Securities Law Developments

CORPORATE FINANCE DEVELOPMENTS

SEC Proposes Significant Amendments to Offering Regulations

On November 3, 1998, the Securities and Exchange Commission (the "Commission") issued two releases proposing amendments that would, if adopted, significantly change the regulation of offers and sales of securities, tender offers, exchange offers and mergers. The first release, which is referred to in this newsletter as the "Securities Act Reform Release,"[1/] proposes significant amendments to the regulatory structure for offerings under the Securities Act of 1933 (the "Securities Act"). The companion "Reg M&A Release"[2/] proposes substantial changes to the regulation of mergers and acquisitions under the Securities Act and the Securities Exchange Act of 1934 (the "Exchange Act"). This newsletter and its annexes discuss the Securities Act Reform Release. The proposed changes regarding tender offers, exchange offers and mergers in the Reg M&A Release are described in a separate newsletter.

The Securities Act Reform Release proposes changes in the following general areas:

Registration System and Prospectus Delivery Requirements.

> The proposals would provide greater flexibility and speed in the registration process by allowing issuers and underwriters to make offers before filing registration statements in some circumstances. In addition, some registration statements would become effective at the time requested by the issuer without the possibility of pre-sale staff review. On the other hand, the timing of fast-paced shelf takedowns under the current system would

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1/ Securities Act Release No. 7606 (November 3, 1998). The Securities Act Reform Release is also known as the "Aircraft Carrier Release" because of its size.

2/ Securities Act Release No. 7607 (November 3, 1998).

be substantially altered because offerors would be required to deliver prospectus information -- perhaps as a "securities term sheet" -- before completion of sales in all offerings. Also, some companies would no longer be eligible to use short-form registration.

Communications Around the Time of Offerings.

The proposals would give issuers greater freedom to make public statements around the time of offerings without the statements being considered "gun jumping" or invalid prospectuses. Bright-line safe harbors would be adopted to provide more certainty. Issuers generally would be required to file and assume statutory liability for any documents that constitute offers. Analysts would be allowed to publish research reports about an issuer in more circumstances than currently permitted.

Integration of Public and Private Offerings.

The proposals would ease substantially restrictions on an issuer changing a public offering to a private offering or private offering to a public offering.

Periodic Reporting.

Issuers would have some additional disclosure requirements in annual and periodic reports. The proposals would also require some additional items to be reported on current reports on Form 8-K and shorten filing times for most Form 8-K reporting.

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The Commission's proposals are far-reaching and complex. The following overview sets out the Commission's primary objectives and the principal effects on issuers and others if the proposals are adopted. This overview does not describe all of the changes the proposals would make. Please read the annexes for a detailed description of the proposals.

Objectives of the Proposals

For the last several years, the Commission has been evaluating the existing securities registration system in light of evolving conditions in the capital markets. A Task Force on Disclosure Simplification issued a report in March 1996 and the Commission subsequently adopted a number of the Task Force's recommendations. In July 1996, the Commission's Advisory Committee on the Capital Formation and Regulatory Processes recommended a "company registration" system and the Commission issued a concept release seeking comment on reform of the registration system. Under the National Securities Markets Improvement Act of 1996, Congress granted the Commission broad, general exemptive authority under the Securities Act for the first time. Following this grant of exemptive authority, the Commission staff further

studied the existing regulatory system and possible improvements. The proposals in the Securities Act Reform Release and the Reg M&A Release are the result of these efforts.

The Commission identified the following objectives it seeks to achieve through the current proposals:

- increase the speed and efficiency of some registered offerings;
- encourage registered offerings of securities and reduce reliance on Securities Act Rule 144A offerings;
- encourage effective due diligence by underwriters in expedited offerings;
- clarify and liberalize rules regarding issuer and analyst communications while extending liability for these communications;
- require delivery of information to investors in registered offerings at an earlier time in the offering process;
- increase issuers' flexibility to switch from registered offerings to private offerings and vice versa; and
- improve the quality and meaningfulness of periodic reporting.

Overall, the Commission hopes the proposals in the Securities Act Reform Release will make registered offerings more workable and attractive to issuers by increasing an issuer's flexibility with respect to timing and disclosure while giving investors and the market greater access to more timely information about the issuer.

Principal Effects of Proposals

As proposed, the amendments would have far-reaching effects on both issuers and underwriters. We highlight below the most notable of those effects.

Issuers would be permitted to make offers before filing registration statements in some offerings.

An issuer must now wait until a registration statement is filed before making an offer to sell or soliciting an offer to buy securities. The Commission's proposals would allow offers before a registration statement is filed for offerings by issuers that have been reporting companies for at least one year, have timely filed all reports for at least 12 months and have filed at least one annual report, if the offering is one of the following:

- By an issuer that has either (1) a public float of at least $250 million, or (2) a public float of at least $75 million and an average daily trading volume of $1 million;

- Made solely to qualified institutional buyers ("QIBs") as defined in Securities Act Rule 144A;

- Made solely to existing security holders in certain specified circumstances (including, for example, upon exercise of options and warrants, pursuant to dividend reinvestment plans or in connection with direct stock purchase plans); or

- An offering of non-convertible, investment grade securities.

Certain offerings would not be subject to review by Commission staff; registration statements could go effective immediately upon filing (or at the time designated by the issuer).

Currently, any registration statement may be selected for staff review. Review can delay completion of offerings for six weeks or more and the possibility of this review creates uncertainty for issuers. The proposals would exempt from pre-sale staff review any registration statement that relates to the offerings described immediately above. The Commission would also exempt from pre-sale staff review offerings by an issuer that has been a reporting company for at least 24 months (and has been timely for at least the last 12 months) and (1) that has a public float of at least $75 million or (2) whose most recent annual report is incorporated by reference in the registration statement and that report has been reviewed by the staff and amended in response to staff comments.

Issuers would be able to specify when they wished such registration statements to go effective, and this could be immediately upon filing. In an underwritten offering, an exhibit with the managing underwriter's concurrence in the requested effective date would be required. Post-effective amendments to these registration statements would also be effective immediately upon filing (or later if requested). These filings, however, would be subject to post-effective screening to confirm eligibility for this treatment and to see whether the disclosure raises any "red flags" concerning compliance with antifraud provisions. The possibility of post-sale review will create some uncertainty and risk for completed sales.

In all offerings, issuers and underwriters would be required to deliver prospectus information before purchasers make a binding commitment.

Under the current rules, as long as no writings are used to offer a security, a reporting company generally can postpone delivery of a prospectus until delivery of the confirmation of a sale. Under the proposals, every issuer would be required to deliver a term sheet or prospectus containing offering information before a buyer makes a

binding decision. This requirement, combined with the requirement to file registration statements or post-effective amendments for each takedown and the inability to "forward incorporate" Exchange Act filings, would add new delays and complexity for sales currently conducted through shelf programs (such as sales under medium-term note programs). In addition, the requirement to pre-deliver disclosure for secondary sales into an existing trading market (such as in non-underwritten selling stockholders deals) appears to raise significant practical problems.

An unseasoned or smaller issuer would be required to deliver a preliminary prospectus from three to seven days prior to pricing of an offering. The proposals would eliminate the requirement to deliver a final prospectus, although one would have to be filed and available to any investor wishing to receive one.

Some issuers currently eligible for short-form registration on Form S-3 would no longer be eligible for short-form registration.

An issuer that has been a reporting company for at least one year (and meets certain other conditions) currently is able to use Form S-3 short-form registration for primary offerings if the issuer's public float is over $75 million. Issuers with a one-year reporting history may use Form S-3 for an offering by selling stockholders without meeting the minimum float test. Under the proposals, full incorporation by reference would only be available to an issuer with a public float over $75 million if it had an average daily trading volume of at least $1 million (or if its public float was over $250 million). Other issuers with public floats of between $75 million and $250 million would be able to incorporate by reference only if they had been reporting companies for at least 24 months, and they would be required to deliver incorporated documents with the prospectus (like current Form S-2). Under the Commission's proposals, an issuer registering an offering by selling stockholders could not incorporate by reference unless the issuer was allowed to incorporate by reference in primary offerings.

Issuers would be able to make public statements more freely without the risk of the statements being considered "gun jumping" or a non-conforming prospectus; liability for many such statements, however, would be increased.

A proposed new bright-line communications safe harbor would exclude any communication made by an issuer more than 30 days before filing a registration statement from being considered an offer. Such statements therefore would not constitute "gun jumping." As noted above, some issuers could make offers before filing registration statements, so no statements made by such issuers would constitute "gun jumping." In addition, all issuers would be free to make written statements that constitute offers outside the statutory prospectus after the filing of a registration statement. Issuers would be free to conduct electronic road shows, use E-mail to answer investor questions or post messages on bulletin boards following the filing of a registration statement. Issuers, however, would be required to file any writings that

constitute offers (subject to some specific exceptions), and issuers would be subject to liability under the Securities Act for these statements.

More issuers would qualify for the streamlined disclosure requirements for "small business issuers."

The definition of "small business issuer" would be expanded to include issuers with annual revenues below $50 million, instead of the current $25 million ceiling. In addition, there would no longer be a public float limitation.

Issuers would no longer be able to convert privately placed securities into registered securities through "Exxon Capital" exchanges.

Issuers currently are able to place certain securities in private transactions and then exchange these securities for substantively identical securities in registered transactions. The staff of the Commission has permitted these transactions in the *Exxon Capital* line of no-action letters. The Securities Act Reform Release states that if the proposals are adopted, the staff would repeal the *Exxon Capital* line of no-action letters, in light of the staff's view that *Exxon Capital* exchanges would no longer be necessary because offerings to QIBs would become easier to register. This would mean that, if investors require registered securities (with no resale prospectus delivery obligation), it will be necessary to register the initial placement.

Issuers would be freer to abandon public offerings and complete private offerings or to convert private offerings into public offerings.

An issuer that commences a public offering and finds limited interest currently must wait a substantial amount of time after it has abandoned a public offering to commence a private offering, or the public offering may be considered a prohibited general solicitation with respect to the private offering. The proposals would allow issuers to commence private offerings promptly after abandoning public offerings, as long as certain conditions are met.

Similarly, an issuer that commences a private offering and then decides that a public offering is better cannot currently commence a public offering promptly because the private offers might be considered offers made before the registration statement was filed. Under the proposals, offers can be made by some issuers prior to registration in the circumstances described earlier, so pre-filing offers would no longer be an impediment to commencing a public offering in those circumstances. The proposals also would allow any issuer to file a registration statement for any public offering 30 days after notifying private offerees of abandonment of the private offering, as long as certain conditions are met.

Issuers would be required to include risk factor disclosure in annual and quarterly reports.

Many issuers are now including risk factors in periodic reports. The proposals would require all issuers to include risk factors (drafted in plain English) in annual reports and to update the risk factors in quarterly reports.

Issuers would be required to file summary earnings information before the current due date for reports on Form 10-Q.

The proposals would require issuers to file reports on Form 8-K including selected financial data similar to (but perhaps more extensive than) the financial information that many issuers currently publish in earnings releases. The reports would be due within 30 days after the end of each fiscal quarter and 60 days after the end of the fiscal year. Alternatively, the Commission is considering accelerating the due dates for Forms 10-Q and 10-K.

Issuers would be required to disclose additional types of information in current reports on Form 8-K, and would be required to file such reports sooner than currently required.

Issuers would be required to report a number of new items on Form 8-K including: material modifications to the rights of security holders, departure of a CEO, CFO, COO or president and material defaults on senior securities. The due date for filing reports on Form 8-K would generally be accelerated from 15 calendar days to five calendar days; some items would need to be reported within one business day.

Directors would be required to sign quarterly reports on Form 10-Q and officers and directors would be required to make certifications in connection with filing periodic reports.

These signature and certification requirements are designed to encourage officers and directors to pay greater attention to the quality of periodic reporting.

Underwriters would receive additional guidance as to appropriate due diligence in connection with expedited offerings.

The proposals would add a number of factors to consider in determining whether an underwriter had completed adequate due diligence in connection with an expedited offering. The new factors include: receipt of "comfort letters" from accountants, receipt of opinions of counsel and research coverage of the issuer by an analyst employed by the underwriter. The proposals request comment on whether additional factors should be considered, including auditor review of management's discussion and analysis disclosure and review of the entire disclosure by "independent qualified professionals."

Analysts (whether or not affiliated with underwriters for an offering) would have greater freedom to publish research reports on issuers that are engaged in offerings.

> Existing Rules 137, 138 and 139 under the Securities Act provide that analyst reports on issuers that are in registration will not be considered offers or prospectuses under certain circumstances. The proposals would liberalize these rules and allow analysts reports for more issuers, including in some circumstances issuers that are not public companies and issuers the analyst has not previously covered. In addition, a restriction on reports that are more favorable to the issuer than prior reports would be lifted in some circumstances.

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The details of the proposals are described in the annexes to this newsletter.

Comments on the Securities Act Reform Release are due April 5, 1999, and we expect that there will be substantial comment on, and discussion of, the proposals. The Commission has explicitly requested comment on alternatives to a number of the proposals.

If you have any questions, please call Meredith Cross (202/663-6644), Roger Patterson (202/663-6246), Erika Robinson (202/663-6402) or Deborah Wiggin (202/663-6522).

Table of Annexes

Annex A

Changes to Registration System

In the Securities Act Reform Release, the Commission proposed a three-tiered registration system for offerings consisting of:

- Form A for smaller issuers and unseasoned issuers,
- Form B for larger, seasoned issuers and specified offerings by other issuers and
- Form C for business combinations and exchange offers.

Small business issuers would continue to use Form SB-1 and a revised Form SB-2, but would now use Form SB-3 for business combinations and exchange offers. These forms would be used by both U.S. issuers and foreign private issuers; foreign government issuers would continue to register offerings on Schedule B.

Form B Offerings.

Form B generally would replace Forms S-3 and F-3.

Required Disclosure. Registration statements on Form B would contain: (1) a cover page; (2) a prospectus containing transactional disclosure about the offering, company information (primarily through incorporation by reference), a securities term sheet and certain undertakings; and (3) signatures and selected exhibits.[1/]

The Commission proposed, and solicited comment on, two fairly similar alternatives for transactional disclosure on Form B. The first alternative would require issuers to include all "offering information" in the prospectus. "Offering information" would consist of: the amount of securities offered, material changes in the issuer's affairs not reflected in its Exchange Act reports, use of proceeds, information about underwriter's discounts and commissions, risks of the offering, selling security holder information, the material terms of the securities, all other information regarding the transaction that is material, any offering information disclosed during the offering period (other than oral communications) and offering information communicated orally that the issuer chooses to file.[2/] Issuers would have discretion to determine the materiality and applicability of the other traditional items of transactional disclosure. The second alternative would maintain the same transactional disclosure required today under Forms S-3 and F-3. This alternative would require the following disclosure in addition to the disclosure required under the first alternative: certain portions of Item 501 of Regulation S-K (forepart of registration

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[1/] The securities term sheet is discussed in Annex C "Prospectus Delivery Reforms."

[2/] Proposed Form B. The "offering period" would be defined as the period beginning 15 days before the first offer is made and ending when the offering is completed.

statement and outside front cover page of prospectus); Item 502 of Regulation S-K (prospectus summary and address and telephone number); Item 509 of Regulation S-K (interests of named experts and counsel); and Item 510 of Regulation S-K (disclosure of Commission position on indemnification for Securities Act liabilities).

Written information disclosed during the offering period would be classified as either "offering information," as described in the preceding paragraph, or "free writing" materials. Free writing materials would include all written information disclosed by or on behalf of the issuer during the offering period other than offering information. While offering information would be filed as part of the registration statement, free writing materials not containing unfiled offering information would be filed with the Commission under proposed Rule 425 but would not be considered part of the effective registration statement.

For company disclosure, an issuer filing a Form B registration statement would be required to incorporate by reference its latest annual report under the Exchange Act and any Exchange Act reports filed since the end of the fiscal year covered by the latest annual report. Form B issuers would not be permitted to incorporate by reference their Exchange Act reports filed after the end of the offering period.[3/] This is a significant change from current Form S-3, where forward-incorporation is permitted. Such incorporation allows shelf registration statements to be continuously current without the filing of a post-effective amendment. In addition to incorporation of certain Exchange Act reports, a Form B issuer would be required to disclose in its registration statement updated company information that describes material changes not reflected in any Exchange Act reports incorporated by reference.

Filing and Effectiveness. An eligible issuer could file a registration statement on Form B at any time before the first sale of securities occurred. The Commission would accept Form B registration statements after hours via EDGAR or facsimile until 10:00 p.m. to permit issuers to file their registration statements following after-hours pricing.[4/] When an issuer filed a Form B registration statement, it would also file all free writing materials it had disseminated prior to filing the registration statement.[5/] After the registration statement is filed, the issuer would file all subsequent free writing materials at the time of first use.

[3/] For offerings currently conducted as delayed shelf offerings, each takedown would have a separate offering period.

[4/] Proposed Rule 110(d). Filing fees for after-hours filings would be paid in the same way they are paid today for Rule 462(b) filings. Proposed Rule 111(b).

[5/] Proposed Rule 425(b). Materials that would not have to be filed under Rule 425 include: (1) any factual business communication; (2) any research report used in reliance on Rules 137, 138 or 139; (3) any information used in connection with an offering on Form S-8; (4) any information used in connection with an offering on Form B under a dividend or interest reinvestment plan; (5) any information used in connection with a registrant-sponsored direct stock purchase plan for existing stockholders; or (6) any information filed or to be filed as part of an effective registration statement.

A Form B issuer would designate when the registration statement was to become effective by indicating on the cover page whether it was to become effective (1) upon filing; (2) at a date and time specified by the issuer; or (3) as specified in a later amendment to the registration statement.[6/] Because the issuer would have complete control over the effectiveness of the registration statement, the Commission has proposed requiring the filing of an exhibit evidencing the managing underwriter's concurrence with the issuer's designation of effectiveness.

Eligible Offerings. Form B would be available to register the offerings described below.[7/]

(1) **Primary and Secondary Offerings by Larger, Seasoned Issuers**. In order to be eligible to file a registration statement for a primary or secondary offering on Form B an issuer must have (1) a public float of at least $75 million and an average daily trading volume ("ADTV") of at least $1 million or (2) a public float of at least $250 million.[8/] ADTV would be measured during the three full calendar months preceding filing of the registration statement, and public float would be measured as of the end of the issuer's last fiscal quarter. In addition to meeting these quantitative criteria, the issuer would have to have been a reporting company under the Exchange Act for at least one year, have filed at least one annual report, have filed all Exchange Act reports due and on a timely basis in the 12 months before the filing and have previously conducted a registered offering of its securities unless it became a publicly held entity in a spin-off transaction.[9/]

The addition of a $1 million ADTV requirement will render certain issuers that are currently able to file registration statements on Form S-3 ineligible to use Form B.

[6/] Proposed Rule 462(f)(1)(i).

[7/] The following issuers would be ineligible to file registration statements on Form B: "blank check companies;" shell entities; companies offering penny stock; companies subject to "going concern" opinions from their independent auditor; companies that have failed to pay dividends on preferred stock, experienced a material delinquency with respect to preferred stock that was not cured within 30 days or defaulted on any payment of principal, interest, a sinking fund installment, a purchase fund installment or any other installment or indebtedness, or defaulted on any rental or a long-term lease, if such debt and lease defaults in the aggregate are material; companies recently involved in bankruptcy or insolvency proceedings; companies that have been found to have violated provisions of the federal securities laws or that have been convicted of securities fraud or business-related fraud or perjury during the five years prior to filing (or that have executive officers, directors, general partners or nominees to such positions or underwriters who have done the same); and companies that have failed to amend their Exchange Act reports in accordance with Commission staff comments. Proposed Form B, General Instruction I.B.6.

[8/] "Public float" would be defined as the market value of the issuer's outstanding voting and non-voting common equity held by non-affiliates of the issuer. Proposed Form B, General Instruction I.C.1(d).

[9/] Proposed Form B, General Instruction I.B. Canadian issuers that file annual reports on Form 40-F or whose previous offerings have been registered under the Securities Act on MJDS forms would not be eligible to use Form B. Proposed Form B, General Instruction I.B.7.

Furthermore, a significant cutback on short-form eligibility would be applied to selling stockholder offerings. Under the proposals, unlike Form S-3, the issuer qualifications for primary offerings would apply to secondary offerings. Consequently, many issuers currently able to file resale registration statements on Form S-3 would not be eligible to use new Form B.

(2) **Offerings to QIBs**. In addition to offerings by larger, seasoned issuers, Form B would be available to all issuers with a one-year reporting history[10/] for offerings made solely to qualified institutional buyers ("QIBs") (as defined in Rule 144A), other than dealers or investment advisers, as long as the QIBs are purchasing for their own account or for the account of other QIBs.[11/] Because such an offering would be registered, the securities offered could be fungible with those that are listed on exchanges or quoted on Nasdaq (unlike Rule 144A) and the securities generally would be freely resalable immediately following the offering, even to non-QIBs. However, the Commission noted that Form B registration would not be available if the QIBs are mere conduits for sales to the public. In such cases, the Commission stated that the QIB would be deemed a statutory underwriter and resale of the securities would violate Section 5 of the Securities Act absent an applicable exemption. Also, the Commission indicated that in such a case, the offering to the QIB on Form B may be a violation of Section 5. This possibility could raise substantial concerns for issuers, underwriters and QIBs considering such offerings.

Under the new registration system, the Commission would view as unnecessary the interpretations that allow issuers to sell certain securities in a private offering and shortly thereafter register an offering of substantially identical securities to be exchanged for those privately placed in so-called "*Exxon Capital* exchange offers." Consequently, the staff would repeal the *Exxon Capital* interpretive letters.

(3) **Offerings to Existing Security Holders**. Registration on Form B would also be available under certain conditions for reporting issuers for the following offerings to existing security holders: rights offerings, offerings of securities pursuant to a dividend or interest reinvestment plan ("DRIP"), offerings of common stock to existing common stock holders, offerings of securities upon exercise of either outstanding transferable options or outstanding transferable warrants and offerings of securities upon conversion of outstanding convertible securities. The issuer must have been reporting under the Exchange Act for at least one year, have filed at least one annual report and be current

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[10/] The issuer would have to have been a reporting company for at least one year, have filed at least one annual report, and have been current and timely in its reporting. The Commission solicited comment on whether issuers without a reporting history should be eligible to register offerings to QIBs on Form B.

[11/] Proposed Form B, General Instruction I.C.2. In the Securities Act Reform Release, the Commission indicated that it would reconsider its interpretation that the filing of a registration statement by itself constitutes a general solicitation for purposes of a QIB-only Form B offering.

and timely in filing its reports. Depending on the type of offering, the Commission would impose restrictions on the amount of securities that could be registered by the issuer or purchased by one security holder in any 12-month period. In addition, the existing security holder generally must have held the issuer's securities for at least two months. For DRIPs, these requirements appear to be significant new restrictions not currently imposed for registration of DRIPs on Form S-3.

(4) **Offerings of Non-Convertible, Investment Grade Securities**. Any issuer that has been reporting under the Exchange Act for at least one year, has filed at least one annual report and is current and timely in filing those reports would be able to use Form B to register offerings of non-convertible, investment grade securities. This would be consistent with current Form S-3, although the reporting history requirement would be more rigorous.[12/]

(5) **Affiliated Broker-dealer Transactions**. Issuers that are reporting companies would be able to register transactions by affiliated broker-dealers on Form B as long as the broker-dealer engages in the transactions only in its ordinary capacity as a market maker and the securities are outstanding securities the broker-dealer did not acquire directly from the issuer or its affiliate.[13/]

Delayed Shelf Offerings. Delayed shelf offerings would generally be eliminated (or substantially altered) under the proposed system, although other types of shelf offerings, such as continuous offerings, would remain largely unchanged by the proposals. Currently, for delayed shelf offerings, an issuer files a registration statement covering a certain amount of specified or unspecified securities. The registration statement includes a generic base prospectus, which is supplemented by a prospectus supplement filed pursuant to Rule 424 describing the specific terms of the securities offered for each subsequent takedown. Rule 424 prospectus supplements must be filed by the second business day following the earlier of first use or pricing. Under the revised system, no registration statement would be required to be filed until the first sale; that registration statement, however, would need to include the final prospectus and a securities term sheet for the securities offered. In the alternative, issuers could file some information in a registration statement before the takedowns begin and either file post-effective amendments containing the remaining required disclosure or delay effectiveness of the initial registration statement pending

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[12/] Proposed Form B, General Instruction I.C.4. Majority-owned subsidiaries of such an issuer would also be eligible to register investment grade securities as long as the parent guarantees the obligations and registers its guaranty under the Securities Act. Proposed Form B, General Instruction I.C.5. Currently, offerings of investment grade securities by majority-owned subsidiaries of Form S-3 eligible companies generally do not require a parent guarantee to qualify for Form S-3.

[13/] Proposed Form B, General Instruction I.C.6.

filing of a pre-effective amendment.[14/] In either case, the current practice of preparing and filing the prospectus supplement after the offering is sold would need to be accelerated so that the terms of the offering are finalized and the prospectus supplement is prepared and filed prior to the first sale. Frequent shelf issuers, such as finance companies, may have concerns about how to maintain their current flexibility under this proposed new system.

Form A Offerings.

Required Disclosure. Form A would be the basic form for registration of securities under the Securities Act. A registration statement on Form A would contain the same itemized disclosures required in current Forms S-1 and F-1. "Seasoned" Form A issuers would be eligible to incorporate by reference their company information instead of presenting it directly in the prospectus, but would be required to deliver the incorporated information in a manner similar to current Forms S-2 and F-2. Seasoned Form A issuers would be issuers that have been reporting companies under the Exchange Act for at least 24 months[15/] and that (1) have a public float of at least $75 million or (2) have filed at least two annual reports. As noted, these issuers would have to deliver along with the prospectus, their latest annual report filed under the Exchange Act, as well as the information in Part I of their most recent Form 10-Q or 10-QSB.[16/] For initial public offerings ("IPOs") and offerings by all other issuers that are not seasoned, the issuer must include the company information directly in the prospectus.

Filing and Effectiveness. Like Form B issuers, seasoned Form A issuers would be able to designate the effectiveness of their Form A registration statements if (1) their public float is at least $75 million or (2) their most recent annual report has been fully reviewed by the Commission Staff and there are no outstanding, unresolved staff comments.[17/] In addition, the issuer must be subject to Exchange Act reporting requirements, current in its Exchange Act filings and timely in its Exchange Act filings during the last 12 months. Issuers designating the effectiveness of a Form A registration statement would need to file the registration statement prior to making offers; as with Form B registration statements, these issuers would have to include an exhibit evidencing the managing underwriter's concurrence with the issuer's designation of effectiveness.

[14/] All information in the registration statement would be subject to Section 11 liability. The Commission expressed its view that information currently filed in prospectus supplements under Rule 424 is also subject to Section 11 liability but noted that the practicing bar does not agree uniformly with that interpretation.

[15/] This 24-month period is shorter than the 36 months currently required on Form S-2.

[16/] Proposed Form A, General Instruction II.A.

[17/] Proposed Rule 462(f)(1)(iii). The same types of companies disqualified from using Form B would also be ineligible to incorporate by reference under Form A or designate the effectiveness of a Form A registration statement. Proposed Form A, General Instruction I.B. See footnote 7.

For all other issuers, the timetable for filing and effectiveness of Form A registration statements would be similar to the current timetable for filings on Forms S-1 and F-1.

Eligible Offerings. Form A would be available for any offering for which no other form is authorized or prescribed.[18/] In addition, real estate companies would register on Form A instead of Form S-11, unless they meet the eligibility requirements of another form.[19/]

Form C Offerings.

Required Disclosure. Form C would be used to register business combinations and exchange offers.[20/] Form C registration statements would include: (1) a cover page; (2) a prospectus with information about the material features of the proposed transaction, the issuer, the company to be acquired, and voting and management information and certain undertakings; and (3) signatures and exhibits. As with Forms S-4 and F-4, the prospectus in a Form C registration statement could serve as the proxy or information statement used in connection with the transaction.[21/] Like current Forms S-4 and F-4, an issuer's ability to incorporate by reference its company information on Form C would vary depending on which Securities Act registration statement form the issuer could use to make a primary offering.[22/] Form B issuers and seasoned Form A issuers could incorporate by reference company information, although seasoned Form A issuers would have to deliver the incorporated documents. All other registrants would have to provide the required company disclosure directly in the prospectus. Presentation of disclosure about the company to be acquired would require the same analysis about that company.[23/] If the company to be acquired were not a reporting company, Form C would require it to provide the

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[18/] Proposed Form A, General Instruction I.A.

[19/] The Commission proposed adding (with some changes) the real estate-specific disclosure required by Form S-11 to Regulation S-K. Proposed Items 1101-1113 of Regulation S-K.

[20/] Transactions that would be required to be filed on Form C (or Form SB-3 if the issuer is a small business issuer) are: Rule 145(a) business combination transactions, mergers not requiring solicitation of votes or consents of all security holders of the company being acquired, exchange offers, public reofferings or resales of securities acquired pursuant to a Form C registration statement or any combination of these transactions. Proposed Form C, General Instruction I.A.

[21/] For more information on specific proposals relating to business combinations and tender offers, see the newsletter regarding the Reg M&A Release.

[22/] Proposed Form C, General Instruction II.

[23/] Proposed Form C, General Instruction III.

same non-financial disclosure as a reporting company, but would not require it to provide the full financial statement disclosure.[24/]

Filing and Effectiveness. Registration statements on Form C would be subject to Commission Staff review and would become effective in the same manner that Forms S-4 and F-4 do today.

Small Business Issuers.

In the Securities Act Reform Release, the Commission proposed amending the definition of "small business issuer" to reflect changing economic conditions. Under the proposed amendments, an issuer would qualify as a small business issuer eligible for the streamlined small business issuer forms if it has less than $50 million in annual revenues. The proposals would increase the revenue limitation from $25 million to $50 million and eliminate the public float limitation. As under the current definition, reporting companies would measure revenues as of the end of the issuer's last two consecutive fiscal years, while non-reporting companies would look at revenues during their last fiscal year.

Small business issuers would continue to register offerings on Forms SB-1 and SB-2. The Securities Act Reform Release proposes amending Form SB-2 to permit eligible small business issuers to incorporate by reference their company information if they meet certain requirements. If a small business issuer chose to incorporate by reference it must deliver its full Exchange Act annual report to investors with the prospectus. Finally, small business issuers would be required to register business combination transactions on new Form SB-3.

Foreign Government Issuers.

The proposals would permit certain seasoned foreign government issuers filing registration statements on Schedule B to designate the date and time of effectiveness of their registration statements just as Form B issuers and seasoned Form A issuers would be permitted to do. This would only be available for firm commitment underwritten offerings of at least $250 million by foreign government issuers that have registered an offering under the Securities Act within the three most recent years.

Asset-backed Securities.

The Commission solicited comment on how offerings of asset-backed securities should be regulated, rather than setting forth proposals in the Securities Act Reform Release. The Commission explained that the staff is engaged in an ongoing effort to address that question. Forms A and B, as proposed, do not contemplate registration of asset-backed offerings. Instead,

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[24/] Forms S-4 and F-4 currently give non-reporting acquired companies the option to provide abbreviated company information.

the request for comment suggests that the Commission expects to publish separate proposals governing registration of asset-backed securities.

Civil Liability Provisions.

In the Securities Act Reform Release, the Commission discussed the application of the various civil liability provisions of the federal securities laws to the filings under the proposed registration system. In a Form A or Form B offering, Section 11 liability would attach to the effective registration statement, including the prospectus, any offering information used during the offering period and any incorporated Exchange Act reports. Section 11 liability would also attach to any prospectus included in, or any Exchange Act report incorporated by reference through, a post-effective amendment and to any prospectus supplement.[25/] Section 12(a)(2) liability would attach to all free writing materials used during the offering period.[26/] In addition, the Commission noted that Section 12(a)(2) liability may apply to factual business communications during the offering period. Finally, all of these communications would be subject to the anti-fraud provisions of the Securities Act and the Exchange Act, as would communications used before the 30-day limited communications period discussed below.

Concurrent Exchange Act Registration.

The Commission proposed allowing issuers to use Form A, B, C, SB-1, SB-2 or SB-3 or Schedule B to register a class of securities under Section 12 of the Exchange Act at the same time they register public offerings of securities of the same class under the Securities Act.[27/] Issuers would effect concurrent registration by checking a box on the cover of their Securities Act registration statements, and Exchange Act registration would become effective at the same time the registration statement became effective pursuant to Rule 499.[28/] Concurrent registration would eliminate the need to file a Form 8-A except where no public offering was occurring.

Commission Staff Review Policy.

In the Securities Act Reform Release, the Commission indicated that the staff would continue to review all IPO registration statements, and would review certain other Form A and Form C registration statements and certain Exchange Act reports. The filings reviewed would be selected in accordance with the Commission's internal review criteria, which would not be

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[25/] As noted previously, the Commission expressed its view that Section 11 liability currently applies to prospectus supplements used in shelf offerings, although it recognized that there is disagreement in the practicing bar on this point.

[26/] For more information on free writing, and the safe harbors for factual business communications and regularly released forward-looking information, see Annex B.

[27/] Proposed notes to Rule 12d1-2.

[28/] See Proposed Forms A, B, C, SB-1, SB-2.

publicly available. Registration statements on Form B would not be reviewed by Commission staff before effectiveness, nor would Form A registration statements filed by seasoned issuers eligible to designate the effectiveness of the registration statement. Instead, the staff would screen these filings to determine (1) whether the offering was eligible to be registered on Form B or, in the case of a registration statement on Form A whether the issuer was eligible to designate effectiveness of the registration statement and (2) whether the disclosure raises any "red flags" concerning compliance with antifraud provisions of the Securities Act or the Exchange Act requiring the Staff to conduct an immediate review of the registration statement. The Commission stated that if the offering was not eligible to be registered on Form B, the issuer would have violated Section 5 of the Securities Act and would be referred to the Division of Enforcement.

In the Securities Act Reform Release, the Commission indicated that, while it would not make its internal review criteria public, it would notify issuers as soon as their Exchange Act reports were selected for review. In addition, the Commission indicated that it would begin to consider requests for Exchange Act disclosure review prior to a contemplated offering, subject to staff resource limitations. If the staff is unable to review an issuer's reports when requested, it would notify the issuer. In that case, the staff would not select those reports for a "routine" review for the next 30 days. The staff could, however, review the reports for "cause," or after the 30 days has passed.

The Role of Underwriters.

The Commission attempted to address concerns about the liability of underwriters which have become increasingly pronounced as the speed of offerings has increased. An underwriter is not subject to liability under Section 11 of the Securities Act for the non-expertised portions of a registration statement if, after reasonable investigation, it had reasonable grounds to believe and did believe that the statements in the registration statement were true and that there was no omission to state a material fact.[29/] Similarly, an underwriter is not subject to liability under Section 12(a)(2) of the Securities Act for misstatements or omissions in a prospectus if it exercised "reasonable care" and did not know of the misstatement or omission. Current Securities Act Rule 176 identifies a number of factors that a court should consider in assessing the reasonableness of a person's due diligence.[30/] In light of the additional timing pressures for

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[29/] Section 11(b)(3)(A). For expertised portions of the registration statement, the underwriter need only show that it had no reasonable ground to believe, and did not believe, that the statements in the registration statement were untrue or omitted to state a material fact. Section 11(b)(3)(C).

[30/] These factors are:

1. the type of issuer;

2. the type of security;

(continued...)

underwriters that may result from the new registration system, the Commission proposed to expand Rule 176. Proposed Rule 176 would address both the reasonable investigation standard of Section 11 and the reasonable care standard of Section 12(a)(2). New subsection (i) of Rule 176 would identify six due diligence practices that, if present, may be indicative of a "reasonable investigation" under Section 11 and "reasonable care" under Section 12(a)(2) when an underwriter conducts an expedited Form B offering of equity or non-investment grade debt securities marketed and completed in fewer than five days.[31/] These practices are:

(1) review of the registration statement and a reasonable inquiry into any fact or circumstance that would cause a reasonable person to question whether the registration statement contains an untrue statement or material omission;

(2) discussion of the information contained in the registration statement with the relevant executive officers of the issuer, including, at a minimum, the chief financial officer or chief accounting officer or his or her designee, and the chief financial officer or chief accounting officer has certified that he or she has read the registration statement and that to the best of his or her knowledge it does not contain an untrue statement of a material fact or omit to state a material fact necessary to make the statements therein not misleading;

(3) receipt of a SAS 72 comfort letter;

(4) receipt of a favorable opinion from issuer's counsel regarding compliance of the registration statement as to Form and including a Rule 10b-5 opinion;

30/ (...continued)

3. the type of person;

4. the office held when the person is an officer;

5. the presence or absence of another relationship to the issuer when the person is a director or proposed director;

6. reasonable reliance on officers, employees and others whose duties should have given them knowledge of the particular facts;

7. for underwriters, the type of underwriting arrangement, the role as underwriter, and the availability of information with respect to the registration; and

8. where a fact or document is incorporated by reference, whether the person had any responsibility for the fact or document when filed.

31/ The Commission did not propose that these practices would apply to offerings of investment grade debt because the Commission believed that underwriters usually perform due diligence for those offerings on a periodic basis rather than with each takedown.

(5) employment of underwriter's counsel who has reviewed the registration statement, all periodic reports filed by the issuer for the last full fiscal year and any portion of a fiscal year thereafter, the issuer's charter, by-laws, corporate minutes for the same period and all material contracts entered into by the issuer in the last five years and has given a favorable Rule 10b-5 opinion; and

(6) employment of, and consultation with, a research analyst that has followed the issuer or the issuer's industry on an ongoing basis for at least six months and has issued a report on the issuer or the issuer's industry within the 12 months prior to commencement of the offering.[32/]

The proposed rule provides that the foregoing practices are factors in determining whether an underwriter's conduct constitutes a reasonable investigation or reasonable grounds for belief. The absence of one or more of the practices, other than the practice specified in (1) above, would not be considered definitive in determining whether the underwriter has met the appropriate standard.

In the Securities Act Reform Release, the Commission pointed out that in limited circumstances, cooperation between analysts and underwriters could be useful. Analysts with information about the company could assist the underwriters in their due diligence process while taking care to prevent any flow of information from the underwriter to the analyst that would result in selective disclosure.

[32/] The Commission also solicited comment on a number of other possible due diligence practices including (1) a timely SAS 71 review of quarterly financial information, (2) an SSAE 8 opinion on the MD&A, and (3) review by an underwriter of a favorable report issued by a qualified independent professional to the issuer after a year-end disclosure review.

Annex B

Easing Restrictions on Communications

The Securities Act imposes limitations on communications during the time an issuer is engaged in a registered public offering. Current limitations vary depending on when the communication occurs. Prior to filing a registration statement, the "pre-filing period," an issuer may not offer or sell the securities. Between the filing and effectiveness of a registration statement, the so-called "waiting period," the issuer may make oral offers; any written offer must conform to Section 10. Following effectiveness of the registration statement, the issuer may offer and sell securities and use supplemental sales materials, but only if it delivers a final prospectus complying with Section 10(a) before or with those supplemental materials.

The Commission's proposals, which are intended to provide greater flexibility to issuers, increase the amount of information provided to investors and minimize the problem of selective disclosure, would alter this structure substantially.

Pre-Filing Period.

Form B Issuers. The Commission has proposed removing all restrictions on offering communications for issuers registering offerings on Form B and permitting these issuers to make offers during the pre-filing period.[1/] This treatment would be available for each type of offering that would be registered on Form B under the new system, not just offerings by issuers meeting the public float tests. The registrant would have to file under proposed Rule 425 any prospectus used in reliance on the exemption in the period beginning 15 days before the first offer and ending with completion of the offering. While the proposal would provide significant new flexibility, there could be some administrative burdens and interpretive questions associated with determining when the issuer will make its first "offer," so that communications for 15 days before such "offer" can be monitored and filed.

Other Issuers. For all other issuers, the Commission has proposed a safe harbor under which communications made more than 30 days before the initial filing of a registration statement would not be deemed an offer as long as the issuer, underwriter and participating dealers take all reasonable steps within their control to prevent further distribution of such communication during the 30-day period immediately preceding filing.[2/]

[1/] This treatment would also apply to seasoned foreign government issuers conducting firm commitment underwritings of at least $250 million. Proposed Rules 166(a), 167(a).

[2/] Proposed Rule 167(c). The Securities Act Reform Release noted that if an issuer places information not covered by the forward-looking information and factual business communication safe harbors discussed below on its web site during a period of free communication, such information could be viewed as outside the safe harbor if the issuer does not remove the information during the 30-day limited communication period.

Business Combinations. For offerings in business combinations, offerors may communicate freely about matters other than the proposed transaction without gun-jumping concerns before the first communication or announcement related to the transaction if (1) the parties to the transaction take all reasonable steps to prevent further distribution or publication of pre-announcement communications during the period between the first communications about the transaction and the date of filing of the registration statement; (2) written materials relating to the transaction used between announcement of the transaction and filing of the registration statement are filed as they are used under Rule 425; and (3) in an exchange offer or transaction involving the vote of security holders, the offers are made in accordance with the tender offer rules or proxy rules, respectively.[3/] Thus, significant new flexibility would be added to allow acquiring companies to discuss publicly the "synergies" and other benefits of proposed mergers. After announcement, an offeror in a merger could disseminate written materials about the merger before filing the registration statement without violating Section 5 of the Securities Act as long as the materials are filed under Rule 425 at the time of use. Oral information would also be permitted and would not have to be filed.

Safe Harbors for Factual Business Communications and Regularly Released Forward-Looking Information. Under Proposed Rule 169, the Commission would exempt "factual business communications" from the prohibition on offers during the 30-day limited communication period.[4/] The proposed rule defines "factual business communications" as including:

(1) factual information about the issuer or some aspect of its business;

(2) advertisement of the issuer's products or services;

(3) factual business or financial developments with respect to the issuer;

(4) dividend notices;

(5) factual information required to be set forth in any Exchange Act report the issuer is required to file; and

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[3/] Proposed Rules 166(b), 167(b).

[4/] For offerings registered on Form S-8, C, SB-3, F-8, F-80 or F-10 (when that form is used in a business combination transaction), the safe harbors for factual business communications and regularly released forward-looking information would apply to communications made during the period between the public announcement of the offering and filing of the registration statement. Proposed Rules 168(b), 169(b).

(6) factual information communicated with respect to unsolicited inquiries by persons other than affiliates of the issuer, underwriter or participating dealer.[5/]

Although factual business communications do not include forward-looking information,[6/] "regularly released forward-looking information" released during the 30-day limited communications period would be exempt from the prohibition on offers during the 30-day limited communication period under the safe harbor in proposed Rule 168. "Regularly released forward-looking information" is defined to include the following information disseminated by a reporting company:

(1) projections of the issuer's revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;

(2) statements about management's plans and objectives about future operations, including plans or objectives relating to the products or services of the issuer;

(3) statements about the issuer's future economic performance of the type contemplated by Item 303 of Regulation S-K (MD&A); and

(4) assumptions underlying or relating to any of the information described above.[7/]

To be considered "regularly released," the issuer must customarily release information of the same type on a regular basis and must have done so in the two fiscal years and any portion of a fiscal year immediately prior to the communication. The time, manner and form in which the information is released must also be consistent with past practice.

Under proposed Rule 425, any prospectus used in reliance on the regularly released forward-looking information safe harbor would have to be filed with the Commission at the time the related registration statement is filed.

Notices of Proposed Offerings. Proposed Rule 135 would combine the safe harbors for limited notices regarding registered and unregistered proposed offerings found in Rule 135 and Rule 135c. As proposed, the rule provides that a publication of a notice of a proposed offering (whether registered or unregistered) will not constitute an offer of securities for sale if the

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[5/] Proposed Rule 169(c).

[6/] Information about the offering itself would also be excluded from the factual business information safe harbor and would continue to be governed by amended Rule 135, which is discussed below.

[7/] Proposed Rule 168(c). According to the Commission, these categories of information are essentially the same as those found in Section 27A(i)(1) of the Securities Act, with the exception of statements by an underwriter or participating dealer assessing any of the itemized information.

information included in such notice is limited to those items specified in the rule.[8/] These disclosure items are essentially the same as those permitted under current Rule 135. However, unlike the current rules, an issuer would not be required to specify whether the offering would be registered or exempt. Under the proposed rule, issuers that publish notices in reliance on this rule may also correct inaccuracies that have been published about their offerings, as long as the correction contains no more information than is necessary.

Waiting Period Communications.

Under the proposals, the Commission would eliminate the existing prohibition on "free writing" during the waiting period. Companies would be allowed to make offers and disseminate offering information during the waiting period in any form without each communication having to meet the requirements of Section 10 if the issuer (1) delivers a preliminary prospectus or securities term sheet as required under proposed Rule 172; (2) files the writing with the Commission under proposed Rule 425;[9/] and (3) files a Section 10(a) prospectus prior to the first sale in the offering.[10/] As noted in the Securities Act Reform Release, issuers would be free to conduct electronic roadshows, use E-mail to answer investor questions and conduct chat room discussions or post messages on bulletin boards following the filing of a registration statement.

Research Reports.

Rules 137, 138 and 139 provide safe harbors from the definitions of "offer" and "prospectus" for broker-dealer research in and around the time of a registered offering. To reflect rapid advances in communications technology and to increase investor access to information, particularly during registered offerings, the Commission has proposed to relax some of the requirements of these rules.[11/]

[8/] Those items include: (1) the name of the issuer; (2) the title, amount and basic terms of the securities offered; (3) the amount of the offering, if any, to be made by selling security holders; (4) the anticipated timing of the offering; (5) a brief statement of the manner and purpose of the offering; (6) whether the issuer is directing its offering to only a particular class of purchasers; (7) any statements or legends required by the laws of any state or foreign country or administrative authority; and (8) certain additional information if the offering is a rights offering, offering to employees or an exchange offer. Proposed Rule 135(a)(2).

[9/] Because communications filed under Rule 425 would be filed electronically and EDGAR is not able to accept multimedia prospectuses at this time, the Commission would require that a transcript of such multimedia materials be filed via EDGAR and that five copies of the presentation in the form used would be filed with the Commission for use in the public reference rooms.

[10/] Proposed Rule 165. All free writing materials would also have to include a legend urging investors to read the issuer's other filings with the Commission. The free writing itself, however, would not be subject to a delivery requirement.

[11/] The Commission also proposed amendments to Regulation S, Rule 144A, Rule 138 and Rule 139 to clarify that research published or distributed in accordance with Rules 138 and 139 does not contravene the prohibition

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Rule 137. As proposed, Rule 137 would permit a broker-dealer to publish or distribute information, opinions and recommendations about any reporting or non-reporting company as long as the broker-dealer is not participating and does not propose to participate in the distribution and it is not receiving consideration directly or indirectly from the issuer, selling stockholder, a participant in the distribution or any other person with an interest in the distribution. This represents an expansion of current Rule 137, which provides a safe harbor only with respect to reporting companies and limits the safe harbor to communications published in the regular course of the broker-dealer's business. The proposed safe harbor does not apply to "blank check companies," shell entities or penny stock offerings.[12/]

Rule 138. Rule 138 provides a safe harbor for a broker-dealer participating in a distribution of one type of securities (e.g., non-convertible debt) of an issuer to publish research confined to another type of the issuer's securities (e.g., common stock) if it publishes or distributes the research in the regular course of business. The current safe harbor only applies, however, to Form S-2/F-2-eligible issuers, Form S-3/F-3-eligible issuers and non-reporting foreign private issuers with a public float of at least $75 million and a one-year trading history on a designated offshore securities market. Under the proposed amendments, Rule 138 would cover almost all companies subject to Exchange Act reporting, as well as non-reporting foreign private issuers that meet the public float/ADTV thresholds for filing on Form B (using worldwide markets for measurement) and whose securities trade on a designated offshore trading market.[13/]

Rule 139. Rule 139 addresses two types of research reports: reports focussed on one issuer that is engaged in an offering and industry reports that include an issuer that is engaged in an offering. The safe harbor is available to a broker-dealer engaged in a distribution of securities that are the subject of its reports. The Commission proposes to lift some of the current restrictions in Rule 139.

Currently, for focussed reports, the issuer must be eligible for Form S-3 or F-3 for a primary offering, or, if it is a non-reporting foreign issuer, the issuer must meet the Form F-3 float requirements and have securities traded for at least 12 months on a designated offshore securities market. Also, the report must be contained in a publication that is distributed with reasonable regularity in the normal course of business.

[11/] (...continued)
against directed selling efforts in Regulation S and the limitation in Rule 144A that offers be limited to QIBs as long as the research in question is distributed with reasonable regularity in the ordinary course of the broker-dealer's business. Proposed Rules 138(b), 139(b), 144A(d)(1)(1), 902(c). In addition, the Commission is proposing to codify its position that distribution of research in accordance with Rule 138 or 139 is an exempt solicitation for purposes of the proxy rules. Finally, the Commission expressed its view that research reports that comply with current Rules 138 or 139 are not directed selling efforts under Regulation S.

[12/] Proposed Rule 137(b).

[13/] Excluded from the safe harbor would be blank check companies, shell entities and companies making offerings of penny stock. Proposed Rule 138(a)(2).

Under the proposals, focussed research would no longer be limited to Form S-3 or F-3 eligible companies. Instead, it would be sufficient for the company to satisfy a one-year reporting history requirement. If the issuer is a non-reporting foreign issuer, it would have to meet the Form B public float/ADTV thresholds (using worldwide markets for measurement), and have securities traded for at least 12 months on a designated offshore securities market. Foreign government issuers on Schedule B would be eligible, even for a first-time offering, as long as the offering is a firm commitment underwriting of more than $250 million. Finally, the "reasonable regularity" requirement would be deleted, and a requirement to prominently disclose the capacity in which the broker-dealer is participating in the distribution would be added.

Rule 139's current requirements for industry research include the following: (1) the issuer must be a reporting company, or a non-reporting foreign issuer that meets the Form F-3 float tests and has been traded on a designated offshore market for at least one year; (2) the report must be contained in a publication that is distributed with reasonable regularity and include similar information about other companies in the industry; (3) the information must be given no greater prominence than the information about other companies; and (4) the recommendation cannot be more favorable than the one included in the last publication of the broker-dealer addressing the issuer.

The proposals would liberalize Rule 139 for industry research by eliminating the requirement that the company be a reporting company and the requirement that the recommendation not be more favorable than the previous one. The same information about the broker-dealer's participation in the offering proposed for focussed reports would apply to industry reports. In addition, if the recommendation is more favorable, the broker-dealer would have to describe the last two recommendations made before it became a participant in a distribution for the issuer.

Annex C

Prospectus Delivery Reforms

Under Section 5 of the Securities Act, any written offers must be made by means of a Section 10 prospectus. Oral offers, however, do not require delivery of a prospectus. In any event, however, a Section 10(a) prospectus must accompany or precede a confirmation of sale. Accordingly, under current rules, oral offers can be made after a registration statement is filed and no preliminary prospectus is required to be delivered, but a final prospectus must be delivered prior to or with a confirmation of sale. However, in the case of an IPO, Exchange Act Rule 15c2-8 includes a requirement that participating brokers and dealers must deliver a copy of a preliminary prospectus to anyone expected to purchase in the offering at least 48 hours prior to sending a confirmation of sale.

The Commission expressed concerns that the current regime does not result in delivery of information to investors in offerings in a timely manner. Based on this concern, the Commission proposed significant changes to require earlier delivery of information. In connection with those changes, the Commission proposed to provide an exemption from the final prospectus delivery requirements.

Preliminary Prospectus Delivery. Under Proposed Rule 172, issuers would be required to provide investors transactional information before they make their investment decision. The information required to be delivered and the timing of the delivery would depend on the type of issuer and offering.

Form B Offerings and Certain Schedule B Offerings. The Commission proposed two alternatives for offerings registered on Form B and firm commitment underwritten offerings for more than $250 million registered on Schedule B. Under the first alternative, the issuer would be required to deliver a securities term sheet prior to the date the investor makes a binding investment decision. The securities term sheet would: (1) itemize the material terms of the securities in summary format; (2) identify any selling stockholders; and (3) identify a contact person for questions and a person who will, upon request, send documents defining the terms of the securities.[1/] Under the second alternative, delivery of a full prospectus containing the transaction disclosure currently required in Forms S-3 and F-3 would be required prior to the date the investor makes a binding investment decision.

Offerings by Small or Unseasoned Issuers. For an IPO or a repeat offering registered on Form A, SB-1, SB-2, F-7, F-9 or F-10 or Schedule B (other than as described in the preceding paragraph) within one year of the effective date of the issuer's IPO, investors must be sent a Section 10 prospectus in a manner reasonably designed to arrive at least seven calendar days before the pricing date or, for offerings

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[1/] Proposed Form B.

underwritten on a best efforts basis, seven days before the investor signs a subscription agreement or otherwise commits to purchase the securities. For an offering that takes place more than one year after the effective date of the issuer's IPO, a Section 10 prospectus must be sent to arrive at least three calendar days before the pricing date or, for offerings underwritten on a best efforts basis, three days before the investor signs a subscription agreement or otherwise commits to purchase the securities. In both cases, if material changes to the transaction or company information arise after delivery of the preliminary prospectus, the information must be set forth in a document and delivered to investors at least 24 hours before the pricing or the date the investor signs a subscription agreement or otherwise commits to purchase the securities.[2/]

The proposed prospectus delivery rules apply to both primary offerings and secondary offerings made by selling security holders. In light of the obvious difficulties of pre-delivering a prospectus when sales are made by selling security holders into an existing trading market, the Commission asks for comments on whether the requirements should apply to those offerings.

Exemption from Final Prospectus Delivery. Proposed Rule 173 would provide an exemption from the final prospectus delivery requirements in Section 5(b)(2) of the Securities Act for most offerings not involving a business combination or employee benefit plan.[3/] The conditions to the availability of this exemption would be: (1) a final prospectus has been filed with the Commission prior to confirmation of sales; (2) preliminary prospectus delivery in accordance with proposed Rule 172 or Rule 174 has been made; (3) at the time or before investors receive sale confirmation, they are informed where they can acquire promptly and free of charge the final prospectus; and (4) the security in question is not issued by an investment company.

The Commission did not, however, propose to change the final prospectus delivery requirements in Rule 15c2-8(d). Broker-dealers would still have to take reasonable steps to comply promptly with the written request of any person for a copy of a final prospectus until the expiration of the applicable period under Section 4(3). Finally, in light of the other proposed revisions to the registration system, the Commission proposed revising Rule 434, which permits delivery of a final prospectus in multiple documents at different intervals in the offering process, to apply only to investment company issuers.

[2/] If the size of an offering is increased though a registration statement filed under Rule 462(b) or (e), proposed Rule 172(f) requires that the issuer, underwriter or dealer inform investors purchasing the offering of the change in size.

[3/] The exemption would not be available for offerings registered on Form S-8, C, SB-3, F-8, F-80 or F-10 (when that form is used in a business combination). The proxy rules and tender offer rules independently impose informational and delivery requirements on business combination transactions. Nevertheless, in proposing Form C, the Commission has proposed to eliminate the 20-day period from prospectus delivery to meeting date or corporate action found in Forms S-4 and F-4.

Aftermarket Prospectus Delivery. The Commission has proposed revisions to Rule 174 so that a dealer's aftermarket prospectus delivery obligation is satisfied if (1) a final prospectus is on file with the Commission and (2) the dealer notifies each investor, at or before the time the investor receives a sale confirmation, where the investor may promptly acquire, free of charge from the issuer, final prospectus information.[4/] The delivery obligation would last for a period of 25 calendar days after the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public, regardless of whether the offering is an IPO or repeat offering.[5/]

At the same time, the Commission proposed to make aftermarket prospectus delivery apply to transactions in securities of reporting companies, which currently are exempt under Rule 174.

[4/] The Commission stated that under this proposed prospectus delivery system, Rule 153 (which addresses delivery of final prospectuses in transactions between brokers on a national exchange) would be unnecessary. Thus, the Commission has proposed to repeal Rule 153.

[5/] A 90-day obligation would apply to securities of "blank check companies." Proposed Rule 174(c).

Annex D

Integration of Private and Public Offerings

Integration of public and private offerings, which is the process of combining separate securities transactions into a single offering for the purpose of analyzing the registration provisions of the Securities Act, has generated considerable uncertainty for securities law practitioners as well as a variety of sources of guidance from the Commission, including interpretive releases and no-action letters.[1/] Another source of Commission guidance is Rule 152, which provides a safe harbor from integration when an issuer makes a private offering pursuant to Section 4(2) and then decides to make a public offering. Nevertheless, a number of questions regarding the application of the safe harbor remain.

The Securities Act Reform Release proposes to clarify and expand the integration safe harbor with a complete revision of Rule 152. Many of the revisions to Rule 152 are codifications of existing interpretations, while others offer important new relief from integration concerns. The Commission also proposed new Rule 159 concerning lock-up agreements and amendments to Rule 477 to facilitate withdrawals of registration statements.

Completed Private Offerings. Under Proposed Rule 152(a), a private offering would not be considered part of a subsequent registered offering, as long as the registration statement is filed after completion of the private offering.[2/] The length of time between the offerings would be irrelevant. The revised rule deems private offerings "completed" when either (1) all purchasers in the private offering have paid the purchase price or (2) all purchasers are unconditionally obligated to pay the purchase price (except based on conditions not in the direct or indirect control of any purchaser), and the purchase price is fixed and not contingent on the market price of the securities at or around the time of the registered offering. If the private offering transaction is subsequently renegotiated, the exemption would not remain available.

[1/] The general framework for analyzing whether two offerings should be integrated and considered a single transaction is to consider:

1. Are the offerings part of a single plan of financing?
2. Do the offerings have the same general purpose?
3. Are the offerings of the same class of securities?
4. Are the offerings being made at or about the same time?
5. Are the securities being sold for the same type of consideration?

Securities Act Release 4552 (November 6, 1962).

[2/] Under Proposed Rule 152(d), "private offerings" would be defined as unregistered offerings of securities exempt from registration under Section 4(2) or 4(6) of the Securities Act or Rule 506 of Regulation D.

Proposed Rule 152 would also clarify that, for the purpose of Rule 152, an offering of securities underlying convertible securities or warrants would be complete when the offering of the convertible securities or warrants is completed, regardless of when the convertible securities or warrants become convertible or exercisable.[3/] This provision should be quite helpful for analyzing difficult integration issues posed by the general Commission staff view that any offering of convertible securities or warrants that are convertible or exercisable within one year involves a current offering of the underlying securities. In addition, private offerings that involve "pre-IPO reorganizations" would not be integrated with the IPO as long as the offering (1) does not raise capital for the issuer; (2) is undertaken for the sole purpose of modifying the issuer's capital structure; and (3) does not involve a roll-up transaction.[4/] Thus, integration issues should not raise problems for IPO formation put-togethers, unless any of the combining entities is a "finite-life partnership" as defined in the roll-up rules.

Rule 152 also would be revised to make clear that issuers can register securities sold in a completed private offering for resale by persons other than affiliates or dealers who have purchased directly from the issuer or its affiliates. The rule would clarify that private offerings would not be integrated into the public filing of a resale registration statement even though payment for the securities would not be made until a resale registration statement has become effective, as long as effectiveness is a condition to purchase that is outside of the purchaser's control and the price in the private offering is fixed as described above.

Abandoned Private Offerings Followed by a Public Offering. Under the proposed registration system, Form B issuers would be able to switch from a private offering to a public offering at will because they would not be required to file a Form B registration statement until the time of sale, and offers could be made before filing.

For Form A and other issuers, Proposed Rule 152(b) would permit the issuer to abandon a private offering and then conduct a public offering if:

(1) the issuer notifies all offerees in the private offering of its abandonment;

(2) the registrant waits 30 days after notifying the private offerees before filing a registration statement if the issuer offered securities in the private offering to any person ineligible to purchase in an offering in accordance with Section 4(2) or 4(6) of the Securities Act or Rule 506 of Regulation D;

(3) neither the issuer nor anyone acting on its behalf conducted a general solicitation or general advertising during the private offering;

[3/] Proposed Rule 152(a)(3).

[4/] Proposed Rule 152(a)(4).

(4) no securities were sold in the private offering; and

(5) either (a) the issuer files any selling materials used in the private offering as part of the registration statement, or (b) it informs all private offerees that the filed prospectus replaces the selling materials used in the private offering and all indications of interest during the private offering are considered rescinded.

Abandoned Public Offerings Followed by a Private Offering. A frequent problem encountered by smaller companies and companies planning IPOs is that they find that public offerings will not work out after registration statements are filed. Under staff interpretations, if a company in that situation still needs to raise money, it encounters serious integration problems if it tries to do a private offering after it abandons the public offering.

The proposed amendments to Rule 152 would provide significant relief and certainty for companies in that situation. Under the revisions, Rule 152 would permit issuers to "test the waters" in the public market without foreclosing the option of a private offering if investor interest turns out to be softer than expected. Under Proposed Rule 152(c), an offering for which a registration statement was filed (or that was eligible to be registered on Form B) will not be considered part of a subsequent private offering if: (1) the issuer notifies all offerees in the public offering of the abandonment (in Form B offerings where no registration statement was filed for the purpose of making public offers) or withdraws the filed registration statement (for other offerings); (2) no securities were sold in the public offering; and (3) either (a) if the issuer first offers the securities in the private offering 30 days or fewer after the abandonment or withdrawal of the public offering, the issuer and any underwriter agree that they will be liable for any material misstatements or omissions in the private offering documents under Section 11 for purchasers who commit to purchase within the 30 days, or Section 12(a)(2) for purchasers who commit to purchase after the 30 days, or (b) if the issuer first offers the securities in the private offering more than 30 days after abandonment or withdrawal of the public offering, the issuer notifies each purchaser that the offering is not registered, the securities are restricted and cannot be resold without registration or an available exemption from registration and investors do not have the protection of Section 11.

Lock-Up Agreements. Another frequently encountered integration problem is how to treat privately obtained agreements to vote for a business combination when the securities to be offered in the combination will be registered under the Securities Act. The proposals provide helpful guidance in this area. As long as certain conditions are met, proposed Rule 159 would permit all offers and sales in a business combination transaction to be registered under the Securities Act even if certain shareholders of the acquired company have committed to vote in favor of the transaction pursuant to a so-called "lock-up agreement" prior to any action by the public shareholders. To rely on this rule, (1) the lock-up agreements in question must be limited to executive officers, affiliates and directors of the company to be acquired, the founders of that company and their family members and 5% shareholders; (2) the persons signing the agreements must own less than 100% of the securities of the company being acquired; and (3) votes must be solicited from shareholders who are not parties to a lock-up agreement and who would be

ineligible to purchase in an offering under Section 4(2) or 4(6) of the Securities Act or Rule 506 of Regulation D.

Withdrawal of Registration Statements. Currently, to withdraw a registration statement, the Commission must consent to the withdrawal after determining that the withdrawal is consistent with the public interest and investor protection. To speed the withdrawal of registration statements, the Commission has proposed amending Rule 477 to permit automatic withdrawal upon an issuer's request prior to effectiveness. The issuer must state the grounds for the withdrawal, and if the request is being made in anticipation of reliance on new Rule 152(c), the issuer must state that no securities were sold in connection with that offering.

Annex E

Periodic Reporting under the Exchange Act

The Commission also proposed a number of amendments to Exchange Act regulations and forms that would affect the disclosure obligations of both domestic and foreign issuers. The proposed amendments would:

- require risk factor disclosure in Exchange Act reports;
- treat quarterly financial information as "filed" for purposes of Section 18 liability;
- expand the disclosure items required to be reported on Form 8-K and accelerate the due dates for filing this information;
- accelerate the due dates for Form 20-F and possibly for Forms 10-Q, 10-QSB, 10-K and 10-KSB.
- encourage voluntary reporting on Form 6-K; and
- require management to certify that they have reviewed the disclosure in all Exchange Act reports and registration statements.

Risk Factor Disclosure. The proposed amendments would require an issuer to disclose the most significant risk factors relating to the company's future financial performance in its periodic reports on Forms 20-F, 10-Q, 10-QSB, 10-K, 10-KSB and 18-K, as well as in any Exchange Act registration statements on Forms 10, 10-SB, 18 and 20-F.[1/] New Rule 12b-24 would require issuers to draft all risk factor disclosure in "plain English."[2/]

Annual disclosure on Forms 10-K, 10-KSB, 18-K and 20-F would describe the most significant factors with respect to the registrant's business, operations, industry or financial position that may have a negative impact on the registrant's future financial performance.[3/] A registrant would explain how each risk affects it. Quarterly disclosure on Forms 10-Q and 10-QSB would include a new Item 1A "Updated Company Risk Factors" in which the registrant would disclose company risk factors that either were not included in its most recent registration statement or annual report, or which have changed since the filing of that registration statement or annual report.

[1/] Item 1(b) of Exchange Act Form 20-F already requires risk factor disclosure.

[2/] Currently, if risk factors voluntarily included in an Exchange Act report will be incorporated by reference into a Securities Act registration statement, such risk factors must be drafted in plain English.

[3/] Exchange Act registration statements would require the same disclosure.

"Filed" Status of Quarterly Information. Proposed revisions to Form 10-Q would designate all information in the Form 10-Q, except the quantitative and qualitative disclosures about market risk required by Item 305 of Regulation S-K, as "filed" for the purpose of Section 18 liability under the Exchange Act. Currently, the information in Part I of Form 10-Q, which generally includes financial statements, MD&A and market-risk disclosure, is not deemed "filed" for purposes of Section 18.

Form 8-K. The Securities Act Reform Release proposes requiring registrants to report on Form 8-K certain information and events currently reported only on a voluntary basis or required to be reported only on Form 10-Q or 10-QSB. Most significantly, the Securities Act Reform Release proposes that all issuers (including small business issuers) report selected financial data on Form 8-K by the earlier of (1) the date they issue an earnings press release or (2) 30 days after the end of each of their first three fiscal quarters and 60 days after the end of their fiscal year. The selected financial data would include the information required in Item 301 of Regulation S-K for the most recently completed fiscal quarter and interim period or year, as well as for the same periods of the prior year.

An issuer also would have to file a Form 8-K if its certifying accountant notifies the issuer that reliance on its prior audit report is no longer permissible or notifies the registrant that it will not consent to the use of its prior audit report in a filing with the Commission. The filing of the Form 8-K would be required within one business day of the notification. Finally, issuers would also have to report on Form 8-K: material modifications to the rights of security holders; defaults, dividend arrearages and delinquencies; the departure of the registrant's CEO, CFO, COO or president; or a change in the registrant's name.

The Commission also proposed accelerating the Form 8-K due date for most reportable events from 15 to five calendar days. However, material defaults, director resignations and required information regarding the company's accountants would be required to be reported within one business day after the reportable event occurs.

Accelerated Due Date for Forms 10-Q, 10-QSB, 10-K, 10-KSB and 20-F. As an alternative to filing quarterly financial information on Form 8-K, the Commission requested comment on accelerating the due date for Form 10-Q to 30 days after the end of each of the first three fiscal quarters of a registrant's fiscal year and for Form 10-K to 60 days after the end of the registrant's fiscal year.

In addition, the Commission proposed to require that annual reports of foreign private issuers on Form 20-F be filed within five months, rather than six, after the end of the foreign private issuer's fiscal year-end.

Signatures and Certifications. Under the proposed amendments, before filing any Exchange Act report or registration statement, two officers of the issuer would have to certify that they have read the registration statement or report on behalf of the issuer and that, to their knowledge, the registration statement or report does not contain any material misstatements or

material omissions. In addition, Forms 10-Q, 10-QSB, 8-A, 10, 10-SB, 40-F and 20-F would be amended to require signatures of the registrant; its principal executive officer or officers; its principal financial officer; its controller or principal accounting officer; at least a majority of its board of directors; and, where the issuer is a foreign issuer, its authorized representative in the United States.[4/] Under the proposals for Forms 8-K and 6-K, the signatory for the registrant would have to certify that he or she had provided a copy of the report to the registrant's board of directors.

Form 6-K. The Securities Act Reform Release proposes amending Form 6-K to expand the list of examples of material events that the Commission would encourage foreign private issuers to report voluntarily to include: changes in business; changes in the issuer's name; changes in control; acquisitions or dispositions of assets; bankruptcy or receivership; changes in the issuer's certifying accountants; the issuer's financial condition and results of operations; material legal proceedings; changes in securities or in the security for registered securities; material modifications to the rights of security holders; material increases or decreases in the amount of outstanding securities or indebtedness; material defaults on indebtedness, material arrearages in dividends and other material delinquencies; results of submissions of matters to a vote of security holders; transactions with directors, officers or principal security holders; a departure of the issuer's CEO, CFO, COO or president; granting options or payment of other compensation to directors or officers; and any other information that the issuer deems of importance to security holders. Because the submission of reports regarding these events would be voluntary, the Commission did not propose a specific filing deadline.

Request for Comment Regarding Plain English. The Commission noted that some portions of Exchange Act reports that are incorporated by reference into Securities Act filings, such as risk factors, currently must comply with the plain English rules, and the proposed new risk factors requirement would mandate that Exchange Act risk factors be written in plain English. The Commission specifically requested comment on whether the plain English rules also should be extended to other portions, or all portions, of Exchange Act reports.

[4/] Forms 10-K and 10-KSB already require these persons to sign the report. Securities Act registration statements on Forms A, B, C, SB-1, SB-2 and SB-3 would require the same certification.

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