17	$26.27	8
13	GMP Securities Ltd.	$108.47	$13.56	8
13	Dundee Securities Corporation	$82.87	$10.36	8
13	Stonegate Securities, Inc.	$34.43	$4.30	8
17	Leerink Swann & Company	$300.85	$42.98	7
17	CIBC World Markets Inc.	$139.10	$19.87	7
17	Burnham Hill Partners	$47.35	$6.76	7
17	H.C. Wainwright & Co., Inc.	$40.43	$5.78	7
17	Westminster Securities Corporation	$20.11	$2.87	7
22	Orion Securities, Inc.	$118.64	$19.77	6
22	First Associates Investments Inc.	$85.83	$14.30	6
22	Loewen, Ondaatje, McCutcheon Ltd.	$50.82	$8.47	6
22	Pacific International Securities Inc.	$44.80	$7.47	6

Unless otherwise noted, PIPEs data based on PrivateRaise.com's proprietary EPP Database (TM). EPP Database includes only PIPEs that are at least US $1.0 million and have been executed by public corporations domiciled in the U.S. or by public, foreign companies that have a primary listing or a consistent/significant trading presence on any of the U.S. stock exchanges or markets. EPP Database is maintained and updated based on availability and timing of public disclosures (e.g. press releases and SEC filings). Information contained in the EPP Database has been obtained from sources deemed reliable. However, PrivateRaise.com cannot guarantee the accuracy and completeness of this information. The opinions expressed herein do not necessarily reflect those of PrivateRaise LLC. Rankings EXCLUDE Equity Lines and Corporate Investors.

INDUSTRY RANKINGS FOR 2005 YEAR-TO-DATE

Investor Legal Counsel

RANKED BY TOTAL DOLLARS ADVISED

Rank	Investor Legal Counsel	Total $m	Avg. $	#
1	Schulte Roth & Zabel LLP	$545.87	$24.81	22
2	Latham & Watkins	$420.95	$84.19	5
3	Wachtell, Lipton, Rosen & Katz	$350.00	$116.67	3
4	Andrews & Kurth L.L.P.	$307.23	$102.41	3
5	Baker Botts, L.L.P.	$300.01	$100.00	3
6	Blackwell Sanders Peper Martin LLP	$241.00	$60.25	4
7	Fried, Frank, Harris, et al.	$201.00	$67.00	3
8	Lowenstein Sandler PC	$192.69	$8.76	22
9	Feldman Weinstein LLP	$163.19	$5.83	28
10	Milbank, Tweed, Hadley & McCloy	$145.00	$36.25	4
11	Skadden, Arps, Slate, et al.	$142.54	$35.63	4
12	Proskauer Rose LLP	$124.03	$9.54	13
13	Paul, Weiss, et al.	$123.64	$24.73	5
14	Katten Muchin Rosenman LLP	$105.50	$26.38	4
15	Mayer, Brown, Rowe & Maw	$105.00	$52.50	2
16	Duval & Stachenfeld	$74.00	$12.33	6
17	Wilson Sonsini Goodrich & Rosati, PC	$70.00	$70.00	1
18	Willkie Farr & Gallagher	$66.99	$33.49	2
19	Loeb & Loeb LLP	$66.90	$6.08	11
20	Bryan Cave LLP	$65.99	$9.43	7
21	Fraser Milner Casgrain LLP	$60.60	$60.60	1
22	Dewey Ballantine LLP	$58.52	$58.52	1
23	Drinker Biddle & Reath L.L.P	$55.50	$18.50	3
24	Gunderson Dettmer et al.	$54.50	$54.50	1
25	Vinson & Elkins L.L.P.	$50.00	$50.00	1

RANKED BY # OF PLACEMENTS ADVISED

Rank	Investor Legal Counsel	Total $m	Avg. $	#
1	Feldman Weinstein LLP	$163.19	$5.83	28
2	Schulte Roth & Zabel LLP	$545.87	$24.81	22
2	Lowenstein Sandler PC	$192.69	$8.76	22
2	Ballard Spahr Andrews & Ingersoll	$41.64	$1.89	22
5	Grushko & Mittman, P.C.	$30.81	$1.81	17
6	Proskauer Rose LLP	$124.03	$9.54	13
7	Loeb & Loeb LLP	$66.90	$6.08	11
7	Sheppard, Mullin, Richter & Hampton	$42.60	$3.87	11
9	Bryan Cave LLP	$65.99	$9.43	7
9	Kramer Levin Naftalis & Frankel LLP	$28.72	$4.10	7
11	Duval & Stachenfeld	$74.00	$12.33	6
12	Latham & Watkins	$420.95	$84.19	5
12	Paul, Weiss, et al.	$123.64	$24.73	5
12	Greenberg Traurig, LLP	$14.55	$2.91	5
15	Blackwell Sanders Peper Martin	$241.00	$60.25	4
15	Milbank, Tweed, Hadley & McCloy	$145.00	$36.25	4
15	Skadden, Arps, et al.	$142.54	$35.63	4
15	Katten Muchin Rosenman LLP	$105.50	$26.38	4
15	Warren W. Garden, P.C.	$20.04	$5.01	4
15	Krieger & Prager, LLP	$19.48	$4.87	4
21	Wachtell, Lipton, Rosen & Katz	$350.00	$116.67	3
21	Andrews & Kurth L.L.P.	$307.23	$102.41	3
21	Baker Botts, L.L.P.	$300.01	$100.00	3
21	Fried, Frank, et al.	$201.00	$67.00	3
21	Drinker Biddle & Reath L.L.P	$55.50	$18.50	3

Issuer Legal Counsel

RANKED BY TOTAL DOLLARS ADVISED

Rank	Issuer Legal Counsel	Total $m	Avg. $	#
1	Willkie Farr & Gallagher	$1,286.00	$257.20	5
2	Vinson & Elkins L.L.P.	$524.58	$65.57	8
3	Andrews & Kurth L.L.P.	$473.05	$118.26	4
4	Cooley Godward LLP	$361.14	$36.11	10
5	Kirkland & Ellis	$251.30	$125.65	2
6	Skadden, Arps, et al.	$240.17	$60.04	4
7	Fulbright & Jaworski L.L.P.	$225.42	$37.57	6
8	Sullivan & Cromwell	$177.44	$88.72	2
9	Heller Ehrman/Venture Law Group	$177.18	$14.77	12
10	Baker Botts, L.L.P.	$176.80	$29.47	6
11	McGuire Woods LLP	$176.38	$88.19	2
12	Wilson Sonsini Goodrich & Rosati	$174.92	$15.90	11
13	Paul, Hastings, Janofsky & Walker	$163.51	$32.70	5
14	Dickstein Shapiro Morin & Oshinsky	$162.72	$40.68	4
15	Greenberg Traurig, LLP	$157.52	$7.50	21
16	Shearman & Sterling	$150.00	$150.00	1
17	Latham & Watkins	$147.53	$21.08	7
18	Blank Rome LLP	$141.29	$23.55	6
19	Katten Muchin Rosenman LLP	$139.56	$34.89	4
20	Wilmer Cutler et al.	$137.55	$22.93	6
21	Sichenzia Ross Friedman Ference	$125.80	$3.23	39
22	DLA Piper Rudnick Gray Cary US	$122.31	$15.29	8
23	Hunton & Williams	$101.56	$33.85	3
24	Morgan, Lewis & Bockius LLP	$100.60	$14.37	7
25	Foley, Hoag & Eliot LLP	$100.04	$50.02	2

RANKED BY # OF PLACEMENTS ADVISED

Rank	Issuer Legal Counsel	Total $m	Avg. $	#
1	Sichenzia Ross Friedman Ference	$125.80	$3.23	39
2	Greenberg Traurig, LLP	$157.52	$7.50	21
3	Heller Ehrman/Venture Law Group	$177.18	$14.77	12
3	Kirkpatrick & Lockhart et al.	$51.04	$4.25	12
5	Wilson Sonsini Goodrich & Rosati	$174.92	$15.90	11
6	Cooley Godward LLP	$361.14	$36.11	10
7	Vinson & Elkins L.L.P.	$524.58	$65.57	8
7	DLA Piper Rudnick Gray Cary US	$122.31	$15.29	8
9	Latham & Watkins	$147.53	$21.08	7
9	Morgan, Lewis & Bockius LLP	$100.60	$14.37	7
9	Sheppard, Mullin, et al.	$86.35	$12.34	7
9	Mintz, Levin, et al.	$63.77	$9.11	7
9	Richardson & Patel, LLP	$59.30	$8.47	7
9	Troy & Gould PC	$52.19	$7.46	7
9	Clark Wilson LLP	$31.64	$4.52	7
16	Fulbright & Jaworski L.L.P.	$225.42	$37.57	6
16	Baker Botts, L.L.P.	$176.80	$29.47	6
16	Blank Rome LLP	$141.29	$23.55	6
16	Wilmer Cutler et al.	$137.55	$22.93	6
16	Morrison & Foerster LLP	$67.81	$11.30	6
16	Jackson Walker L.L.P.	$64.97	$10.83	6
16	Gersten, Savage, et al.	$48.77	$8.13	6
16	Patton Boggs LLP	$27.89	$4.65	6
24	Willkie Farr & Gallagher	$1,286.00	$257.20	5
24	Paul, Hastings, et al.	$163.51	$32.70	5

Unless otherwise noted, PIPEs data based on PrivateRaise.com's proprietary EPP Database (TM). EPP Database includes only PIPEs that are at least US $1.0 million and have been executed by public corporations domiciled in the U.S. or by public, foreign companies that have a primary listing or a consistent/significant trading presence on any of the U.S. stock exchanges or markets. EPP Database is maintained and updated based on availability and timing of public disclosures (e.g. press releases and SEC filings). Information contained in the EPP Database has been obtained from sources deemed reliable. However, PrivateRaise.com cannot guarantee the accuracy and completeness of this information. The opinions expressed herein do not necessarily reflect those of PrivateRaise LLC. Rankings EXCLUDE Equity Lines and Corporate Investors.

Continued from front page

trade close-out provisions of the law. Stocks which have FTDs that exceed the threshold level in excess of 0.5% of the issuers' total outstanding shares are placed on a "threshold list" that is distributed daily by each primary U.S. exchange and market center. Those stocks are subject to the mandatory borrow and close-out rules, which are intended to clean up the excessive settlement failures within 13 days of becoming a threshold-listed stock.

Yet, in the first six months after Reg SHO's "mandatory close-out" rule for threshold-listed stocks went into effect, the amount of FTDs in Amex, Bulletin Board and Pink Sheets-quoted stocks which exceed the threshold level has decreased only 17% from the average daily levels of June 2004, when the SEC adopted Reg SHO. Excessive settlement failures decreased only slightly more for the more liquid stocks traded on the New York Stock Exchange and Nasdaq.

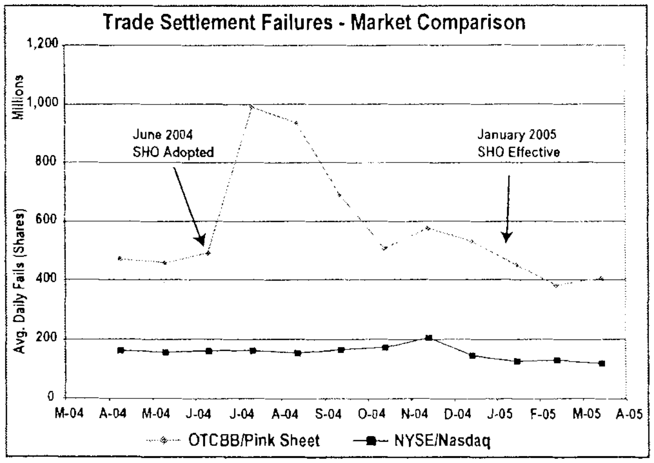
And while FTD levels have decreased since SHO's implementation in January, the amount of decrease pales in comparison to the more than 120% increase in FTDs in Amex, OTCBB, and Pink Sheets stocks that occurred in August 2004, shortly after Reg SHO was adopted but not yet implemented. The sharp increase in naked shorting immediately after the adoption of the new rules calls into question the wisdom of a decision advocated by the SEC Division of Market Regulation's former head, now commissioner, Annette Nazareth, to delay implementation of Reg SHO and to "grandfather" all failed naked short sale trades executed prior to the January 5 implementation date.

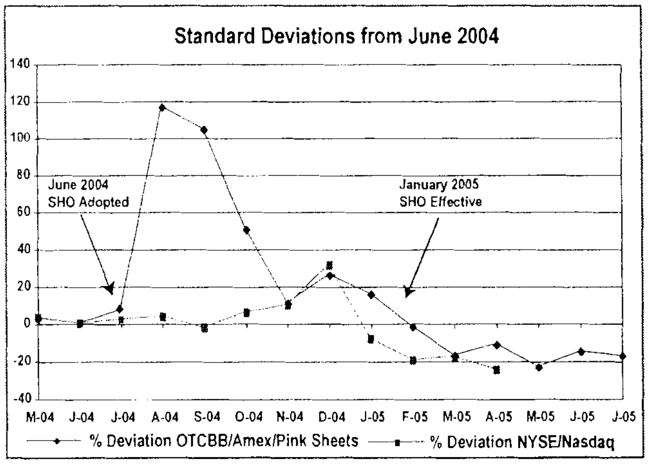
"Failures-to-deliver" are created when equity securities are sold -- either short or long - and not delivered within the three-day period mandated by the SEC. Long sales rarely result in extended FTDs because in most cases shares are automatically debited from sellers' accounts when they are sold, but short sale rules do not require that the seller have control of the shares he is shorting prior to executing their sale. Short sellers must only attest to their likely availability to be borrowed in time to settle the trade in three days, when delivery of the shares to the buyer must be made. When shares are sold short and, either intentionally or unintentionally, never borrowed and delivered for settlement, a "naked short" is created. When the naked short fails to settle three days later, it is recorded at the clearing agent as a "failure-to-deliver."

Naked short selling, by creating trades that are not backed by the timely transfer of bonafide securities between seller and buyer, injects selling pressure into the market that is not bound by the basic supply-demand forces that normally determine market prices for securities, because the naked short seller is not restricted by the available inventory of shares that can be borrowed for delivery to the buyer at settlement.

Prior to Reg SHO's adoption last year, some PIPE investors employed naked shorting as a means of hedging their investments in illiquid micro cap companies whose stock was otherwise unavailable to be borrowed to support a traditional short position. Several have been accused, by the SEC, NASD, and issuer managements, of using naked shorting to manipulate the pricing of their PIPE investments and increase their returns. The SEC has likened a naked short position to an "undated put option" that gives the investor virtually risk-free leverage.

The daily fails data, provided to the SEC by the National Securities Clear-





Source: National Securities Clearing Corp.

ing Corp. (NSCC), the equities clearing unit of the Depositary Trust and Clearing Corp. (DTCC), includes FTD data for all stock trades processed between large brokerages in the DTCC's Continuous Net Settlement (CNS) system. Trades between buyers and sellers using the same broker are settled internally, referred to as "ex-clearing," and are not included in the CNS data. The data obtained by *TPR* is divided into two sets, one aggregating daily fails of threshold level stocks listed on the more liquid NYSE and Nasdaq, and another set combining fails in the shares of fully-reporting companies quoted on the less liquid Amex, Bulletin Board, and Pink Sheets markets.

In the two months prior to the SEC's adoption of Reg SHO in June 2004, excessive delivery failures averaged 570 million shares a day among stocks quoted on the Amex, Bulletin Board, or Pink Sheets, and 161 million shares a day among stocks quoted on the NYSE or Nasdaq. In the six months following adoption of Reg SHO, but prior to it going into effect, the average level of daily FTDs climbed 17% among the Amex, Bulletin Board, and Pink Sheet stocks, and 4% for NYSE and Nasdaq stocks.

Since Reg SHO went into effect, average daily fail levels have decreased 20% for NYSE and Nasdaq stocks, and 28% for Amex, Bulletin Board, and Pink Sheets shares. While it appears implementation of the rule had a substantive initial effect on failure levels, the effect appears to have quickly reached its limits. Virtually all of the decrease in failure levels occurred in the first 60 days after SHO's effective date. Settlement failure rates have not changed significantly since March.

While some progress is evident in reducing the number of extended failed settlements since Reg SHO went into effect, it is a far cry from the expectations of SEC staff and short sale reform advocates when the rule was adopted. In a Securities Industry Association forum on Reg SHO last November, Larry Bergmann of the SEC's Division of Market Regulation told the assembled crowd of clearing and prime brokerage executives that the average level of FTDs at the time of SHO's adoption should be considered "the high water mark."

"The level of fails should decrease over the level before [Reg SHO]," Bergmann said. "The ultimate goal is to reduce the extended fails we've seen in past years." Bergman did not respond to calls seeking comment on the FTD data.

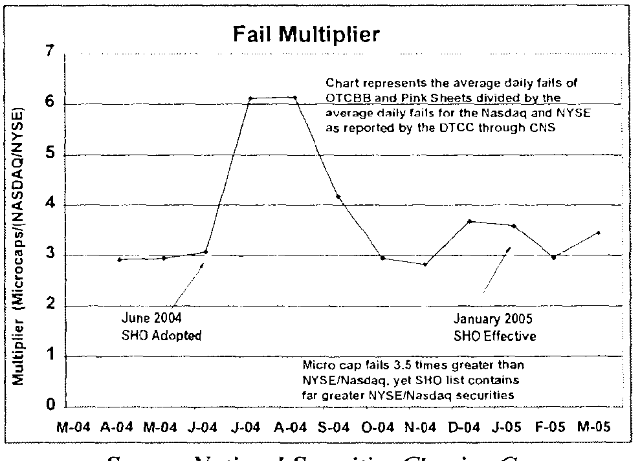
Disparity: Liquid v. Illiquid

The two sets of settlement failure data bring into sharp relief the disparity in settlement failures of liquid versus illiquid stocks. On average, there are 3.5 times as many shares in FTD status of companies listed on the less liquid OTCBB, Amex, and Pink Sheets markets than of companies listed on the NYSE and Nasdaq. This is despite the huge difference in overall volume between the two groups of market centers: the NYSE and Nasdaq trade about 3.3 billion shares daily, while the OTCBB, Amex and most active Pink Sheets average about 1.7 billion shares a day, 95% of which is on the Bulletin Board.

Such disparity in settlement failures resulting from naked short trades was first predicted by Dr. Leslie Boni of the University of New Mexico in a study prepared while a visiting financial economist at the SEC in 2004. The resulting research paper, "Strategic Delivery Failures in U.S. Equity Markets," postulated that most delivery failures were intentional, the result of investors and market makers choosing to naked short securities that were either too expensive to borrow or unavailable to borrow at all. As liquidity was the primary factor influencing the price and availability of borrowable shares, illiquid markets such as the Bulletin Board would experience the highest level of settlement failures, Boni suggested.

"Long-lived fails are more likely the result of strategic fails rather than inadvertent delivery errors or delays.... Stocks that trade on the Over-the-Counter Bulletin Board and Pink Sheets are likely to be among the hardest hit," wrote Boni. The study, released as a working paper last November, has been peer-reviewed and accepted for publication by the *Journal of Financial Markets*.

The lack of progress in eliminating naked shorting is bringing pressure on the SEC to strengthen the enforcement of Reg SHO and perhaps rewrite it to toughen the rule's tolerance for extended settlement failures. The SEC's Division of Market Regulation has been heavily criti-



Source: National Securities Clearing Corp.

TREND WATCH ***SHO Fails to Deliver***

cized for intervening to halt NASD initiatives to adopt much stricter anti-naked shorting and mandatory settlement rules that would have required "pre-borrowing" of all Bulletin Board short trades and required mandatory close-out through forced buy-ins of all FTDs within 10 days. The SEC rejected the initiatives, claiming they were superseded by Reg SHO.

A growing chorus of critics among small public company managements, small cap investors, state regulators and former SEC staff is calling on the agency to revisit Reg SHO's more controversial provisions, to step up enforcement (the agency has yet to bring an action against a Reg SHO violator) and to bring more transparency to the micro cap market centers experiencing the brunt of naked shorting activity. Many have pointed to the Reg SHO threshold lists themselves – which routinely list several hundred issuers traded on Nasdaq and the NYSE, yet include fewer than a dozen Bulletin Board issuers on most days – as proof that, for micro caps traded on the less liquid markets, the SEC neither cares to know of nor intends to prosecute violations of Reg SHO.

Cromwell Coulson, CEO of Pink Sheets LLC, has petitioned the SEC to require reporting of short interest in OTC issues, as has been done for years in Nasdaq and NYSE stocks.

"There is a crisis facing the OTC market today in the lack of short sale position reporting and disclosure for OTC issues," Coulson wrote in a recent letter to the agency. "This lack of transparency regarding short selling in the OTC market allows fraudulent acts to go undiscovered and manipulative short sellers to hide.... Small issuers traded on the Pink Sheets and the OTCBB deserve the same transparency and regulatory oversight of short selling as those listed on Exchanges or Nasdaq."

Coulson has asked the SEC to cause the amendment of NASD Rule 3360 and require NASD broker dealers to maintain a record of total "short" positions in all customer and proprietary firm accounts in all publicly traded equity securities as well as report the information to the NASD for public dissemination. "The SEC's action is urgently needed to prevent fraudulent acts, expose market manipulation, promote fair principles of trade and protect investors," he wrote. The agency has made no comment on the proposal.