July 1, 2005

# SEC Approves Significant New Reforms to Facilitate Registered Securities Offerings

With its adoption at a public meeting this Wednesday (June 29) of significant registration reforms designed to facilitate capital formation in the U.S. public securities markets, the Securities and Exchange Commission ("SEC") has embarked on a new era of measured deregulation under the Securities Act of 1933, as amended ("Securities Act"). Described by departing SEC Chairman William Donaldson as designed to effect "constructive, incremental adjustments to the integrated disclosure and shelf registration systems," the various new and amended rules that now comprise the regulatory framework for registered offerings introduce the concept of modified "company registration" for the largest U.S. and non-U.S. companies filing reports with the SEC-termed "Well-Known Seasoned Issuers," or "WKSI's."[1] In addition, the final reforms streamline the shelf-registration process on a somewhat less ambitious scale for a broader group of smaller and/or less-seasoned reporting companies without regard, again, to whether they are incorporated within or outside the United States. Substantial relaxation of prohibitions against written and oral communications in a registered offering context will benefit all otherwise eligible companies to varying degrees, depending largely on their size and SEC reporting history. Last but not least, the SEC has finally accepted the legitimacy of an "access-equals-delivery" model (outside of the investment company setting) for delivery to investors of the final prospectus in all registered offerings, including IPOs.

Although the reforms are intended to reduce, if not eliminate, legitimate issuer and underwriter fears of undue "gun-jumping" liability exposure, they are not entirely deregulatory in nature. In some cases, the SEC "clarified" the parameters of longstanding Securities Act liability principles in a manner that provoked critical commentary, whereas in others the agency sharpened and potentially even enhanced such exposure for certain offering participants. Only time will tell whether the benefits of relatively unfettered communication with investors will overcome the liability concerns of the various interested constituencies – companies, their senior managers and directors, the outside auditors, and the underwriters.

We caution you that we are providing here our best summary of the reforms approved during the June 29 meeting based only on the dialogue between the SEC Commissioners and responsible senior staff of the SEC Division of Corporation Finance. Perhaps in part because of the sheer volume of the final release in its present draft, non-public form (460+ pages, according to one Commissioner) and resultant need for post-vote tinkering with regulatory text, we may not see the text of the new and revised regulations for some time. Nor did the SEC or its staff reveal the anticipated effective date of these regulations once published officially in the Federal Register. However, it does appear that the final rules are substantially similar to those proposed, with considerable flexibility injected in response to public comment.

Highlights of the new and improved registration scheme outlined during the June 29 meeting are as follows:

## A. Deregulate Communications

It will be much easier for companies and underwriters to engage in oral and written communications with prospective investors at various stages of the offering process, depending in major part on the size and seasoning of the issuer and the identity of the particular offering participant.

[1] This term is defined to mean Form S-3/F-3-eligible companies that either have a $700 million worldwide public float or have issued $1 billion dollars in non-convertible debt or preferred for cash under a registration statement in the last three fiscal years. There was no indication at the meeting whether the SEC has modified the proposed ineligibility criterion that would have prevented many otherwise-eligible companies from invoking the benefits of WKSI status.

**1. New, "Bright-Line" Safe Harbor**

Most issuers will be free to communicate more than 30 days before filing a registration statement, so long as they do not refer to the impending offering and "go silent" on the first day of the pre-filing, 30-day "quiet period." In this regard, the SEC has not narrowed its expansive definition of "offer" under Securities Act Section 2(a)(3), so difficult judgments still may be necessary under this "bright-line" safe harbor. At the same time, the expanded safe harbors for regularly released business and financial information should facilitate these judgments for reporting companies.

**2. New "Free-Writing Prospectus" as a Communications Tool in Registered Offerings**

**a. Issuers**: Eligible issuers will be able to use a free-writing prospectus after a registration statement is filed, subject to certain filing and other requirements calibrated to the individual issuer's size and reporting history.

**i.** WKSI's have the most freedom to communicate with potential buyers of their securities, both orally and in writing, on virtually any subject at any phase of an offering – whether during the 30-day "quiet period" to which other companies are subject, after the registration statement is filed or, as under the prior regime, after its effectiveness. There are, of course, some filing and liability trade-offs. We nevertheless expect WKSI's to take full advantage of their new-found ability to "file and go" via an immediately effective shelf registration statement.

**b. Underwriters**: These offering participants do not have a safe harbor for pre-filing communications, oral or written, even in connection with WKSI offerings. On the other hand, they will enjoy the benefits of using a free-writing prospectus after the registration statement is filed, in virtually all circumstances without the burden of the more expansive filing obligations borne by issuers (in recognition of underwriters' serious cross-liability concerns). In any event, this factor will be irrelevant in shelf deals.

**c. Electronic Roadshows** : Generally speaking, electronic roadshows and other e-communications will be treated as free-writing prospectuses, with the only question being whether they must be filed by a particular offering participant.

**i.** Responding to commenters' concerns, the SEC will NOT require that e-roadshows constituting free-writing prospectuses be filed UNLESS used to solicit in an IPO of common or convertible equity securities. Even then, an e-roadshow will not have to be filed if the issuer makes at least one "bona fide" version readily available to an unrestricted audience.

**ii.** There is a welcome exception to the general principle that electronic communications are writings – "real-time" webcasts (and other "real-time" e-communications, such as a "live" phone call made over the Internet, and a simultaneous transmission of an otherwise "live" roadshow to an overflow audience via closed-circuit television, that seemed to be captured by the proposed definition of written communications) will be deemed oral, rather than "graphic" (and therefore written), in character. As a result, these communications will not have to be filed, although they remain subject to the same negligence-based liability standard (under Securities Act Section 12(a)(2)) as free-writing prospectuses.

**3. Expanding Categories of Communications Not Deemed a "Prospectus" and/or an "Offer"**

**a. Ordinary/Regular Corporate Communications**: Companies conducting a registered offering can continue to release an even wider array of business and financial information, both historical and forward-looking (the latter only in the case of more seasoned reporting companies that are not "volunteers"), than they could under the previous regulatory regime.

**i.** Again, the most onerous conditions are imposed on IPO and unseasoned companies, the least on WKSI's.

**b. Rule 134 Expanded**: The SEC has broadened the scope of Rule 134 for post-filing written communications by issuers and other offering participants that relate to the offering – this means that such communications will not be covered by the definition of "prospectus" and thus will not incur potential liability under Section 12(a)(2).

**c. Broker-Dealer Research**: Research safe harbors will be expanded, although there was no indication during the meeting whether the final amended safe harbors are the same as those proposed.

**B. Liability Considerations**

**1. Adjustment of Timing of Securities Act Section 11 (Strict) Liability Determinations for Issuers in a Shelf World**

The SEC has made clear that each shelf takedown will be regarded as creating a new "effective date" for purposes of gauging the potential liability under Section 11 of BOTH companies and their underwriters.

**a.** The SEC has not dealt with the serious due-diligence concerns of underwriters (either for purposes of the Section 11 "due diligence" or 12(a)(2) "reasonable care" defense) in an automatic and/or streamlined shelf environment.

**b.** However, the agency has addressed criticisms that officers, directors and auditors should not be exposed to the heightened Section 11 liability risks that would have arisen had their liability determinations been tied to the takedown date rather than, as under current law, the date of filing of the company's annual report on Form 10-K or 20-F (the so-called "Section 10(a)(3) update").

**c.** The SEC has adopted its proposal to "attach" Section 11 liability to shelf prospectus supplements.

**2. Liability for Material Misstatements or Omissions**

Liability under Securities Act Sections 12(a)(2) and 17(a)(2) for material misstatements or omissions will attach at the time of the investment decision, meaning the time a contract of sale is made between seller and buyer. In other words, liability under these provisions will be based on information "conveyed" orally or in writing to a particular investor <u>at or before</u> the time of the contract of sale, without regard to the content of the final prospectus.

**a.** The SEC believes that the unprecedented ability to use free-writing prospectuses, in addition to the longstanding practice of calling investors to assure any relevant additional information has been transmitted on or before the point at which the contract of sale is made, will be sufficient to address liability concerns.

**b.** There was some discussion between senior staff and the SEC regarding the implications of this position in circumstances where post-"sale" developments compel a seller to go back to the investor with new or corrected information. It would appear now that a seller in this instance would have to terminate the existing contract of sale and enter into a new one with the investor (assuming the investor decides to proceed with the transaction in light of the additional information communicated). In this connection, Corporation Finance Director Alan Beller indicated that the staff has been examining the interplay between state contract law governing when a binding contract of sale will be deemed made between a seller and buyer of securities, and the federal securities laws, particularly the non-waiver provisions. We anticipate that there will be further guidance on this subject in the adopting release.

**c.** Companies now will be considered "sellers" for purposes of assessing negligence-based liability under Section 12(a)(2), even in underwritten offerings. The courts generally have not taken this position.

**C. Improvements in Shelf Registration For All Eligible Issues**

**1. Special Benefits for WKSI's**

**a.** Register an unspecified amount of types or classes of securities on an immediately effective Form S-3/F-3. Post-effective amendments to a WKSI's shelf registration statement similarly will be deemed effective immediately upon filing.

**b.** Exclude more information from the base prospectus, including the description of securities (other than identification of type or class), and the plan of distribution.

**c.** "Pay-as-you-go" at the time of each takedown, if desired.

**d.** Add new classes of securities and eligible majority-owned subsidiaries after effectiveness.

**2. Improvements to Shelf Registration for All Primary S-3/F-3 Eligible Issuers**

**a.** Eliminate previous "at-the-market" restrictions imposed on equity offerings, including the requirement to identify the underwriter(s) in the prospectus, and the 10% volume limitation.

**b.** No "convenience" shelf problems if the first takedown occurs immediately after effectiveness.

**c.** Eliminate the prior limit on the amount of securities that can be registered to that amount which the issuer intends to offer or sell within two years of the effective date. However, the short-form registration statement on S-3/F-3 now has a maximum life of three years.

**d.** Use a prospectus supplement, rather than a post-effective amendment, to revise the plan of distribution and to identify selling shareholders. Despite the attachment of Section 11 liability to supplements under the new rules, this change benefits non-WKSI's because they no longer risk staff review during the delayed effectiveness of most post-effective amendments.

**D. Final Prospectus Delivery**

Shift to an access-equals-delivery model for all types of offerings, including IPO's, in recognition of enhanced investor access to EDGAR-filed documents.

**1.** Confirmations of sale and notices of securities allocations cannot be sent to investors until the final prospectus is filed. There is a new requirement to notify investors that they have purchased securities, and a cure provision covering inadvertent issuer failures to file the final prospectus. (Underwriters had expressed concern during the comment process about the negative liability implications of sending out confirmations in situations where the issuer had mistakenly failed to file).

**E. Changes to Annual Reports on Forms 10-K and 20-F Filed Under the Securities Exchange Act of 1934, As Amended ("Exchange Act")**

**1.** Risk factors now must be included in all annual reports filed on Forms 10-K and 20-F.

**2.** Unresolved written staff comments that are deemed material must be disclosed if received 180 or more days before the covered fiscal year-end.

**3.** Disclose in the annual report whether the issuer is a "voluntary" filer (e.g., an issuer of registered public debt that no longer is required under the Exchange Act to file periodic reports, but nevertheless continues to file them under an indenture covenant).

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If you have any follow-up questions or comments, please do not hesitate to contact us. We will notify you when the SEC makes the text of the new rules publicly available. [2]

[2] This memo is intended only as a general summary of the SEC's open meeting, and should not be viewed as furnishing legal advice.

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