

U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515

March 20, 1991

The Honorable Richard C. Breeden
Chairman
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Dear Chairman Breeden:

Thank you for your letter of February 22, 1991, which transmitted to the Subcommittee the Commission's report on limited partnership roll-ups, and your letter of March 18, 1991, which transmitted additional information requested in the Subcommittee's letter of June 11, 1990.

We are pleased to learn that the issues the Subcommittee raised with the Commission last June regarding limited partnership roll-ups are now the subject of a review being conducted by the staff of the Commission's Division of Corporation Finance. As you know, on October 3, 1990, the Subcommittee held an initial hearing on roll-ups. This hearing identified a number of serious concerns about abusive roll-up practices, the adequacy and readability of disclosure documents, the lack of "dissenters' rights" options for limited partners opposed to roll-ups, and a number of problems associated with the proxy solicitation process associated with roll-ups.

At the Subcommittee's October 3rd hearing special concern was expressed on whether the increasing complexity and unreadability of disclosure documents was interfering with the fundamental purpose of assuring access to information needed to make informed investment decisions. We understand that in recent Congressional testimony you stated you had personally examined some roll-up disclosure documents and that you would "like to meet the person who can understand all the provisions in the documents." So would we.

We are certain that you would agree that when seasoned securities lawyers and financial professionals have difficulty understanding disclosure documents, there is a very serious problem. We appreciate your candor in acknowledging the inadequacies in current disclosure documents, and we look forward to working with you and the SEC staff in a bipartisan fashion to develop standards for all disclosure documents, not just roll-ups, which result in clear, concise, and comprehensible disclosure for investors.

At the same time, we are somewhat surprised to learn that the SEC apparently considers comparisons between exchange values and market values to be "an inappropriate basis for price

comparisons, since they are calculated solely for purposes of the roll-up." Using the first day of trading as the baseline for measuring the price performance of rolled-up securities is like measuring the October 1987 market crash using the opening trading prices on October 20th -- the day after the 500-point drop -- as the baseline. We would expect that the SEC -- which is charged with the responsibility of assuring the protection of investors -- would not want to close its eyes to the critical event which results in so substantial a diminution in value to investors -- the roll-up transaction itself.

It is our understanding, based on the SEC's roll-up report, that the exchange value is typically based on the underlying appraised market value of the investor's equity interest in the underlying assets of the partnership. If the roll-up transaction itself results in dramatic losses in investor equity compared to other options (such as holding and disposing of the assets of the partnership in the ordinary course of business, liquidating the assets immediately, or selling the partnership on the secondary market), it would appear reasonable for the SEC to require that a clear comparison of these alternatives be provided to investors, rather than a nebulous statement that "market values are likely to be substantially below exchange values."

As you may know, the Subcommittee is planning a hearing on roll-ups on March 21st and intends to hold an additional hearing on this issue within the next several weeks. The Subcommittee also is moving forward on a bipartisan basis to consider possible legislative remedies to help curb roll-up abuses. In order to better inform the Subcommittee's deliberations on this matter, it is requested that the Commission provide answers to the following questions:

1. Your letter of February 22, 1991, and the accompanying SEC staff report on roll-ups both indicate that the Commission is presently examining the readability and understandability of roll-up disclosure documents filed with the SEC. Please inform the Subcommittee:

A.) What criteria the SEC presently uses to determine readability and understandability.

B.) Whether any readability tests are used by the SEC to evaluate prospectuses (e.g., the Flesch test, Gunning's Fog Index or other objective test of readability). If not, are there any plans to use such tests in the future?

C.) Whether the SEC applies any other established measures of readability to roll-up or other disclosure documents.

D.) Whether there have been any instances in which the SEC required the issuer of a roll-up prospectus/proxy statement to rework a section due to its unreadability alone.

E.) Whether the SEC has ever conducted or commissioned any scientific polling of investors or conducted any investor focus groups aimed at determining whether investors can actually read and understand disclosure documents. Does the SEC anticipate conducting polling or focus groups on this matter in the near future?

- F.) Whether the Commission believes that a short, concise summary in readily understandable English at the beginning of all proxy/prospectus documents would benefit investors. If so, is it possible within the existing securities rules and regulations to require such a summary or would additional legislation be needed?
2. The SEC Staff Report indicates that “as part of its review of the disclosure requirements and practices, the staff is specifically addressing the need for modifications of current requirements to enhance the usefulness of forecast and appraisal disclosure.” What specific modifications are being considered? Do you believe that the “issuance of common stock” exemption from the filing requirement of Rule 13e-3 is sufficient to protect limited partners where the resulting roll-up results in a change in the liquidation rights and tax attributes of the security?
3. The SEC Staff Report indicates that “the staff is reviewing the valuation information currently being provided to investors to determine whether the requirements need to be revised, or further guidance given.” The Staff Report further indicates that “a particular focus of the staff review is on whether liquidation or dissolution value (where it would be materially different from the exchange value) information should be discussed in the disclosure document.” What would be the benefits of including information on liquidation or dissolution value where it differs from the exchange value?
4. With regard to the specific disclosure items of Schedule 14a and the general antifraud prohibitions of Rule 14a-9, the SEC Staff report indicates that “the staff is in the process of reviewing these requirements and disclosure practices thereunder to determine the need for additional requirements or guidance, in light of the concerns raised by commentators and participants in these transactions.” The Report further states that “In a heightened effort, a number of suggestions have already been implemented through the review and comment process.” Please inform the Subcommittee what specific roll-up proposals have been affected by the changes SEC has implemented to date.
5. The SEC Staff Report indicates that “the adequacy of solicitation periods is being considered as part of the Commission’s review of proxy issues in general.” Does the SEC believe that an extension of the time for consideration of proxy documents to at least 45 days would be adequate?
6. The SEC Staff Report indicates that “the confidentiality of preliminary proxy material is the same for corporate and partnership business combinations, and is an issue being considered in the Commission’s review of the proxy rules.”
- A.) Please describe the specific justifications for allowing roll-up prospectuses/proxy statements to be filed on a confidential basis.
- B.) Is the same level of confidentiality needed for roll-up transactions as might be needed for corporate business combinations?

C.) Does the SEC see any difference between partnership roll-ups and mergers/acquisitions with respect to the need for protection of the roll-up sponsor from takeover attempts should the prospectus be made public during the registration period?

7. The SEC Staff Report states that many limited partnerships “were formed as ‘tax deals’ and were designed to provide tax losses to investors.” What number and percentage of partnerships that have been the subject of roll-ups had as a primary purpose of the partnership the preservation of capital, income, growth or other purpose, with tax benefits being of secondary or lesser importance?

8. Has the SEC received complaints about unfair or abusive tactics used by roll-up sponsors or proxy solicitors in conjunction with roll-ups? If so, what steps, if any, are being taken to investigate and prevent such abuses?

9. The Subcommittee has received a number of complaints from limited partners who have encountered difficulties in obtaining access to lists of other limited partners from the general partner. What right does a limited partner have regarding access to partnership member lists? Does the general partner have any responsibility to provide such lists in a timely fashion? Has the SEC received any complaints from limited partners about failures to provide access to such lists, and, if so, what action has the SEC taken in response?

10. Does the SEC consider the filing of complaints by investors to the Enforcement Division of the SEC to be a material disclosure item which should be disclosed to investors, assuming that the Enforcement Division is pursuing an investigation or enforcement action against the general partner and the general partner is aware of such investigation or enforcement action? If your answer is no, please indicate what distinction the SEC would draw between such complaints and the filing of lawsuits, with respect to judging what is material to disclose.

11. The Supplemental SEC Staff reports on roll-ups neglected to provide the information the Subcommittee requested regarding comparisons of “secondary trading of limited partnerships before the roll-up, exchange values projected by the general partner, first day and subsequent trading values, and current trading values.” The Subcommittee has just received from the SEC comparing exchange values with closing market price on the first trading day for 23 of the 36 limited partnership roll-ups described in the SEC Supplemental Report. Please provide the same data for the remaining 13 rollups and the secondary market pricing information previously requested by the Subcommittee.

12. The Supplemental SEC Staff Report states that “exchange values are an inappropriate basis for price comparisons, since they are calculated solely for purposes of the roll-up.” If exchange values are not an appropriate basis for price comparisons, why does the SEC staff report state that this information is required to be disclosed in the prospectus in order to “provide investors sufficient information concerning the appraised value of the properties or the oil and gas reserves to assess the adequacy of the exchange value set by the general partner?” How are investors to judge the worth of their investment or the fairness of the roll-up proposal if they

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cannot compare the value of their investment under the roll-up to the value they would retain if they stuck with their original deal or liquidated the assets of the partnership?

Thank you for your assistance and cooperation in this matter. The Subcommittee requests that a response be provided within 15 working days, or not later than close of business day on April 10, 1991. Should there be any questions about this request, please have your staff contact Mr. Jeffrey S. Duncan of the Subcommittee Staff (226-2424) or Mr. Stephen A. Blumenthal of the Minority Staff (226-3400).

Sincerely,

EDWARD J. MARKEY
CHAIRMAN
SUBCOMMITTEE ON
TELECOMMUNICATIONS AND FINANCE

MATTHEW J. RINALDO
RANKING MINORITY MEMBER
SUBCOMMITTEE ON
TELECOMMUNICATIONS AND
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Your help would be greatly appreciated.

Thanks,

Ed.