

NASD NOTICE TO MEMBERS 94-69

**Committee On
Compensation Practices
Requests Comment;
Comment Period
Expires October 14,
1994**

Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

An Open Letter To Members Of The Financial Services Industry Regarding Compensation Of Retail Brokers And Their Supervisors August 29, 1994

As you may be aware, Securities and Exchange Commission Chairman Arthur Levitt asked us to serve on a committee to examine the securities industry's compensation practices and to highlight areas of potential conflicts of interest as well as examples of particularly effective procedures for managing the broker-investor relationship. The Committee is seeking to identify practices that most effectively eliminate, reduce, or mitigate these conflicts of interest.

Specifically, the Committee's mission is to:

- Review industry compensation practices.
- Identify actual and perceived conflicts of interest for both brokers and managers.
- Identify the "best practices" used in the industry to eliminate, reduce, or mitigate such conflicts.

The Committee is particularly interested in any conflicts that exist at the time of sale. Simply stated: When a responsible broker can choose among a large number of reasonable investments, what influences his/her recommendation? Does the broker place the investor's interest first? To what extent do compensation practices influence a broker's recommendation?

We hope that this Committee's work will initiate a dialogue within the industry about the best compensation practices and encourage firms to compete on the basis of how they manage these real and perceived conflicts.

As part of the Committee's process, we would like your help and your views on these issues. We are not seeking information about any specific compensation program at any particular firm. Rather, we are seeking examples of how current compensation practices affect sales behavior, as well as examples of practices that eliminate or reduce conflicts.

The Committee would like your thoughts on what impact, if any, the following compensation practices have on sales behavior: differentiating compensation by product; flat fees versus transactional commissions; recruitment practices (e.g., up-front payments and increased payouts); compensation for fixed income products (e.g., credits); sales contests or other incentive programs; and supervisor compensation.

Similarly, many in the industry have developed practices designed to align closely the broker's interest with that of the client. The Committee is interested in your observations regarding such practices, including supervision and other management techniques, compliance and training programs, and disclosure.

We want to emphasize that the above are only examples of the kinds of practices that we are interested in examining; they are in no way intended to limit any observations or comments you may have on this subject. The Committee

welcomes any insights you may wish to provide, including those based on your experiences with experimental or pilot programs.

We hope you will take the time to respond and share your views with us. Please forward your comments to:

Professor Samuel L. Hayes III
Jacob H. Schiff Professor of Investment Banking
Harvard Business School, Morgan 375
Soldiers Field Road
Boston, MA 02163
Fax: (617) 496-6592

Please respond by Friday, October 14, 1994. Thank you in advance for your assistance.

Sincerely,

Daniel P. Tully
Chairman, Committee on Compensation Practices
Chairman and Chief Executive Officer
Merrill Lynch & Co., Inc.

Warren Buffett
Chairman and Chief Executive Officer
Berkshire Hathaway Inc.

Samuel L. Hayes III
Jacob H. Schiff Professor of Investment Banking
Harvard University, Graduate School of Business Administration

Raymond A. Mason
Chairman and Chief Executive Officer
Legg Mason, Inc.

Thomas O'Hara
Chairman of the Board
National Association of Investors Corp.

John F. Welch, Jr.
Chairman and Chief Executive Officer
General Electric Company

NASD NOTICE TO MEMBERS 94-70

**SEC Approves Adoption
Of NASD Limited
Partnership Rollup
Transaction Rules;
Effective Date:
November 1, 1994**

Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

Executive Summary

On August 15, 1994, the Securities and Exchange Commission (SEC or Commission) approved amendments, in part, to Article III, Section 34 (Section 34), of the NASD Rules of Fair Practice prohibiting NASD members or associated persons from participating in "limited partnership rollup transactions" (rollup or rollup transactions) unless the transaction includes certain specified provisions designed to protect the rights of limited partners, and amendments to Schedule D to the By-Laws (Schedule D) prohibiting the authorization for quotation on the Nasdaq National Market[®] of any security that results from a "limited partnership rollup transaction" unless the transaction was conducted in accordance with certain specified procedures designed to protect the rights of limited partners (together, rollup rules). Simultaneously, the Commission solicited public comment on proposed amendments to Section 34 which would apply the new definition of "limited partnership rollup transaction" to Subsections (A) and (B) of Article III, Section 34(b)(6) that regulate the receipt of differential compensation for the solicitation of sales or tenders in a rollup transaction.¹ The amendments approved by the SEC take effect November 1, 1994. The full text of the amendments follows this Notice.

Background

During the 1980s, more than \$150 billion of public limited partnership interests were sold to U.S. investors, most of whom were small investors with an average investment of about \$10,000. Limited partners, unlike general partners, received many of the tax benefits of business ownership without the resultant responsibility and liability. Partnerships "passed through" tax benefits to the

limited partners who were not involved in the day-to-day management of the limited partnership and usually could not lose more than their capital contributions. Some partnerships financed limited partner contributions through recourse or non-recourse loans, thereby generating an additional layer of tax write-offs for the investor.

Limited partnership interests, however, were typically illiquid, due to the nature of the investment and the lack of an active trading market for such interests. Federal tax reform in 1986 eliminated most tax benefits for limited partner investors by, among other things, lowering the marginal tax rate to 28 percent, eliminating preferential treatment for capital gains, limiting the offsetting use of losses generated from passive activity to passive income only, lengthening depreciation schedules, extending the at-risk rules to include real estate investments, and altering the method for calculating depreciation. Subsequently, economic developments contributed to the deterioration of partnership performance. Some general partners responded by restructuring the limited partnerships or "rolling" them up into new entities.

Use Of Rollups

A limited partnership rollup either reorganizes an existing limited partnership or combines multiple limited partnerships into a new entity to take advantage of larger asset pools and economies of scale. However, many rollups resulted in newly traded securities that immediately traded at a discount to its net asset value, as the cash flow from the stronger partnerships supported losses from weaker

¹ Securities Exchange Act Release No. 34533 (August 15, 1994); 59 F.R. 43147 (August 22, 1994).

partnerships. Also, many investors in rollups found that the terms of the original partnership agreement had changed significantly as to voting rights, term of existence of the entity, management compensation, or investment objectives. Rollups were solicited in many cases with the help of proxy solicitation firms that were paid to solicit only "yes" votes for approval of the rollup.

Federal Legislation

The Limited Partnership Reform Act of 1993, (Rollup Reform Act), enacted in December 17, 1993, as part of the Government Securities Act Amendments of 1993, is the legislative response to rollup transactions. Section 3(a) of the Rollup Reform Act amended Section 15A(b) of the Securities Exchange Act of 1934 (Exchange Act) to require that NASD rules prohibit members from participating in any limited partnership rollup transaction that does not provide procedures to protect the rights of limited partners. Section 3(c) of the Rollup Reform Act also amended Section 15A(b) of the Exchange Act to require that the rules of the Nasdaq National Market prohibit the authorization for quotation of any security resulting from a rollup transaction unless the transaction provides certain rights for limited partners. The NASD believes these new rollup rules comply with this Congressional mandate.

Amendments

DEFINITIONS

Subsection 34(b)(2)(B) and Part I, Schedule D have been amended to add as new definitions the following terms:

- **Cash Available for Distribution:** cash flow of a limited partnership less amounts set aside for restoration or creation of reserves.

- **Cash Flow:** cash provided from limited partnership operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash funds used to pay all other expenses, debt payments, capital improvements and replacements.

- **Dissenting Limited Partner:** a person who, on the date rollup solicitation material is mailed to investors, holds a beneficial interest in a limited partnership that is the subject of the limited partnership rollup transaction and who voted against the transaction and complies with procedures established by the NASD to assert dissenters' rights, except that for purposes of an exchange or tender offer, a person must file an objection in writing with the party responsible for tabulating the votes or tenders during the period in which the offer is outstanding. Consequently, a person who abstains from voting cannot qualify as a dissenting limited partner, and a person who purchases a limited partner interest after the date on which soliciting material is mailed will be prevented from asserting dissenters' rights.

- **Limited Partner or Investor in a Limited Partnership:** the purchaser of an interest in a direct participation program that is a limited partnership, and who is not involved in the day-to-day management of the limited partnership and bears limited liability. The term "direct participation program" is defined in Section 34 as a program that provides for flow-through tax consequences regardless of the structure of the legal entity.

- **Limited Partnership:** an unincorporated association that is a direct participation program organized as a limited partnership, whose partners are one or more general partners and one or more limited partners, that conforms to the provisions of the Revised Uniform Limited

Partnership Act or the applicable state statute that regulates the organization of such partnership.

- **Limited Partnership Rollup Transaction:** a transaction involving the combination or reorganization of one or more limited partnerships, either directly or indirectly, in which: 1) some or all of the investors in any of the limited partnerships will receive new securities reported under a transaction reporting plan (i.e., Nasdaq National Market, the New York Stock Exchange, and the American Stock Exchange); 2) any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan; 3) investors in any of the limited partnerships are subject to a significant adverse change as to voting rights, the term of existence of the entity, management compensation, or investment objectives; and 4) any such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue.²

The first and second requirements are intended to include those limited partnership rollup transactions where the limited partners are not able to

² The SEC has published for comment whether the current definition of "rollup or rollup of a direct participation program" should continue to apply to Subsections 34(b)(6)(A) and 34(b)(6)(B) which regulate the receipt of differential compensation in the solicitation of votes and tenders in a rollup. These provisions were adopted in 1991. See *Notice to Members 91-56* (September 1991). The SEC has approved the new definition of "limited partnership rollup transaction" to apply to new Subsection 34(b)(6)(C). The SEC's comment period expired on September 12, 1994. The text of the rollup rules attached to this Notice show Subsections (A) and (B) as if the proposed amendments published for comment were adopted.

dispose of their interests in an active trading market before the rollup transaction and then, as a result of a rollup, receive new listed securities. The third and fourth requirements are intended to exclude limited partnership rollup transactions that are not subject to significant adverse change or have the option to retain a similar security. As for the fourth requirement, the standards for determining whether the security to be received by all investors are substantially the same as the standards that are included in the requirements applicable to the rights of dissenting limited partners in Subsection 34(b)(6)(C)(i)b and Subsection 3(a)(2)(ii) to Part III, Schedule D.

The inclusion of the terms "directly or indirectly" in the preamble to the definition are intended to include multiple-step transactions in the definition of limited partnership rollup transactions. The definition also covers indirect rollup transactions, such as those in which a single non-traded partnership first undergoes a simple reorganization and then, in a subsequent transaction or series of transactions, the successor entity is either reorganized or merged with other business entities and, as a consequence of this reorganization or merger, there is a publicly traded security with a significant adverse change in voting rights, the term of existence of the entity, management compensation, or investment objectives. Thus, the definition covers not only transactions in which new securities are received directly by limited partners in single or multiple partnership rollups, but also transactions in which securities are received indirectly through a step transaction, such as umbrella partnership real estate investment trusts, discussed below.

• Exclusions from the Definition of "Limited Partnership Rollup Transaction": The definition of "limited partnership rollup transaction" also incorporates six exclusions that

conform to the Rollup Reform Act. The first is for transactions involving partnerships with an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the Commission determines appropriate. This exception is similar to the exclusion recognized by the SEC in adopting a definition of "finite-life" in Item 901(b) of Regulation S-K.³ Such reinvesting partnerships closely resemble ordinary operating businesses and have not been subject to the criticism associated with limited partnership rollup transactions. Investors in such partnerships, like investors in other operating businesses, have no expectation that the partnership will distribute its cash from operations or sell its assets and distribute the proceeds to investors. Moreover, rollups of reinvesting partnerships do not involve many of the fundamental changes associated with finite-life partnerships, such as changes in management compensation and investor voting rights.

The second exclusion is for transactions involving only limited partnerships wherein the interests of the limited partners are repurchased, recalled, or exchanged in accordance with the terms of the pre-existing partnership agreement for securities in an operating company specifically identified at the time of the formation of the original limited partnership. Such partnerships with a pre-existing agreement include, for example, limited partnerships established solely for the purpose of conducting research and development that were always intended to be merged with a parent or other affiliate and are generally not available to the retail public. These are rollup transactions to which the investor agreed at the time of the investor's original investment decision and are not the types of transactions where abuses have been reported.

The third exclusion is for transactions involving securities to be issued or exchanged that are not required to be and are not registered under the Securities Act of 1933 (1933 Act). This provision excludes public issuances of securities, therefore, under Sections 3(a)(9) and (10) of the 1933 Act as well as Section 1145 of the Bankruptcy Code.⁴

The fourth exclusion is for transactions involving only issuers that are not required to register or report under Section 12 of the Exchange Act, both before and after the transaction.

The fifth exclusion is for transactions involving a proposal by an independent, non-affiliated third party to succeed to a general partner or sponsor interest only if the transaction is approved by not less than 66-2/3 percent of the outstanding units of each of the participating partnerships and the existing general partners receive only compensation expressly provided for in the pre-existing partnership agreements of the partnerships being rolled up. This last provision is intended to prohibit payments to the general partners to secure their approval of the transaction. The fifth exclusion is intended to exclude transactions resembling either a "hostile" or "white knight" acquisition by a third-party without extraordinary financial remuneration to the current general partner. In such situations, the limited partners have a bona fide choice of retaining current management or tendering or exchanging their shares in a limited partner rollup transaction that changes the management of the current general partners.

The sixth exclusion is for transactions, except as the Commission may

³ See, Securities Act Rel. No. 6922 (October 30, 1991); 56 FR 217 (November 8, 1991).

⁴ This provision also excludes securities issued pursuant to Sections 3(a)(11), 3(b), 4(2) and 4(6) of the 1933 Act.

by rule deem to fall within the definition of "limited partnership rollup transaction," in which the securities offered to investors are securities of another entity that are listed on the Nasdaq National Market, the New York Stock Exchange or the American Stock Exchange, if: 1) such other entity was formed, and such class of securities was regularly reported and traded, not less than 12 months before the date on which soliciting material is mailed to investors; and 2) the securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

- **Management Fee:** fee paid to a sponsor, general partner(s), their affiliates, or other persons for management and administration of a direct participation program. The definition uses the term "direct participation program" rather than "limited partnership" because the term "management fee" is used in provisions in Section 34 that are applicable generally to direct participation programs offerings. The definition in Schedule D uses the term "limited partnership."
- **Solicitation Expenses:** direct marketing expenses, incurred by a member in a rollup transaction, such as telephone calls, broker/dealer fact sheets, legal and other fees related to the solicitation, and direct solicitation compensation to members. Since the expenses must be incurred by or for a member, the definition does not cover solicitation expenses incurred by general partners or proxy solicitation firms that are not NASD members. These expenses are included, however, in transaction costs.
- **Transaction Costs:** costs incurred in a limited partnership rollup transac-

tion, including printing and mailing the proxy, prospectus and other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not costs that would have been otherwise incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses. As set forth in the definitions, the total costs related to a limited partnership rollup transaction are comprised of solicitation expenses and transaction costs.

Substantive Requirements

The NASD has adopted new Subsection 34(b)(6)(C) to prohibit a member or person association with a member from participating in a limited partnership rollup transaction in any capacity if the transaction is unfair and unreasonable.⁵ Subsection 34(b)(6)(C) contains two basic subdivisions. The first subdivision, Subsection 34(b)(6)(C)(i), defines a series of circumstances and conditions that create a presumption that a limited partnership rollup transaction is not unfair or unreasonable; the second subdivision, Subsection 34(b)(6)(C)(ii), defines a series of circumstances and conditions under which limited partnership rollup transactions are presumed to be unfair or unreasonable. For an applicable limited partnership rollup transaction to comply with Section 34, the transaction must both include one of the provisions set forth in Subsection 34(b)(6)(C)(i) and not violate any of the provisions of Subsection 34(b)(6)(C)(ii).

The NASD has also adopted amendments to Part III, Schedule D that establish listing standards for Nasdaq National Market securities resulting

from a limited partnership rollup transaction in new Section 3 thereof.⁶ With minor contextual exceptions, the rule language is the same as that adopted in Section 34(b)(6)(C). To simplify the following discussion of the substantive requirements of the rollup rules, section designations reference the provisions in new Section 34(b)(6)(C).

Limited Partnership Rollup Transactions Presumed Not To Be Unfair Or Unreasonable

New Subsection (b)(6)(C)(i) defines a series of circumstances under which limited partnership rollup transactions are presumed not to be unfair and unreasonable. It is presumed not to be unfair or unreasonable if dissenting limited partners are offered one of the following:

- **Compensation Based on Appraisal**—New paragraph a. of Subsection (b)(6)(C)(i) provides that dissenting limited partners may receive compensation based on the appraisal of an independent appraiser, unaffiliated with the sponsor or general partner of the program, who values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing. The appraisal should accurately reflect the current value of the assets and be done in a manner consistent with appropriate industry practice.

⁵ The term of "participation" is defined in Article III, Section 44(a)(5) to include acting in "any advisory or consulting capacity to the issuer related to the offering" and would include any member acting as a financial adviser.

⁶ Current Section 3 is redesignated as Section 4 and is amended to reference the limited partnership rollup criteria. Current Section 4 is redesignated Section 5.

The methodology for valuing partnership assets should be that methodology that is appropriate for a particular industry, so that partnerships in real estate, oil and gas, and equipment leasing, for example, may use different valuation models. The professionals in each industry should use whatever appraisal methods are appropriate to that industry. The requirement that the appraisal be performed "in a manner consistent with industry practice" implies that the appraiser must meet certain logical qualifications for the performance of the appraisal. Such qualifications would include consideration of the experience and financial stability of the appraiser, as well as whether the appraiser meets the standards of a qualifying organization.

Forms of compensation based on appraisal include cash, secured or unsecured debt instruments, and freely-tradeable securities. All debt instruments must provide for a trustee and an indenture, and provide for prepayment with 80 percent of the net proceeds of any sale or refinancing of the assets of the entity. All debt instruments must provide the holders with a market rate of interest equal to at least 120 percent of the applicable federal rate as determined by the Internal Revenue Service, have a term no greater than eight years, and allow for the use of unsecured debt instruments only when the entity issuing the debt has a limitation on total leverage of 70 percent of the appraised value of its assets. Freely tradeable securities utilized as compensation must be previously listed on a national securities exchange or previously traded on The Nasdaq Stock MarketSM prior to the transaction. Nasdaq securities used as compensation include all securities traded in The Nasdaq SmallCap MarketSM and the Nasdaq National Market, thus permitting freely tradeable securities of any Nasdaq

company to be utilized as compensation to dissenting limited partners.

The number of freely tradeable securities offered in return for partnership interests would be determined in relation to the average last-sale price of the securities in the 20-day period following the date of the meeting at which the vote on the rollup occurs. If the issuer of the freely tradable securities and the sponsor or general partner are affiliated, and the securities issued as compensation are new securities, such securities must not represent more than 20 percent of the issued and outstanding securities of that class after the issuance. A definition solely for purposes of this provision provides that a sponsor or general partner is deemed affiliated with the issuer if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the rollup transaction or the purchase of the general partner's interest. The 20 percent limitation on the amount of securities offered as compensation by an affiliate helps to establish a threshold below which significant dilution is presumed to have not occurred.

• **Receipt of a Security With Substantially the Same Terms and Conditions**—New paragraph b. of Subsection 34(b)(6)(C)(i) provides that dissenting limited partners may receive or retain a security with substantially the same terms and conditions as the original issue because there is no material adverse change as to the business plan or the investment, distribution, and liquidation policies of the partnership and the dissenting limited partners receive or retain substantially the same rights, preferences, and priorities they had in their original security. Where reliance on this provision is proposed, the NASD Corporate Financing Department will review the terms of a new security to determine if it has substantially the same terms and conditions as the original issue.

• **Comparable Rights**—New paragraph c. of Subsection 34(b)(6)(C)(i) provides for other comparable rights so that sponsors and general partners have the flexibility to propose other protections for limited partners. The comparable rights options include, but are not limited to, the right to supermajority approval of the transaction and the right to review of the transaction by an independent committee.

• **Comparable Rights - Supermajority Approval**—New paragraph c.1. of Subsection 34(b)(6)(C)(i) provides that approval of the limited partnership rollup transaction by 75 percent of the outstanding units of each of the individual participating partnerships provides dissenting limited partners with the presumption that the rollup is fair. The criticism of many limited partnership rollups is that a simple majority of limited partners voting for the rollup can deprive other limited partners of the business and financial opportunities they bargained for when they originally invested. New paragraph c.1. provides that this assumption is no longer reasonable where 75 percent of the partnership interests (supermajority) take affirmative action to approve the transaction, since such an overwhelming approval of the transaction provides an indication of its fairness and beneficial nature. Even though new paragraph c.1. allows a particular limited partnership transaction to be consummated even though individual partnerships did not approve the transaction, any limited partnership that fails to reach the 75 percent threshold is excluded from the transaction.

• **Comparable Rights - Review by Independent Committee**—New paragraph c.2. to Subsection 34(b)(6)(C)(i) provides for a right of review by an independent committee not affiliated with the general partner(s) or sponsors. The independent committee has certain rights and obligations. The independent committee's

rights are that it: 1) shall have access to the books and records of the partnerships; 2) shall have the authority to negotiate the proposed transaction with the general partner or sponsor for the limited partners, but not the authority to approve the transaction for the limited partners; 3) shall have the ability to retain independent counsel and financial advisers to represent all limited partners at the limited partnerships' expense and may be compensated and reimbursed by the limited partnerships subject to the rollup transaction; and 4) shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the rollup transaction against claims, causes of action, or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that the general partner may also agree to indemnify the independent committee.

The independent committee's obligations are that it: 1) shall be approved by a majority of the outstanding securities of each of the participating partnerships; 2) shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents its findings and recommendations, including any minority views; 3) shall deliberate for a period no longer than 60 days unless unanimously extended by the members of the independent committee or if approved by the NASD.

• **Comparable Rights - Other Comparable Rights**—New paragraph c.3. to Subsection 34(b)(6)(C)(i) provides for other comparable rights for dissenting limited partners that are not limited to supermajority approval or the establishment of an independent committee, but include any other comparable rights proposed by general partners or sponsors, provided

that the general partners or sponsors demonstrate to the satisfaction of the NASD or, if the NASD determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

Limited Partnership Rollup Transactions Presumed To Be Unfair And Unreasonable

New Subsection 34(b)(6)(C)(ii) defines a series of circumstances under which limited partnership rollup transactions, regardless of compliance with Subsection 34(b)(6)(C)(i), are presumed to be unfair or unreasonable⁷ if: 1) certain actions taken by the general partner result in the unfair conversion and valuation of general partner interests in a limited partnership rollup transaction; 2) a limited partnership rollup transaction fails to protect the voting rights of the limited partners; 3) the transaction costs of a rejected limited partnership rollup transaction are unfairly apportioned or allocated; or 4) the payment of fees to general partners in limited partnership rollup transactions are unfair, unreasonable, or inappropriate.

• **Actions Taken By the General Partner**—New paragraph a. of Subsection 34(b)(6)(C)(ii) provides that it is presumptively unfair and unreasonable for general partners, when determining their interest in the new entity resulting from a limited partnership rollup transaction, to: 1) convert an equity interest for which consideration has not been paid into a voting interest in the new entity if the equity interest was not otherwise provided for in the limited partnership agreement and disclosed to limited partners; 2) fail to follow the valuation methods, if any, in the partnership agreements when valuing their partnership interests; or 3) utilize a projected value of their equity interest rather than the

appraised current value of their equity interest when determining their interest in the new entity.

• **Voting Rights**—New paragraph b. of Subsection 34(b)(6)(C)(ii) contains four provisions for the protection of investors with respect to voting rights. New subparagraph b.1. provides that it is presumptively unfair if the voting rights in the entity resulting from the limited partnership rollup transaction do not follow the original voting rights of the limited partnerships participating in the transaction. However, the NASD recognizes that certain material changes to voting rights may be necessary to conform disparate rights that may exist among participating partnerships. Material changes may be effected only if the NASD determines that such changes are not unfair or if an independent committee approves such changes.

New subparagraph b.2. provides that it is presumptively unfair if a majority of the interests in an entity resulting from a limited partnership rollup transaction is prevented from voting to take certain actions unless the sponsor, general partner(s), board of directors or trustee concur, such as voting to: amend the limited partnership agreement, articles of incorporation, by-laws or indenture; dissolve the entity; remove and elect new management; and approve or disapprove the sale of substantially all the assets of the entity, unless such voting actions would be inconsistent with state law.

⁷ Where a limited partnership rollup transaction is determined by NASD staff to include one of the arrangements considered to be unfair or unreasonable, the burden of proof is borne by the member to rebut the presumption by demonstrating that the arrangement is not unfair or unreasonable or that the arrangement does not come within one of the enumerated unfair and unreasonable arrangement provisions.

New subparagraph b.3. provides that it is presumptively unfair as to voting rights if the sponsor or general partner proposing a limited partnership rollup transaction is not required to provide a document that clearly delineates instructions and procedures of voting against or dissenting from a proposed transaction.

New subparagraph b.4. provides that it is presumptively unfair if the general partner or sponsor fails to utilize an independent third party to receive and tabulate all votes and dissents or fails to require the third party to make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs.

• **Transaction Costs**—New paragraph c. of Subsection 34(b)(6)(C)(ii) provides that it is presumptively unfair if transaction costs of a rejected limited partnership rollup transaction are not apportioned between the general and limited partners in accordance with the final vote as follows: 1) in the case of a limited partnership rollup transaction that is not approved, the general partner/sponsor bears transaction costs in proportion to the total number of abstentions and votes to reject the transaction, and the limited partners bear transaction costs in proportion to the number of votes to approve the transaction; or 2) in the case of a rollup transaction that is approved, but where some individual partnerships do not approve and are not included in the approved transaction, the general partner is not required to pay costs for the limited partnerships who have voted not to approve the transaction.

• **Fees of the General Partners**—New paragraph d. of Subsection 34(b)(6)(C)(ii) protects limited partners against the assessment of fees by a general partner that are unfair, unreasonable, or inappropriate. New subparagraph d.1. provides that it is presumptively unfair for general part-

ners to receive or convert unearned management fees discounted to a present value while also proposing to receive new asset-based fees. A similar presumption of unfairness applies if property management fees and other fees are inappropriate, unreasonable, or more than, or not competitive with, what would be paid to third parties for performing similar services under new subparagraph d.2. New subparagraph d.3. provides that substantial and adverse changes in fees are presumed unreasonable if not submitted to and approved by an independent committee.

Applicability Of Rollup Rules To UPREITS

During the period when the NASD rule proposal to adopt the rollup rules was under consideration by the SEC, questions were raised concerning the applicability of the proposed rules to umbrella partnership real estate investment trust (UPREIT) transactions.⁸ As a result of an understanding reached between the staffs of the NASD and the SEC, the NASD Corporate Financing Department intends to work closely with the SEC Division of Corporation Finance to review all direct, indirect, and multi-step limited partnership rollup transactions in their entirety, including UPREITS, for an initial determination of whether a transaction constitutes a “limited partnership rollup transaction.”

Implementation

The new rules take effect November 1, 1994, for: 1) any rollup transaction that has not been declared effective by the SEC, regardless of whether the NASD Corporate Financing Department has previously issued an opinion of “no objections” to the proposed underwriting terms and arrangements; and 2) any application for inclusion of a security in the Nasdaq National Market

that has not been designated for inclusion.

* * *

Questions regarding this Notice as to the general applicability of the rollup rules may be directed to Richard J. Fortwanger, Associate Director, Corporate Financing Department at (301) 208-2700. Questions concerning applications to the Nasdaq National Market may be directed to Tim Pupo, Issuer Services, at (202) 728-8115.

Text Of Amendments To Article III, Section 34 Of The Rules Of Fair Practice And Schedule D Of The By-Laws

(Note: New language is underlined; deletions are in brackets.)

Direct Participation Programs

Sec. 34.

(a) No change.

(b)

Application

(1) No member or person associated with a member shall participate in a public offering of a direct participation program or a limited partnership rollup transaction [of a direct participation program] except in accordance with this subsection.

Definitions

(2)(A) No change.

(B) The following terms shall have

⁸ See, discussion of the applicability of the rollup rules to UPREITS accompanying footnotes 32 and 50 in Securities Exchange Act Release No. 34533 (August 15, 1994); 59 F.R. 43147 (August 22, 1994).

the stated meaning when used in this subsection:

(i) Cash Available For

Distribution—cash flow less amount set aside for restoration or creation of reserves.

(ii) Cash Flow—cash funds provided from operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash funds used to pay all other expenses, debt payments, capital improvements and replacements.

(iii) Dissenting Limited Partner—a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by the Association, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under the rules of the Association during the period in which the offer is outstanding. Such objection in writing shall be filed with the party responsible for tabulating the votes or tenders.

(i) (iv) Fair Market Net Worth (Unchanged.)

(v) Limited Partner or Investor in a Limited Partnership—the purchaser of an interest in a direct participation program that is a limited partnership who is not involved in the day-to-day management of the limited partnership and bears limited liability.

(vi) Limited Partnership—an unincorporated association that is a direct participation program organized as a limited partnership whose partners are one or more general partners and one or more limited

partners, which conforms to the provisions of the Revised Uniform Limited Partnership Act or the applicable statute that regulates the organization of such partnership.

(vii) [Rollup or] Limited Partnership Rollup Transaction [of a Direct Participation Program]—a transaction involving [an acquisition, merger or consolidation of at least one direct participation program, not currently listed on a registered national securities exchange or the NASDAQ System, into another public direct participation program or a public corporation or a public trust.] the combination or reorganization of one or more limited partnerships, directly or indirectly, in which:

a. some or all of the investors in any of such limited partnerships will receive new securities, or securities in another entity, that will be reported under a transaction reporting plan declared effective before January 1, 1991, by the Securities and Exchange Commission under Section 11A of the Securities Exchange Act of 1934;*

b. any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan declared effective before January 1, 1991, by the Securities and Exchange Commission under Section 11A of the Securities Exchange Act of 1934;*

c. investors in any of the limited partnerships involved in the transaction are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and

d. any of such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue.

Notwithstanding the foregoing definition, a "limited partnership rollup transaction" does not include:

1. a transaction that involves only a limited partnership or partnerships having an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the Securities and Exchange Commission determines appropriate;

2. a transaction involving only limited partnerships wherein the interests of the limited partners are repurchased, recalled or exchanged pursuant to the terms of the pre-existing limited partnership agreements for securities in an operating company specifically identified at the time of the formation of the original limited partnership;

3. a transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act of 1933;

4. a transaction that involves only issuers that are not required to register or report under Section 12 of the Securities Exchange Act of 1934, both before and after the transaction;

5. a transaction, except as the Securities and Exchange Commission may otherwise provide for by rule for the protection of investors, involving the combination or reorganization of one or more limited partnerships in which a non-affiliated party succeeds to the interests of the general partner or sponsor, if:

A. such action is approved by not less than 66-2/3 percent of the outstanding units of each of the participating limited partnerships; and

B. as a result of the transaction, the

existing general partners will receive only compensation to which they are entitled as expressly provided for in the pre-existing partnership agreements; or

6. a transaction, except as the Securities and Exchange Commission may otherwise provide for by rule for the protection of investors, in which the securities offered to investors are securities of another entity that are reported under a transaction reporting plan declared effective before January 1, 1991, by the Securities and Exchange Commission under Section 11A of the Securities Exchange Act of 1934*; if:

A. such other entity was formed, and such class of securities was reported and regularly traded, not less than 12 months before the date on which soliciting material is mailed to investors; and

B. the securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

(viii) Management Fee—a fee paid to the sponsor, general partner(s), their affiliates, or other persons for management and administration of a direct participation program.

[(ii)] (ix) Organization and Offering Expenses—Unchanged.

[(iii)] (x) Participant—Unchanged.

[(iv)] (xi) Person—Unchanged.

[(v)] (xii) Prospectus—Unchanged.

[(vi)] (xiii) Registration Statement—Unchanged.

(xiv) Solicitation Expenses—direct marketing expenses incurred by a member, in connection with a limited partnership rollup transaction, such as telephone calls, broker/dealer fact sheets, members' legal and other fees related to the solicitation, as well as direct solicitation compensation to members.

(xv) Transaction Costs—costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

* Transaction reporting plans under Section 11A were declared effective prior to January 1, 1991, for the Nasdaq National Market, the New York Stock Exchange, and the American Stock Exchange.

* * *

Participation in Rollups

(6)(A) No member or person associated with a member shall participate in the solicitation of [receive compensation for soliciting] votes or tenders from limited partners [participants] in connection with a limited partnership rollup transaction [of a direct participation program or programs], irrespective of the form of the resulting entity [resulting from the rollup] (i.e., a partnership, real estate investment trust or corporation), unless [such] any compensation received by the member:

(i) is payable and equal in amount regardless of whether the limited partner [participant] votes affirmatively or negatively in the proposed limited partnership rollup transaction;

(ii) in the aggregate, does not exceed 2% of the exchange value of the newly-created securities; and

(iii) is paid regardless of whether the limited partners [participants] reject the proposed limited partnership rollup transaction.

(B) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with [the] a limited partnership rollup transaction [of a direct participation program] unless the general partner(s) or sponsor(s) proposing the limited partnership rollup transaction agrees to pay all solicitation expenses related to the limited partnership rollup transaction, including all preparatory work related thereto, in the event the limited partnership rollup transaction is [not approved] rejected.

(C) No member or person associated with a member shall participate in any capacity in a limited partnership rollup transaction if the transaction is unfair or unreasonable.

(i) A limited partnership rollup transaction will be presumed not to be unfair or unreasonable if the limited partnership rollup transaction provides for the right of dissenting limited partners:

a. to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program which values the assets as if sold in an orderly manner in a reasonable

period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely-tradeable securities; provided, however, that:

1. limited partnership rollup transactions which utilize debt instruments as compensation must provide for a trustee and an indenture to protect the rights of the debt holders and provide a rate of interest equal to at least 120% of the applicable federal rate as determined in accordance with Section 1274 of the Internal Revenue Code of 1986;

2. limited partnership rollup transactions which utilize unsecured debt instruments as compensation, in addition to the requirements of subparagraph 1., must limit total leverage to 70% of the appraised value of the assets;

3. all debt securities must have a term no greater than 8 years and provide for prepayment with 80% of the net proceeds of any sale or refinancing of the assets previously owned by the partnership entities subject to the limited partnership rollup transaction or any part thereof; and

4. freely-tradeable securities utilized as compensation to dissenting limited partners must be previously listed on a national securities exchange or previously traded on the Nasdaq System prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely-tradeable securities in the 20-day period following the date of the meeting at which the vote on the limited partner-

ship rollup transaction occurs. If the issuer of the freely-tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be utilized as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely-tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided, however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this subparagraph;

b. to receive or retain a security with substantially the same terms and conditions as the security originally held. Securities received or retained will be considered to have the same terms and conditions as the security originally held if:

1. there is no material adverse change to dissenting limited partners' rights with respect to the business plan or the investment, distribution and liquidation policies of the limited partnership; and

2. the dissenting limited partners receive substantially the same rights, preferences and priorities as they had pursuant to the security originally held; or

c. to receive other comparable rights including, but not limited to:

1. approval of the limited partnership rollup transaction by 75% of the outstanding units of each of the individual participating limited partnerships

and the exclusion of any individual limited partnership from the limited partnership rollup transaction which fails to reach the 75% threshold. The third-party appointed to tabulate votes and dissents pursuant to subparagraph (C)(ii)b.4. hereof shall submit the results of such tabulation to the NASD;

2. review of the limited partnership rollup transaction by an independent committee of persons not affiliated with the general partner(s) or sponsor. Whenever utilized, the independent committee:

A. shall be approved by a majority of the outstanding securities of each of the participating partnerships;

B. shall have access to the books and records of the partnerships;

C. shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents its findings and recommendations, including any minority views;

D. shall have the authority to negotiate the proposed transaction with the general partner or sponsor on behalf of the limited partners, but not the authority to approve the transaction on behalf of the limited partners;

E. shall not deliberate for a period longer than 60 days, although extensions will be permitted if unanimously agreed upon by the members of the independent committee or if approved by the NASD;

F. may be compensated and reimbursed by the limited partnerships subject to the limited partnership rollup transaction and shall have the ability to retain independent counsel and financial advisors to represent all limited partners at the limited partnerships' expense provided the fees are reasonable; and

G. shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the limited partnership rollup transaction from claims, causes of action or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that general partners or sponsors may also agree to indemnify the independent committee; or

3. any other comparable rights for dissenting limited partners proposed by general partners or sponsors, provided, however, that the general partner(s) or sponsor demonstrates to the satisfaction of the NASD or, if the NASD determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

(ii) Regardless of whether a limited partnership rollup transaction is in compliance with subparagraph (C)(i), a limited partnership rollup transaction will be presumed to be unfair and unreasonable:

a. if the general partner(s):

1. converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);

2. fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or

3. utilizes a future value of their equity interest in the limited partnership rather than the current value of their equity interest, as determined by an appraisal conducted in a manner consistent with subparagraph (C)(i)a., when determining their interest in the new entity;

b. as to voting rights, if:

1. the voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if the NASD determines that such changes are not unfair or if the changes are approved by an independent committee;

2. a majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on the form of entity and to the extent not inconsistent with applicable state law, vote to:

A. amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;

B. dissolve the entity;

C. remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner; board of directors, trustee or similar governing entity; or

D. approve or disapprove the sale of substantially all of the assets of the entity;

3. the general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each limited partner with a document which

instructs the limited partner on the proper procedure for voting against or dissenting from the transaction; or

4. the general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs;

c. as to transaction costs, if:

1. transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:

A. the general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership rollup transaction; and

B. limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or

2. individual limited partnerships that do not approve a limited partnership rollup transaction are required to pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships; or

d. as to fees of general partners, if:

1. general partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;

2. property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would be paid to third parties for performing similar services; or

3. changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

* * *

Schedule D

PART I

Definitions

For purposes of Schedule D, unless the context requires otherwise:

(1)-(4) No change.

(5) "Cash available for distribution" means cash flow of a limited partnership less amount set aside for restoration or creation of reserves.

(6) "Cash flow" means cash funds provided from limited partnership operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash funds used to pay all other expenses, debt payments, capital improvements and replacements.

(5) (7) "Capital and surplus" Unchanged.

[(6)] (8) "Consolidated Quotations Service" Unchanged.

(9) "Dissenting Limited Partner"—a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by the Association, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under the rules of the Association during the period in which the offer is outstanding. Such objection in writing shall be filed with the party responsible for tabulating the votes or tenders.

[(7)] (10) "Firm commitment offering" Unchanged.

[(8)] (11) "Index warrants" Unchanged.

(12) "Limited partner" or "investor in a limited partnership" means the purchaser of an interest in a direct participation program, as defined in Article III, Section 34 of the Rules of Fair Practice, that is a limited partnership who is not involved in the day-to-day management of the limited partnership and bears limited liability.

(13) "Limited partnership" means an unincorporated association that is a direct participation program, as defined in Article III, Section 34 of the Rules of Fair Practice, organized as a limited partnership whose partners are one or more general partners and one or more limited partners, which conforms to the provisions of the Revised Uniform Limited Partnership Act or the applicable statute that regulates the organization of such partnership.

(14) "Limited Partnership Rollup Transaction" means a transaction involving the combination or reorgani-

zation of one or more limited partnerships, directly or indirectly, in which:

(A) some or all of the investors in any of such limited partnerships will receive new securities, or securities in another entity, that will be reported under a transaction reporting plan declared effective before January 1, 1991, by the Securities and Exchange Commission under Section 11A of the Securities Exchange Act of 1934;*

(B) any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan declared effective before January 1, 1991, by the Securities and Exchange Commission under Section 11A of the Securities Exchange Act of 1934;*

(C) investors in any of the limited partnerships involved are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and

(D) any of such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue.

Notwithstanding the foregoing definition, a "limited partnership rollup transaction" does not include:

(i) a transaction that involves only a limited partnership or partnerships having an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the Securities and Exchange Commission determines appropriate;

(ii) a transaction involving only limit-

ed partnerships wherein the interests of the limited partners are repurchased, recalled or exchanged pursuant to the terms of the pre-existing limited partnership agreements for securities in an operating company specifically identified at the time of the formation of the original limited partnership;

(iii) a transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act of 1933;

(iv) a transaction that involves only issuers that are not required to register or report under section 12 of the Securities Exchange Act of 1934, both before and after the transaction;

(v) a transaction, except as the Securities and Exchange Commission may otherwise provide for by rule for the protection of investors, involving the combination or reorganization of one or more limited partnerships in which a non-affiliated party succeeds to the interests of the general partner or sponsor, if:

a. such action is approved by not less than 66-2/3 percent of the outstanding units of each of the participating limited partnerships; and

b. as a result of the transaction, the existing general partners will receive only compensation to which they are entitled as expressly provided for in the pre-existing partnership agreements; or

(vi) a transaction, except as the Securities and Exchange Commission may otherwise provide for by rule for the protection of investors, in which the securities offered to investors are securities of another entity that are reported under a transaction reporting plan declared effective before January 1, 1991, by the Securities and Exchange Commission under Section 11A of

the Securities Exchange Act of 1934*; if:

a. such other entity was formed, and such class of securities was reported and regularly traded, not less than 12 months before the date on which soliciting material is mailed to investors; and

b. the securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

(15) "Management fee" means a fee paid to the sponsor, general partner(s), their affiliates, or other persons for management and administration of a limited partnership.

[(9)] (16) "Member" Unchanged.

[(10)] (17) "NASDAQ Market Maker" Unchanged.

[(11)] (18) "NASDAQ National Market System security" Unchanged.

[(12)] (19) "NASDAQ System" Unchanged.

[(13)] (20) "Net Tangible Assets" Unchanged.

[(14)] (21) "Normal unit of trading" Unchanged.

[(15)] (22) "Penalty bid" Unchanged.

[(16)] (23) "Pre-effective stabilizing bid" Unchanged.

[(17)] (24) "Reported security," Unchanged.

(25) "Solicitation expenses" means direct marketing expenses incurred by a member in connection with a

limited partnership rollup transaction, such as telephone calls, broker/dealer fact sheets, members' legal and other fees related to the solicitation, as well as direct solicitation compensation to members.

[(18)] (26) "Stabilizing bid" Unchanged.

(27) "Transaction costs" means costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

* Transaction reporting plans under Section 11A were declared effective prior to January 1, 1991, for the Nasdaq National Market, the New York Stock Exchange, and the American Stock Exchange.

* * *

PART III

* * *

Designation Of Nasdaq National Market System Securities

Sec. 1. - Sec. 2. No change.

Sec. 3. Limited Partnership Rollup Designation Criteria

In addition to meeting the quantitative criteria for Nasdaq/NMS inclusion, an issuer that is formed as a result of a limited partnership rollup transaction, as defined in Part I, Section (13) hereof, must meet the criteria set forth

below in order to be designated.

(a) The limited partnership rollup transaction must provide for the right of dissenting limited partners:

(1) to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program which values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely-tradeable securities; provided, however, that:

(i) limited partnership rollup transactions which utilize debt instruments as compensation must provide for a trustee and an indenture to protect the rights of the debt holders and provide a rate of interest equal to at least 120% of the applicable federal rate as determined in accordance with Section 1274 of the Internal Revenue Code of 1986;

(ii) limited partnership rollup transactions which utilize unsecured debt instruments as compensation, in addition to the requirements of subparagraph (i), must limit total leverage to 70% of the appraised value of the assets;

(iii) all debt securities must have a term no greater than 8 years and provide for prepayment with 80% of the net proceeds of any sale or refinancing of the assets previously owned by the partnership entities subject to the limited partnership rollup transaction or any part thereof; and

(iv) freely-tradeable securities utilized as compensation to dissenting limited partners must be issued by a company listed on a national securities exchange or traded on the Nasdaq System prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely-tradeable securities in the 20-day period following the date of the meeting at which the vote on the limited partnership rollup transaction occurs. If the issuer of the freely-tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be utilized as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided, however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this section;

(2) to receive or retain a security with substantially the same terms and conditions as the security originally held. Securities received or retained will be considered to have the same terms and conditions as the security originally held if:

(i) there is no material adverse change to dissenting limited partners' rights with respect to the business plan or the investment, distribution and liquidation policies of the limited

partnership; and

(ii) the dissenting limited partners receive substantially the same rights, preferences and priorities as they had pursuant to the security originally held; or

(3) to receive other comparable rights including, but not limited to:

(i) approval of the limited partnership rollup transaction by 75% of the outstanding units of each of the individual participating limited partnerships and the exclusion of any individual limited partnership from the limited partnership rollup transaction which fails to reach the 75% threshold. The third-party appointed to tabulate votes and dissents pursuant to subparagraph (b)(2)(iv) to Section 3 shall submit the results of such tabulation to the NASD;

(ii) review of the limited partnership rollup transaction by an independent committee of persons not affiliated with the general partner(s) or sponsor. Whenever utilized, the independent committee:

a. shall be approved by a majority of the outstanding securities of each of the participating partnerships;

b. shall have access to the books and records of the partnerships;

c. shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents its findings and recommendations, including any minority views;

d. shall have the authority to negotiate the proposed transaction with the general partner or sponsor on behalf of the limited partners, but not the authority to approve the transaction on behalf of the limited partners;

e. shall not deliberate for a period

longer than 60 days, although extensions will be permitted if unanimously agreed upon by the members of the independent committee or if approved by the NASD:

f. may be compensated and reimbursed by the limited partnerships subject to the limited partnership rollup transaction and shall have the ability to retain independent counsel and financial advisors to represent all limited partners at the limited partnerships' expense provided the fees are reasonable; and

g. shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the limited partnership rollup transaction from claims, causes of action or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that general partners or sponsors may also agree to indemnify the independent committee; or

(iii) any other comparable rights for dissenting limited partners proposed by general partners or sponsors, provided, however, that the general partner(s) or sponsor demonstrates to the satisfaction of the NASD or, if the NASD determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

(b) Regardless of whether a limited partnership rollup transaction meets the requirements set forth in Subsection 3(a) above, a limited partnership rollup transaction will not be designated:

(1) if the general partner(s):

(i) converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited

partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);

(ii) fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or

(iii) utilizes a future value of their equity interest rather than the current value of their equity interest, as determined by an appraisal conducted in a manner consistent with subparagraph (a)(1) of Part III, Section 3 hereof, when determining their interest in the new entity;

(2) as to voting rights, if:

(i) the voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if the NASD determines that such changes are not unfair or if the changes are approved by an independent committee;

(ii) a majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on the form of entity and to the extent not inconsistent with state law, vote to:

a. amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;

b. dissolve the entity;

c. remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner, board of directors, trustee or similar governing entity; or

d. approve or disapprove the sale of substantially all of the assets of the entity;

(iii) the general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each person whose equity interest is subject to the transaction with a document which instructs the person on the proper procedure for voting against or dissenting from the rollup; or

(iv) the general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs;

(3) as to transaction costs, if:

(1) transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:

a. the general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership rollup transaction; and

b. limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or (2) individual limited partnerships that do not approve a limited partnership rollup transaction are required to

pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships; or

(4) as to fees of general partners, if:

(i) general partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;

(ii) property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would be paid to third parties for performing similar services; or

(iii) changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

Sec. [3.] 4. Registration Standards

In addition to meeting the quantitative criteria and the limited partnership rollup criteria, if applicable, for NASDAQ/NMS inclusion, the issue must also be:

* * *

Sec. [4.] 5. Quantitative Maintenance Criteria

* * *

Sec. [5.] 6. Non-Quantitative

Designation Criteria for Issuers Excepting Limited Partnerships

* * *

Sec. [6.] 7. Non-Quantitative Designation Criteria for Issuers That Are Limited Partnerships¹

(a) Applicability

No provision of this Section shall be construed to require any foreign issuer that is a limited partnership to do any act that is contrary to a law, rule, or regulation of any public authority exercising jurisdiction over such issuer or that is contrary to generally accepted business practices in the issuer's country of domicile. The Association shall have the ability to provide exemptions from applicability of these provisions as may be necessary or appropriate to carry out this intent.

(b) Distribution of Annual and Interim Reports

(1) Each NASDAQ/NMS issuer that is a limited partnership shall distribute to limited partners copies of an annual report containing audited financial statements of the limited partnership. The report shall be distributed to limited partners within a reasonable period of time after the end of the limited partnership's fiscal year end and shall be filed with the Association at the time it is distributed to limited partners.

(2)(i) Each NASDAQ/NMS issuer that is a limited partnership which is subject to SEC Rule 13a-13 shall make available copies of quarterly reports including statements of operating results to limited partners either prior to or as soon as practicable following the partnership's filing of its Form 10-Q with the Securities and Exchange Commission. Such reports shall be distributed to limited partners if required by statute or regula-

tion in the state in which the limited partnership is formed or doing business or by the terms of the partnership's limited partnership agreement. If the form of such quarterly report differs from the Form 10-Q, the issuer shall file one copy of the report with the Association in addition to filing its Form 10-Q pursuant to Section 1(c)(12) of Part II. The statement of operations contained in quarterly reports shall disclose, at a minimum, any substantial items of an unusual or nonrecurrent nature and net income before and after estimated federal income taxes or net income and the amount of estimated federal taxes.

(ii) Each NASDAQ/NMS issuer that is a limited partnership which is not subject to SEC Rule 13a-13 and which is required to file with the Securities and Exchange Commission, or another federal or state regulatory authority, interim reports relating primarily to operations and financial position, shall make available to limited partners reports which reflect the information contained in those interim reports. Such reports shall be distributed to limited partners if required by statute or regulation in the state in which the limited partnership is formed or doing business or by the terms of the partnership's limited partnership agreement. Such reports shall be distributed to limited partners either before or as soon as practicable following filing with the appropriate regulatory authority. If the form of the interim report provided to limited partners differs

¹ The NASD has pending at the SEC rule filing SR-NASD-91-58 that proposes to adopt corporate governance rules for limited partnerships. This proposed rule change was published for comment in Securities Exchange Act Rel. No. 30811 (June 15, 1992); 57 F.R. 28542 (June 25, 1992). The rule language of this proposed rule change is set forth herein as if adopted.

from that filed with the regulatory authority, the issuer shall file one copy of the report to limited partners with the Association in addition to the report to the regulatory authority that is filed with the Association pursuant to Section 1(c)(12) of Part II.

(c) Corporate General Partner/Independent Directors

Each NASDAQ/NMS issuer that is a limited partnership shall maintain a corporate general partner or co-general partner, which shall have the authority to manage the day-to-day affairs of the partnership. Such corporate general or co-general partner shall maintain two independent directors on its board of directors. An issuer that is a limited partnership may be designated for inclusion in NASDAQ/NMS upon demonstrating that it has one independent director and undertaking to elect a second such director within 12 months of designation. For purposes of this section, "independent director" shall mean a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the

opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

(d) Audit Committee

The corporate general partner or co-general partner of each NASDAQ/NMS issuer that is a limited partnership shall establish and maintain an Audit Committee, a majority of the members of which shall be independent directors.

(e) Limited Partner Meetings

A NASDAQ/NMS issuer that is a limited partnership shall not be required to hold an annual meeting of limited partners unless required by statute or regulation in the state in which the limited partnership is formed or doing business or by the terms of the partnership's limited partnership agreement.

(f) Quorum

In the event that a meeting of limited partners is required pursuant to paragraph (e), the quorum for such meet-

ing shall be not less than 33-1/3 percent of the limited partnership interests outstanding.

(g) Solicitation of Proxies

In the event that a meeting of limited partners is required pursuant to paragraph (e), the issuer shall provide all limited partners with proxy or information statements and if a vote is required shall solicit proxies thereon.

(h) Listing Agreement

Each NASDAQ/NMS issuer that is a limited partnership shall execute a Listing Agreement in the form designated by the Association.

(i) Conflicts of Interest

Each NASDAQ/NMS issuer which is a limited partnership shall conduct an appropriate review of all related party transactions on an ongoing basis and shall utilize the Audit Committee or a comparable body for the review of potential material conflict of interest situations where appropriate.

* * *

NASD NOTICE TO MEMBERS 94-71

SEC Approves Amendments To Trade- Reporting Requirements For Trades Executed Outside Normal Market Hours

Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

Executive Summary

On August 11, 1994, the SEC approved a series of related changes to NASD rules governing transaction reporting in Nasdaq National Market[®] securities, The Nasdaq SmallCapSM Market securities, Nasdaq convertible debt securities ("Nasdaq convertibles"), over-the-counter equity securities (OTC equities), and exchange-listed securities eligible for inclusion in the Consolidated Quotation Service (CQS issues).¹ These amendments will eliminate the manually prepared Form T as the principal means of reporting transactions in the foregoing securities when executed outside normal market hours (9:30 a.m. to 4 p.m., Eastern Time (ET)) or outside the hours of the Automated Confirmation Transaction Service (ACT) (currently 9 a.m. to 5:15 p.m. ET). Instead, the covered transactions will be reported electronically through ACT on either trade date or the next business day. The amendments also recognize that the morning window for reporting contemporaneous trades in Nasdaq-listed securities and OTC equities into ACT will expand by one hour, starting at 8 a.m. ET. Member firms can input the required trade reports via a Nasdaq Workstation[®] unit or a computer-to-computer interface. These changes take effect December 12, 1994. The language of the rule change follows this Notice.

Background And Description

Since inception of real-time trade reporting, the NASD has relied on members' submission of a paper Form T to collect transactional data on off-hours trades. This information was compiled and reviewed solely for regulatory purposes without public dissemination. Subsequently, the NASD introduced the .T function to enable the electronic entry of trade

reports for trades executed between 9 and 9:30 a.m. ET² or between 4 and 5:15 p.m. ET. This rule change continues the progression by expanding the morning window for .T entries to 1 1/2 hours (8 a.m. to 9:30 a.m. ET) and by establishing procedures for electronic reporting of trades executed outside of ACT's normal operating hours.

This rule change is meant to achieve the electronic capture of virtually every round-lot trade executed by NASD members in the covered securities, regardless of execution time. Currently, the only off-hours trades that are reportable electronically are those executed between 9 and 9:30 a.m. ET and between 4 and 5:15 p.m. ET. Such trades are designated .T trades to denote execution outside normal market hours. At present, trades done outside these hours are reportable only via paper Form T.

This latest initiative also will permit .T trades (except .T trades in the subset of OTC equities comprised of foreign issues, Canadian issues, and American Depositary Receipts (ADRs)) to be disseminated to market data vendors and to subscribers of Level 2/3 Nasdaq Workstation service. However, any "as/of" trades reported under the amended rules will be collected solely for audit-trail

¹ See Securities and Exchange Act Release No. 34-34527 (August 11, 1994); 59 FR 42613 (August 18, 1994).

² The morning .T window cannot be used to enter trade reports on contemporaneous transactions in CQS issues because the central processor (The Securities Industry Automation Corporation) of such information does not open until 9:30 a.m. ET. This situation will not change as a result of the NASD's new trade-reporting requirements. However, it will now be possible to report, electronically, trades in CQS issues that are executed outside the hours of 9:30 to 5:15 p.m. ET on the next business day. These will be designated "as/of" trades.

and regulatory purposes. After implementation, NASD staff will evaluate member firms' overall compliance with the new requirements; examine various alternatives for public dissemination of "as/of" trade data; consider the feasibility of expanding the time period for reporting "as/of" trades on T +1; and focus on the complete elimination of paper Form T as a trade-reporting vehicle. Meanwhile, the paper Form T will be maintained solely as a back-up mechanism for reporting last-sale information to the NASD.

Ultimately, these enhanced procedures will enable the NASD to compile and publish comprehensive volume data for individual securities, including block-size and other round-lot trades reported electronically by NASD members.

Rule Changes

By implementing the following procedures, this rule change will substantially reduce the need for reporting any trades via the paper Form T:

- The morning .T window for reporting contemporaneous trades in Nasdaq National Market issues, The Nasdaq SmallCap Market issues, Nasdaq convertibles, and domestic OTC equities (including Canadian issues and ADRs) will be expanded by one hour to run from 8 a.m. to 9:30 a.m. ET. Trades executed during this interval must be reported into ACT within 90 seconds of execution and be designated .T to denote execution outside normal market hours (See Schedule D, Parts X, XI, XII, and XIII);
- Trades executed between midnight and 8 a.m. ET in Nasdaq National Market issues, The Nasdaq SmallCap Market issues, Nasdaq convertibles, and domestic OTC equities (including Canadian issues and ADRs) must be reported into ACT on trade date during

the expanded .T period (8 a.m. to 9:30 a.m. ET); these trades must be designated .T trades to denote execution outside normal hours and be accompanied by time of execution since they are not being reported in real-time (See Schedule D, Parts X, XI, XII, and XIII);

- Trades executed in Nasdaq National Market issues, The Nasdaq SmallCap Market issues, Nasdaq convertibles, and domestic OTC equities (including Canadian issues and ADRs) between 5:15 p.m. and midnight ET must be reported into ACT on the next business day (T+1) between 8 a.m. and 1:30 p.m. ET; these entries must be designated "as/of" trades to denote execu-

tion on a prior day and be accompanied by a time of execution (See Schedule D, Parts X, XI, XII, and XIII);

- Trades executed in foreign OTC equities (excluding Canadian issues and ADRs) shall be reported into ACT on T+1 between 8 a.m. and 1:30 p.m. ET regardless of the time the trade was actually executed; such trade reports must be designated "as/of" trades and be accompanied by a time of execution (See Schedule D, Part XII, (3)(ii)(C));
- Trades executed in CQS issues outside the hours of 9:30 a.m. and 5:15 p.m. ET must be reported into ACT

Following is a chronicle of the revised reporting requirements to be implemented on December 12, 1994:

Nasdaq National Market, Nasdaq SmallCap, Nasdaq Convertible Bonds, And Domestic OTC Equities (Including Canadian Issues And ADRs)

If the trade was executed between:

- Midnight - 8 a.m.
- 8 - 9:30 a.m.
- 4 - 5:15 p.m.
- 5:15 p.m. - midnight

Report to ACT:

- Between 8 and 9:30 a.m.; enter .T modifier and include execution time.
- Enter .T modifier and include execution time if not reported within 90 seconds.
- Enter .T modifier and include execution time if not reported within 90 seconds.
- On T+1 between 8 a.m. and 1:30 p.m.; enter execution time and designate "as/of."

CQS Trades:

- Midnight - 9:30 a.m.
- 5:15 p.m. - midnight

- On T+1 between 8 a.m. and 1:30 p.m.; enter execution time and designate "as/of."
- On T+1 between 8 a.m. and 1:30 p.m.; enter execution time and designate "as/of."

Foreign OTC Equities (Excluding Canadian Issues and ADRs)

Any time on trade date†

- On T+1 between 8 a.m. and 1:30 p.m.; enter execution time and designate "as/of."

† Member firms that have the operational capability to report transactions in foreign securities within 90 seconds of execution, between 8 a.m. and 5:15 p.m. ET, may do so at their option. If a firm chooses this option, it need not report the same transaction(s) on T+1.

on T+1 between 8 a.m. and 1:30 p.m. ET, be designated "as/of" trades, and be accompanied by a time of execution (See Schedule G, Section 2(a)(3)).

Electronic trade reporting will result in greater and more timely dissemination of reliable information for transactions executed outside normal market hours. This will provide broker/dealers and investors with additional information to facilitate investment decisions.

Questions regarding this Notice can be directed to Michael J. Kulczak, Associate General Counsel, Office of General Counsel, at (202) 728-8811; Bernard Thompson, Assistant Director, Market Surveillance; (301) 590-6436; or Nasdaq Market Operations at (203) 378-0284.

Text Of Amendments To Schedule D And G Of The NASD By-Laws

(Note: New text is underlined; deleted text is in brackets.)

Schedule D

Part X

REPORTING TRANSACTIONS IN NASDAQ NATIONAL MARKET [SYSTEM DESIGNATED] SECURITIES

* * *

Sec. 2. Transaction Reporting

(a) When and How Transactions are Reported

2(a)(1)-2(a)(3) No change.

(4) Transaction Reporting Outside Normal Market Hours

(i) Last sales reports of transactions in designated securities executed

between [9:00] 8:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(ii) Last sale reports of transactions in designated securities executed outside the hours of 8:00 a.m. and 5:15 p.m. Eastern Time shall be reported as follows:

(A) Last sale reports of transactions executed between midnight and 8:00 a.m. Eastern Time shall be transmitted through ACT between 8:00 a.m. and 9:30 a.m. Eastern Time on trade date, be designated as ".T" trades to denote their execution outside normal market hours, and be accompanied by the time of execution. The party responsible for reporting on trade date, the information to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below:

(B) Last sale reports of transactions executed between 5:15 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day ("T+1") between 8:00 a.m. and 1:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable pro-

cedures shall be governed, respectively, by subsections (b), (c), and (d) below.

(5) All members shall report weekly to the Market Operations Department in [New York City] Trumbull, Connecticut, on [a] Form T [designated by the Board of Governors], last sale reports of transactions in designated securities [executed outside the hours of 9:00 a.m. and 5:15 p.m. Eastern Time.] that were not transmitted through ACT, for whatever reason, either on the trade date or the next business day. Form T shall be used exclusively as a backup mode whenever electronic entry of trade data is not feasible due to system malfunctions or other unusual conditions.

Part XI

REPORTING TRANSACTIONS IN NASDAQ SMALL[-]CAPSM SECURITIES

* * *

Sec. 2. Transaction Reporting

(a) When and How Transactions are Reported

2(a)(1)-2(a)(3) No change.

(4) Transaction Reporting Outside Normal Market Hours

(i) Last sales reports of transactions in designated securities executed between [9:00] 8:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution;

trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(ii) Last sale reports of transactions in designated securities executed outside the hours of 8:00 a.m. and 5:15 p.m. Eastern Time shall be reported as follows:

(A) Last sale reports of transactions executed between midnight and 8:00 a.m. Eastern Time shall be transmitted through ACT between 8:00 a.m. and 9:30 a.m. Eastern Time on trade date, be designated as ".T" trades to denote their execution outside normal market hours, and be accompanied by the time of execution. The party responsible for reporting on trade date, the information to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below;

(B) Last sale reports of transactions executed between 5:15 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day ("T+1") between 8:00 a.m. and 1:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below.

(5) All members shall report weekly to the Market Operations Department in [New York City] Trumbull, Connecticut, on [a] Form T [designated by the Board of Governors], last sale reports of transactions in designated securities [executed outside the hours of 9:00 a.m. and 5:15 p.m. Eastern Time.] that were not transmitted through ACT, for whatever reason,

either on the trade date or the next business day. Form T shall be used exclusively as a back-up mode whenever electronic entry of trade data is not feasible due to system malfunctions or other unusual conditions.

Part XII

REPORTING TRANSACTIONS IN OVER-THE-COUNTER EQUITY SECURITIES

* * *

Sec. 2. Transaction Reporting

(a) When and How Transactions are Reported

2(a)(1)-2(a)(2) No change.

(3) Transaction Reporting Outside Normal Market Hours

(i) Last sale reports of transactions in OTC Equity Securities executed between [9:00] 8:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Last sale reports of transactions in OTC Equity Securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall also be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(ii) Last sale reports of transactions in OTC Equity Securities executed outside the hours of 8:00 a.m. and 5:15 p.m. Eastern Time shall be reported as follows:

(A) Last sale reports of transactions in American Depositary Receipts

("ADRs"), Canadian issues, or domestic OTC Equity Securities that are executed between midnight and 8:00 a.m. Eastern Time shall be transmitted through ACT between 8:00 a.m. and 9:30 a.m. Eastern Time on trade date, be designated as ".T" trades to denote their execution outside normal market hours, and be accompanied by the time of execution. The party responsible for reporting on trade date, the trade details to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below;

(B) Last sale reports of transactions in ADRs, Canadian issues, or domestic OTC Equity Securities that are executed between 5:15 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day ("T+1") between 8:00 a.m. and 1:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below; and

(C) Last sale reports of transactions in foreign securities (excluding ADRs and Canadian issues) shall be transmitted through ACT on T+1 regardless of time of execution.† Such reports shall be made between 8:00 a.m. and 1:30 p.m. Eastern Time in the same manner as described in subsection (ii)(B) above.

(4) All members shall report weekly to the Market Operations Department in [New York City] Trumbull, Connecticut, on [a] Form T [designated by the Board of Governors], last sale reports of transactions in OTC Equity Securities that [are executed outside the hours of 9:00 a.m. and 5:15 p.m. Eastern Time.] were

not transmitted to ACT, for whatever reason, either on trade date or the next business day. Form T shall be used exclusively as a back-up mode whenever electronic entry of trade data is not feasible due to system malfunctions or other unusual conditions.

† Member firms that have the operational capability to report transactions in foreign securities (excluding ADRs and Canadian issues) within 90 seconds of execution, between the hours of 8:00 a.m. and 5:15 p.m. Eastern Time, may do so at their option. If a firm chooses this option, it need not report the same transaction(s) on T+1 as prescribed by subsection (ii)(C).

Part XIII

REPORTING TRANSACTIONS IN NASDAQ CONVERTIBLE DEBT SECURITIES

* * *

Sec. 2. Transaction Reporting

(a) When and How Transactions are Reported

2(a)(1)-2(a)(3) No change.

(4) Transaction Reporting Outside Normal Market Hours

(i) Last sales reports of transactions in designated securities executed between [9:00] 8:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market

hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(ii) Last sale reports of transactions in designated securities executed outside the hours of 8:00 a.m. and 5:15 p.m. Eastern Time shall be reported as follows:

(A) Last sale reports of transactions executed between midnight and 8:00 a.m. Eastern Time shall be transmitted through ACT between 8:00 a.m. and 9:30 a.m. Eastern Time on trade date, be designated as ".T" trades to denote their execution outside normal market hours, and be accompanied by the time of execution. The party responsible for reporting on trade date, the information to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below;

(B) Last sale reports of transactions executed between 5:15 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day ("T+1") between 8:00 a.m. and 1:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by subsections (b), (c), and (d) below.

(5) All members shall report weekly to the Market Operations Department in [New York City] Trumbull, Connecticut, on [a] Form T [designated by the Board of Governors], last sale reports of transactions in designated securities [executed outside the hours of 9:00 a.m. and 5:15 p.m. Eastern Time.] that were not transmitted through ACT, for whatever reason, either on the trade date or the next business day. Form T shall be used exclusively as a back-up mode whenever electronic entry

of trade data is not feasible due to system malfunctions or other unusual conditions.

Schedule G

REPORTING TRANSACTIONS IN LISTED SECURITIES

* * *

Sec. 2. Transaction Reporting

(a) When and How Transactions are Reported

2(a)(1)-2(a)(2) No change.

[(3) Non-Registered Reporting Members shall report weekly to the Market Operations Department in New York City, on Form T, last sale reports of transactions in eligible securities that are not required to be reported under paragraph (2).]

[(4) (3) All Members shall report [weekly to the NASDAQ Department in New York City, on Form T, last sale reports of] transactions in eligible securities executed outside the hours of 9:30 a.m. and 5:15 p.m. Eastern Time[.] as follows: (i) by transmitting the individual trade reports through ACT on the next business day ("T+1") between 8:00 a.m. and 1:30 p.m. Eastern Time; (ii) by designating the entries "as/of" trades to denote their execution on a prior day; and (iii) by including the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively by subsections (b), (c), and (d) below.

All members shall report weekly to the Market Operations Department in Trumbull, Connecticut, on Form T, last sale reports of transactions in eligible securities that were not transmitted through ACT, for whatever reason, either on the trade date or the

next business day. Form T shall be used exclusively as a back-up mode whenever electronic entry of trade data is not feasible due to system malfunctions or other unusual conditions.