HALE AND DORR LLP

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Corporate Advisor

Rule 10b5-1, Regulation FD Practices Continue to Evolve

As public companies gain experience with Rule 10b5-1, the SEC's new insider trading rule that includes affirmative defenses enabling insiders to establish trading programs, and Regulation FD, the SEC's new rule against selective disclosure, we have identified several new best practices which we recommend:

- **Modify Form 144 certification for sales made under Rule 10b5-1 trading programs.** The notice of proposed sale on Form 144 that must be filed in connection with sales of stock by company affiliates includes a representation that the affiliate does not know any material adverse information regarding the current and prospective operations of the company which has not been publicly disclosed. For sales made under a Rule 10b5-1 trading program, this certification may not always be accurate because, while the seller cannot be aware of material nonpublic information when he or she enters into a trading program, it is permissible for the seller to be aware of material nonpublic information at the time trades are actually made. When sales are being made under a Rule 10b5-1 trading program, the Form 144 certification should be revised by adding the following in the remarks section:

  > "The shares covered by this Form 144 are being sold pursuant to a Rule 10b5-1(c) trading program dated *[insert date]*, and the representation below regarding the seller's knowledge of material information is deemed made only as of the adoption date of such trading program."

(cont. on page 5)

New SEC Rules Facilitate Switching Between Public and Private Offerings

New Safe Harbors Provide Clarity in Volatile Markets

Effective March 7, new SEC rules will facilitate switching between public and private offerings in response to changing market or business conditions.

On January 26, 2001, the Securities and Exchange Commission adopted new rules addressing when a company can switch between a public offering and a private offering in response to changing market or business conditions. The new rules, which become effective March 7, 2001, create safe harbors from application of the SEC's "integration" doctrine when:

- converting a failed public offering into a private offering; or
- abandoning a private offering in favor of a registered public offering.

The new rules also make it easier to withdraw registration statements that have not been declared effective and allow filing fees for withdrawn registration statements to be credited against future filing fees.

The Problem

The capital markets seem to be more volatile than ever. During the bull market of the late 1990s, hundreds of start-up companies turned their attention away from traditional private equity financing towards the promises of the public markets. When the harsh realities of 2000 set in and the Nasdaq tumbled, many of these companies, as well as more established companies,

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saw the window close on their hopes of raising money in the public markets. In periods of market volatility, companies that have already started the process of seeking outside capital face a common dilemma:

- If market conditions deteriorate after the company has already commenced a public offering, can the company withdraw the public offering and raise capital through a private offering?
- If market conditions and investor demand improve after the company has already commenced a private offering, can the company abandon the private offering and pursue a registered public offering?

The SEC's longstanding "integration" doctrine has often failed to provide companies and investors with certainty regarding their compliance with the Securities Act.

Until now, the answers to these questions have been uncertain because of the SEC's longstanding "integration" doctrine, which provides a framework for analyzing whether a company has circumvented the requirements of the Securities Act of 1933 by structuring a single offering of securities as more than one offering so that exemptions from registration (such as a private placement exemption) appear to apply to each of the individual offerings even though no exemption would be available if the offerings were treated as one. Applying the integration doctrine to companies desiring to switch between public and private offerings has traditionally involved a subjective facts and circumstances analysis and often failed to provide companies and investors with certainty as to compliance with the Securities Act.

Abandoned Registered Offering Followed by a Private Offering

New Rule 155(c) under the Securities Act is a safe harbor from integration for companies that have filed a registration statement for a public offering, but decide to withdraw the registration statement in order to pursue a private offering. The SEC views the filing of a registration statement as a general solicitation. Therefore, if a subsequent private offering were integrated with a withdrawn registered offering, the general solicitation would most likely render the private offering exemption unavailable. As a result, companies may be required to wait up to six months after withdrawing their registration statements before they can commence a private offering in order to ensure that the two offerings will not be integrated. Many companies simply cannot wait that long to raise money to fund their operations.

Rule 155(c) offers a safe harbor from integration to any company that abandons a public offering if all of the following conditions are met:

1. The company did not sell any securities in the registered offering.
2. The company withdraws the registration statement. The SEC is amending Rule 477 under the Securities Act to expedite an application to withdraw a registration statement that has not been declared effective by the SEC. Under amended Rule 477, an application to withdraw a registration statement will automatically become effective unless the SEC objects within 15 calendar days after filing of the application.
3. The company does not commence the private offering until 30 calendar days after the registration statement is withdrawn. In addition, the private offering must be made under Section 4(2), Section 4(6) or Rule 506 under the Securities Act to be eligible for the safe harbor. The Rule 155(c) safe harbor is not available if the company conducts its private offering in reliance upon the exemption contained in Rule 505 under the Securities Act.
4. The company notifies each offeree in the private offering (whether or not the offeree actually purchases securities in the private offering) that:
    - the private offering is not registered under the Securities Act;
    - the securities are "restricted securities" within the meaning of Rule 144 under the Securities Act and cannot be sold without registration or an exemption from registration;
    - purchasers in the private offering do not have the protections of Section 11 of the Securities Act (an anti-fraud provision)

that they would have if the offering had been made pursuant to the registration statement; and

- the registration statement for the abandoned public offering was withdrawn, specifying the date of withdrawal.

5. If an offering memorandum or other disclosure document is used in the private offering, the disclosure document reflects all material changes that have occurred in the issuer's business after the date on which the registration statement was filed. Please note that the new rule does not mandate the use of a disclosure document in the private offering.

The safe harbors only offer protection from issues raised by the integration doctrine.

The Rule 155(c) safe harbor only offers protection from issues raised by the integration doctrine. The private offering must otherwise satisfy all of the requirements of the exemption from registration on which the private offering is based.

Abandoned Private Offering Followed by a Registered Public Offering

New Rule 155(b) under the Securities Act is a safe harbor from integration for companies seeking to abandon a private offering and commence a registered offering. Prior to the adoption of Rule 155(b), this practice was problematic since most companies typically make offers to prospective investors early in the private offering process. Consequently, if the abandoned private offering is integrated with the public offering, these offers would have been made prior to the filing of a registration statement, resulting in a violation of the Securities Act commonly referred to as "gun jumping."

Rule 155(b) offers a safe harbor from integration to any company seeking to abandon a private offering in favor of a registered offering if all of the following conditions are met:

1. The company made the abandoned private offering under an exemption from registration contained in Section 4(2), Section 4(6) or Rule 506 under the Securities Act. None of these exemptions permits general solicitations or advertising. The Rule 155(b) safe harbor is not available if the company relied solely upon the exemption contained in Rule 505 under the Securities Act.

2. The company did not sell any securities in the private offering. The new safe harbor does not provide integration relief for companies that have already "completed" a private offering before commencing a registered offering. Existing Rule 152, however, generally permits a registered public offering to commence immediately after completing a private offering, and the SEC stated that Rule 152 is unaffected by the new rule.

3. The company terminates all offering activity in the private offering before filing the registration statement for the public offering. Neither the rule nor the adopting release elaborates on what steps are required to "terminate all offering activity." The SEC noted that in order to prevent misuse of the Rule 155(b) safe harbor it may, in reviewing the subsequent public offering, request supplemental information regarding the termination of the private offering activity. Therefore, companies should be prepared to document for the SEC the steps taken to terminate the abandoned private offering.

4. Any prospectus, including the preliminary and final prospectuses, filed as part of the registration statement for the public offering discloses the following:

   - the size and nature of the private offering, including the amount sought to be raised, the type of securities offered privately and the general purpose of the abandoned private offering;

   - the date on which the company abandoned the private offering;

   - that any offers to buy or indications of interest in the private offering were rejected or not accepted; and

- that the prospectus delivered in the registered offering supersedes any selling material used in the private offering.

5. The company cannot file the registration statement for the public offering until 30 calendar days after it has terminated all offering activity in the private offering. However, there is no 30-day waiting period if the company offered securities in the private offering only to persons who were or were reasonably believed to be "accredited investors" or who have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment.

The new safe harbors are not exclusive and do not affect existing safe harbors and interpretations relating to integration issues.

Crediting of Filing Fees

In order to make Rule 155(c) more practical and cost-effective to use, the SEC also amended Rule 457 so that filing fees paid in connection with a withdrawn registration statement can be credited against filing fees owed for future registration statements filed within five years of the initial filing of the withdrawn registration statement. These filing fees can be credited regardless of whether the class of securities is the same and can be credited by the company itself, its majority-owned subsidiaries or a parent that owns more than 50% of the company's outstanding voting securities.

Existing Integration Interpretations Unaffected

Like other safe harbor rules under the Securities Act, the integration safe harbors provided in Rule 155 are not exclusive. Failure to comply with one of the requirements of a Rule 155 safe harbor does not mean that the public and private offerings will necessarily be integrated. In adopting the new rules, the SEC explicitly stated that existing safe harbors and interpretations relating to integration issues are unaffected by the new safe harbors, including:

- the SEC's "five-factor" test for analyzing integration issues , which involves a subjective analysis of five factors surrounding the offerings in question;
- Regulation D, which provides a safe harbor for offers and sales made more than six months before the start of, or more than six months after completion of, a Regulation D offering; and
- the SEC's "Black Box" no-action interpretations, which in limited circumstances permit a private offering to be conducted concurrently with a public offering.

The new rules are solely meant to clarify and provide a safe harbor from integration for the limited situations where a company changes an offering from private to registered and vice versa. ■

– Michael D. Bain and Mark L. Johnson

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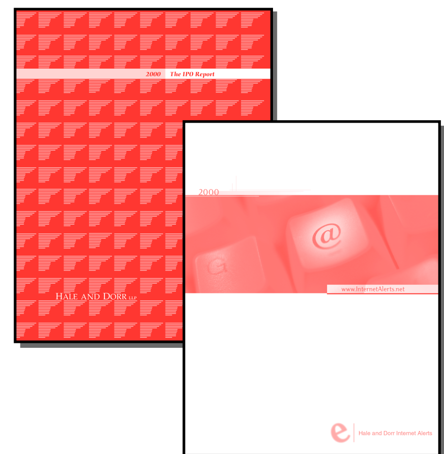

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If the trading program is structured to delegate authority to a third party, compliance with Rule 10b5-1 also requires that the third party not be aware of material nonpublic information when exercising the delegated authority. If the third party is a trustee effecting sales under a Rule 10b5-1 trading program on behalf of a trust, the statement added to the remarks section should generally be modified as follows:

> "The shares covered by this Form 144 are being sold by the trust in accordance with a Rule 10b5-1(c) trading program created by *[insert name of insider who created the trust]*, the settlor of the trust, on *[insert date]*, and the representation below regarding the seller's knowledge of material information is deemed made only as of the adoption date of such trading program insofar as it relates to the settlor of the trust."

- **Require company review of Rule 10b5-1 trading programs.** More and more "standard forms" of Rule 10b5-1 trading programs are in circulation, but not all of these programs adequately take into account a company's interests. Every public company should require its insiders to submit their proposed Rule 10b5-1 trading programs to the company for review. When reviewing proposed Rule 10b5-1 trading programs, a company should focus on:

  ~ whether the program complies with the company's insider trading policy (in most cases, modifications of the insider trading policy are required if the company wishes to let insiders take advantage of Rule 10b5-1);

  ~ the timing and source of any public disclosures about the trading program that will be made (for example, will one Form 144 be filed at the start of the program covering all shares that may be sold, or will the broker instead file a series of Forms 144 as sales are made);

  ~ the circumstances in which the company can require that scheduled trades be cancelled or postponed (for example, to preserve the availability of pooling of interests accounting for a pending transaction);

  ~ the mechanical process for removing legends from shares of stock to be sold under the program; and

  ~ the avoidance of provisions that inappropriately place obligations or liabilities on the company.

- **Disclaim any duty to update forward-looking statements.** If a company has publicly made a forward-looking statement which has subsequently become inaccurate or misleading due to changes in circumstances, the law is unsettled as to whether or not the company has an obligation to update that statement. Some courts have imposed a "duty to update" forward-looking statements about earnings expectations, in part because those courts believe that market participants expect such statements to be updated. Other courts have said that a company has a "duty to correct" statements about earnings expectations that were untrue or misleading when made, but does not have a "duty to update" such statements that were true and not misleading when made.

  In order to reduce the likelihood of having a duty to update, whenever a company makes forward-looking statements it should explicitly disclaim any duty to update, in addition to providing an appropriate safe harbor statement under The Private Securities Litigation Reform Act. For example, at the start of every quarterly conference call a company spokesperson could say:

  > "Various remarks that we may make about the Company's future expectations, plans and prospects constitute forward-looking statements for purposes of the safe harbor provisions under The Private Securities Litigation Reform Act of 1995.

Not all "standard forms" of Rule 10b5-1 trading programs adequately take into account a company's personal interests.

Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those discussed in the Company's most recent Annual Report of Form 10-K, which is on file with the SEC. In addition, any forward-looking statements represent our estimates only as of today and should not be relied upon as representing our estimates as of any subsequent date. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our estimates change."

- **Limit audio replays of conference calls.** As part of its Regulation FD compliance program, a company should tape investor conference calls and permit people to listen to a rebroadcast of the call, either through a dial-in number or over the web. However, given rapidly changing business environments, statements that were true when made on the call may soon cease to be true. As a result, companies should limit the time during which a rebroadcast of the conference call is available to not more than one week. In addition, since the SEC may take the position that making a replay available results in the replay constituting a "written" statement, rather than an "oral" statement, for purposes of the safe harbor for forward-looking statements, companies should require anyone who wants to listen to a replay of the call to first receive, by click-through agreement or otherwise, the more detailed safe harbor statement required to protect written forward-looking statements.

For a full description of Rule 10b5-1 and Regulation FD, including practical guidance for taking advantage of, and avoiding getting tripped up by, the new rules, please see our October 2000 and November 2000 issues of the *Corporate Advisor.* Copies of these publications are available on our web site, www.haledorr.com, by email request sent to marketing@haledorr.com or by telephone request at 617.526.5600. ■

– Jonathan Wolfman

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