Session 705

The Aircraft Carrier Release

John J. Huber
Partner
Latham & Watkins

John T. Bostelman
Partner
Sullivan & Cromwell

Michael R. McAlevey
Deputy Director, Division of Corporate Finance
U.S. Securities and Exchange Commission

Stanley Keller
Partner
Palmer & Dodge

Joseph A. Heyison
Senior Vice President and General Counsel
Ridgewood Power Management LLC

Alan B. Rabkin
General Counsel/Senior Vice President
SierraWest Bancorp

Richard M. Starr
Managing Counsel
American Express Company

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
Materials may not be reproduced without the consent of ACCA.
Reprint permission requests should be directed to James Merklinger at ACCA: 202/293-4103, ext. 320; merklinger@acca.com

THE SEC's AIRCRAFT CARRIER RELEASE

What You Need To Know NOW!

Presented By The Corporate Counsel and Federal Regulation of Securities Committees of the American Bar Association and the Corporate and Securities Law Committee of the American Corporate Counsel Association

American Corporate Counsel Association Annual Meeting
San Diego, California
10:15 a.m. - 12:30 p.m. November 5, 1999

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

ALAN B. RABKIN

- Your Moderator
- General Counsel/SVP, SierraWest Bank recently acquired by BancWest Corporation, owners of Bank of the West and First Hawaiian Banks and itself owned 46% by Banque Nationale de Paris ("BNP")

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

TOPICS

- Overview of the Carrier Release and Other Recent Rulemaking Related To It
- Reasons For the Carrier and Reg M-A Proposals
- A 5 Part Discussion of How Actual Deals Would Change By Deal
- Q&A

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

5 Part Discussion of "Real Deals"

- IPO Deals
- Private Placements, Resale/Shelf/144A Offerings
- Repeat Issuer Deals
- Reg M-A/Form C
- '34 Act Issues

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

SPEAKERS FOR THE PROGRAM

- Richard Starr, Managing Counsel
  American Express
- Michael McAlevey, Deputy Director
  Securities and Exchange Commission
- Joseph Heyison, General Counsel/SVP
  Ridgewood Power Management LLC
- John Huber, Partner
  Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

SPEAKERS

- John Bostelman, Partner
  Sullivan & Cromwell
- Stanley Keller, Partner
  Palmer & Dodge, LLP

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

"Last November the SEC published a sweeping set of proposals to modernize a 65-year-old set of laws governing the capital formation process. The proposals are the result of years of work by the Commission staff."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

"The proposals address a number of the difficulties present in the regulatory structure of offerings. Just as the major reforms to the regulatory structure in 1964 and the early 1980's drew a host of criticisms from market participants, so too have our most recent efforts."

Brian Lane
Director of Corporation Finance, SEC
April 22, 1999

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Generally

- In November 1998, the SEC proposed significant reforms to the regulatory structure for securities offerings (Release No. 33–7606A; File No. S7-30-98)
- Known as the "aircraft carrier" due to the massive scope of the initiative

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Generally (continued)

- The proposals cover five main topics:
  - the registration system for offerings
  - prospectus delivery requirements
  - communications around the time of an offering
  - integration of private and public offerings
  - periodic reporting under the Securities Exchange Act of 1934

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Generally (continued)

- Aims to "modernize and clarify" the regulatory structure for securities offerings while maintaining investor protection
- The fundamental changes relate mostly to the structure and process of offering securities
- The main focus is not on revising the content of the disclosure requirements applicable to public companies--next step in the Commission's reform work

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Registration System for Offerings

- Revised registration forms
  - Form A for smaller or unseasoned companies
  - Form B for larger seasoned companies or for offerings to informed or sophisticated investors
  - Form C for business combinations and exchange offers
  - Forms SB-1, SB-2 and SB-3 for small business issuers

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Registration System for Offerings

(continued)

- More control over the timing of registration for Form B issuers and certain Form A issuers

  - registration statements effective on demand
  - can designate the time of effectiveness
  - not subject to pre-effectiveness review by the staff

- File registration statement and prospectus prior to first sale--in contrast to "go and file" shelf system

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Prospectus Delivery

- Delivery of preliminary prospectus or term sheet prior to investment decision

- Final prospectus delivery eliminated in many cases

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Communications Around Time of an Offering

- Restrictions on communications during the offering period reduced
- Statutory prospectus no longer the exclusive offering document
- Gun jumping eliminated for Form B issuers -- pre-filing offers permitted

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Communications Around Time of an Offering

[continued]

- Bright line test for commencement of the offering period
- Filing requirements for all offering materials
- Liability issues

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

•Overview of Aircraft Carrier Proposals

Integration of Private and Public Offerings

- Increased flexibility and clarity in switching from a private offering to a public offering and vice versa

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview of Aircraft Carrier Proposals

Periodic Reporting Under the Securities Exchange Act of 1934

- Signature and certification requirements for officers and directors
- Filing 8-K's for more events and in a shorter time frame
- Faster and uniform reporting of quarterly and yearly results
- Additional disclosure in 10-K's and 10-Q's

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

REASONS FOR THE ‘CARRIER AND REG M-A PROPOSALS

Michael R. McAlevey

Deputy Director

SEC

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

REASONS FOR THE PROPOSALS

- *Modernize/Rationalize The Law*
- *More Information Rather Than Less*
- *Timely Delivery of Information*
- *Remove Incentives To Go To Private Markets*
- *Improve '34 Act Reporting*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

BENEFITS OF THE PROPOSALS

- *Benefits To Investors*
  - *Protection of Investors is a main mission of the SEC*
  - *Timely receipt of current information*
  - *Equal access to information*
- *Benefits To Small Businesses*
  - *Benefit even more than larger companies*
  - *Easier small business disclosure system*
  - *Streamlined Registration*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Benefits...

- *Benefits To Larger Companies*
  - *Gain Complete Control Over Timing*
  - *No Staff Review*
  - *Could Communicate With Investors At Any Time*
  - *Liberalized Delivery Requirements*
- *Benefits To Underwriters*
  - *Freedom To Issue Research Reports*
  - *Freedom to Use Documents Other Than Prospectus To Sell Offerings*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

EARLY REACTIONS TO THE PROPOSALS

- *Review of Comment Letters*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

OPTIONS FOR 'CARRIER GOING FORWARD

- *Adoption*
- *Adoption of Some*
- *Reproposal*
- *Abandonment*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- *Too Many Restrictions On Communications*
- *Exchange Offers and Cash Tenders On An Equal Footing*
- *Reduce Regulatory Burdens On Deals*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

IPO's Old and New

Joseph A. Heyison

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Outline of issues -- 1

- *Form A -- Eligibility and contents*
- *Pre-offering safe harbor for disclosures*
- *30 day pre-filing period - limited disclosure*
- *Waiting period - free writing and red herring delivery*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Outline of issues -- 2

- *Effectiveness and post-effective period*
- *Private to public / public to private offerings*
- *Small business initiatives*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Form A -- Eligibility

- *General form for registration -- similar to S-1*
- *Required for issuers that have less than one year of reporting history and that have not filed their first 10-K or that are not timely in reporting*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- *Form A would be generally used by issuers too small to use Form B:*
  - *less than of public float an average daily trading volume (in the U.S.) of less than*
  - *public float of at least*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- *Content equivalent to S-1 or S-2*
- *Will free writing change content?*
- *"Seasoned" mid-size issuers can incorporate company-related information by reference*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Form A -- Incorporation by reference similar to S-2 rules

- *"Seasoned" issuers*
  - *$75 million in public float and 24 month reporting history under 1934 Act*
  - *24 month reporting history under 1934 Act and two 10-K's filed*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Form A -- Incorporation by reference issues

- *No option to summarize 1934 Act reports in prospectus -- must deliver the reports or include all information in prospectus*
- *Open issue -- retain ability to deliver glossy annual report to shareholders rather than 10-K?*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- *Essentially equivalent to S-1*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

PRE-OFFERING SAFE HARBOR FOR DISCLOSURES

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current practice

- *No offering of securities or 'conditioning the market" before filing*
- *S.E.C. encourages reporting factual information, but does not set any bright lines*
- *Result: prudent counsel choke off or at least review everything*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Bright-line pre-filing safe harbor

- *Anything disseminated more than 30 days before filing a registration statement is presumed not to be a Section 5 offer.*
- *Includes factual information, forward-looking information and rank speculation, from issuer or others -- including analysts*
- *Anti-fraud remedies still apply*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- *Issuer must take all reasonable steps to prevent others from re-distributing statements within 30 day period*
- *Telegraph your offering, or place embargoes on everything*
- *Forward looking statements or offering information can backfire*

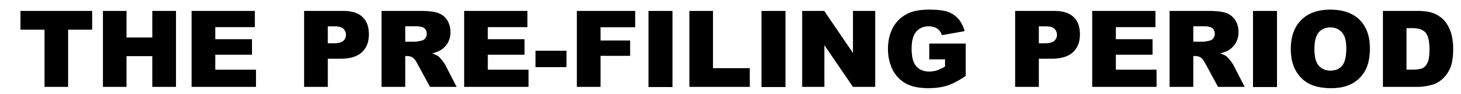
This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Effects on underwriting community

- *In theory, underwriters and issuers could canvass dealers more than 30 days ahead*
- *Benefits in deciding to go ahead*
- *Will dealers be circled into offerings?*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

THE PRE-FILING PERIOD



- *Beyond Rule 135*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

F-30 days safe harbor for factual information

- *Factual business or financial developments, dividend notices*
- *Advertisements of products or services*
- *Facts in required S.E.C. reporting (and presumably MD&A)*
- *Factual responses to unsolicited inquiries from non-affiliates*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

F-30 days -- prohibitions

- *Offering information (terms, pricing)*
- *Forward-looking statements and projections*
- *Possible exception for regular releases (with two full fiscal year history)*
- *Internet sites -- need to remove information for 30 days*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

THE WAITING PERIOD -- NOW, THE NOISY PERIOD

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The quiet period

- *Legal theory --*
  - *the prospectus is the only written selling document*
  - *no commitment before effectiveness*
- *Practice*
  - *oral sales efforts*
  - *road shows*
  - *circle dates*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Why change?

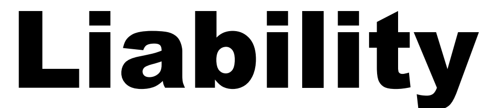
- *More communication undermines exclusive use of prospectus*
- *Red herring not an effective means of attracting investor attention*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Free writing requirements

- *Deliver red herring before effectiveness*
  - *seven days for IPO and for one year thereafter*
  - *three days after issuer in system for one year*
- *File all free writing materials -- but not as part of registration statement*
- *File final prospectus on time*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).



Liability

- *Free writing materials would be subject to Section 12(a)(2) liability*
  - *essentially negligence-based*
  - *no automatic liability of officers and directors, unless controlling person*
  - *underwriters only liable on fault basis*
- *No Section 11 liability*
- *Anti-fraud remedies remain*

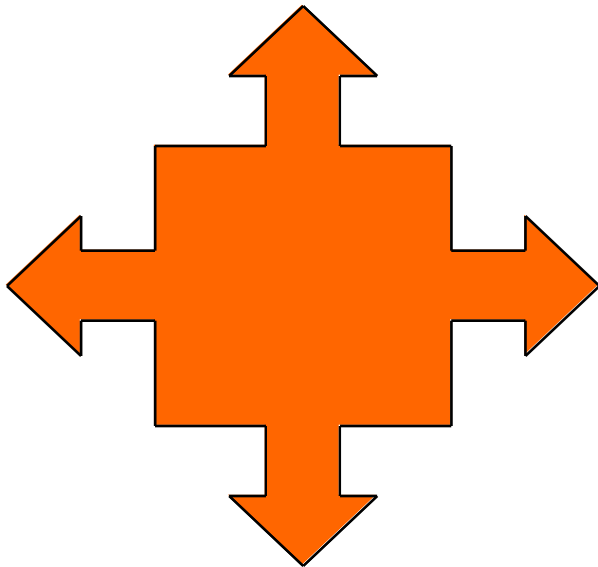
This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Objections to free writing proposal

- *Burden of filing documents on EDGAR*
- *Issuer concern over control of underwriters and others ("by or on behalf of the issuer")*
- *Shift of power to issuers as direct marketing becomes possible*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

widgetSoft.com



- *Bleeding edge, high res, e-commerce software.*
- *Buy a piece of the Internet economy at www.widgetsoft.com/ipo !*
- *No securities broker needed!*

BEFORE YOU INVEST, YOU SHOULD READ THE OTHER DOCUMENTS THAT WE HAVE FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. THESE DOCUMENTS, INCLUDING THE PROSPECTUS, FREE WRITING AND OTHER OFFERING DISCLOSURES, CONTAIN IMPORTANT INFORMATION THAT YOU NEED TO CONSIDER BEFORE MAKING AN INVESTMENT DECISION. YOU MAY GET THESE DOCUMENTS FOR FREE BY VISITING EDGAR ON THE SEC WEB SITE AT WWW.SEC.GOV. WE WILL SEND YOU THOSE DOCUMENTS FOR FREE IF YOU CALL US AT 1 (800) WIDGETS.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Practical benefits of the free writing proposal

- *Ability to respond to investor queries*
- *Combating the chat room menace*
- *Internet communication*
- *Opening up road shows*
- *Direct advertising*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

An unresolved issue

- *Free writing that goes beyond prospectus disclosures can create Section 11 liability*
- *Practical results:*
  - *incentive to parrot the prospectus*
  - *free writing may shut down several days before effectiveness*
- *Limited usefulness -- mainly IPO's?*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Preliminary prospectus requirements

- *For an IPO and for one year later, must deliver at least seven calendar days before pricing date*
- *Other Form A issuers must deliver at least three days before pricing*
- *Must update material information at least 24 hours before pricing*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Preliminary prospectus delivery

- *In manner reasonably designed to be received by each investor*
- *Need to track all offerees may force the circle date back*
- *Late investors*
- *Material last-minute changes: communicate to all investors 24 hours before pricing*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

EFFECTIVENESS AND POST-EFFECTIVENESS ISSUES

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Effectiveness and final prospectus

- *Pricing date practice unchanged*
- *Constructive delivery of final prospectus*
  - *Filed on EDGAR*
  - *Issuer, brokers and dealers must provide copies on request*
  - *Notice in confirmation or prior document*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

After-market delivery requirements

- *Gustafson v. Alloyd Co. implied that Section 12(a)(2) liability ends with duty to distribute prospectus*
- *Constructive delivery of after-market prospectuses for 25 days in almost all cases, even reporting issuers*
- *90 day period retained for blank check companies*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

PUBLIC / PRIVATE; PRIVATE / PUBLIC

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- *Registration statement is a general offer to the world*
- *Thus, no private offer possible until integration period ends*
- *Conversely, incomplete private offering before filing can be a prohibited offer of the public securities*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Unsuccessful public offering -- subsequent private offering

- *Either withdraw registration statement, wait 30 days, and advise private purchasers they have no Section 11 protection,*
- *Issuers and underwriters covenant to accept Section 11 liability, and proceed immediately to private offers*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Unsuccessful private offering -- subsequent public offering

- *Wait 30 days,*
- *Notify all offerees of abandonment, and either*
  - *include the private offering materials in the registration statement or*
  - *inform all private offerees that the private offering materials and any indications of interest have been superseded*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Successful private offering, subsequent public offering

- *Limitations of current Rule 152*
- *Define completion of offering as binding obligation to pay*
- *Allow subsequent conversion or exercise of derivative securities*
- *Allow registration of resale by non-affiliates*
- *Allow normal lockups*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Major small business proposals

- *Increase SB eligibility maximum to $50 million of revenues, eliminate maximum public float requirement*
- *Payment of filing fee can be delayed on SB filings until acceleration*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Other SB proposals

- *Allow incorporation by reference into Form SB-2 for seasoned, timely issuers*
- *Ongoing offer of securities underlying Rule 504 convertible securities permitted after 1934 Act reporting starts*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

In closing

- *What can the issuer say?*
- *When can it be said?*
- *How can it be said?*
- *Who can say it?*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Repeat Issuer Deals

Panel Discussion on the SEC's Aircraft Carrier Release

November 3-5, 1999
San Diego

John T. Bostelman
Sullivan & Cromwell

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Overview

- Effect of Form B proposals on offerings of
  - Investment Grade Debt
  - Common Stock
- vs. today's shelf system for larger public companies

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Conclusions

Investment Grade Debt

- Pricing delayed by a full day
- More retail investors excluded
- Deal size fixed the night before (vs. at pricing for shelf)

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Conclusions

Common Stock

- *If offering is over-subscribed:*
  - *skip opportunity to upsize, or*
  - *delay pricing by one day.*
- *If disclosure event occurs on pricing day:*
  - *postpone pricing by one day.*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Assumptions

- Underwriters unwilling to price until clear to make immediate oral sales
  - Minimize underwriting risk
  - Prospectus supplement for Form B (ex 430A info) must be on file by pricing
- Term sheet must arrive before oral sales
  - Deal size must be included

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Assumptions, continued

- *Advance shelf filings will still be made under Form B*
  - *File-and-go is unrealistic*
- *Required director readings and certifications will be dropped from Form B*
  - *Mechanically unworkable*
- *24-hour prior delivery of material changes disclosure not required under Form B*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Significance of Delay

- Shelf take-downs in 1998
  - $350 billion in debt, mostly investment grade
  - $50 billion in equity
- SIA economist estimated cost of delay is
  - Debt: 5-10 bp per year
    - $175-350 million per year for just 1998's issuances
  - Equity: 40 bp of proceeds
    - $200 million in 1998

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Assumptions

- High state of readiness
  - Documents
  - Counsel
- No lengthy marketing period
- Form B only: Deal size and maturities fixed in afternoon of day before pricing
  - vs. at time of pricing for today's shelf system

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 1

9:00 am - Issuer calls 10 investment banks. Asks for price bids on 5- and 10-year maturities on Day 2 at 9:00 am

9:01 am- 10 investment banks sticker research to indicate possible involvement in offering (Form B only)

9:05 am - Potential underwriters start calling customers

10:00 am - Issuer alerts underwriters' and issuer's counsel and accountants

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 1

11:00 am - Issuer asks 10 investment banks to confirm absence of prior "offers" at any time and absence of written "offering information" or "free writing" in past 15 days

- Any such information would have to be filed
  - Offering information as part of registration statement
  - Free writing as a 425 prospectus
- Expectation of no future written material unless issuer OKs

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 1

11:01am - Counsel starts to prepare "Recent Developments" and updates documentary due diligence

- Counsel confirms no unresolved SEC comments
- Counsel starts drafting securities term sheet, prospectus supplement and post-effective amendment(s)
- Accountants begin comfort letter bring-down procedures
- Accountants begin consent procedures

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 1

4:30 pm - Potential underwriters assess investor interest collected during the day

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 2

- **9:00 am** - 10 potential underwriters submit bids to issuer
- **10:00 am** - Issuer selects 5 underwriters (no syndicate) and all agree orally on all terms except price or other 430A information (Price OK in today's shelf)
- **10:01 am** - Issuer and underwiters sign UA and fax signature pages
- **10:02 am** - Underwriters telephone investors and orally confirm sales (settlement T+3 on Day 5)

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 2

10:01 am - 10 firms sticker research to reflect definite/no involvement in offering

10:02 am - Underwriters may not make sales, but may continue to solicit indications of interest

10:05 am - Issuer obtains written concurrence to effectiveness of PEA from "managing" underwriter or "principal underwriters"

10:06 am - Issuer obtains written accountants' consents for PEA

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 2

10:07 am - *Issuer and underwriters issue to each other written confirmation as to absence of "bad boy" disqualification*

- *Issuer confirms no unresolved SEC comments and no prior "offers", written "offering information" or "free writing"*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 2

11:00 am - Due diligence call of underwriters and counsel with issuer. Results in

- Additions to "Recent Developments"
- Details to be filed via 8-K

12:01 pm - Work to prepare 8-K

12:02 pm - Work to finalize prospectus supplement

3:00 pm - Issuer EDGARizes and files 8-K with SEC

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 2

3:05 pm - Directors "read" the term sheet PEA

3:10 pm - Finalize term sheet and file with SEC as PEA via EDGAR

3:15 pm - Underwriters fax and e-mail term sheet to investors to arrive before binding investment decisions tomorrow morning

- No more incorporation by reference
- No oral sales permitted yet

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 2

7:30 pm - Accountants deliver comfort letter

8:00 pm - Print prospectus supplement

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 3

8:25 am - Directors "read" PEA with prospectus supplement

8:30 am - Prospectus supplement (excluding 430A) filed with SEC as PEA via EDGAR

- Filed under 424 today

8:31 am - Issuer and underwriters agree on price

8:32 am - Issuer and underwriters sign underwriting agreement

8:33 am - Underwriters make oral sales (settlement T+3 on Day 6)

8:34 am - Underwriters send confirmations

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 3

8:35 am - Work to finalize prospectus supplement, including 430A information

5:25 pm - Directors "read" PEA

5:30 pm - File 430A information with SEC as PEA via EDGAR

7:30 pm - Accountants deliver comfort letter

8:00 pm - Print prospectus supplement

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Investment Grade Shelf Take-Down

Day 4

9:00 am - Prospectus supplement sent to any investors that have requested it

Day 5

9:00 am - Closing (T+3)

Day 6

9:00 am- Closing (T+3)

Days 4 - 28

- File PEA to update prospectus supplement if necessary

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Assumptions

- There will be marketing, a 1-week road show and a syndicate
- Other assumptions as for debt shelf take-down
  - Shelf registration on file
  - Underwriting agreement on the "shelf"
  - Forms of comfort letter and opinions
  - Designated underwriters' counsel

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 1

9:00 am - Issuer selects a managing underwriter and 2 co-managers from many that have been pitching the business

- 3 investment banks sticker research to indicate involvement in offering

10:00 am - Issuer and underwriters alert underwriters' and issuer's counsel and accountants

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 1

11:00 am - Issuer and 3 investment banks confirm to each other absence of prior "offers" at any time and absence of written "offering information" or "free writing" in past 15 days

- Agree to use only mutually approved material

- Issuer and underwriters issue to each other written confirmation as to absence of "bad boy" disqualification

- Issuer confirms no unresolved SEC comments

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Days 2 - 9

- Working group prepares preliminary prospectus to use for marketing
  - Also any required exhibits
  - Will be "offering information"
  - Will include term sheet
- Working group prepares supplemental written marketing material
  - Intended to be "free writing"
- Underwriters and issuer prepare road show speeches and slides
- Due diligence conducted
- Accountants start comfort letter

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 9

9:00 am - Issuer publicly announces quarterly earnings

- Filed via 8-K

8:00 pm - All sign off on preliminary prospectus supplement

8:05 pm - Directors "read" PEA containing preliminary prospectus supplement

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 10

9:00 am - Preliminary prospectus supplement filed with SEC

- Also term sheet, as PEA via EDGAR
- As Rule 424 prospectus

- Written marketing material filed with SEC as free writing under Rule 425

10:00 am - Road show begins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Days 11 - 16

Syndicate members are invited

- Each member must confirm absence of
  - "bad boy" disqualification
  - "offers" prior to Day 1
  - use of unapproved "offering information" or "free writing"
- Each member must sticker research for involvement in offering

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 16

- Road show finishes today
- Final prospectus supplement draft is updated

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 17

8:30 am - Deal size is tentatively fixed, erring on smaller size

9:55 am - Directors "read" term sheet PEA

10:00 am - Term sheet (excluding 430A) filed with SEC as PEA via EDGAR

10:01 am - Underwriters fax, e-mail and mail term sheet to investors

- No more incorporation by reference

10:30 am - Working group finalizes final prospectus supplement

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 17

- If a disclosure event occurs today, pricing will probably need to be delayed until tomorrow.
  - Regulatory development
  - Litigation
  - Small acquisition
  - New material contract

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 17

4:00 pm - Deal size assessed in light of order book and market. If demand would support upsizing:

- *In Form B, price today at the smaller size or price tomorrow to allow revised term sheet distribution*
- *In today's system, upsize and price today*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering
Common Stock Offering

Day 17

4:25 pm - Directors "read" PEA

4:30 pm - Final prospectus supplement (excluding 430A) filed with SEC as PEA via EDGAR

5:00 pm - Issuer and underwriters agree on price

5:02 pm - Issuer and underwriters sign underwriting agreement

5:03 pm - Underwriters make oral sales (T+4)

6:00 pm - Underwriters send confirmations

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 17

- 9:30 pm - Accountants deliver comfort letter
- 9:55 pm - Directors "read" PEA
- 10:00 pm - File 430A information with SEC as PEA via EDGAR
- 10:05 pm - Print final prospectus supplement

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Common Stock Offering

Day 18

9:00 am - Final prospectus supplement sent to any investors who have requested it

- Underwriters mail confirmations
- Prospectus supplement filed under 424

Day 21

9:00 am - Closing (T+4)

Days 18 - 43

- File PEA to update prospectus supplement if necessary

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Conclusions

Investment Grade Debt

- Pricing delayed by a full day
- More retail investors excluded
- Deal size fixed the night before (vs. at pricing for shelf)

Common Stock

- If offering is over-subscribed:
  - skip opportunity to upsize, or
  - delay pricing by one day
- If disclosure event occurs on pricing day:
  - postpone pricing by one day

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Rule 144A/Exxon Capital Exchange Offers

American Corporate Counsel Association Annual Meeting

November 3-5, 1999

San Diego, California

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Current Market for High Yield Debt

- Highly efficient market for both issuers and institutions
- Facilitates capital raising, particularly by entrepreneurial companies
- Represents "securitization" of bank debt
- In 1987: $139.0 billion

  In 1997 : $254.4 billion
- *Exxon Capital* exchange offers represent 1/3 of 1933 Act filings by first time registrants

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Development of the Rule144A/Exxon Capital Market

- Before 1988
  - For Issuers:
    - Private placements with resale registration agreements
    - Resale shelf registration for up to 3 years
    - Black out periods
    - Costly for issuers to maintain
  - For Institutions:
    - Liquidity (4 (1_) or resale registration)
    - When were securities freely tradeable for regulatory purposes?

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Development of the Rule 144A/Exxon Capital Market (cont'd)

- *Exxon Capital* (1988)
  - Allows institutions to exchange restricted securities for substantially identical registered securities
- Rule 144A (1990)
  - Exempts resales of restricted securities to QIBs
  - Institutions are able to "fend for themselves"
  - Represents adoption of 1979 ABA Committee Report
- Long-term trend toward greater efficiency and flexibility
- No demonstrated harm or abuse

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Aircraft Carrier Release

- Eliminates *Exxon Capital* exchange offers
- Seasoned Issuers could use Form B for sales to QIBs:
  - Seasoned Issuers:
    - 1-year reporting history and 1 filed annual report
  - Other issuers must use Form A:
    - Non-reporting companies account for majority of Rule 144A issuers
- Securities must "come to rest" with QIBs
    - Issuers can retroactively lose Form B availability

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Commission's Concerns

- *Exxon Capital* provides an incentive to avoid registration
- *Exxon Capital* results in registration at time of exchange, rather than at time of issuance
- Institutions need protections too
- Institutions act as conduits

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Responses to the Commission's Concerns

- The disclosure provided in a Rule 144A/*Exxon Capital* offering is substantially the same as that provided in a registered offering
- Commission experience, rulemaking, legislation and case law show that institutions do not need the protection of registration
- Rule 144A/*Exxon Capital* brings non-reporting and foreign companies into the reporting system

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Responses to the Commission's Concerns (cont'd)

- Institutions are not acting as conduits
  - Would resurrect "Presumptive Underwriter" doctrine
  - American Council of Life Insurance letter (1983)
- The study by Lexecon Inc. is intended to show:
  - institutions are the purchasers in the Rule 144A market
  - institutions are the dominant participants 6 months after the Exxon Capital exchange offer
  - no significant increase in trading volume follows the *Exxon Capital* exchange offer

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Effects of Aircraft Carrier, if Adopted

- Takes high yield market back to the future
  - New costs for issuers: long-form multiyear shelf registration for resales
  - New costs for institutions: fill up restricted securities "basket"
  - Spreads will rise
  - No benefit to the market or investor protection
- Best alternative — do nothing. It ain't broke, don't fix it

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Proposals on Short-Form Registration for Resales

- Unless issuer is eligible for Form B for a primary offering, issuer must register resales on Form A
  - 1175 fewer Form B issuers under Aircraft Carrier proposals
- Even if issuer can use Form B for resales
  - no forward incorporation by reference
  - must file a post-effective amendment with each take down
- Resale registration will not be as efficient as 1978 when S-16 was adopted

Latham & Watkins

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal

(The M&A Release)

Stanley Keller
PALMER & DODGE LLP

November 3-5, 1999

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Current Environment

- Merger and acquisition activity has mushroomed in the U.S. and globally.
- Strategic mergers involving acquirer securities have increased.
- Increased use of proxy activity in hostile transactions.
- Revolution in electronic communication has increased flow of information.
- Relationship to Aircraft Carrier and CrossBorder Tender Offers Proposals.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Problems

- Practices in communicating with investors and the market do not comport with regulatory restrictions.
- Exchange offers are at a regulatory disadvantage to cash offers.
- Distinct regulatory regimes for securities registration, proxy solicitation and tender offers result in complex, costly and sometimes inconsistent regulation.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Problems

- Practices in communicating with investors and the market do not comport with regulatory restrictions.
- Exchange offers are at a regulatory disadvantage to cash offers.
- Distinct regulatory regimes for securities registration, proxy solicitation and tender offers result in complex, costly and sometimes inconsistent regulation.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Proposed Solution

- Relax Restrictions on Communications
  - Permit free communication regarding an acquisition before a registration statement is filed and thereafter, but subject to requirement to file written communications on first use.
  - Permit freer communications before filing a proxy statement.
  - Eliminate requirement to commence a tender offer promptly after public announcement.
  - Eliminate confidential treatment accorded preliminary merger proxy

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The ABA Response - Generally Supportive

- Relax Restrictions on Communications
  - Accept modified file on first use filing requirement.
    - Communications in mergers more controlled than in securities offerings.
    - Limit to new, material and widely disseminated information.
    - Failure to comply with safe harbor should not itself create a section 5 violation.
  - Adopt broad test-the-waters approach of Rule 14a-2 to permit freer proxy communications.
  - Preserve current confidential treatment alternative but at cost of giving up communications safe harbor.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Problems

- Practices in communicating with investors and the market do not comport with regulatory restrictions.
- Exchange offers are at a regulatory disadvantage to cash offers.
- Distinct regulatory regimes for securities registration, proxy solicitation and tender offers result in complex, costly and sometimes inconsistent regulation.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Proposed Solution

- Level Playing Field for Stock and Cash Tender Offers
  - Permit commencement of third party exchange offers upon filing of registration statement.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The ABA Response - Generally Supportive

- Level Playing Field for Stock and Cash Tender Offers
  - Make registration effective on filing.
  - Provide for expedited review.
  - Include issuer self tenders.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Problems

- Practices in communicating with investors and the market do not comport with regulatory restrictions.
- Exchange offers are at a regulatory disadvantage to cash offers.
- Distinct regulatory regimes for securities registration, proxy solicitation and tender offers result in complex, costly and sometimes inconsistent regulation.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The Proposed Solution

- Integrate and Streamline Disclosure Requirements and Procedures for Tender Offers and Mergers
  - Adopt one-set of integrated disclosure rules as Regulation M-A.
  - Adopt single tender offer form – Schedule TO.
  - Require plain English summary.
  - Permit subsequent offering period after completion of tender offer.
  - Reduce financial statement requirements for cash bidders.
  - Consider extending forward-looking safe harbor provision to tender offers.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Regulation of Takeovers and Security Holder Communication Proposal (The M&A Release)

The ABA Response - Generally Supportive

- Integrate and Streamline Disclosure Requirements and Procedures for Tender Offers and Mergers
  - Establish a single form (Form M-A) for all business combination transactions.
  - Support extension of forward-looking information safe harbor to tender offers.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

Purpose of Changes

- **Enhance timeliness and quality of information in Exchange Act reports**
- **Important to both securities offerings and secondary market trading**

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

Signature and Certification Requirements

- Signatories for a 10-Q (among other Exchange Act forms) expanded to principal executive officer and a majority of the board of directors
- All signatories of Exchange Act registration statements and reports to certify:
  - have read the registration statement or report
  - to their knowledge no material misstatements or omissions contained therein
- 8-K signatory to certify that the report has been provided to the board of directors

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

8-K Reporting and Timing Requirements

- **Expands the list of items that would be reportable on Form 8-K**
  - **material modifications to the rights of security holders**
  - **departure of the CEO, CFO, COO or President**
  - **material defaults on senior securities**
  - **certain auditor notifications**
  - **company name changes**

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

8-K Reporting and Timing Requirements (continued)

- Accelerates the 8-K due date to within 5 calendar days of event in most cases
- Certain 8-K's due within one business day after the event occurs
  - reporting material defaults on senior securities
  - auditor-related information
  - departure of key officers
  - resignation of directors

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

Reporting Quarterly and Annual Results; Acceleration of Filing Dates

- File on 8-K, on quarterly and annual basis, selected financial data called for by Item 301 of Regulation S-K
- Due earlier of
  - 30 days after quarter end for the first 3 quarters and 60 days after fiscal year end
  - the date of issuing a press release containing quarterly or annual earnings information

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

Reporting Quarterly and Annual Results; Acceleration of Filing Dates (continued)

- As an alternative, accelerate due dates
  - for Form 10-K: from 90 days to 60 days following fiscal year end
  - for Form 10-Q: from 45 days to 30 days following the quarter end for each of the first 3 quarters

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

Disclosure of Risk Factors

- Required risk factor disclosure in 10-K annual reports
  - most significant risk factors relating to the company's business, operations, industry or financial position that may have a negative impact on its future financial performance
- Updates of material changes in quarterly reports on Form 10-Q
- Subject to plain English requirements

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Aircraft Carrier Proposals--Key Changes Under the Securities Exchange Act of 1934

Staff Review of Exchange Act Reports

- The staff's review process would be focused more on Exchange Act periodic reports
- Issuers notified by telephone as soon as Exchange Act reports selected for review
- Approximate date provided for expected comments
- Staff would consider requests by issuers for review of Exchange Act reports
- 30 day non-review period would follow if staff could not review Exchange Act reports upon request

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

AMERICAN CORPORATE COUNSEL ASSOCIATION

1999 ANNUAL MEETING

THE SEC AIRCRAFT CARRIER RELEASE – WHAT YOU NEED TO KNOW NOW!

Program materials – Initial public offerings August 16, 1999

COMPARISON CHART
CURRENT IPO PRACTICE VERSUS SEC PROPOSALS

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
PRE-FILING STATEMENTS For an indefinite period before the filing of the registration statement the issuer can make no statement that could be construed as an offer of securities ("gun-jumping"). See Section 5(c) of the 1933 Act.		
Factual information concerning the issuer. Although the Commission has stated that "purely factual" information about the issuer's ongoing business may be distributed without violating Section 5 of the 1933 Act, the difficulty of applying that standard generally results in little or no discussion of many events after an issuer begins considering a securities offering.	"Factual business communications" made at any time before filing the registration statement are excluded from Section 5(c) liability. Includes factual business or financial developments, advertisements of products or services, dividend notices, facts in required S.E.C. reporting and factual responses to unsolicited inquiries from non-affiliates of issuer, underwriters and participating dealers. Proposed Rule 169.	• Rule 10b-5 and §17 liability still attach to any pre-filing communication that could be considered to be in connection with the sale of securities. • Post-filing announcements of factual information are treated as free writing under Proposed Rule 165, see below.
Other statements made more than 30 days before the filing of the registration statement. Treated on same basis as statements made within 30 days of filing.	Any statement made more than 30 days before filing of the registration statement is not an offer of the securities for Section 5(c) purposes, *if* the issuer, underwriters and participating dealers take all	• There are practical problems with obtaining assurances from news media, analysts and others that they will not republish or transmit

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
	reasonable steps in their control to prevent further distribution of that statement within the 30 day period. Proposed Rule 167(c).	statements within the 30 day period and with removing all dangerous statements from websites and company publicity before the 30 day period begins. • Rule 10b-5 and §17 liability still attach to any pre-filing communication that could be considered to be in connection with the sale of securities.
Pre-filing forward-looking statements. Considered to be "particularly troublesome" as conditioning the market and are effectively banned.	Still banned for initial public issuers, but only in the 30 days prior to the filing of the registration statement. Limited safe harbor proposed for reporting issuers that have customarily released this type of information for at least two fiscal years. Proposed Rule 168.	
Information about the offering. Limited safe-harbors for offering information under Rule 135. Underwriters cannot be identified.	Rule 135 essentially unchanged but applies only during the 30 day period prior to filing.	
Communications with potential underwriters and dealers. Communications with potential underwriters permitted, but neither issuer nor underwriters may canvass dealers prior to filing.	In IPO's, issuers and underwriters may contact dealers up to 30 days before filing and dealers may commit to offering.	This creates some anomalies and potential pressure on dealers to sign up before the 30 day period begins, with possible adverse effects on dealer due diligence.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	**Proposed Form A practice for initial public offerings**	**Notes**
INTEGRATION OF PRIOR PRIVATE OFFERINGS WITH INITIAL PUBLIC OFFERING ("Securities Act Metaphysics")		
Private offering after an unsuccessful public offering. Because filing a registration statement is considered to be a general offer to the world, no private offer of the same or similar securities is possible until at least six months after the withdrawal of the registration statement or abandonment of the offering. (Rule 502(a).)	Safe harbor allows private offering promptly after a failed public offering with two options • if the issuer and any underwriter in private offering accept Section 11 liability for statements made in the private offering, the private offering can be made immediately; or • wait 30 days after withdrawal of registration statement, and sell with normal liabilities under Sections 12(a)(2) and 17 of the 1933 Act and Rule 10b-5. Purchasers must be advised that the public offering was withdrawn and that they do not have Section 11 remedies. In all cases, the registration statement must be withdrawn with no sales made under it.	• The safe harbor doesn't address the need to make a private offering after a partially successful public offering. • Can an issuer effectively create federal civil liability by contract, or will the cause of action be under state contract law? Compare the situation under the Trust Indenture Act of 1939.
Completed private offering before public offering. Although the private offering's status is preserved by Rule 152, the private offers may be considered to be pre-filing offers of the public securities in violation of Section 5(c), unless they are made more than six months before filing. Rule 502(a).	If the sale in the private offering is completed before the issuer files a registration statement, the private offers will not be integrated with the public offering, even if made in the 30 day period before filing. Proposed Rule 152.	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
• An issuer that registers privately placed securities for resale risks integration of the placement with the resale. • Privately placed convertible securities may be considered to be a continuing offer of the common stock. This may jeopardize a subsequent registration of that common stock.	• Private offerings that are completed before the filing of the resale registration statement will not be integrated, so long as sales are not made by broker-dealers who purchased securities from the issuer or its affiliates, or by affiliates of the issuer. Proposed Rule 152. • Proposed Rule 152 prevents integration of the ongoing offer through convertible securities with the subsequent registered offering.	• The definition of "affiliate" will track the Rule 144 definition, which is currently under review.
Unsuccessful private offering before public offering of similar securities. Private offering is a prohibited, pre-filing offer of the securities being registered. Issuer should wait six months.	If no securities are sold in the private offering, all offerees are notified that it was abandoned, and the issuer (a) either includes the private offering materials in the registration statement or (b) informs all private offerees that the private offering materials and any indications of interest have been superseded, the issuer may file a registration statement. It may do so immediately unless the private offering was made to offerees who cannot qualify under Sections 4(2) or 4(6) or Rule 506.	The exemption for any statement that may be considered to be an offer, if made at least 31 days before filing, effectively limits the restrictions of this exemption to the 30 day period after the end of the private offering. See Proposed Rule 167(c).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
FILING THE REGISTRATION STATEMENT AND WAITING PERIOD CONDUCT		
Filing. File registration statement before first offer	No change.	
Content of registration statement prescribed by Forms S-1, SB-1 or SB-2	Forms A, SB-1 and SB-2 essentially unchanged.	
Fees paid for unused portions of prior registrations. May be used against obligations on new registration under Rule 429 (combined prospectuses) but cannot be used if prior registration withdrawn.	Fees on unused portions of completed or withdrawn registrations may be offset against any other 1933 Act registration fee for five years. Amended Rule 457.	
Written materials during the waiting period. Use of written offering materials except preliminary "red herring" prospectus violates Sections 5(a) and (b).	Issuers and underwriters may freely use written offering materials ("free writing") that do not meet Section 10 standards if • a red herring is delivered at least seven days before effectiveness; • the materials are filed with the S.E.C. before first use; • the final prospectus is properly filed and • the materials contain prominent legends advising investors to read the disclosure documents and stating how they may be obtained. Proposed Rule 165.	• Free writing must be converted to EDGAR format and filed before use. Issuers have concerns about their ability to review or control use of statements made by underwriters and dealers. • There is no requirement to deliver all free writing materials to any investor.
Road shows. Currently limited to broker-dealers and large institutions, with no written materials allowed to be taken other than a preliminary prospectus.	If written materials are concurrently filed on EDGAR, they may be disseminated freely.	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
Electronic communication. Limited to website information not related to offerings, Rule 135 notices and copies of preliminary prospectus. "Electronic road shows" must limit participation by use of passwords.	Freedom to use any electronic means, including road shows, e-mail responses to investor questions, even "chat room" participation, if materials immediately filed via EDGAR.	Impossibility of filing interactive materials such as chat room dialogues before use.
Delivery of preliminary prospectus. Preliminary prospectus for an IPO must be delivered at least 48 hours before mailing of confirmations, and broker-dealers must deliver a copy to any person expected to purchase. Rules 460 and 15c2-8.	Issuer and underwriters must deliver a preliminary prospectus in a way reasonably designed to reach each investor at least seven days before date of pricing of an IPO. Material changes to transaction or company information must be delivered in a way reasonably designed to reach each investor at least 24 hours before pricing or commitment to buy. Proposed Rules 172(b) & (c).	• The proposal effectively requires the issuer and underwriters to track each offeree who indicates interest. • There is no requirement to deliver a pricing term sheet, as in Form B offerings. • Seasoned Form A issuers need only deliver a preliminary prospectus three days before pricing.
Circle date . Currently, shortly before the pricing date, underwriters take indications of interest.	Binding obligations to purchase still prohibited before effectiveness.	However, the seven day delivery requirement for preliminary prospectuses in an IPO may force the circle date back to seven or more days before pricing, so that there is a reasonable basis to believe investors will be sent the preliminary prospectus at least a week before pricing.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
PRICING, EFFECTIVENESS AND FINAL PROSPECTUS DELIVERY		
Acceleration. Currently dependent on delivery of preliminary prospectus and underwriter consent.	Preliminary prospectus now required by rule. Otherwise little change.	
Pricing and preparation of definitive prospectus. • Pricing done evening before effectiveness. Definitive prospectus with pricing information prepared immediately thereafter and filed within 48 hours under Rule 424(b). Prospectus must be delivered with confirmation. Alternative under Rule 434 of delivering a term sheet to persons receiving a preliminary prospectus is rarely used. • Arguable whether 424(b) prospectus is subject to Section 11 liability.	• Constructive delivery of the final prospectus filed with the Commission. The confirmation of sale or a prior document must state where investors may promptly obtain the prospectus information free of charge. Rule 173. • Brokers and dealers still must provide hard copies on request to any person during aftermarket period. Rule 15c2-8. • Final prospectus is clearly subject to Section 11.	
Aftermarket delivery by dealers. All dealers are required to deliver prospectuses for any transaction in a registered security if the issuer was not previously a reporting company, as are most IPO's. Under Rule 174, the period is 25 days from effectiveness for a non reporting listed or quoted company (most IPO's), except for blank check companies (90 days)	Proposed Rule 174 provides for constructive delivery for all distributions except for those of blank check companies. The dealer in the confirmation or an earlier-delivered document must state where the purchaser may obtain the information free of charge.	The formalism of constructive delivery responds to the courts' decision that a distribution and investors' rights under Sections 11 and 12(a)(2) end when the prospectus delivery obligation ends. *See Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Current S-1 practice for initial public offerings	Proposed Form A practice for initial public offerings	Notes
SMALL BUSINESS INITIATIVES		
Eligibility for small business disclosure system. Small business issuers must have no more than $25 million of average annual revenues and a public float of $25 million.	The public float requirement is removed and the limit is increased to $50 million in annual revenues, computed under existing procedures.	The staff estimates that an additional 1,100 issuers will become eligible for the small business system.
Timing of filing fee payment. Pay fee on filing.	Small business issuers may wait to pay the filing fee until they make their acceleration request or withdraw a delaying amendment. Proposed Rule 456.	
Incorporation of Exchange Act filings by reference into 1933 Act SB registration statements. Not permitted.	Permitted on Form SB-2 for seasoned small business issuers (24 months of reporting history, two Forms 10-KSB, and timely for at least 12 months) who meet other requirements for incorporation by reference. Proposed Form SB-2.	S.E.C. experience with Form S-2 indicates that few issuers will elect this approach. Delivery of a batch of Exchange Act reports with a prospectus is cumbersome, off-putting to investors and raises serious disclosure coordination problems.
***Privately placed convertible securities*.** Convertible securities issued under Rule 504, which create an ongoing offer of underlying securities, lose their Rule 504 exemption for the continuing offer when the issuer begins Exchange Act reporting. Rule 504. Nor can the underlying securities be registered for initial sale because they were offered before filing of the registration statement.	Rule 504 remains available even after Exchange Act reporting begins solely for purposes of offer of securities underlying convertible securities, if securities were immediately convertible or convertible within one year at time reporting begins.	Rare event.

Joseph A. Heyison
Senior Vice President and General Counsel
Ridgewood Power Management LLC

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Walk-Through of a Form B Offering

Introduction

Purpose

These timetables are intended to illustrate the substantial additional requirements that the Form B proposals will impose on the offering process, as compared with today's shelf registration system. These requirements will slow down offerings, add burdensome new steps to the process and impose additional potential disclosure and rescission liabilities on issuers, directors, signing officers and underwriters. The new requirements will probably not have the intended effect of making more information available more broadly.

Two typical types of offerings have been selected to illustrate these effects – an investment grade debt offering (scenario 1) and a syndicated common stock offering (scenario 2). While there are many variables that make every offering different, these scenarios are believed to be representative and fair examples of how these two types of offerings would proceed under the Form B proposals, as compared with today's shelf system.

Conclusions

The investment grade debt scenario (Scenario 1) shows that a Form B offering differs in the following ways from today's shelf system:

- Pricing for the issuer is delayed by a full day under Form B, even though launched at the same time as the comparable shelf take down.
- Underwriter oral sales to investors and closing with the issuer are similarly delayed under Form B.
- More retail investors may be excluded from the Form B offering.
- Deal size must be fixed the evening of the day before pricing under Form B (vs. at pricing under today's shelf system).

The common stock scenario (scenario 2) shows that a Form B offering differs from today's shelf system in the following ways:

- If the Form B offering is oversubscribed, the issuer will have to choose between skipping the opportunity to upsize or delaying pricing by a full day and assuming the risk that the market and investor demand could move adversely during that delay. In today's shelf system, deal size can be increased at pricing without delaying the offering.
- If any disclosure event occurs during the day of pricing in the Form B offering, the pricing will have to be postponed a day to allow time for

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

prospectus supplement revisions to be implemented, even if the changes are relatively modest. Today's shelf system is flexible enough to allow for alternative means of pre-pricing disclosure to the marketplace without delaying pricing.

Form B Assumptions

No Pricing Until Prospectus Supplement Is Complete. Implicit in the Form B timing for both offering scenarios is that the underwriters will not be willing to agree on a price with the issuer until they are clear to make immediate oral sales to investors after pricing. (Otherwise, they take on additional underwriting risk as compared with today's shelf system.) Under the Form B regime, they may not make sales until the complete prospectus supplement has been filed with the SEC, other than Rule 430A information. That means deal size and, for debt offerings, maturity, which are not Rule 430A information, must be agreed upon sufficiently in advance of this filing to have the necessary information reflected in the filing. These scenarios assume, perhaps aggressively favoring Form B, that this can be accomplished within a few hours. If extensive pro forma information must be calculated, the deal size and maturities would probably have to be fixed even earlier in the Form B examples.

No Pricing Until Term Sheet Delivery Is Complete. Also implicit in the Form B timing is that the term sheet must be physically sent to investors in a manner reasonably designed to *arrive* at or before the time they are asked to make a binding investment decision, which in practice is the same time as oral sales. Because this will physically take time, underwriters will want to initiate this process at least several business hours before pricing and complete it by the time of pricing. The term sheet may exclude Rule 430A information, but deal size is not that kind of information. Therefore, practical reasons relating to term sheet delivery also require that the deal size be fixed several business hours before pricing in the Form B scenarios.

Shelf Filings Will Still Be Made. The Form B timelines assume a basic shelf-type registration statement will have been filed. In theory, it would be permissible under Form B to omit all registration statement and post-effective amendment filings until just before the first oral sale is to be made. However, this would require finalization, EDGARization and SEC filing of a document of substantial length (including exhibits) at a critical time in the offering process. The timelines assume that for maximum timing flexibility issuers and underwriters will prefer instead to have filed this information in advance, as under today's shelf system. Filing in advance also obviates the need to send drafts of the unfiled basic prospectus material and exhibits to prospective underwriters well prior to any offering in order to enable their legal and documentation groups to conduct the internal review of those materials that their underwriting policies require. They can instead review the public filings, as they do today. In any event, deferring the filing of any of the pre-sale Form B registration statement material would not affect the relative timing of the Form B process vs. today's shelf system with respect to important milestones, such as fixing deal size, pricing, making sales and closing. (In other words, file-and-go is a myth.)

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Director and Officer Reading of Each Amendment Will Not Be Required. The Form B timeline unrealistically assumes that the issuer's signing directors and officers will be able to receive and read each post-effective amendment within 5 minutes. This is to avoid distorting the timeline against Form B for this impractical requirement (which it is assumed would be deleted from any final rules), while illustrating just how impractical it is.

Term Sheet Delivery the Day Before Investment Decision Will Not Be Required. Proposed Rule 172(a)(2) requires term sheet delivery in a manner reasonably designed to arrive "before the date" an investor makes a binding investment decision. The Form B timeline assumes this requirement will be changed or clarified in the final rules to require delivery only "before the time" of the investment decision. The SEC staff has previously stated this to have been the intended meaning. If not, and it is to be read literally, then one more day should be added to the delays in pricing under Form B (*i.e.*, to two days).

Material Changes Disclosure 24 Hours Before Pricing Will Not Be Required. It is assumed that the requirement of Rule 172(e) to deliver 24 hours before pricing a document setting forth material changes to the disclosures will not apply to Form B offerings. This seems to be the case because subsection (e) does not refer to subsection (a), which describes Form B offerings. However, Form B itself specifies in Item 6 of "Information Required in the Prospectus That Is Part of the Effective Registration Statement" that the Rule 172(e) material changes document must be filed. It is assumed this is a mistake in Form B that will be removed (or changed to a reference to the securities term sheet) in the final rules. If it is intended that a Rule 172(e) material changes document be delivered in Form B offerings, this will in many cases add an additional day to the delay.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Scenario 1: Investment Grade Shelf Take-Down

A. There is a high state of readiness for both the Form B version and today's shelf:*

1. A shelf registration statement covering a sufficient principal amount of unsecured senior debt securities is on file and effective, including
   - Basic prospectus
   - Open-end indenture
2. An underwriting agreement is on the "shelf."
   - Not a required exhibit under the Form B proposals.
3. Forms of comfort letter and opinions are already negotiated.
4. Underwriters' counsel has been designated.
   - Counsel is familiar with the registration statement and related documents.
   - Background documentary due diligence is complete.

B. There will be no lengthy marketing period.

C. For the reasons described above in the Introduction under "Form B Assumptions," the deal size and maturities must be fixed in the Form B offering in the afternoon of the day before pricing, whereas they do not have to be fixed until the time of pricing under the existing shelf system.

Timing	Form B	Today's Shelf
Day 1		
9:00 am	Issuer calls 10 investment banks. Asks for price bids on 5- and 10-year maturities to be communicated on Day 2 at 9:00 am.	
9:01 am	The 10 investment banks sticker their research on the issuer to indicate possible involvement in the offering.**	—

* For the reasons described in the Introduction under "Form B Assumptions," file-and-go is not a practical alternative under Form B.

** This timetable assumes the research stickers themselves (and the research to which they are attached) would not be considered "offers" for purposes of the 15-day look-back for "offering information" or the filing requirement for "offering information."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Timing	Form B	Today's Shelf
9:05 am	The 1 0 investme nt banks (potential underwrite rs) start calling custo mers to as sess appet ite for 5- year and 1 0-year matur ities at vario us interes t rates.	
10:00 am	Issuer alerts its accountants and counsel and underwriters' counsel.	

11:00 am	Issuer asks 10 investment banks to formally confirm the absence of prior "offers" at any time (which would cause the 15-day look-back of the "offering period" to start earlier than Day 1) and the absence of written "offering information" or "free writing" in the past 15 days.
	• Any such information would have to be filed.
	    • Offering information as part of the registration statement
	    • Free writing as a Rule 425 prospectus
	• Participants expect no future written material unless approved by the issuer and each underwriter.
		—

11:01 am	Issuer's and underwriters' counsel begin to prepare "Recent Developments" for prospectus supplement to reflect any important recent information to be emphasized, such as recently announced quarterly earnings.	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	—*	If the earnings release was not previously filed and (as in the usual case) it contains greater detail than the summary earnings information in the prospectus supplement, the issuer files its earnings release with the SEC under cover of a Form 8-K.

Underwriters' counsel begin to update their documentary due diligence.

Issuer's accountants begin their procedures required to prepare and issue their comfort letter on the prospectus supplement, basic prospectus and incorporated documents.

Timing	Form B	Today's Shelf
	Accountants begin procedures to issue their consents for various post-effective amendment filings.	—
	Issuer's and underwriter's counsel informally ask the issuer to confirm it has no "unresolved" SEC comments. Counsel also telephones the SEC staff for confirmation.	—

Issuer's and underwriter's counsel start drafting the relevant documents needed for this issue of securities:

Timing	Form B	Today's Shelf
	• Securities term sheet (needed in 24 hours)	—
	• Prospectus supplement (needed before pricing)	• Prospectus supplement
	• Post-effective amendment(s)	—
	• Underwriting agreement/terms agreement	• Underwriting agreement/terms agreement
	• Officers' certificate or supplemental indenture establishing terms of securities	• Officers' certificate or supplemental indenture establishing terms of securities

* In the Form B scenario, the issuer would have previously filed a Form 8-K containing specified quarterly earnings information on the same day it publicly announced its quarterly earnings. This timetable assumes the Form 8-K in the Form B scenario would include the entire earnings release, even if it contained more than the minimum earnings information required by Form 8-K.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Timing	Form B	Today's Shelf
4:30 pm	The 10 potential underwriters assess investor interest solicited during Day 1.	

Day 2

Timing	Form B	Today's Shelf
9:00 am	The 10 potential underwriters submit their bids or other terms proposals to the issuer.	
10:00 am	Issuer selects 5 underwriters (no syndicate) and all agree orally on approximate deal size and all other terms except price and other Rule 430A information.	Issuer selects 5 underwriters and **all agree orally on all terms including price**.*
10:01 am	The 5 selected firms re-sticker their research to reflect their definite involvement in the offering. The 5 firms not selected remove the previous stickers from their research.	Issuer and underwriters sign the underwriting agreement and exchange signature pages by fax.*
10:02 am	Underwriters continue to solicit indications of interest from investors, but may not make sales.	**Underwriters telephone investors to make offers and orally confirm sales (settlement in T+3 on Day 5).***
10:05 am	Issuer obtains written concurrence to effectiveness of the contemplated post-effective amendments from the "managing" underwriter or "principal underwriters."	—

* As a business matter, in today's shelf system the issuer and underwriters could instead agree to postpone pricing and signing the underwriting agreement until 12:01 pm, after completion of the due diligence conference call.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
10:06 am	Issuer obtains written consents from accountants for continued incorporation by reference of their audit report in the post-effective amendment.*	—
10:07 am	Issuer and underwriters issue to each other formal written confirmation as to absence of "bad boy" disqualification.	—
	Issuer formally confirms to underwriters absence of "unresolved" SEC comments and absence of any prior "offers," written "offering information" or "free writing."	—

11:00 am A one-hour due diligence conference call is held for the underwriters and counsel to discuss relevant matters with management of the issuer.** As a result of this discussion, it is agreed that one or more matters will be added to the "Recent Developments" section of the prospectus supplement and that additional details will be filed via Form 8-K.

12:01 pm Upon completion of the due diligence call, issuer, underwriters, counsel and accountants work to prepare and finalize the Form 8-K disclosure.

12:02 pm Issuer, underwriters, counsel and accountants review proofs and work to finalize prospectus supplement.

---

* Current SEC staff practice and the policies of the major accounting firms require the filing of a new accountant's consent at the time of each amendment to the registration statement, even if the amendment does not affect the audited financial statements.

** Because this is investment grade debt, the additional (protective) due diligence guidance included in Rule 176 would not be applicable.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Timing	Form B	Today's Shelf
3:00 pm	Issuer EDGARizes and files the Form 8-K with the SEC reflecting the additional disclosures discussed during due diligence. Appropriate highlights may also be included in the "Recent Developments" section of the prospectus supplement.	
	—	If the prospect of a post-due diligence Form 8-K filing is known the day before, this Form 8-K could also include the earnings release information otherwise contemplated for 8-K filing at 11:01 am the previous day.
3:05 pm	Signing directors and officers "read" the term sheet post-effective amendment so their signature page certification will be true.	—
3:10 pm	Finalize term sheet and file with SEC as post-effective amendment via EDGAR.* If deal size changes before prospectus supplement is filed tomorrow at 8:30 am, a revised term sheet must be prepared, filed with the SEC and sent to investors to arrive before they commit.	—

* This is the earliest the term sheet can be used, because incorporation by reference of the post-due diligence Form 8-K is not permitted after term sheet delivery starts. Even if no Form 8-K were to be filed, the term sheet process could not start until this morning (*i.e.*, a few hours earlier). This is because the participants cannot know enough terms to do the term sheet until the underwriters have been selected *and* have a reaction from investors. For example, the maturity could be 5 years, 10 years, or 5 years extendible at the issuer's option to 10 years. There could be two tranches of different maturities (*i.e.*, both 5 years and 10 years). The term sheet may exclude Rule 430A information. However, maturity is not Rule 430A information. The deal size must also be fixed in the term sheet because it is not Rule 430A information.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
3:15 pm	Underwriters fax and e-mail term sheet to investors so it will arrive before investors make binding investment decisions tomorrow morning. Retail investors may be excluded if too numerous or not equipped to receive term sheets by fax or e-mail. Incorporation by reference is not permitted after this time.	—
	Underwriters continue to solicit indications of interest but may not make sales. (Sales started earlier today at 10:02 am under the existing shelf system.)	—
7:30 pm	—	Accountants deliver to the underwriters their signed comfort letter, as required by the underwriting agreement, covering the prospectus supplement, basic prospectus and all incorporated documents.
8:00 pm	—	Issuer and underwriters authorize printing of the final prospectus supplement, which is dated Day 2, the trade date for sales of the offered securities.

Day 3

Timing	Form B	Today's Shelf
8:25 am	Signing directors and officers "read" the post-effective amendment containing the prospectus supplement.	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
8:30 am	Prospectus supplement (excluding Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including underwriters' concurrence and accountants' consent).*	—
8:31 am	**Issuer and underwriters agree on price.**	—
8:32 am	Issuer and underwriters sign the underwriting agreement and exchange signature pages by fax. (This occurred at 10:01 am yesterday under the existing shelf system.)	—
8:33 am	**Underwriters make oral** sales **(settlement in T+3 on Day 6).** (This occurred at 10:02 am yesterday under the existing shelf system.)	—
8:34 am	**Underwriters may start sending confirmations to investors (without prospectus supplement).**	Underwriters mail confirmations to all investors with the prospectus supplement.
	—	Prospectus supplement is filed with the SEC via EDGAR under Rule 424 (could also be filed on Day 4).
8:35 am	Working group prepares final prospectus supplement during the course of the day, including Rule 430A information.	—
5:25 pm	Signing directors and officers "read" the post-effective amendment.	—

* If fo r some rea son it is considered desirable in the Fo rm B offer ing not previ ously to f ile the ba sic prospe ctus, rela ted shelf registrati on stateme nt, exhib its and term sheet, the se would a ll have to be filed as part of the regis tration state ment at th is time.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Timing	Form B	Today's Shelf
5:30 pm	Final prospectus supplement (including Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including underwriters' concurrence and accountants' consent).	—
7:30 pm	Accountants deliver to the underwriters their signed comfort letter, as required by the underwriting agreement, covering the prospectus supplement, basic prospectus and all incorporated documents.	—
8:00 pm	Issuer and underwriters authorize printing of the final prospectus supplement, which is dated Day 3, the trade date for sales of the offered securities.	—
Day 4		
9:00 am	Underwriters send hard copies of the prospectus supplement to any investors that have requested it.	—
Day 5		
9:00 am	—	Closing (T+3)
Day 6		
9:00 am	Closing (T+3)	—
Days 4-28		
	File post-effective amendment(s) to update the prospectus supplement if necessary. Signing directors and officers must "read" before filing. Accountants' consent and underwriters' concurrence may be required. Incorporation by reference is *not* permitted.	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Scenario 2: Primary Offering of Equity or Other Securities

A. There will be an active marketing effort, including a one-week road show, and a full underwriting syndicate.

B. There is a high state of readiness (as for the debt shelf take-down scenario).*

1. A universal (or common stock) shelf registration statement covering a sufficient amount of securities is on file and effective.
2. An underwriting agreement is on the "shelf".
3. Forms of comfort letter and opinions are already negotiated.
4. Underwriters' counsel has been designated.

C. For the reasons described above in the Introduction under "Form B Assumptions," the deal size must be fixed in the Form B offering at the beginning of the day of pricing, whereas it does not have to be fixed until the time of pricing at the end of the day under the existing shelf system.

Timing	Form B	Today's Shelf
Day 1		
9:00 am	Issuer selects a managing underwriter and two co-managers from many that have been pitching the business.	
	The three selected investment banks sticker their research to indicate their involvement in the offering.	—
10:00 am	Issuer and underwriters alert issuer's and underwriters' counsel and accountants.	

* For simplicity, this timetable assumes the offering is for common stock. If the offering involves a more novel security, there will have to be extra up-front time spent to develop the necessary documentation and prospectus disclosure to be ready in time for the various on-demand filings.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Timing	Form B	Today's Shelf
11:00 am	Issue r and the three inve stments banks formally confirm to each othe r the a bsence of prior "off ers" at an y time (which wou ld cause t he 15-day look- back of the "offering period" to start earlier t han Day 1) and the absen ce of writ ten "offer ing infor mation" or "free wri ting" in t he past 15 days.	—
	• Participants agree to use only mutually approved material.	
	Issuer and underwriters issue to each other formal written confirmation as to absence of "bad boy" disqualification.	—
	Issuer formally confirms to the under-writers the absence of unresolved SEC comments. Counsel also telephones SEC staff for confirmation.	—

Days 2-9

Working group prepares preliminary prospectus supplement to use for marketing.

Form B	Today's Shelf
• Also prepare any required exhibits	—
• Will be "offering information"	—
• Will include term sheet	—
Working group prepares supplemental written marketing material.	No written marketing material.*
• Intended to be "free writing"	—

Underwriters and issuer prepare road show speeches and slides.

---

* Under the existing shelf system, any written marketing material must be accompanied or preceded by a final prospectus. Even though the registration statement is effective, the prospectus may not be considered final because pricing has not yet occurred. Due to these concerns, no written marketing material other than the preliminary prospectus supplement itself will be used in the offering under the existing shelf system.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	Underwriters and their counsel conduct business and documentary due diligence.*	
	Issuer's accountants begin their procedures required to prepare and issue their comfort letter on the final prospectus supplement, basic prospectus and incorporated documents (including substantive work on the preliminary prospectus supplement).	

Day 9

Timing	Form B	Today's Shelf
9:00 am	Issuer publicly announces quarterly earnings via press release and also files the results with the SEC under cover of a Form 8-K. Summarized quarterly results are also reflected in the preliminary prospectus supplement.	
	• Form 8-K is mandatory and must be filed on Day 9.	• Form 8-K is optional, but practically speaking is required in order to achieve incorporation by reference of full earnings release so that preliminary prospectus supplement may limit disclosure to summary information.
8:00 pm	Issuer, underwriters, counsel and accountants sign off on the preliminary prospectus supplement.	
8:05 pm	Signing directors and officers "read" the preliminary prospectus supplement so their certification will be true.	—

* Because this offering is "marketed and priced" over a period of more than five days, the additional (protective) due diligence guidance included in Rule 176 would not be applicable.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf

Day 10

Timing	Form B	Today's Shelf
9:00 am	Preliminary prospectus supplement and term sheet are filed with the SEC as a post-effective amendment via EDGAR (including managing underwriters' concurrence and accountants' consent).	Preliminary prospectus supplement is filed with the SEC under Rule 424 (could also be filed on Day 11 or 12).
	Writt en marketi ng materia l is filed with the S EC as free writing u nder Rule 425.	—

Issuer files its listing application with NYSE, including a copy of the preliminary prospectus supplement.

10:00 am The r oad show b egins. Th is consist s of meeti ngs in var ious major cities by th e issuer a nd managin g underwri ters with institutio nal invest ors in both group and one-on-one formats. Projectio ns may be part of th e prese ntation ma terial to these inst itutional investors, but will *not* be inclu ded in the prospectu s or other wise discl osed to re tail inves tors.

Timing	Form B	Today's Shelf
	Road show slides will not be used if required to be filed with the SEC as free writing. Instead, presentations (including discussion of projections) would be made exclusively orally.	Road show slides may be used.
	Filed written material may be distributed, but is not required to be distributed.	—

Days 11-16

Road show continues. Syndicate members are invited by the managing underwriters, subject to approval of these additional underwriters by the issuer.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	Each new syndicate member must formally confirm to the issuer and other underwriters the absence of • "bad boy" disqualification • "offers" prior to Day 1 (to ensure "offering period" is not expanded) • use of unapproved "offering information" or "free writing"	—
	Each new syndicate member must sticker its research to reflect its involvement in the offering.	—

Day 16

If re ady, the i ssuer file s its quar terly Form 10-Q repo rt, and an y corre sponding u pdates are worked in to the dra ft of the final pros pectus suppl ement. If the Form 10-Q repor t is not r eady, the issuer, under writers an d counsel confirm th at the fin al prospec tus supple ment (or a special F orm 8-K to be filed today) wil l otherwis e appropri ately refle ct any mat erial deve lopments.

If the offering involves a new class of securities (instead of common stock) that would be exchange-listed:

Form B	Today's Shelf
The Form B filings already also constitute the required Exchange Act registration statement.	Issuer files its Form 8-A with the SEC and exchange, prospectively incorporating the final prospectus supplement.

The exchange certifies to the SEC its approval of the listing, subject to notice of issuance. The Exchange Act registration statement thereby automatically becomes effective.

Day 17

Timing	Form B	Today's Shelf
8:30 am	**Issuer and underwriters agree on tentative deal size, so necessary information can be included in term sheet.** Because a deal cannot be later downsized without disastrous marketing consequences, the parties will err on the side of a smaller deal.	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
9:55 am	Signing directors and officers "read" the post-effective amendment before filing.	—
10:00 am	Term sheet (excluding Rule 430A information) is filed with SEC as a post-effective amendment via EDGAR (including managing underwriters' concurrence and accountants' consent).	—
10:01 am	Underwriters start faxing, e-mailing and mailing the term sheet to investors.	—
	No more incorporation by reference after this point.	—
10:02 am	Underwriters continue their marketing efforts and the lead managing underwriter continues the process of compiling investor interest and managing the order book.	
10:30 am	Issuer, managing underwriters, counsel and accountants work during the day to finalize the final prospectus supplement.	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).
NY125TG:9984.2

Timing	Form B	Today's Shelf
	If any event occurs today that requires changes in the prospectus disclosure:	
	The pricing will likely need to be delayed until tomorrow. Even relatively modest disclosure changes can be expected to require several hours to prepare and be reviewed by the issuer, managing underwriters and counsel.* Examples of these events are: • Regulatory development • Litigation development • Small acquisition • New material contract	The pricing may continue today as scheduled. The prospectus disclosure changes do not need to be finalized and filed until late tonight (or even tomorrow if the underwriters are willing to delay sending confirmations). The disclosures could also be incorporated by reference from a special Form 8-K filing. The underwriters will use their business judgment in deciding whether the event is significant enough to orally disclose to investors when making oral sales.
4:00 pm	Managing underwriters assess the status of the order book and prepare deal size and pricing recommendations for the issuer. As long as the deal size is at least equal to the size used in the term sheet (for the Form B offering) or in the preliminary prospectus supplement (for the shelf offering), there will be no adverse marketing impact. These early deal size indications were intentionally established at conservative levels. Hence, the recommended deal size at pricing will most likely be *greater* than those levels, but in any event should not be smaller.	

* Although not particularly relevant to the timing question, because the disclosure would require preparation and review in any event, it should be noted that subsequent to term sheet delivery incorporation by reference is not permitted, so the full disclosure must be included in the prospectus supplement.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	—	
	If there is s uffic ient deman d to upsiz e the deal , the mana ging under write rs wil l giv e the issu er tw o cho ices: (1) pri ce no w at the s malle r siz e or (2) del ay pr icing unti l tom orrow so t hat rev ised term sheet s can be dis tribu ted t o inv estor s. T he fi rst cho ice m eans compl eting a sm aller off ering than the marke t cou ld sup port. The seco nd ch oice invol ves the risk that adve rse m arket con ditio ns co uld d evelo p the next day and forc e the offe ring to be redu ced, del ayed or ev en ca ncele d. T he rem ainde r of this timel ine a ssume s the issu er pr efers cert ainty and makes the first choice of a smaller off ering pric ed to day.	If there is sufficient demand to upsize the deal, this can readily be done at pricing.
4:25 pm	Signi ng directo rs and off icers "rea d" the p ost-effect ive amendm ent before filin g.	—
4:30 pm	Final prospectu s suppleme nt (excl uding Rule 430A info rmation) i s filed with the SEC as a p ost-effect ive amend ment via E DGAR (incl uding manag ing underw riter's co ncurrence and a ccountants ' consent) . This wi ll inclu de final d eal size, which is n ot Rule 430A infor mation.*	No need to finalize the prospectus supplement until later this evening.
5:00 pm	**Issuer and underwriters agree on the public offering price and underwriting discount.**	**Issuer and underwriters agree on deal size, as well as public offering price and underwriting discount.**

---

* If fo r some rea son it is considered desirable in the Fo rm B offer ing not previ ously to f ile the ba sic prospe ctus, rela ted shelf registrati on stateme nt, exhib its and term sheet, the se would a ll have to be filed as part of the regis tration state ment at th is time.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	—	
5:02 pm	Issuer and the underwriters sign the underwriting agreement and exchange signature pages via fax.	
5:03 pm	Underwriters start making oral sales to as many investors as they can reach by telephone (settlement in T+4 on Day 21).	
5:04 pm	Underwriters start sending confirmations to investors (without prospectus supplement).	—
9:30 pm	Accountants deliver to the underwriters their signed comfort letter, as required by the underwriting agreement, covering the prospectus supplement, basic prospectus and all incorporated documents.	
9:55 pm	Signing directors and officers "read" the post-effective amendment before filing.	—
10:00 pm	Final prospectus supplement (including Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including managing underwriters' concurrence and accountants' consent).	—
10:05 pm	Issuer and managing underwriters authorize printing of final prospectus supplement, which is dated Day 17, the trade date for the first sales of the offered securities.	

Day 18

Timing	Form B	Today's Shelf
9:00 am	Underwriters send hard copies of the final prospectus supplement to any investors who have requested it.	Underwriters mail confirmations to all investors with the final prospectus supplement.
	—	Final prospectus supplement is filed with the SEC via EDGAR under Rule 424 (could also be filed on Day 19).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	—	
	Issuer files a copy of the final prospectus supplement with the NYSE.	

Day 21

9:00 am	Closing (T+4). If the underwriters have decided by Day 20 whether to exercise any part of their 15% overallotment option ("Green Shoe"), then the closing for the sale of those shares may also occur on Day 21.	

Days 18-43

	File post-effective amendment(s) to update the prospectus supplement if necessary. Signing directors and officers must "read" before filing. Accountants' consent and underwriters' concurrence may be required. Incorporation by reference is not permitted.	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

September 9, 1999

Securities and Exchange Commission
450 Fifth Street, N.W., Stop 6-9
Washington, D.C. 20549

Attention: Mr. Jonathan G. Katz, Secretary

Re: File No. S7-30-98

Dear Mr. Katz:

Latham & Watkins is pleased to submit comments on the Aircraft Carrier proposal.[1] Our letter specifically focuses on the proposed repeal of the *Exxon Capital*[2] no-action letter and its progeny and its replacement with registration on proposed Form B for sales to Qualified Institutional Buyers (QIBs). This letter is submitted by Latham & Watkins on behalf of 15 of the nation's leading investment banks.[3] We have joined together because of our similar

[1] The Regulation of Securities Offerings, Securities Act Release No. 7606 (Nov. 3, 1998) as originally published and as amended by Securities Act Release No. 7606A (Nov. 13, 1998) are referred to together as the "Release" or the "Aircraft Carrier."

[2] *Exxon Capital* Holdings Corp., SEC No-Action Letter, 1988 SEC No-Act. Lexis 682 (May 13, 1988). The *Exxon Capital* no-action letter allows an issuer to sell certain securities in a private offering and shortly thereafter register an offering of substantially identical securities in exchange for the privately placed securities.

[3] The alphabetical listing of investment banks participating in the economic study (discussed below) and the preparation of this comment letter are: Banc of America Securities LLC, BancBoston Robertson Stephens Inc., Bear, Stearns & Co. Inc., CIBC Oppenheimer Corporation, Chase Securities

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

experiences in the Rule 144A marketplace and our mutual concerns about the effect of the Release on that marketplace. While we support aspects of the Release, we disagree with the proposal to repeal *Exxon Capital* and replace it with a registration system available only to a select group of issuers. We believe this proposal, if adopted, would substantially increase the cost of capital, without any significant increase in investor protection.

To provide an economic framework for our letter, we commissioned Charles C. Cox of Lexecon Inc.[4] to study trading during the entire Rule 144A / *Exxon Capital* process, from the private placement through secondary trading with particular focus on secondary trading following the *Exxon Capital* exchange offer.[5] The Cox Study shows that typically there is no retail trading after the *Exxon Capital* exchange offer. The study also shows that to the extent there is retail trading after the *Exxon Capital* exchange offer, it averages less than 0.5% of the principal amount issued and just over 1% of the aggregate trading volume.[6] The study is attached hereto.

In addition to describing the study, this letter discusses:

(1) the success and importance of the current market for high yield debt;

(2) the problems that constrained growth in this market prior to *Exxon Capital* and the Commission's adoption of Rule 144A;

(3) why the concerns expressed in the Release and in statements by members of the Commission and its staff with respect to the current system are misplaced, including a detailed discussion of:

Inc., Credit Suisse First Boston Corporation, Donaldson, Lufkin & Jenrette Securities Corporation, Goldman, Sachs & Co., J.P. Morgan Securities, Inc., Lehman Brothers Inc., Merrill Lynch & Co., Morgan Stanley Dean Witter, Paine Webber Inc., Prudential Securities Incorporated and Salomon Smith Barney Inc. These 15 banks also provided all of the trading data for the Cox Study. Each of these investment banks concurs in the recommendations in this letter.

[4] Charles C. Cox is the Senior Vice President of Lexecon Inc., a consulting firm that specializes in the application of economics to a variety of legal and regulatory issues. Mr. Cox served as Commissioner of the Securities and Exchange Commission from 1983 to 1989 and was Acting Chairman of the Commission in 1987. He was also Chief Economist of the Commission from 1982 to 1983. Prior to joining the Commission, Mr. Cox was a professor in the Economics Department at Ohio State University and in the College of Business at Texas A&M University. From 1990 to 1993, Mr. Cox served as Chairman of United Shareholders Association, a nonprofit, nationwide organization that advocates shareholder rights and management accountability to shareholders.

[5] *See* the Cox Study at 5 for a detailed description of the methodology that Mr. Cox used in the study.

[6] *Id.* at 8.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- the predominance of institutions in the Rule 144A market, even following *Exxon Capital* exchange offers, and

- the safeguards that the current system provides to all investors; and

(4) problems inherent with the Aircraft Carrier proposal.

I. THE CURRENT MARKET FOR HIGH YIELD DEBT

As a result of the Commission's actions since 1988, an efficient market for high yield debt has developed where an inefficient market previously existed. In 1988, the staff of the Division of Corporation Finance issued the *Exxon Capital* no-action letter. In 1990, recognizing that registration provided no meaningful benefits to institutions that were already trading among themselves in a large secondary market for privately placed securities, the Commission adopted Rule 144A[7] to provide an exemption from registration under the Securities Act for resales of restricted securities to QIBs. The Rule has the dual benefit of enabling issuers to place debt offerings to institutions on a schedule that meets the issuers' needs, on the one hand, and providing necessary liquidity to institutions to trade among themselves, on the other. A subsequent *Exxon Capital* exchange offer permits institutions that face regulatory and other limitations on the percentage of their portfolio that may be invested in restricted securities to exchange their restricted securities for registered securities with identical terms within a few months of closing. The Rule 144A / *Exxon Capital* framework has replaced 4 (1_) trading and selling securityholder shelf registration.

The Rule 144A / *Exxon Capital* framework has created a vibrant high yield market which facilitates capital raising by entrepreneurial companies and promotes economic growth. This market is dominated by institutions and offers issuers and investors key advantages in liquidity, transparency and efficiency over traditional bank loans and private placements. As a result, this market has grown dramatically. In 1997 alone, companies issued $260.6 billion of debt and equity securities through Rule 144A offerings, of which high yield debt and preferred stock offerings represented more than $100 billion dollars.[8]

[7] Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27928, 55 FR 17933 (Apr. 30, 1990).

[8] Contrast this to 1990 when the total amount of high yield debt and preferred stock issued by companies was $2.1 billion. *See* Exhibit A to the Cox Study. Exhibit A to the Cox Study represents only debt and preferred stock offerings, while the Release contains a preliminary estimate of the 1997 Rule 144A market for both debt and equity securities compiled by the Securities Data Company as set forth in a January 2, 1998 Wall Street Journal article. *See* the Release at 51, n.102, 94. The final number for both debt and equity securities compiled by the Securities Data Company in February 1998 was $260.6 billion.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

II. INEFFICIENCIES AND LIMITATIONS PRIOR TO THE RULE 144A / *EXXON CAPITAL* FRAMEWORK

Prior to the Rule 144A / *Exxon Capital* framework, the high yield market was limited and inefficient in comparison to the current regime. Issuers of corporate debt generally sold their securities pursuant to separate (but typically identical) purchase agreements directly to institutions. This structure developed because issuers needed to deal directly with the institutions to receive appropriate representations, non-distribution and stop-transfer agreements and other assurances that subsequent transfers of the debt securities would not constitute a distribution under the securities laws. Otherwise, the issuer could lose the exemption for the offering. This process was costly for both the issuer and the institution.

Issuers were also required to grant each buyer shelf registration rights for multi-year periods to cover resales. Extended shelf registration rights were necessary to enable institutions, such as mutual funds and insurance companies, to comply with the regulatory limitations on the amount of unregistered securities they could own.

Shelf registration for resale by selling securityholders is inferior to the *Exxon Capital* exchange offer for issuers because[9]:

- the issuer is required to maintain an effective shelf registration statement and continually update the prospectus for a multi-year period to reflect changes in the identities of the selling securityholders and events at the issuer, with all the attendant costs; and
- the issuer, unless it is eligible for short-form registration on Form S-3, must file the information contained in its periodic reports under the Securities Exchange Act of 1934 (the "Exchange Act") as either prospectus supplements or post-effective amendments to the registration statement. [10]

Shelf registration for resales by selling securityholders is also inferior to the *Exxon Capital* exchange offer for institutions because *Exxon Capital* enables institutions to readily obtain freely tradeable securities for regulatory purposes, whereas institutions under shelf registration continue to hold restricted securities until the securities are sold off the shelf. In addition, institutions are unable to offer or sell the securities during "black out" periods or when the registration statement is not current.

---

[9] *See* Section IV of this letter for a discussion of how resale shelf registration is even more impractical under the Aircraft Carrier.

[10] This is especially problematic for high yield issuers that typically experience events giving rise to a need to disclose material information more frequently than investment grade issuers. Often these factors result in the shelf securities not being freely tradeable on a real time basis.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The costs to an issuer of maintaining an effective shelf registration statement for a multi-year period[11] and the costs to an institution of switching its securities from its "restricted basket" to its "unrestricted basket" were often prohibitive. Issuers often utilized other forms of financing in lieu of this costly alternative. The overall result was a much smaller market for institutionally placed corporate debt securities, which were sold at a significantly higher interest rate than registered debt securities of similar tenor and maturity.

An *Exxon Capital* exchange offer is a far more cost-effective alternative and has brought many institutions and issuers into this marketplace. It also enables institutions to purchase more securities, while still complying with applicable regulations. This makes the institutional market for high yield debt more liquid.

The proposed repeal of *Exxon Capital* and its progeny would have the effect of substantially diminishing the current Rule 144A market because most institutions would be unwilling to accept the costs associated with resale shelf registration,[12] especially under the Aircraft Carrier proposal. The Release asserts that the repeal would encourage registration of offerings that otherwise would be made in reliance on Rule 144A.[13] It is unclear why registration is a desirable result because, as the Cox Study demonstrates, QIBs dominate this market and the history of the Securities Act and the related case law show that registration was not intended to protect sophisticated investors that could "fend for themselves."[14] Even assuming that there were benefits of registration in this context, the repeal of *Exxon Capital* would not encourage registration because of the associated high costs and delays. Rather, the repeal would have the unintended result of forcing issuers to exit the U.S. securities markets entirely.[15]

III. THE CURRENT SYSTEM

The following four concerns, which can be derived from the Release and subsequent statements by members of the Commission and its staff, appear to explain the impetus behind the proposal to eliminate *Exxon Capital* exchange offers, despite the absence of any demonstrated harm or abuse:

---

[11] Practical limitations such as the need for audited financial statements of an acquired company or material corporate developments often make the shelf prospectus unavailable.

[12] Salomon Smith Barney Inc.'s capital markets professionals estimate that the elimination of *Exxon Capital* exchange offers could cost issuers 25-50 basis points in interest rate for billions of dollars of their debt. *See* Salomon Smith Barney Inc. / Citibank, N.A. comment letter to the Commission regarding the Aircraft Carrier (June 30, 1999).

[13] *See* the Release at 122.

[14] SEC v. Ralston Purina Co., 346 U.S. 119 at 125 (1953).

[15] *See* Section IV of this letter for a discussion of how the Aircraft Carrier proposal could turn many issuers away from the U.S. securities markets.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- institutions that purchase securities using the Rule 144A / *Exxon Capital* framework are acting as "conduits" for such securities to flow into public markets;

- *Exxon Capital* provides an incentive to avoid registration;

- *Exxon Capital* lacks intuitive sense because it results in registration with the Commission during the exchange offer, rather than at the time of the original issuance of the securities; and

- even if institutions are the only holders of securities in this market, the Commission has never concluded that core protections need not apply in a registered offering because institutions are the purchasers.

We believe that these concerns are misplaced and that the proposed repeal of *Exxon Capital* may result in unintended adverse effects, particularly with respect to access to, and the costs of, capital.

A. INSTITUTIONS AS CONDUITS

First, the concern that institutions purchasing securities using the Rule 144A / *Exxon Capital* framework are acting as conduits to retail investors is not supported by the facts. Institutions are the dominant investors in the initial private placement of high yield debt securities. As required by Rule 144A, resales by the initial purchasers can only be made to QIBs. Thus, institutions continue to be the dominant investors in Rule 144A traded securities at the time of the *Exxon Capital* exchange offer. According to the Cox Study, Rule 144A offerings accompanied by *Exxon Capital* exchange offers accounted for approximately 80% and 84% of the number of issues of all high yield debt and preferred stock in 1997 and 1998, respectively.[16] Trading data analyzed by the Cox Study indicates that in the pre-exchange offer period, institutional and broker/dealer trading averages 99.3% of volume.[17]

More importantly, institutions remain the dominant participants in the aftermarket for securities exchanged in the *Exxon Capital* exchange offer. According to the Cox Study, retail trading after the *Exxon Capital* exchange offer averages less than 0.5% of the principal amount issued and just over 1% of the aggregate trading volume.[18] Moreover, while the trading data indicates that the number of customers and trades increased after the *Exxon Capital* exchange offer, it also indicates that (1) there is a decrease in the trading volume as a percentage of

[16] *See* the Cox Study at 5.

[17] *Id*. at 10.

[18] *Id*. at 8.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

the total amount outstanding following the *Exxon Capital* exchange offer[19] and (2) the retail component remains de minimus throughout pre- and post-exchange trading.[20] Accordingly, there is no evidence in the Cox Study to support the view that retail investors acquire securities issued in *Exxon Capital* exchange offers to any meaningful degree. The institutions that originally purchased such securities in the Rule 144A market are not acting as conduits to the retail market by means of the *Exxon Capital* exchange offer. This conclusion is apparent from the realities of this marketplace. Institutions do not use *Exxon Capital* exchange offers to resell their securities to retail investors. Rather, institutions use *Exxon Capital* exchange offers as an efficient means to place their restricted securities into their "unrestricted basket" for regulatory purposes.

The Release's concern that institutions are acting as conduits to the retail market appears to be a resurrection of the "presumptive underwriter" doctrine. After informally abandoning the doctrine in the 1970s, the staff of the Division of Corporation Finance formally announced the end of the "presumptive underwriter" doctrine in the *American Council of Life Insurance* letter, which stated that "insurance companies and similar institutions generally should not be deemed to be underwriters under Section 2(11) with regard to the purchase of large amounts of registered securities provided such securities are acquired in the ordinary course of their business from the issuer or underwriter of those securities and such purchasers have no arrangement with any person to participate in the distribution of such securities."[21] Given the Commission's goal in the Release to "modernize and clarify" the current regulatory structure, reopening the presumptive underwriter doctrine in the absence of demonstrated abuse does not appear to achieve modernization, nor is it necessary for investor protection.

The limited number of retail investors trading in the secondary market after the *Exxon Capital* exchange offer has the same quantum of publicly available information as purchasers in the aftermarket for initial public offerings in the equity markets. Information is available through EDGAR, and the provisions of Rule 174 under the Securities Act apply just as with other registered offerings. Moreover, these retail investors benefit from the sophistication of QIBs which, because of their dominance of the market, largely determine the trading prices of the securities. Rule 144A offerings are scrutinized by the QIBs that know that, unlike in a registered offering, their securities can only be sold to other sophisticated investors before the *Exxon Capital* exchange offer (and, for all practical purposes, even after that). Additionally, debt

[19] Trading volume was 39.7% before the *Exxon Capital* exchange offer and 16.5% after the *Exxon Capital* exchange offer. *See* the Cox Study at 10. This is consistent with the fact that unlike resale shelf registration, institutions receiving securities in an *Exxon Capital* exchange offer do not have to sell and then repurchase their securities to receive freely tradeable securities.

[20] Trading volume of the retail component was 0.19% in the pre-exchange market and 0.22% in the post-exchange market. The trading periods analyzed for the comparisons in footnotes 19 and 20 are equal numbers of days before and after the *Exxon Capital* exchange offer. *See* the Cox Study at 10.

[21] American Council of Life Insurance, 1983 SEC No-Act. LEXIS 2442 (May 10, 1983).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

securities are typically rated by credit rating agencies that assign standardized ratings, which allow investors to readily measure the securities' price and risk profile against others in its rating class or industry group.

B. AVOIDING REGISTRATION

The second concern, that *Exxon Capital* acts as an incentive to avoid registration, fails to acknowledge that, in all practical respects, the Rule 144A / *Exxon Capital* framework does not differ from registration. High yield issuers prepare their disclosure documents for the Rule 144A offering in contemplation of the *Exxon Capital* exchange offer and, accordingly, prepare a disclosure document that generally conforms to the Commission's requirements for registered offerings. The practice of making the Rule 144A offering memoranda conform in all material respects with the requirements for a prospectus included in a registration statement on Form S-1 is driven by (1) the demands from the QIBs to have all material information, (2) the reputation of the initial purchasers (often investment banks) which typically act as market makers after the Rule 144A offering and (3) liability concerns.[22]

Rather than a scheme to avoid registration, the Rule 144A / *Exxon Capital* framework represents an efficient system that provides full disclosure which benefits both issuers and institutions in a cost-effective manner.[23] The Rule 144A / *Exxon Capital* framework also brings non-reporting companies and foreign issuers into the registration and reporting regime, thereby enhancing investor protection overall by making more information about more companies publicly available. In addition, indentures for debt securities generally require issuers in Rule 144A offerings to become and remain Exchange Act reporting companies, even if the Exchange Act does not require them to do so.

[22] The issuer and the initial purchasers remain subject to liability pursuant to Rule 10b-5 under the Exchange Act. To that end, initial purchasers and their counsel typically perform substantially the same due diligence review of the issuer for a Rule 144A offering that they would for an offering registered with the Commission. The initial purchasers also require the same comfort letters under Statement of Accounting Standards No. 72 from the issuer's accountants and substantially the same so-called "10b-5 assurances" from issuer's counsel and their own counsel as they would in a registered offering.

[23] Rule 144A offerings with *Exxon Capital* exchange offer registration rights are used primarily by issuers to raise capital by accessing the debt markets, not as a "stealth" way to go public. The Release states that since July 1, 1998, one-third of all initial public offerings have been *Exxon Capital* exchange offers. *See* the Release at 253. This is not a fair characterization because this number is almost exclusively debt securities, and the market does not typically view registered offerings of debt securities in the way that it views initial public offerings in the equity markets. Furthermore, debt and equity are different by nature. While debt represents a contractual right to receive interest and repayment of principle, equity represents an ownership interest in the company issuing the equity.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

C. TIMING OF REGISTRATION

The third concern, that *Exxon Capital* does not make intuitive sense because it results in registration at the time of the exchange offer, rather than at the time of the original issuance of the securities, places the timing of the registration process above all other concerns, including efficiency of the market and investor protection. The concern that registration should occur at the time of original issuance presumes that under the Rule 144A / *Exxon Capital* framework the disclosure requirements of registration have not been satisfied. As discussed above, issuers prepare their Rule 144A offering memoranda in a manner that generally complies with the registration statement requirements of the Securities Act. Furthermore, the investors in these offerings are sophisticated institutions that determine for themselves whether they have been provided with sufficient information to make an investment decision. These institutions have the ability to ask for additional information if they believe it is necessary, and the nature of the capital formation process readily ensures that the requests of such institutions will be met. Because the QIBs are already receiving full disclosure by virtue of their buying and bargaining power, just as the Commission anticipated would occur when Rule 144A was adopted, these institutions do not need the protections of registration under the Securities Act. Thus, the timing of registration is not relevant. Moreover, any putative issue with respect to the timing of registration would be outweighed by the benefits that the Rule 144A / *Exxon Capital* framework provides.

There is also a related concern that the *Exxon Capital* exchange offer protects the QIBs that receive registered securities in the exchange offer, but not the investors that purchase securities subsequent to the *Exxon Capital* exchange offer because these investors do not receive a prospectus prior to their purchase. We believe that this concern is flawed because investors that purchase securities in the secondary market following a registered public offering (even under the Aircraft Carrier proposal) do not receive a prospectus prior to their purchase.[24] Purchasers following a registered public offering and purchasers following an *Exxon Capital* exchange offer only obtain full disclosure from the issuer's registration statement which is publicly available on EDGAR.

D. REGISTRATION FOR INSTITUTIONS

A final concern appears to be that even if securities that are sold privately under Rule 144A and exchanged in an *Exxon Capital* exchange offer are held only by institutions, the Commission has never concluded that core protections need not apply in a registered offering

[24] The only exception to this general rule is if the seller of such securities is deemed an underwriter. Institutions that resell their securities (if they do so at all) following an *Exxon Capital* exchange offer are not deemed underwriters because these institutions purchase the securities in the ordinary course of business without a view to a distribution. The *American Counsel of Life Insurance* letter was written in response to just this type of situation and confirmed this point. *See supra* n.21. Therefore, there is no prospectus delivery requirement for these institutions when they resell their securities.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

because institutions are the purchasers. The record does not support this position. In fact, the current Rule 144A / *Exxon Capital* framework, which is based on the premise that institutions are sophisticated and, therefore, do not need the protections provided by registration, is the result of decades of Commission experience in rulemaking, as well as related legislation and case law.[25]

The legislative history of the Securities Act demonstrates that the focus of the Securities Act was the protection of the "average investor." For example, James Landis, a principal draftsman of the House and Senate bills that became the Securities Act, stated that:

> "The sale of an issue of securities to insurance companies or to a limited group of institutional investors was certainly not a matter of concern to the federal government. That bureaucracy, untrained in these matters as it was, could hardly equal these investors for sophistication…"[26]

1. SECTION 4(2)

The ability of institutions to "fend for themselves" has dominated the case law under Section 4(2) of the Securities Act, which provides an exemption from registration if the offering is not a "public offering." In *Ralston Purina Co*.,[27] the Court stated that the availability of the Section 4(2) private offering exemption turns upon "whether the particular class of persons affected need [sic] the protection of the Securities Act." The judicial gloss on the section clarifies that an offeree's sophistication plays an important role in determining whether a transaction involves a public offering. The courts have continually emphasized the importance of the offeree's sophistication, even in construing the applicability of other sections of the Securities Act.[28] The Fifth Circuit's decision in *SEC v. Continental Tobacco Co.*[29] was

---

[25] "Congress and the Commission historically have recognized the ability of professional institutional investors to make investment decisions without the protections mandated by the registration requirements of the Securities Act." Resale of Restricted Securities; Changes to Method of Determining of Holding Period Under Rules 144 And 145, Securities Act Release No. 6806, 53 FR 44016. (Nov. 1, 1998). *See* the remainder of Section III of this letter for a discussion of the highlights of the relevant rulemaking, related legislation and case law.

[26] Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 37 (1959).

[27] *Supra* n. 14.

[28] *See e.g.*, Value Line Fund, Inc v. Marcus, 161 F. Supp. 533 (S.D.N.Y. 1958); Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963); Sorrell v. SEC, 679 F.2d 1323 (9th Cir. 1982); Maldonado v. Dominguez, 137 F.3d 1, 8 (1st Cir. 1998); ACME Propane v. Tenexco, Inc., 844 F.2d 1317, 1321 (7th Cir. 1988).

[29] 463 F.2d 137 (5th Cir. 1972).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

interpreted by some to mean that all offerees in a private placement had to be insiders of the issuer. Commissioner Hugh F. Owens responded by stating that "[I]f such an interpretation were to prevail, it could lead to such a narrowing of the exemption that even an *institutional investor* could not qualify. This is certainly not a conclusion which I can support; in fact, I do not believe it was intended by the Commission."[30] Thus, the private placement exemption from registration is clearly intended to include institutions and is an example of the Commission's longstanding policy toward institutions.

2. REGULATION D

Given the uncertainty in meeting the elements of a private placement exemption under Section 4(2), in 1974 the Commission adopted Rule 146 to provide objective standards for determining when the exemption is available.[31] When Rule 146 proved to be more restrictive than Section 4(2),[32] the Commission adopted Regulation D.[33] Rule 506 of Regulation D, which replaced Rule 146 as a safe harbor under Section 4(2), focuses on purchasers, not offerees, and permits a private placement to "accredited investors"[34] and 35 nonaccredited investors with "knowledge and experience in financial and business matters."

While Rule 506 requires disclosure to nonaccredited investors similar to that provided by a registration statement, the Rule has no specific disclosure requirement for accredited investors. Regulation D assumes that an accredited investor has the bargaining power to secure the necessary information to make an investment decision. Thus, financial sophistication or wealth alone provides a sufficient basis to assume that access to information will be provided. Rule 506 is a good example of the Commission balancing the concern for capital formation[35] with the type of investor involved in an offering.

---

[30] Address by Commissioner Hugh F. Owens before the National Association of Securities Dealers, Inc., *reprinted in* 152 Sec. Reg. & L. Rep. (BNA) G-2 (May 17, 1972).

[31] Notice of Adoption of Rule 146 under the Securities Act of 1933 – "Transactions by an Issuer Deemed Not to Involve any Public Offering, Securities Act Release No. 5487, 1974 WL 14643 (April 23, 1974).

[32] *See, e.g.*, Woolf v. S.D. Cohen & Co., 515 F.2d 591, 612 n.14 (5th Cir. 1975), *vacated and remanded on other grounds,* 426 U.S. 955 (1976).

[33] Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6389, 1982 WL 35662 (Mar. 8, 1982).

[34] The definition of "accredited investor" includes certain banks, investment companies, employee benefit plans, broker-dealers, insurance companies, business trusts, directors or officers of the issuer and natural persons with a net worth of over $1,000,000. The number of accredited investors is of course limited by the concept of general solicitation. *See* Rule 501(a) under the Securities Act.

[35] *See* the adopting release for Regulation D, *supra* n. 33.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

3. 4(1_) EXEMPTION

Prior to the adoption of Rule 144A, the so-called "4 (1_) exemption" was the most popular way for institutions to transfer securities purchased in a private placement to institutions in the secondary market.[36] It is still used for resales to accredited investors. It is a hybrid consisting of (a) a Section 4(1) exemption which exempts transactions by anyone other than an "issuer, underwriter or dealer" and (b) a Section 4(2) analysis to determine whether the seller is an "underwriter," *i.e.*, whether the seller purchased the securities with a view to a distribution. If the resale transaction would meet the requirements of a private placement by an issuer under Section 4(2), which would include sales to sophisticated investors, then the reseller will not be considered an underwriter and can take advantage of the 4(1_) exemption. The Commission's acknowledgment of the validity of the 4 (1_) exemption results from "the recognition that registration of such sales would be an unnecessary burden to the holder and of little practical benefit to the purchaser."[37]

4. SECTION 4(6)

Section 4(6) of the Securities Act exempts transactions involving offers or sales by an issuer solely to accredited investors up to a maximum of $5,000,000. Section 4(6) was added to the Securities Act by the Small Business Investment Incentive Act of 1980, which was designed to help small businesses raise capital. "The rationale underlying the adoption of Section 4(6) is that financial institutions and other sophisticated investors purchasing securities … are 'able to fend for themselves.' "[38]

5. NO-ACTION LETTERS

The *Black Box* and *Squadron Ellenoff* no-action letters[39] confirmed that a private placement to QIBs and/or a limited number of institutional accredited investors would not be integrated with a subsequent initial public offering. Black Box, Inc. stated in its request for no-action that if "the nature of the…purchasers is such that they are capable of fending for

[36] The 4(1_) exemption is far less efficient than Rule 144A because issuers must receive contractual protective measures including initial representations and warranties, transfer restrictions, mandatory legal opinions on transfer and the like to insure that the offering will not retroactively become illegal because of a subsequent "distribution."

[37] C. Porter Vaughn, A Report to the Committee on Federal Regulation of Securities from the Study Group of Section "4(1_)" of the Subcommittee on [the] 1933 Act, *reprinted in The Section "4(1_)" Phenomenon: Private Resales of "Restricted" Securities*, 34 BUS. LAW. 1961, 1962 (1979).

[38] Adoption of Interim Notice-of-Sales Form for Transactions Pursuant to Section 4(6), Securities Act Release No. 6256 at 2, 1980 WL 25728 (Nov. 7, 1980).

[39] Black Box, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 926 (June 26, 1990); Squadron, Ellenoff, Pleasant & Lehrer, SEC No-Action Letter, 1992 SEC No-Act. LEXIS 363 (Feb. 28, 1992).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

themselves and do not need the protections afforded by registration under the Securities Act, then no purpose is served by integrating the offering to such purchasers with the registered offering."[40]

In the *Pacific Mutual Life Insurance Company* no-action letter,[41] the staff confirmed that it would not recommend enforcement action to the Commission in connection with the presentation in the sales literature of certain life insurance companies of hypothetical rates of return in excess of the current recognized maximum rate generally permitted by the NASD and the Commission's staff. The no-action position was based on the representation that the data would only be presented to qualified institutional investors.[42] In the incoming letter, the insurance companies submitted that "the SEC and NASD staffs have implemented a restriction on using rates of return that exceed the recognized maximum rate because…such a rate has the potential to mislead the general public," "…qualified institutional investors do not require this type of protection otherwise intended for the general public" and "…this type of investor is sufficiently sophisticated so that it does not require the protection of a regulatory position under which a certain rate of return is deemed to be per se misleading."[43]

6. RULE 144A AND EXXON CAPITAL

As the culmination of this legislative, rulemaking and judicial experience, in 1990 the Commission adopted Rule 144A to achieve a more liquid and efficient institutional resale market for unregistered securities.[44] "As the Commission determined in adopting Rule 144A, larger institutional investors, or QIBs as denominated in the Rule, are presumed to be sophisticated securities investors. Their investing experience and size purportedly puts them in a position to insist on as much information as would be provided by registration. Also their size, which may be viewed as signifying buying and bargaining power, should allow them to demand from issuers protective covenants and restrictions. In other words, their sophistication enables them to fend for themselves."[45] Similarly, the *Exxon Capital* no-action letter was based on the premise that the securities exchanged in reliance on those letters would trade predominately among institutions. Although decades of experience have led to what is today the thriving Rule 144A / *Exxon Capital* framework, the Release is proposing the repeal of *Exxon Capital*, which

[40] Black Box, Inc., at 43-44.

[41] Pacific Mut. Life Ins. Co., SEC No-Action Letter, 1990 WL 286907 (Aug. 31, 1990).

[42] Defined in the no-action letter as any non-natural person having $100 million or more in assets. *Id.* at 5.

[43] *Id. at 13*.

[44] *See* the adopting release for Rule 144A, *supra* n. 7.

[45] The Release at 47.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

will, in turn, severely impair the Rule 144A marketplace. This proposal is being made in the absence of any demonstrated harm or abuse with respect to investor protection.

It is difficult to fathom an unsophisticated investor with $100.0 million in securities under management. The QIB threshold is far greater than the accredited investor threshold under Regulation D. Furthermore, as we discussed in Section III.B above, institutions are already being provided with full disclosure under the Rule 144A / *Exxon Capital* framework, substantially equivalent to that provided in a registration statement. QIBs are given access to far more information than Rule 144A requires. In fact, many comment letters in response to the proposal of Rule 144A opposed the "disclosure-on-request" requirement,[46] the only informational requirement in the Rule,[47] which states that the issuer must provide the QIB with certain very limited disclosure upon request. These comments focused on the fact that QIBs should be able to fend for themselves. Thus, the current Rule 144A / *Exxon Capital* framework already provides institutions with adequate disclosure for both the initial purchase and the subsequent trading.[48]

IV. THE AIRCRAFT CARRIER'S PROPOSAL

The Aircraft Carrier's proposal to repeal *Exxon Capital* and adopt Form B registration would not work as well as the current system because:

- Form B would not be available to all of the issuers that currently use the Rule 144A / *Exxon Capital* framework, only to "seasoned" issuers;[49]
- the "coming to rest" aspect of Form B offerings would deter companies from utilizing Form B for sales to QIBs for fear of Section 5 liability, including rescission remedies;
- reinstitution of the "presumptive underwriter doctrine" would deter institutions from purchasing a large amount of securities in Form B offerings;

---

[46] *See* Rule 144A(d)(4).

[47] Other than the applicability of Rule 10b-5 liability which promotes adequate disclosure.

[48] Even though retail investors are able to acquire the securities subsequent to the *Exxon Capital* exchange offer, they have the benefit of the publicly available registration statement, to the same extent they would after any other public offering.

[49] "Seasoned" issuers for the purposes of Form B for sales to QIBs would be those with a one-year reporting history that have filed an annual report under the Exchange Act.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- shelf registration to register restricted securities for resale would be impractical under the Aircraft Carrier proposal, irrespective of the availability of Form B; and
- an entire category of issuers that are currently filing reports under the Exchange Act as a result of *Exxon Capital* might never become Exchange Act reporting companies.

A. LIMITED AVAILABILITY OF FORM B

Only "seasoned" issuers would be eligible to use Form B for sales to QIBs. According to the Cox Study, approximately 51% of the issuers currently relying on *Exxon Capital* exchange offers are not "seasoned" issuers.[50] These issuers would be required to utilize Form A, which would be subject to staff review. Review necessarily entails delay compared to the Rule 144A / *Exxon Capital* framework, which could result in additional costs for issuers as a result of either (a) increased interest rates for missing market windows or (b) increased costs associated with the inability to access the capital markets within the necessary time frame.[51]

B. "COMING TO REST" UNDER FORM B

Even issuers that qualify for Form B would bear significant burdens because eligibility for registration on Form B would be lost retroactively if the offered securities did not "come to rest" in the hands of QIBs. In that event, the offering would violate Section 5 of the Securities Act and purchasers would have a cause of action for rescission under Section 12(a)(1) of the Securities Act. Issuers would either forego registration in favor of an alternative means of financing or adopt costly contractual protective measures not unlike those commonly used to police 4(1_) transactions. Thus, the costly and unnecessary measures Rule 144A was adopted to short-circuit would be reinstated under the Aircraft Carrier proposal, if adopted.

C. REINSTITUTION OF THE "PRESUMPTIVE UNDERWRITER" DOCTRINE

Although in 1983 the staff of the Division of Corporation Finance successfully ended institutions' concerns with the "presumptive underwriter doctrine,"[52] the adoption of the Aircraft Carrier would resurrect these concerns. A QIB deemed to be a conduit would be viewed as participating in a distribution under Section 2(11) of the Securities Act. In the absence of clarity as to their status, the institutions might forgo purchasing securities in Form B offerings

---

[50] *See* the Cox Study at 7.

[51] For example, we would expect costly bridge loan financing to increase dramatically if acquisitions could no longer be timely financed by accessing capital markets.

[52] *See supra* n.21.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

rather than devoting time, effort and expense in analyzing whether they would be deemed to be an underwriter as was done prior to the *American Council of Life Insurance* letter.

D. DIFFICULTIES WITH SHELF REGISTRATION

If Form B were not available, we believe that many companies would elect to avoid the time and expense associated with staff review by raising capital elsewhere.[53] This is because without *Exxon Capital*, registration of the restricted securities issued in private transactions could only be achieved through resales under effective resale registration statements. Resale registration under the Aircraft Carrier would be impractical because of the concerns mentioned in Section II above as well as the newly-proposed requirement that the issuer file a post-effective amendment for each resale.[54]

Rather than providing purchasers of privately placed securities with registration rights, companies may require these purchasers to rely on Rule 144A, 4(1_) and Rule 144 of the Securities Act[55] for resale of securities acquired in private placements. As a result, the cost of capital would be substantially increased because the pricing terms would include a premium. Issuers that could not afford these added costs would lose access to the securities markets entirely if there were no means of ensuring the exchange of restricted securities into unrestricted securities in a manner comparable to the Rule 144A / *Exxon Capital* framework. There would also be less capital available for the purchase of restricted securities because institutions would quickly reach the maximum on the amount of securities that they could hold in their restricted basket. This decrease in liquidity among QIBs would also have a negative effect on pricing.

E. LOSING NON-REPORTING AND FOREIGN ISSUERS FROM THE REPORTING REGIME

As a result of the Rule 144A / *Exxon Capital* framework, many companies and foreign issuers that are not otherwise required to do so file reports under the Exchange Act. Of the 447 companies that issued high yield securities in 1997 using the Rule 144A / *Exxon Capital* framework, 233 of the companies began as non-reporting companies and approximately 185 or 79.4% of these former non-reporting companies remain reporting companies today.[56] Without

---

[53] Many borrowers would be forced to turn away from the U.S. securities markets and raise capital through other options including: commercial bank loans (which are often not available, especially to new companies that do not have the requisite collateral to secure such loans), bridge loans followed by a post-closing registered offering, offshore financing pursuant to Regulation S and private financing without registration rights.

[54] This requirement would result in either (1) underwritten secondary offerings in which all the securities are sold at a lower price in view of the volume of securities being offered at one time or, more likely, (2) institutions avoiding resale shelf registration altogether.

[55] Rule 144 generally allows holders to resell restricted securities one year following the date the securities were acquired from the issuer or an affiliate of the issuer.

[56] *See* the Cox Study at 8.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exxon Capital, many non-reporting and foreign issuers would never enter the Exchange Act reporting regime because Form B would not be available and because of the time and expense associated with: (1) Form A registration or (2) shelf registration as proposed under the Aircraft Carrier. These issuers would pursue private placements without registration rights or other options outside of the U.S. securities markets,[57] resulting in an overall decrease in investor protection due to a decrease in publicly available information about companies with outstanding securities. In contrast to the Aircraft Carrier proposal, not only does the Rule 144A / *Exxon Capital* framework encourage issuers to access the U.S. securities markets, it acts as an incentive for issuers to become Exchange Act reporting companies and it keeps these issuers in the Exchange Act reporting regime.

Furthermore, registration of the initial sale of securities (whether on Form B or otherwise) would not increase delivery of prospectuses to non-institutional investors. Institutions dominate the Rule 144A market, and as the Cox Study demonstrates, institutions remain the dominant investors in the Rule 144A market following the *Exxon Capital* exchange offer. Presumably, institutions would continue to account for the overwhelming majority of initial purchases under the Aircraft Carrier proposal. As we stated earlier, investors in the secondary market do not, and after the expiration of the applicable prospectus delivery requirement under the Aircraft Carrier proposal would not, receive an updated prospectus in connection with their purchases. They would only obtain full disclosure from the issuer's filings available to the public on EDGAR. Requiring high yield issuers to register the initial sale of these securities would have no impact on the information available to retail or other investors which purchase in secondary market transactions.

V. CONCLUSION

The Rule 144A / *Exxon Capital* framework is the result of decades of Commission effort to maximize the efficiency of the private placement marketplace consistent with investor protection. Today, we have a vibrant and efficient marketplace for high yield debt. Therefore, we recommend that the current system be preserved and *Exxon Capital* and its progeny be retained. Without *Exxon Capital*, many issuers would not be able to use Rule 144A because of the costs and burdens associated with resale shelf registration, especially resale shelf registration as proposed in the Release. These issuers would be forced to consider other less viable options, with all of their respective attendant costs. These options are unnecessary because the trading that occurs in the Rule 144A marketplace, even after the *Exxon Capital* exchange offer, is dominated by institutions which do not need the benefits of registration. Registration in this context only burdens capital formation with added costs. These costs outweigh any benefits registration could provide, given the institutional nature of the purchasers in this market. While

[57] *See supra* n. 53.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

there are a few "retail" investors in this market,[58] they are adequately protected by the registration statement available on EDGAR and the sophistication of QIBs and ratings agencies that scrutinize the high yield offerings.

In summary, we do not believe the current system is "broken." Therefore, we respectfully submit that regulatory change is neither necessary nor appropriate to protect investors and would, if adopted, have adverse effects on capital formation.

[58] While retail investors typically purchase certain fixed-income securities like U.S. Treasuries and municipal bonds, they are averse to high-yield securities that offer less liquidity and price transparency. *See* William Pesek Jr., *Bonds, Those High-Brow Instruments for Investment, Slowly Become Popular with the Retail Crowd,* Barron's (June 28, 1999).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

We are pleased to have had this opportunity to provide you with our comments on the Aircraft Carrier. If you have any questions concerning this letter, please contact either Kirk A. Davenport at (212) 906-1284 or John J. Huber at (202) 637-2242.

Sincerely,

/s/ Latham & Watkins

Attachment: Report of Charles C. Cox
of Lexecon Inc.

cc: The Honorable Arthur Levitt
The Honorable Norman S. Johnson
The Honorable Isaac C. Hunt, Jr.
The Honorable Paul R. Carey
The Honorable Laura S. Unger
Brian J. Lane, Esq.
Richard H. Walker, Esq.
Harvey J. Goldschmid, Esq.
Anita T. Klein, Esq.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

REPORT OF CHARLES C. COX
OF
LEXECON INC.

I. QUALIFICATIONS

1. I am a Senior Vice President of Lexecon Inc., a consulting firm that specializes in the application of economics to a variety of legal and regulatory offerings. Among the staff and professional affiliates of Lexecon are several prominent academics (including three recipients of the Nobel Prize in economics) and a group of full-time economists, accountants, computer programmers, and research assistants.

2. I served as a Commissioner of the U.S. Securities and Exchange Commission ("SEC") from 1983 to 1989 and was Acting Chairman of the SEC in 1987. During this time, I was responsible for enforcing and interpreting the federal securities laws. I was Chief Economist of the SEC from 1982 to 1983 when I was responsible for analyzing the economic effects of proposed rules and legislation, and for evaluating established SEC policy.

3. I was a professor in the Economics Department at Ohio State University and in the College of Business at Texas A&M University before joining the SEC. My research and teaching focused on the regulation of economic activity and on the operation of financial markets. I have published numerous articles on financial markets and securities regulation.

4. I served from 1990 to 1993 as Chairman of United Shareholders Association, a nonprofit, nationwide organization that advocated shareholder rights and management accountability to shareholders.

5. I am a member of the American Economic Association.

6. I have testified as an expert financial economist in the Northern District of Illinois, the Southern District of New York, the Western District of Michigan, the District of New Jersey, the Southern District of California, the State of Minnesota (County of Mower), the Com-

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

monwealth of Pennsylvania (Berks County), an SEC Administrative Proceeding, before the NASD Market Regulation Committee, and before Congress.

II. INTRODUCTION AND SUMMARY OF CONCLUSIONS

7. The SEC rulemaking proposal commonly called the Aircraft Carrier proposes numerous fundamental changes to the regulatory framework underlying the Securities Act and the Exchange Act. SEC Release No. 33-7606 (November 3, 1998) as originally published and as amended by SEC Release No. 33-7606A (November 13, 1998), referred to together as the "Release". One of the proposed changes would eliminate the *Exxon Capital* line of no-action letters.[1] Under Rule 144A and the *Exxon Capital* line of no-action letters, issuers privately place unregistered high yield securities with Qualified Institutional Buyers ("QIBs") and agree under customary registration rights agreements to subsequently exchange such securities for identical registered securities in an *Exxon Capital* exchange offer. *Exxon Capital* exchange offers enable issuers to obtain the certainty and speed of a private placement in raising capital while avoiding the price discount that typically accompanies a restricted private offering. Put differently, *Exxon Capital* exchange offers provide issuers with the benefits of a private placement without the costs. If, as proposed in the Aircraft Carrier, *Exxon Capital* were repealed, *Exxon Capital* exchange offers would be eliminated. The SEC has proposed that certain "seasoned" issuers could use new registration procedures as a substitute for *Exxon Capital* exchange offers; however, non-public and small companies that do not qualify as "seasoned" issuers could not use these new registration procedures.

8. In proposing to repeal the *Exxon Capital* line of no-action letters, the SEC emphasized that the basic premise underlying the Staff's original no-action position was that the securities exchanged in reliance on *Exxon Capital* would remain in the institutional investor

---

1. *Exxon Capital Holdings Corp*., SEC No-Action Letter, 1988 SEC No-Act. Lexis 682 (May 13, 1988). The *Exxon Capital* no-action letter allows the exchange of certain privately issued securities for identical registered securities.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

secondary market. Release 7606A, n251. According to the SEC, elimination of *Exxon Capital* is appropriate because non-QIBs need additional protections in offerings by unseasoned issuers. Release 7606A, p. 212.

9. Latham & Watkins, counsel for a group of leading investment banks in the high yield market,[2] asked me to analyze the economic evidence pertaining to issuers and investors in high yield securities that were issued under Rule 144A and subsequently exchanged through *Exxon Capital* exchange offers. I selected 102 of the 566 Rule 144A high yield offerings completed in 1997 as my sample. I reviewed the sample from a number of perspectives. First, I determined the percentage of "seasoned" issuers that would qualify for registering high yield securities on the SEC's proposed Form B.[3] Then I investigated the trading after the privately placed high yield securities were exchanged for registered securities ("post-exchange trading") to quantify the trading by QIBs, other institutions, broker-dealers, and retail investors. I have reviewed the Aircraft Carrier Release and various publicly available sources of data on the high yield securities market. In addition, I have collected non-public data from the investment banks to analyze trading in high yield securities before and after *Exxon Capital* exchange offers. Based on my review and analysis and on my knowledge and experience, I have reached the following principal conclusions:

- Rule 144A offerings accompanied by *Exxon Capital* exchange offers are currently the predominant method of issuing high yield securities;
- Approximately 51% of high yield issuers who use *Exxon Capital* exchange offers are not "seasoned" issuers that would qualify for Form B registration under the Aircraft Carrier's proposals; and

---

2. B of A Securities LLC, BancBoston Robertson Stephens Inc., Bear, Stearns & Co. Inc., CIBC Oppenheimer Corporation, Chase Securities Inc., Credit Suisse First Boston Corporation, Donaldson, Lufkin & Jenrette Securities Corporation, Goldman, Sachs & Co., J.P. Morgan Securities, Inc., Lehman Brothers Inc., Merrill Lynch & Co. Inc., Morgan Stanley & Co. Incorporated, PaineWebber Incorporated, Prudential Securities Incorporated, and Salomon Smith Barney Inc.

3. Under the SEC's proposal, issuers that have a one-year reporting history and have filed an annual report under the Exchange Act would be "seasoned" issuers that could use Form B. Form B would allow those issuers to "file and go" without SEC review under certain circumstances.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

_ Retail investors' purchases through post-exchange trading average approximately 1% of volume and 0.5% of the amount issued.

In the remainder of this report I summarize the bases for these conclusions.

III. RULE 144A OFFERINGS ACCOMPANIED BY *EXXON CAPITAL* EXCHANGE OFFERS ARE CURRENTLY THE PREDOMINANT METHOD OF ISSUING HIGH YIELD SECURITIES

10. Since 1989-90, the high yield securities market has grown into a significant and active source of capital for U.S. businesses. Exhibit A shows that in 1990 there were only 13 new offerings of high yield securities for a total amount of $2.15 billion. By 1998, however, that market had grown to 692 offerings totaling $150.63 billion, representing an average annual growth rate of 93% in number of offerings and 103% in principal amount of financings.

11. As the market for high yield securities grew, securities offered pursuant to Rule 144A came to dominate the market. There were no Rule 144A offerings of high yield securities during 1990-91, and in 1992 there were 18 different offerings totaling $2.2 billion or less than 5% of the principal amount of high yield securities issued that year. By 1998, 583 Rule 144A offerings totaled $121.6 billion or more than 80% of the high yield securities issued.[4] See Exhibit A.

12. Virtually all Rule 144A offerings of high yield securities include registration rights in the form of a contractual provision for a future exchange of the privately placed securities for registered securities.[5] Thus, Rule 144A offerings accompanied by *Exxon Capital*

---

4. The SEC states that companies raised approximately $254 billion through 144A offerings in 1997. See Release 4606A at 51, n102. The $254 billion is a preliminary figure, compiled by Securities Data Co. (SDC) and published January 2, 1998 in the Wall Street Journal, that includes stock as well as high yield securities. The final number as released by SDC on February 25, 1998 is $260.6 billion.

5. My understanding that virtually all Rule 144A high yield securities offerings include an *Exxon Capital* exchange offer component is based on discussions with personnel at the various investment banks that provided data for this study. In addition, I confirmed that 517 or 91% of the 566 offerings of Rule 144A high yield securities in 1997 consummated an *Exxon Capital* exchange offer.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

exchange offers accounted for approximately 80% and 84% of the number of offerings of all high yield securities in 1997 and 1998, respectively.

13. For my empirical analyses, I used a sample of high yield securities offered in 1997 pursuant to Rule 144A and followed by an *Exxon Capital* exchange offer in which the privately placed securities were exchanged for the registered securities. I selected the sample from 1997 to provide ample time after the offering date for the *Exxon Capital* exchange offer to occur and for post-exchange trading to develop. Fifteen investment banks provided data on the original Rule 144A offering and post-exchange trading for my study.[6] See Exhibit B. These investment banks were lead-managers for 369 (71%) of the 517 Rule 144A high yield offerings in 1997 for which I have identified subsequent *Exxon Capital* exchange offers. These 369 deals accounted for 71% of the total value of Rule 144A offerings during 1997. Of the investment banks that lead-managed Rule 144A offerings in 1997, no single bank accounted for more than 10% of the number or total principal amount of 1997 Rule 144A high yield offerings.

14. I selected a stratified random sample of 102 high yield securities offerings lead-managed by the participating investment banks from a universe of 331 offerings lead-managed by these firms in 1997.[7] The sample was stratified in proportion to the participating investment banks' share of this market in 1997.[8] Exhibit B summarizes this random sample. The sample represents approximately 18% of all Rule 144A high yield securities offerings completed in 1997 and 28% of the high yield securities offerings in 1997 for which the 15

6. Although 16 investment banks agreed to participate in the study, two of the investment banks, B of A Securities LLC and NationsBanc Montgomery Securities LLC, merged before the data were collected. Consequently, 15 investment banks provided the data.

7. I excluded 38 of the 369 *Exxon Capital* exchange offers before selecting the sample because 20 did not have a full year of post-exchange trading prior to July 1, 1999 and 18 had other complications such as the security being issued as part of a unit.

8. If one investment bank was lead-manager for 15% of all offerings in 1997, then 15% of the sample was selected from deals lead-managed by that investment bank in that year. If another investment bank was lead-manager for 2% of all 1997 offerings, then 2% of the sample was selected from that investment bank. Due to rounding and the fact that offerings are whole numbers, the percentages selected are approximates.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

participating investment banks were lead-managers. I chose an initial sample with at least 100 offerings to ensure enough observations to adequately support statistical inferences drawn from the empirical analysis even if unforeseen data problems kept some of these transactions from being included in the final sample. From my analysis, I have found no reason to believe that the high yield securities offerings managed by the 15 investment banks that provided data differ from the offerings managed by other banks in any material respect. Consequently, I am confident that the statistics yielded by this sample accurately represent the characteristics of the universe of high yield securities offered under Rule 144A and subsequently exchanged under an *Exxon Capital* exchange offer.

15. I requested trading data (CUSIP, issuer, issue description, coupon, maturity, trade date, customer name, buy/sell, price, and quantity) for each of the 102 offerings from all of the participating investment banks. Because these data are proprietary and confidential for each investment bank, I agreed to keep all of the data strictly confidential. Nevertheless, four investment banks provided customer categories rather than specific customer names.[9] I asked each investment bank to classify customers as QIB, other institution, broker-dealer or retail. As the data were received, I reviewed them for consistency and anomalies.

16. The final sample for the analysis of post-exchange trading consists of data for 83 of the 102-offering random sample. Of the 102 offerings for which trading data were requested, 13 offerings were eliminated because three investment banks did not provide all of their data by the analysis deadline. Another six offerings were eliminated for a variety of reasons: I found that three offerings were not actually high yield debt securities, two offerings were never registered, and one offering was not exchanged because the issuer filed for bankruptcy. To standardize the sample, I analyzed the one-year period following each offering's exchange consummation date.

9. Four investment banks provided classifications of each of their trades within categories such as QIB, other institution, broker-dealer.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

IV. APPROXIMATELY 51% OF HIGH YIELD ISSUERS WHO USE *EXXON CAPITAL* EXCHANGE OFFERS ARE NOT "SEASONED" ISSUERS THAT QUALIFY FOR FORM B REGISTRATION UNDER THE AIRCRAFT CARRIER'S PROPOSALS

17. I investigated each of the issuers in the sample of 102 deals to see how many were "seasoned" issuers (as defined in the Aircraft Carrier). Approximately 51% of the issuers (50 of 98 issuers) were not qualified as "seasoned" issuers at the time of their Rule 144A offering.[10] See Exhibit C. In terms of value, the 53 offerings by issuers that do not qualify as "seasoned" issuers totaled $9.6 billion (47% of the sample's value), and the 49 offerings by "seasoned" issuers totaled $10.6 billion (53% of the sample's value).

18. I used a three-step methodology to determine whether or not an issuer is a "seasoned" issuer. From the Center for Research in Security Prices ("CRSP") stock trading data set, I determined all the issuers that had publicly traded securities on a U.S. national securities exchange or the Nasdaq Stock Market for at least one year prior to the earliest Rule 144A offering date. I classified all of these issuers as "seasoned" issuers. For the remaining issuers, I searched the Disclosure Inc. data set of SEC filings to determine the first date any publicly traded security was registered and compared that registration date to the Rule 144A offering date. I classified all of the issuers with a security registered more than one year before the offering date as "seasoned" issuers. Finally, I checked to see that each registered issuer had filed an annual report under the Exchange Act within one year of the Rule 144A offering date.

19. These empirical results show that approximately half of the issuers currently relying on *Exxon Capital* exchange offers are not "seasoned" issuers.[11] For these

---

10. The sample contains 102 offerings, but four of the 102 issuers each have two offerings of high yield debt that are in the sample. Hence, there are 98 different issuers in the sample.

11. The point estimate is 51%. For the 369 *Exxon Capital* exchange offers, a 95% confidence interval is 47–55%. That is, at the 95% confidence level, the true percentage of issuers failing to qualify as seasoned issuers is between 47% and 55%.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

issuers, the alternative of registering high yield debt on Form B as suggested in the Aircraft Carrier would not be a feasible substitute.

20. After reviewing the preceding statistics, Counsel asked me to calculate additional statistics for the 517 Rule 144A issues offered in 1997 that completed *Exxon Capital* exchange offers. For these offerings, 233 or 52.1% of the 447 issuers were non-reporting companies at the time of their Rule 144A offering, and 185 or 79.4% of the 233 remain reporting companies as of the date of this study.

V. RETAIL INVESTORS' PURCHASES THROUGH POST-EXCHANGE TRADING ARE APPROXIMATELY 1% OF VOLUME AND 0.5% OF AMOUNT ISSUED

21. Trading data from the post-*Exxon Capital* exchange offer periods show that retail investors on average acquire less than 0.5% of the registered securities even though there are no restrictions on selling to retail investors at that time. Almost all of the post-exchange trading is between institutional investors. Typically, there is no post-exchange trading by retail investors, and on average retail investors account for just over 1% of the trading volume. Moreover, the total volume of post-exchange trading is less than one-third of the securities' amounts outstanding. Overall, there is minimal participation by retail investors in the high yield securities market – retail investors account for little of the trading volume and acquire only a small portion of the amounts outstanding through that trading.

22. Statistics characterizing the volume of post-exchange trading are presented in Exhibit D.[12] On average, retail investors account for 1.21% of volume. The median retail volume, however, is 0.04% -- for 42 offerings there is no retail trading at all.[13] Maximum retail trading is 26.2% of volume in one offering, the only offering above 8%, and retail trading exceeds 5% of the trading volume for only 5 offerings. In contrast, QIB trading averages

12. The trading data analyzed in this report are purchases by customers from the participating investment banks. Consequently, "trading volume" refers to the volume of purchases.

13. For three offerings, there is no post-exchange trading at all. For 39 offerings, there is no post-exchange trading by retail investors, but there is trading by other classes of investors. The trading statistics presented in ¶ 22 and Exhibit D are based on the 80 offerings in which there is trading.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

74.7% of volume and there are 13 offerings in which QIBs account for 100% of trading volume. The median QIB volume is 82.3%. Other institutional investors and broker-dealers average 8.4% and 15.7% of volume, respectively. Thus, QIBs, other institutions and broker-dealers account for approximately 99% of post-exchange trading volume.[14]

23. Some of the 15.7% of volume attributed to broker-dealers could end up in accounts of retail investors. I was unable to trace this trading to the accounts of ultimate investors. If all of the broker-dealer purchases were attributed to retail investors, the percentage of volume for retail customers would be approximately 17%. However, it is unlikely that such a percentage of trading by broker-dealers would have passed through to retail accounts. This conclusion is based on my analysis of the trading data provided by the participating investment banks. For example, Merrill Lynch & Co., a participating investment bank that has a large retail component in its broker dealer operations, traces less than 0.5% of high yield securities trading to retail accounts. After discussions with investment banks participating in the study, there is no reason to believe that the retail component for other broker-dealers would differ materially from the Merrill Lynch experience.

24. Exhibit E presents statistics that summarize the volume of post-exchange trading relative to the outstanding amount of each offering. The volume of trading averages 33.1% of the outstanding offering. For three offerings, there is no post-exchange trading at all. For the other 80 offerings with post-exchange trading, the volume of trading averages 34.3% of the total offering amount. The range of volume to offering amount is 0.08% to 115%.[15]

---

14. One investment bank classified trades only as retail or institutional. I checked to see how this classification affects the empirical results and found that they are not significantly different. The percentage of trading by QIBs increases to approximately 81% and trading by other institutions decreases to approximately 3%.

15. It is possible that there is trading in the sample offerings that is not captured by my empirical analysis because there could be some trading through investment banks that did not participate in this study. Therefore, the total trading relative to the amount outstanding could be larger than reported here. Although it is appropriate to consider this qualification in interpreting the empirical results, it is, in my opinion, unlikely to be a significant problem. First, the lead-manager for each offering is included in the sample and the lead-managers' records generally contain most of the trading data. Second, post-exchange purchases by

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

25. In light of the modest trading relative to the offering amounts, retail acquisitions average 0.47% of the amounts outstanding. The maximum percentage of any single offering acquired by retail investors is 11.2%, and retail acquisitions exceed 2% of the outstanding amounts for only four offerings. Even trading by QIBs, other institutions, and broker-dealers (which account for 99% of trading volume) effects only a modest reallocation among holders of the securities. The average trades relative to amounts outstanding for QIBs, other institutions and broker-dealers are 23.2%, 3.4%, and 6.0% percent, respectively. <u>See</u> Exhibit E.

26. For comparison, I computed statistics for pre-exchange trading under Rule 144A.[16] In the pre-exchange period, institutional and broker-dealer trading averages over 99.3% of volume. While the trading data indicate that the number of customers and trades increased after the *Exxon Capital* exchange offer,[17] they also indicate that: i) there is a decrease in the trading volume as a percentage of the total amount outstanding following the *Exxon Capital* exchange offer (39.7% in the pre-exchange market vs. 16.5% in the post-exchange market); and ii) the retail component remains de minimus (0.19% in the pre-exchange market vs. 0.22% in the post-exchange market).

(...continued)
retail investors are so small that even doubling the retail purchases would not change my conclusion that retail purchases are negligible. Third, the provision of data by 15 of the leading investment banks should accurately reflect the universe of market participants trading in high yield securities.

16. The trading periods analyzed for this comparison are equal numbers of days before and after the *Exxon Capital* exchange offers.

17. The number of customers more than doubled, while the number of trades increased by approximately one-third.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exhibit A

High Yield Debt and Preferred Stock Offerings 1990-1998

	Rule 144A		Total		%	
Year	#	Value ($MM)	#	Value ($MM)	#	Value ($MM)
1990	0	0.00	13	2,146.94	0	0.0
1991	0	0.00	58	12,306.05	0	0.0
1992	18	2,228.55	269	45,596.43	6.7	4.9
1993	119	20,444.62	446	78,364.53	26.7	26.1
1994	69	8,166.75	242	42,317.34	28.5	19.3
1995	92	16,503.80	228	45,818.02	40.4	36.0
1996	217	38,486.74	384	72,623.40	56.5	53.0
1997	566	104,053.38	705	133,054.43	80.3	78.2
1998	583	121,600.90	692	150,634.31	84.2	80.7

Source: Donaldson, Lufkin & Jenrette Securities Corporation

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exhibit B

Investment Banks Participating in Study
Number of 1997 Lead-Managed 144A High-Yield Deals Selected

	Investment Bank	Total Number of Deals Lead Managed		Number of Deals Selected	
		#	Value ($MM)	#	Value ($MM)
1	B of A Securities LLC[1]	17	2,335.00	7	1,025.00
2	BancBoston Robertson Stephens Inc.	2	210.00	2	210.00
3	Bear, Stearns & Co. Inc.	39	7,711.03	10	2,444.00
4	CIBC Oppenheimer Corporation[2]	0	0.00	0	0.00
5	Chase Securities, Inc.	42	7,904.00	11	2,030.00
6	Credit Suisse First Boston Corporation[3]	28	3,977.41	7	995.00
7	Donaldson, Lufkin & Jenrette Securities Corp.	59	10,571.58	15	2,807.00
8	Goldman, Sachs & Co.	30	7,598.30	8	1,992.00
9	J.P. Morgan Securities, Inc.	17	3,327.65	4	725.00
10	Lehman Brothers Inc.	15	2,839.00	4	640.00
11	Merrill Lynch & Co. Inc.[3]	45	9,405.99	12	3,312.22
12	Morgan Stanley Dean Witter[3]	33	9,894.66	8	1,740.00
13	PaineWebber Incorporated	1	60.00	1	60.00
14	Prudential Securities Incorporated[3]	3	315.00	2	200.00
15	Salomon Smith Barney Inc.	38	7,381.09	11	2,002.00
		369	73,530.72	102	20,182.22

Note: Number selected is not exactly proportional due to rounding and availability of trading data.

(1) B of A Securities LLC and NationsBanc Montgomery Securities LLC were both participants in this study prior to Bank of America's acquisition of Nations Bank, NA.

(2) CIBC Oppenheimer joined late and was not included in sample selection, but did provide trading data included in the study.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

(3) Provided classifications of customer account names rather than actual customer account names.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exhibit C

Non-Seasoned Issuers

	Issuer	Offering Date	Exchange Consummation Date	Par Value of Offering ($MM)	% of Total Par Amount Offered
1	Ainsworth Lumber	07/02/97	11/30/97	232	1.15%
2	Altos Hornos de Mexico	04/29/97	10/15/97	225	1.11%
3	Anchor Advanced Products	03/26/97	09/23/97	100	0.50%
4	Anker Coal Group	09/22/97	03/11/98	125	0.62%
5	Anvil Knitwear	03/11/97	08/22/97	130	0.64%
6	Argo-Tech	09/23/97	01/21/98	140	0.69%
7	Aurora Foods	02/05/97	10/09/97	100	0.50%
8	AFC Enterprises	05/16/97	09/08/97	175	0.87%
9	B&G Foods	08/06/97	03/11/98	120	0.59%
10	Citadel Broadcasting	06/30/97	01/28/98	100	0.50%
11	Comcast Cable Communications	04/24/97	10/28/97	550	2.73%
12	CEI Citicorp Holdings	02/14/97	03/16/98	100	0.50%
13	Delta Mills	08/20/97	02/12/98	150	0.74%
14	Doskocil Manufacturing	09/11/97	03/27/98	85	0.42%
15	EV International	03/19/97	09/05/97	100	0.50%
16	Fairchild Semiconductor	03/06/97	08/13/97	300	1.49%
17	FelCor Suites	09/26/97	03/20/98	125	0.62%
18	Fonda Group	02/24/97	07/31/97	120	0.59%
19	Fox Family Worldwide	10/22/97	05/11/98	1,094	5.42%
20	GeoLogistics	10/24/97	05/28/98	110	0.55%
21	Glenoit	03/26/97	04/01/98	100	0.50%
22	Globalstar	10/23/97	01/15/98	325	1.61%
23	GST Equipment Funding	05/08/97	11/13/97	265	1.31%
24	Hollywood Theaters	07/31/97	03/05/98	110	0.55%
25	Holmes Products	11/19/97	05/01/98	105	0.52%
26	Imperial Credit Capital Trust I	06/05/97	06/22/98	70	0.35%
27	Iridium	07/11/97	10/07/97	500	2.48%
28	J. Crew Group	10/14/97	04/03/98	142	0.70%
29	Leiner Health Products	06/20/97	12/15/97	85	0.42%

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

30	McLeodUSA	02/27/97	09/08/97	500	2.48%
31	Multicanal	01/27/97	08/01/97	125	0.62%
32	Neenah	06/26/97	09/11/97	45	0.22%
33	Netia Holdings	10/24/97	06/01/98	394	1.95%
34	PCI Chemicals Canada	10/22/97	02/09/98	175	0.87%
35	Roller Bearing Company of America	06/18/97	01/22/98	110	0.55%
36	Stanadyne Automotive	12/04/97	06/05/98	100	0.50%
37	Sunterra	08/05/97	01/29/98	200	0.99%
38	SIG Capital Trust I	08/07/97	10/31/97	135	0.67%
39	Tekni-Plex	04/01/97	10/03/97	75	0.37%
40	Telegroup	10/20/97	03/04/98	97	0.48%
41	Tjiwi Kimia Finance Mauritius	07/29/97	03/18/98	600	2.97%
42	Tom's Foods	10/08/97	03/17/98	60	0.30%
43	Trident Automotive	12/09/97	06/25/98	75	0.37%
44	TCI Satellite Entertainment	02/14/97	03/30/98	275	1.36%
45	UNICCO Service	10/14/97	03/12/98	105	0.52%
46	Wavetek	06/06/97	10/29/97	85	0.42%
47	Wilshire Financial Services Group	08/12/97	03/04/98	100	0.50%
48	Wilsons The Leather Experts	08/14/97	01/09/98	75	0.37%
49	Windy Hill Pet Food	05/16/97	10/10/97	120	0.59%
50	WinStar Equipment	08/08/97	01/27/98	250	1.24%
				9,583	47.48%

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Seasoned Issuers

	Issuer	Offering Date	Exchange Consummation Date	Par Value of Offering ($MM)	% of Total Par Amount Offered
1	Acme Metals	12/16/97	06/19/98	200	0.99%
2	Adelphia Communications	02/21/97	09/26/97	350	1.73%
3	Allied Holdings	09/19/97	11/21/97	150	0.74%
4	Ameristar Casinos	07/10/97	12/26/97	100	0.50%
5	Amtran	07/17/97	01/09/98	100	0.50%
6	Armco	09/09/97	11/21/97	150	0.74%
7	AEP Industries	11/14/97	05/18/98	200	0.99%
8	AES	10/24/97	03/16/98	375	1.86%
9	Belco Oil & Gas	09/17/97	11/15/97	150	0.74%
10	Borg-Warner Security	03/19/97	07/24/97	125	0.62%
11	Clark Refining & Marketing	11/14/97	02/23/98	100	0.50%
12	Cleveland Electric Illuminating/Tol	06/11/97	10/27/97	350	1.73%
13	Connecticut Light and Power	06/19/97	09/30/97	200	0.99%
14	DII Group	09/16/97	01/22/98	150	0.74%
15	Federal-Mogul	04/17/97	09/20/97	125	0.62%
16	Fleming Companies	07/18/97	02/10/98	500	2.48%
17	Greyhound Lines	04/11/97	08/01/97	150	0.74%
18	Hollywood Entertainment	08/07/97	10/31/97	200	0.99%
19	HMH Properties	07/10/97	10/28/97	600	2.97%
20	Imperial Credit Industries	01/17/97	05/01/97	200	0.99%
21	Imperial Holly	12/17/97	03/12/98	250	1.24%
22	Insilco	08/07/97	11/14/97	150	0.74%
23	Intermedia Communications	07/03/97	09/29/97	649	3.22%
24	Iron Mountain	10/21/97	01/13/98	250	1.24%
25	Jacor Comunications	06/11/97	01/02/98	150	0.74%
26	Kevco	11/21/97	03/04/98	105	0.52%
27	Lamar Advertising	09/19/97	12/19/97	200	0.99%
28	LaRoche Industries	09/18/97	04/06/98	175	0.87%
29	Marsh Supermarkets	07/29/97	12/03/97	150	0.74%
30	Metris	11/04/97	03/09/98	100	0.50%
31	Metrocall	10/16/97	03/17/98	200	0.99%
32	Nextel Communications	09/10/97	01/14/98	840	4.16%

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

33	NTL	02/07/97	06/30/97	400	1.98%
34	Ocean Energy	06/26/97	10/02/97	200	0.99%
35	Perkins Family Restaurants	12/17/97	04/24/98	130	0.64%
36	Pioneer Americas Acquisition	06/11/97	10/29/97	200	0.99%
37	Polymer Group	06/30/97	10/03/97	400	1.98%
38	Silgan Holdings	06/03/97	09/05/97	300	1.49%
39	Sinclair Broadcast Group	06/25/97	11/07/97	200	0.99%
40	Speedway Motorsports	07/30/97	10/28/97	125	0.62%
41	Stater Brothers	07/21/97	11/17/97	100	0.50%
42	Stone Energy	09/16/97	12/10/97	100	0.50%
43	Sun International Hotels	03/05/97	05/13/97	200	0.99%
44	Tuesday Morning	12/15/97	05/11/98	100	0.50%
45	Tultex	04/10/97	09/04/97	75	0.37%
46	Walbro	12/11/97	06/30/98	100	0.50%
47	WinStar Communications	03/13/97	09/27/97	100	0.50%
48	Worldtex	11/20/97	05/22/98	175	0.87%
				10,599	52.52%

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exhibit D

Percentage of Volume of Post-Exchange Trading

Category	Number of Offerings	Mean	Minimum	Median	Maximum
QIB	80	74.69	0.00	82.28	100.00
Other Institution	80	8.43	0.00	1.21	98.88
Broker/Dealer	80	15.65	0.00	10.83	60.78
Retail	80	1.21	0.00	0.04	26.22

Notes: Percentage statistics exclude offerings with no trading. Maximum represents the highest percentage from a single offering.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exhibit E

Volume of Post-Exchange Trading Relative to Amount Outstanding

Category	Number of Offerings	Mean	Minimum	Median	Maximum
QIB	83	23.20	0.00	19.97	94.11
Other Institution	83	3.39	0.00	0.23	66.60
Broker/Dealer	83	6.00	0.00	1.94	48.97
Retail	83	0.47	0.00	0.00	11.20
Total	83	33.07	0.00	25.35	115.04

Notes: Maximum represents the highest percentage from a single offering.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

REPRINT COURTESY OF THE AMERICAN BAR ASSOCIATION

28 SEPTEMBER 1999

Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

Attention: Mr. Jonathan G. Katz, Secretary

RE: The Regulation of Securities Offerings (File No. S7-30-98)

Ladies and Gentlemen:

The Committee on the Federal Regulation of Securities of the Section of Business Law of the American Bar Association submits this letter in response to the Securities and Exchange Commission's request for comments on The Regulation of Securities Offerings, Release No. 33-7606 (November 3, 1998) as amended by Release No. 33-7606A (November 13, 1998) [63 FR 67174 (December 4, 1998)] (the "Proposing Release"). The Committee consists of approximately 2,000 members of the securities bar who practice in-house and as outside counsel. The Committee has previously filed a separate comment letter responding to the request for comments in the Proposing Release regarding asset-backed securities.[**]

Given the scope and importance of the Proposing Release, we augmented our typical comment letter procedures. In addition to having ten drafting sub-committees prepare the first drafts of sections of this comment letter, we sponsored a panel at the Committee's Spring Meeting on April 16, 1999. A draft of this comment letter was circulated for comment among numerous members of the Committee and has received the general agreement of the majority of those who responded. We also distributed the draft for review by an editorial board that is geographically diverse and includes lawyers who represent issuers, underwriters and institutional investors, and the comments expressed in this letter have received the general agreement of the majority of the members of that board. Altogether, over 120 Committee members participated in this process. This letter, however, does not represent the official position of the American Bar Association, the Section on Business Law, or the Committee, and does not necessarily represent the views of all who reviewed it.

The general agreement of the great majority of the members who drafted and reviewed this comment letter may be summarized as follows:

The Commission's staff has informally christened the release as the "Aircraft Carrier". *See also* The Regulation of Securities Offerings Securities Act Release No. 7,659 [File No. S7-30-98] (March 24, 1999] (extending public comment period until June 30, 1999).

** John M. Liftin, *et al.*, Committee on the Federal Regulation of Securities of the Section of Business Law of the American Bar Association [File No. S7-30-98 (Asset-Backed Securities)] (June 29, 1999).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

A Recognition of Current Market Realities

As identified in the Proposing Release, we recognize the changes that are occurring in our capital markets which warrant a review of the securities offering process. These changes include:

- the electronic communications revolution which enables more investors to have greater access to more information faster than ever before
- global securities markets which render national borders less significant and increase the flow of and competition for capital between markets
- markets dominated by institutions and market intermediaries which act on behalf of a greater percentage of individuals than ever before
- continual innovation in the development and proliferation of financial products which expands financing opportunities and access to capital
- convergence of public and private markets which benefit both issuers and institutions by combining the speed and access of a private offering with the ability to meet regulatory requirements and achieve the liquidity provided by a public market

The Fundamental Flaws of the "Aircraft Carrier"

While recognizing the ongoing changes that are occurring in the marketplace, we do not believe the Aircraft Carrier achieves the Commission's goal of making the registration system more workable for issuers and underwriters and more effective for investors. After extensive consideration and debate, we have concluded that the proposals are fundamentally flawed. Many of the proposals are based on premises that are either faulty or out-of-date. With respect to other proposals, the underlying premises are given unwarranted importance, when compared to their adverse effect on market efficiency and undue burdens on capital formation. These premises include:

- a channeling of the variety of public and private offerings into a "one size fits all" regulatory structure
- a prominence given to selective disclosure in the absence of evidence that abuse is pervasive and warrants a new registration system, rather than enforcement action on a case by case basis
- the doubts raised about the roles of analysts, institutions and market professionals as well as a distrust of the efficient market theory which was the Commission's underlying theory in adopting the integrated disclosure system which has worked well
- a focus on the need for physical delivery of a prospectus, or term sheet, to each potential investor by a specified period in advance of making an investment decision in every offering

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- rejection of over 15 years' experience of shelf registration and incorporation by reference as a regulatory response that balances investor protection with the needs of the marketplace
- resurrection of the constructive or presumptive underwriter theory, particularly with respect to institutions
- efforts to reverse *Gustafson v. Alloyd Co., Inc.* and expand liability in the offering process

While a number of the proposals have merit, we are reluctant to characterize them as positive or negative and be perceived as "cherry picking." Rather, we recommend:

1. the withdrawal of the "Aircraft Carrier";
2. a thorough economic study of the registration system, particularly the communications process; and
3. re-proposal, as necessary, after completion of further study.

To facilitate an understanding of our comment letter, we have organized the Table of Contents in a sentence and topic format. We have also included an alternative proposal to the "Aircraft Carrier". Our alternative is premised on our belief that reform does not require an entirely new registration system like the "Aircraft Carrier" and that only incremental change is warranted, other than changing the existing regulation of communications.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

A. The proposals in the Proposing Release are fundamentally flawed and should be withdrawn. 3

1. The proporsals constitute a marked departure from a system that is the gold standard of capital formation. 3
2. The Proposing Release strikes the wrong balance. 4
3. The current registration system "ain't broke". 4
4. In general, the proposals are not an improvement on the present régime, and in many cases are impractical. 4
5. A cost-benefit analysis is essential. 5
6. The Proposing Release would unnecessarily expand and increase liability. 6

B. The sparse evidence of "selective disclosure" does not warrant the adoption of an entirely new system. 7

C. Our capital markets have benefited from intelligent, rational administration of federal securities laws. 9

D. Regulation can accommodate innovations in capital formation without compromising investor protection or the public interest. 11

E. Irrespective of the ultimate fate of the "Aircraft Carrier" proposals, the Commission should make adequate provision for offerings of Asset-Backed Securities. 12

II. REGISTRATION AND DISCLOSURE POLICY 13

A. The shelf registration process and current registration forms are superior to the proposed regulatory structure. 13

1. Proposed forms for Securities Act registration should not be adopted. 13

a. Proposed Form A. 13

i. A 7 or 3 calendar day preliminary prospectus delivery requirement would seriously impede the underwritten distribution process and place many offerings in jeopardy. 13

ii. Issuers should be permitted to incorporate by reference or deliver company information. 15

iii. Issuer's ability to time effectiveness of registration statement is illusory. 16

iv. Definition of "seasoned" issuer should not be complex. 17

v. Specific comments on the text of the proposed form. 17

(A) Should include definition of "seasoned issuer". 17
(B) "General Instructions" to the form should be revised. 17
(C) The proposed certifications on the signature page should not be adopted. 18

b. Proposed Form B. 18

i. Shelf registration is without question one of the Commission's most successful regulatory innovations, and has operated without abuse since 1982. 18

ii. Proposed Form B is fundamentally flawed and would disrupt capital formation. 19

(A) Current *sell, then document* process should continue to be permitted. 19
(B) Term sheet delivery requirement should be eliminated. 22

iii. Form B's eligibility requirements should be revised. 22

(A) Disqualification under so-called "bad boy" provisions should not be adopted. 22

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

(B) The existence of unresolved comments in connection with staff review of Exchange Act filings should not block financings. 23
(C) Penalty for filing on the incorrect form should be clarified and eased. 23
(D) Financial eligibility criteria should not be changed. 24
(E) Secondary offerings should be permitted on Form B. 24
iv. Specific comments on the text of the proposed form. 26
(A) The proposed certifications on the signature page should not be adopted. 26
(B) Forward incorporation by reference should be permitted on Form B. 26
(C) Interim incorporated reports cannot be new registration statements. 27
(D) After-market prospectus constructive delivery creates an update problem in all offerings. 28
c. Proposed Form C. 28
i. The Commission should adopt an *omnibus* Form M-A instead of proposed Form C. 28
2. The *metaphysics* of integration of private and public offerings. 29
a. Integration initiatives are a welcome response to a complex issue. 29
i. Completed private offering. 30
ii. Abandoned private offering. 31
iii. Abandoned public offering. 32
iv. Expanded Rule 152. 34
v. Lock-up agreements. 34
vi. Withdrawal of registration statements. 35
b. We encourage the Commission to rationalize law and lore with more systemic revisions. 35
3. Repeal of *Exxon Capital* A/B exchange offers is unwarranted. 36
4. Small Business Issuers. 40
a. Several of the Commission's proposals would have a disproportionate impact upon, and unduly burden capital formation by, smaller business issuers. 40
i. Prospectus delivery requirements would prolong and delay offerings, thereby increasing the risk of missing market opportunities. 40
ii. Smaller business issuers should be permitted to use Form B to register resales by selling security holders. 40
iii. Pre-filing communications proposals would impose a greater burden on smaller business issuers. 41
iv. The "free writing" and "offering information" proposals are especially burdensome for small issuers. 41
v. Proposed Rule 152(b) is extremely helpful, but should be revised to provide greater flexibility for smaller business issuers. 41
vi. Definition of "small business" should not include a public float test. 42
vii. Incorporation by reference should be permitted in Form SB-2. 42
viii. Exchange Act proposals would unduly burden smaller business issuers. 42
ix. Increased exposure to liability for directors and officers is a concern to smaller business issuers. 43
5. Foreign Issuers. 43
a. Existing reluctance of foreign issuers to access US public capital markets may increase. 43
i. Enhanced exposure to liability. 44

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

ii. Reduced eligibility for short-form registration. 45

iii. Elimination of *Exxon Capital* exchange offers. 46

iv. Interference with multi-market timing constraints. 46

v. Accelerated filing of annual reports. 47

III. COMMUNICATIONS WITH INVESTORS 48

A. Benefits of the Commission's "free writing" proposals are seriously threatened by filing requirements and indiscriminate application of civil liabilities. 48

1. Proposed framework for communications with investors. 48

a. Proposals would have a chilling effect on communications with the market. 49

b. Proposals would re-define the offering period. 50

i. "Factual business" and "forward-looking" communications during the offering period. 50

(A) Written communications. 51

c. Impact on electronic communications. 52

2. "Free writing" and "offering information". 53

a. "Free writing" materials should not be filed. 53

b. Concept of "offering information" should be narrowed. 54

c. Further comments on the Commission's proposed "free writing" and "offering information" standards. 55

i. Standard for identifying "first offer" is vague. 55

ii. "By or on behalf of the issuer" should be narrowed. 55

iii. Failure to file should not create civil liability. 56

iv. Clarify no "material change updates" are required. 56

3. Research Reports. 56

a. Research safe harbors should be expanded for registered offerings. 57

i. Rule 137. 58

ii. Rule 138. 59

iii. Rule 139. 60

(A) Focused reports. 60

(B) Industry reports. 61

(C) IPOs and unseasoned issuers. 61

b. Research safe harbors should encompass all unregistered offerings. 62

c. Safe harbors for proxy solicitations should encompass all transactions. 63

IV. PERIODIC EXCHANGE ACT REPORTS 64

A. Issuer press releases and analysts' reports assist investors and enhance efficient markets. 64

1. Investors rely on information disseminated by a company's press releases and conference calls with research analysts. 64

2. Proposed revisions to disclosure required in annual and quarterly reports. 65

a. Risk factor disclosure should apply solely to a company's business and not to the terms of its securities or offerings. 65

b. Quarterly information should not be subjected to liability under Section 18 of the Exchange Act. 66

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

c. Requiring a filed "Management Report to Audit Committee" would not enhance the quality of Exchange Act reporting. 67

3. Interim reports on Form 8-K. 68

a. Timely disclosure of annual and quarterly results of domestic companies is desirable. 68

i. Requiring S-K Item 301 information in Form 8-K would delay release of earnings information. 68

ii. Current due dates for Forms 10-K and 10-Q should be retained. 69

b. Form 8-K should be amended to require disclosure of a limited number of specified corporate events. 70

i. Material modifications to the rights of security holders. 71

ii. Departure of chief executive officer, chief financial officer, chief operating officer, or president. 72

iii. Material defaults on senior securities. 72

iv. Reliance on prior audit. 73

v. Name changes. 74

vi. Due dates for reporting events. 74

4. Signatures. 76

a. Exchange Act reports and registration statements. 76

b. Securities Act filings. 77

5. Proposed expansion of disclosure in Form 6-K submissions is relatively benign. 77

6. Potential liability and other valid concerns militate against extending "plain English" requirements to Exchange Act reports. 77

B. Notwithstanding its unfettered right to review Exchange Act reports, the staff should work efficiently and expeditiously in order not to impede an issuer's access to capital markets. 78

1. Proposed staff review policy should be revised to provide a greater degree of certainty to the process. 78

V. LIABILITY 80

A. The Commission's proposals would alter the liability régime with inappropriate and unpredictable consequences. 80

1. Issuers would be subjected to unforeseen liability arising from a latent violation of Section 5 of the Securities Act. 80

2. Directors and officers would be exposed to increased liability unnecessarily. 81

3. Underwriters would have increased exposure to liability for latent violations of Section 5 of the Securities Act. 81

B. Proposed guidance concerning "reasonable investigation" and "reasonable grounds for belief" defenses under Sections 11 and 12(a)(2) of the Securities Act is deficient. 82

1. Rule 176 should provide a rebuttable presumption that underwriters have met "due diligence" obligations. 82

C. Abuses arising out of "selective disclosure" are not pervasive and do not justify the sweeping changes proposed. 83

1. The Commission inappropriately seeks to resurrect a "parity-of-information" theory rejected by the Supreme Court in *Chiarella v. United States*, and impose liability for violation. 83

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

VI. STATUTORY AUTHORITY 86

A. The Commission has not identified bases for its proposals to "*modernize*" and "*rationalize*" its registration and disclosure policy. 86

1. Legislative history. 86

2. Federal Administrative Procedure Act. 88

a. Formal rulemaking. 88

3. Cost-benefit analysis. 89

4. The Commission should publish notice of, and solicit comment on, incremental revisions to registration and disclosure requirements under the existing integrated disclosure system. 92

VII. AN ALTERNATIVE PROPOSAL 93

A. The underlying premise of the Committee's Alternative Proposal is that no serious problems exist with the registration process that warrant major overhaul and disruption of current practices. There are problems that should be corrected; however, most of these can be addressed through focused rulemaking or changes in administrative practice. 94

B. The Committee's alternative is based upon further enhancement of the Commission's integrated disclosure system and existing shelf registration process. 95

VIII. CONCLUSION 100

Appendix I - "Walk-Through of a Form B Offering" 108

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

I. INTRODUCTION

Every generation, the Commission revisits its regulations to address developments and anticipate trends that affect capital formation and investor protection. In the early 1980s, the Commission adopted the integrated disclosure system,[1] which has, with modifications, been the regulatory framework for over 15 years.

The Commission is to be commended for its thought-provoking analysis of the challenges to our nation's continuing preeminence in global capital markets. The Proposing Release clearly represents a substantial commitment on the part of the Commission to its traditional role of proactive regulation of our markets. When approximately 48 percent of US households own stock and 69 million individuals own shares in a public company, mutual fund, retirement savings account or pension fund investment account,[2] regulation of our capital markets is not just a "Wall Street" issue, but one that affects all Americans. As citizens and members of the private bar, we appreciate this commitment, and are pleased to have an opportunity to contribute in a meaningful manner to this process.

Several proposals suggest positive regulatory innovations for our capital markets, and represent a forward-looking approach to the Commission's disclosure and registration régime. For example, the Commission's integration proposals are a welcome response to a complex and often arcane area of federal securities practice. Permitting seasoned issuers to determine the time of effectiveness of their registration statements makes sense as does "exempting" these registration statements from pre-effective review by the staff of the Division of Corporation Finance ("staff"). Relaxing the rules governing communications with the market by issuers, underwriters and other offering participants to encourage "free flows" of information is a welcome breath of fresh air. However, on balance the proposals in the "Aircraft Carrier" are impractical and, if adopted, would seriously erode the efficiency of US capital markets.

Recognizing the technological and financial developments that have occurred since its adoption of integrated disclosure, the Commission has declared that its overall goal in the Proposing Release is "to make the registration system more workable for issuers and underwriters and more effective for investors in today's capital markets."[3] We share and support that overall goal. Unfortunately, we believe that the proposals do not achieve that goal and, indeed, conflict with it.

Traditionally, the private securities bar has worked in close harmony with the Commission in its rulemaking activities. Obviously, there have been proposals and interpretations with which we have disagreed.

---

[1] Adoption of Integrated Disclosure System. Securities Act Release No. 6,383 [47 FR 11380 (March 16, 1982)] ("Final Rule"). Under the integrated disclosure system, the Commission instituted comprehensive revisions to registration forms and procedures. Integrated disclosure is premised on the efficient market theory (*i.e.,* market prices of securities reflect all publicly available information about the issuer). *The administrative oil that makes integration run efficiently is incorporation by reference.*

[2] *See* SIA, "Securities Industry Briefing Book" (1999) at 2-3 ("median family income of stockholders in 1995 was $50,000").

[3] Proposing Release "Section IV" at 26.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

On those occasions when we have disagreed, we have, nonetheless, tried to be supportive of the Commission and have offered suggestions designed to improve the rule proposals.

In this case, however, we are unable to support the major proposals in the Proposing Release because, in our judgment, the underlying premises of the "Aircraft Carrier" are fundamentally flawed. The problems with the approach taken in the Proposing Release are basic and systemic, and cannot be readily cured or adequately addressed without re-thinking the proposed regulatory régime.[4] Rather, it is our considered judgment, based upon our expertise and experience, that the Proposing Release should be withdrawn because it is irremediably flawed.

Moreover, the Proposing Release does not proffer objective evidence of abuse or harm to investors that would justify rescission of the very successful shelf rule,[5] which was introduced over 15 years ago. For example, the "Aircraft Carrier" does not cite empirical studies that would justify either this proposal or, indeed, any regulation that would impose additional costs and burdens on issuers and selling securityholders, who rely on shelf registration to provide quick and efficient access to capital markets.

It is apparent to us that many of the proposals in the "Aircraft Carrier" are, at best, impractical and, if adopted, would materially impede the efficacy and efficiency of a system for capital formation that *works* and is the envy of the world. The proposed régime would also impose increased and unnecessary costs and liability on issuers, officers and directors of issuers, underwriters, and broker/dealers, without providing significant corresponding benefits to investors and the public interest. Simply put, the substantial costs and regulatory burdens of the proposed new régime outweigh the purported benefits.

---

4 As noted above, the Committee believes that some of the proposals have merit. We have suggested modifications that would enhance their effectiveness (*e.g.,* granting certain issuers complete discretion over the timing of effectiveness of their registration statements ("effectiveness on demand"); less restrictive rules governing communications with investors; and eliminating physical delivery of final prospectuses). We recommend, however, that these "incremental" changes be reproposed in the context of the existing regulatory structure. *See infra* page 97, "VI.A.4. The Commission should publish notice of, and solicit comment on, incremental revisions to registration and disclosure requirements under the existing integrated disclosure system." In Part VII, we suggest an alternative regulatory approach.

5 Rule 415 under the Securities Act, 17 C.F.R. § 230.415. *See also* Shelf Registration. Securities Act Release No. 6,499 (November 17, 1983) [48 FR 52889 ("Shelf Registration Final Rule").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

A. THE PROPOSALS IN THE PROPOSING RELEASE ARE FUNDAMENTALLY FLAWED AND SHOULD BE WITHDRAWN.

Our concerns about the Proposing Release include:

1. The proposals constitute a marked departure from a system that is the gold standard of capital formation.

The United States' securities regulatory system is the gold standard of capital formation for the world: it is followed by developed countries, and is the ideal to which emerging countries aspire. Under the knowledgeable and effective oversight of the Commission, regulation has successfully matched market realities and cost effectiveness, most notably through integrated disclosure and the shelf rule. These developments enabled us to combine enhanced transaction efficiency with fuller disclosure than the systems used in Europe in the early 1980s. As a result, we "took back" the Eurobond market for US issuers.

In the late 1980s, the Commission began initiatives with the International Organization of Securities Commissions ("IOSCO") and other foreign authorities to advocate adoption of a regulatory régime consonant with that extant in the US, of which the multi-jurisdictional disclosure system with Canada ("MJDS")[6] was the most ambitious. Now the Commission has proposed an entirely new régime, but it is questionable whether foreign regulators will continually revise their own régimes to harmonize with changes in US law.

Adoption of the Proposing Release would move us backward at a time when the United States' economy needs to be even more competitive, and would do so without a persuasive explanation to foreign regulators as to why they should give up the efficiencies of the current American model. This would have two effects: (1) the US would lose the benefits of efficiency and of "settled law"[7] precisely at the time the Europeans are embarking on the new world of the Euro, thus forfeiting a competitive advantage, and (2) the rest of the world, which has previously sought to emulate the US model, will not switch to the over-regulated capital formation régime embodied in the Aircraft Carrier because of the demonstrated advantages of the current system. The result will be a breach in the uniform development of global securities offering practices and possible forfeiture of the success and leading role in global capital markets that the United States has enjoyed.

---

6 Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers. Securities Act Release No. 6,902 (June 21, 1991) [56 FR 30036 (July 1, 1991)] ("Final Rule") (regulating cross-border offerings of securities and continuous reporting by specified Canadian issuers). We note also that the Commission has recently published for comment proposals that would revise its Securities Act and Exchange Act disclosure requirements for foreign private issuers to conform to those endorsed by IOSCO. *See* International Disclosure Standards. Securities Act Release No. 7,637 [File No. S7-3-99] (February 2, 1999).

7 The benefits of settled law are no less important in the federal regulation of securities than they are in corporate governance and commercial law. For example, the General Corporation Law of Delaware is highly prized by corporations and their counsel because the Delaware legislature made a commitment to a sophisticated legal system for corporations, and the Chancery Court brings expertise to the interpretation of that law. Similar analogies are present in respect of the commercial law of the State of New York and the United Kingdom for domestic and international transactions.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

2. The Proposing Release strikes the wrong balance.

The Proposing Release strikes the wrong balance between investor protection on the one hand and the efficiency of capital formation on the other. While investor protection is primary, investors have an interest in a vibrant capital formation system.[8] For example, a company can build the safest car in the world at a cost that results in sales of few, if any, of these cars and no decrease in highway fatalities. Similarly, what may be initially intended to be investor protective may not protect US investors in practice, if it creates new costs spent, that drives capital-raising offshore or to private markets. Similarly, increasing potential liability for informal communications may result in providing less information to investors or in driving communication into oral, and therefore less reliable, forms.

The delays to the offering process inherent in both proposed Form A and proposed Form B offerings would result in a less efficient system. A delay of 24 hours (much less seven or three days) can result in a significant change in the price of common stock or the interest rate for debt securities. Mismatching pricing and process results in inefficiencies that cause uncertainty and increase offering costs. Rather than follow an inefficient system, issuers and underwriters will (as they have in the past) find or create a more efficient market elsewhere.

3. The current registration system "ain't broke".

The Proposing Release represents an entirely new registration system that would replace one that has worked effectively for at least 15 years. The Proposing Release does not demonstrate any significant abuse or harm to investors that warrants an entirely new system nor does it describe any case law, administrative proceedings, Commission investigation or economic studies that support such action. While the communications aspects of the current system are in need of significant revision in light of changes in technology and practice, that deficiency alone does not mean the entire system is broken, nor do regulatory changes to modernize communications require wholesale replacement of the existing system. Thus, whatever is broken in the system can be fixed by mending, not ending, the current offering system.

4. In general, the proposals are not an improvement on the present régime, and in many cases are impractical.

Many aspects of the Proposing Release do not reflect an understanding of the process by which securities are offered and sold. From an intensified transactional approach in which each offering must be the subject of a separate registration statement, to requiring "free writing" and "offering information" to be filed, and requiring all investors to receive disclosure at a certain time, the proposals in the Proposing Release are impractical and do not reflect the timing constraints that vary greatly in securities offerings.

Disclosure policy is like a mobile in which pushing one piece affects all the other pieces of the mobile. The proposed transaction model, in which all offerings proceed on a schedule similar to that of an initial public offering ("IPO"), is not just a step back; it also does not accommodate the ever-increasing variety of

---

8 *Cf*. Section 3(f) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(f), which requires consideration not only of investor protection but also the efficiency of the capital formation process. *See* Part VI *infra*.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

issuers or diversity of offerings. One size does not fit all, and attempting to place all transactions into the same template does not work.

The types of offerings, which vary from tranches off a shelf to offerings of debt pursuant to Rule 144A[9] under the Securities Act of 1933 ("Securities Act"),[10] are practical responses by the marketplace to the needs of issuers and investors, including legal investment limits on investments in restricted securities by important categories of institutional investors. By eliminating *Exxon Capital*[11] exchange offers, the Proposing Release would seek to channel private offerings to institutional investors into registered public offerings, thereby limiting flexibility and increasing the offering costs. Traditional selling security holder registration statements, which are proposed to be eliminated, provide essential liquidity for venture capitalists, entrepreneurs, and shareholders of acquired companies. It is impractical to conclude that the regulatory framework of the Proposing Release can impose artificial mechanisms on all such offerings with the same efficiency and cost effectiveness as the current marketplace.

5. <u>A cost-benefit analysis is essential</u>.

The current integrated disclosure system, a recommendation of the Wheat Report,[12] has evolved over 30 years by a process of incremental steps and experimentation. The Proposing Release would result in a fundamental change to the offering process, both public and private. There is no evidence of abuse in the current system that is so serious as to warrant the significant cost of adopting an entirely new system. Therefore, a cost-benefit analysis, including economic studies such as were conducted by the Commission in adopting the integrated disclosure system and the shelf rule, would seem to be essential.[13]

Instead of incremental revisions resolving issues of uncertainty, the proposals in the "Aircraft Carrier" would require greater resort than ever to legal counsel by issuers and underwriters, who in turn would require formal advice from the staff in order to provide proper legal advice to their clients.[14] This arduous, expensive, and time-consuming process is antithetical to the needs of issuers for rapid access to capital

---

9 17 C.F.R. § 230.144A (investors are limited to "qualified institutional buyers" ("QIBs")).

10 15 U.S.C. § 77a, *et seq.* (1994, Supplemented 1996).

11 Exxon Capital Holdings Corp. (May 13, 1988).

12 "Disclosure to Investors — A Reappraisal of Administrative Policies under the 1933 and 1934 Acts", Report and Recommendations to the SEC from the Disclosure Policy Study (March 27, 1969). The Wheat Report was prepared by The Staff Study on Disclosure to Investors, under the guidance of then-Commissioner Francis M. Wheat.

13 *See, e.g.* Edwin T. Burton and Lawrence E. Kochard, "An Analysis of the Economic Impact of Timing Delays Contained in the 'Aircraft Carrier' Proposal" (May 15, 1999). The study, which was commissioned by the Securities Industry Association, generally found that "substantial cost increases" would be imposed on US capital markets.

14 For example, the necessity of filing "free writing" materials, coupled with subjective determinations such as what is "offering information", "free writing", and "ordinary business communications", will mean that securities law determinations will invade everyday corporate communication like an "oil slick". We encourage our clients to seek appropriate legal advice; however, as business lawyers, we are loathe to impose unnecessary costs on our clients, our capital markets, or our economy.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

markets.[15] The resulting market uncertainty, confusion, and costs would precipitate the flight of capital formation to other markets (with the prospect of accelerating the development of viable, Euro-denominated Eurobond markets), and would result in greater reliance on private placements.

6. The Proposing Release would unnecessarily expand and increase liability.

From our perspective, expanding liability is the least efficient way of regulating the marketplace. Yet, from requiring new certifications and signatures on periodic reports, to filing "free writing", to post-effective amendments (rather than supplements), the Proposing Release would increase and expand liability at every turn. In light of the absence of evidence of wide-scale abuse, and the success of the current system, it is puzzling that the Commission's effort to "modernize" the registration process should feature "increased and expanded liability" as a major component.

As noted in our six-prong analysis *supra*, the conceptual underpinnings of the "Aircraft Carrier" do not support the Commission's stated goal of "[making] the registration system more workable for issuers and underwriters and more effective for investors in today's capital markets."[16] Our fundamental concerns with the proposals included in the "Aircraft Carrier" are as follows:

- The proposals expanding liability for offering participants are controversial, and would undermine recent legislative initiatives to curb frivolous private litigation.
- "Abuses" of "selective disclosure" (a term that apparently includes such traditional communications as "road shows" or issuer conference calls with institutional investors and analysts) may exist in some instances, although the Commission offers no proof. In any event, adequate remedies presently exist for any violation of the prohibitions on insider trading. The Committee believes vigorous enforcement action by the Commission to pursue any such violations would be more effective than further rulemaking. We are also gravely concerned about the return of the "parity of information" theory and resulting liability the Commission seeks to impose. The likely result would be to stifle communication and drive it into purely oral forms.
- The Aircraft Carrier evidences a regulatory bias favoring registration, notwithstanding that the statute[17] permits the issuer to exercise its discretion in choosing to offer securities publicly under a registration statement or privately (including to QIBs) where an exemption is available.

---

15 *See, e.g.,* George N. Hatsopoulos, Chairman of the Board and President of Thermo Electron [File No. S7-19-96] (October 22, 1996) at 2 ("The globalization of equity markets makes it imperative for a company to move very fast in accessing capital….[O]ne day there's ample opportunity to raise necessary capital but within 24 hours that opportunity can disappear"). The letter was a response to publication of Securities Act Concepts and Their Effects on Capital Formation. Securities Act Release No. 7,314 [File No. S7-19-96] (July 25, 1997) ("Concept Release").

16 Proposing Release "Section IV" at 26.

17 Section 4 of the Securities Act, 15 U.S.C. § 77d.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- The proposals would forestall further use of a very efficient institutional market that developed as a result of the *Exxon Capital*[18] A/B exchange offer process and its progeny.

- The prospectus and term sheet delivery requirements are structured to interpose "artificial" delays and regulatory "speed bumps" prior to sale, with no discernible benefits to investors that outweigh the costs to issuers and underwriters or the burdens imposed on domestic capital markets.

- The proposals define the term "QIB" to exclude many investors (including dealers who also provide liquidity to this market) that are currently eligible to participate in Rule 144A transactions. Moreover, with the excessive focus on "conduits", the proposals would resurrect the "presumptive underwriter" concept.

- The proposals reduce the availability of "short form" registration for primary offerings and secondary resales of securities by security holders.

The "Walk-Through of a Form B Offering" illustrates some of the practical concerns we have with the Proposing Release.[19]

B. THE SPARSE EVIDENCE OF "SELECTIVE DISCLOSURE" DOES NOT WARRANT THE ADOPTION OF AN ENTIRELY NEW SYSTEM.

The Commission's focus on "selective disclosure" is of concern for three reasons. First, while one may speculate about the activities sought to be regulated,[20] the term "selective disclosure" is not defined in the Proposing Release. The concept is vague and, therefore, the full scope of activities sought to be covered is unclear. Further, the Commission offers no real evidence that there is a problem in this area.

Second, the proposals apparently question the legitimacy of traditional methods of obtaining and disseminating information. The Committee believes that the proposed changes would have an adverse impact on the efficiency of our capital markets. The price discovery function performed by the markets is based upon information analyzed by market professionals.

---

18 These filings were described in the Proposing Release as IPOs; however, these were primarily offerings of fixed-income securities which are very dissimilar in substance and impact on public trading markets from IPOs in equity securities. *See* Proposing Release at "Section V.H." (stating "more than one-third of all initial public offerings" since July 1, 1998, were *Exxon Capital* exchanges).

19 *See* Appendix I.

20 *See, e.g.,* "Unger Addresses the Impact of Stock Information on the Internet," *The SEC Today*, vol. 99-46 at 1 (March 10, 1999); Remarks of The Honorable Isaac C. Hunt, Jr., Commissioner of the United States Securities and Exchange Commission, Practising Law Institute's "The SEC Speaks in 1999" (February 26, 1999) at 2-3; Remarks of The Honorable Arthur Levitt, Chairman of the United States Securities and Exchange Commission, Practising Law Institute's "The SEC Speaks in 1998" (February 27, 1998).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The traditional means[21] of obtaining and disseminating information include:

(a) *Issuer communications* with research analysts employed by broker/dealers; analysts employed by Moody's, Standard & Poor's, and similar entities; and institutional investors; and

(b) *Broker/dealers* communications through research analysts' conference calls with the sales force research and with institutional investors; and publication and dissemination of proprietary research reports to clients.

When the Commission considered the three-tier registration system under the Securities Act for purposes of its integrated disclosure system, it explicitly recognized the value provided by research analysts employed by full-service broker-dealers.[22] In essence, the Commission acknowledged that not all investors (or potential investors) have comparable analytical skills, time, or interest to assimilate great quantities of market data, issuer information, industry data, economic trends and data, and political and strategic information, but took the view that the market price of securities would reflect this information for all investors as a result of the activities of research analysts and other market professionals.

The Commission has stated its belief that "small investors" are the last to realize the benefits of "the filtering and dissemination function customarily performed by research analysts."[23] However, it is not apparent that investors generally — including small investors — suffer any discernible harm from the traditional means of disseminating information, given the impact of the "Internet, instant television analysis and the explosion of electronic means of moving money."[24] We believe that, in fact, today small investors have more relevant information available more quickly than ever before in history.

---

21 This is in contradistinction to various methods of disseminating information that have become more prevalent with the advent of the Internet and cable television channels devoted almost exclusively to information concerning financial markets. *See infra* page 88, "V.C.1." at note 175 and accompanying text.

22 Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, Securities Act Release No. 6,331 [46 FR 41902 (August 18, 1981)] ("Proposing Release") at n. 7 and accompanying text ("However, integration also in *[sic]* predicated on the fact that information regularly is being furnished to the market, in part, through periodic reports under the Exchange Act. This information is evaluated by professional analysts and other sophisticated users, is available to the financial press and is obtainable by any other person who seeks it for free or at nominal cost." *See also* Research Reports, Securities Act Release No. 6,550 (September 19, 1984) ("Final Rule") at "Section I". In describing the changes in regulation effected by the integrated disclosure system and markets since adoption in 1970 of rules governing distribution of research, the Commission noted, "Among the participants whose publication practices have evolved are: (1) Financial analysis *[sic]*, who constantly digest and synthesize information and act as essential conduits in the continuous flow of information to investors; and (2) the financial press, which facilitates the broad dissemination of timely and material corporate information. This flow of information is an integral part of the integrated disclosure system because the existence of timely and complete corporate information in the marketplace allowed the Commission to streamline the Securities Act registration process."

23 Proposing Release at 226.

24 *See* E.S. Browning, "New Forces Are Now Powering Surging Stocks," *The Wall Street Journal* (March 15, 1999) at col. 1. "What moves stocks today are the Internet, instant television analysis and the explosion of electronic means of moving money. They aren't necessarily improvements; all seem to have created greater market volatility. But the theory has it that more information is better than less. Regardless, these market-accelerators are replacing reasoned analysts' reports, brokers'

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

If the activities of any of the key players in the disclosure cycle (issuers and their affiliates, research analysts, or institutional investors) violate prohibitions on insider trading, the Commission and any aggrieved investor already have available more than adequate remedies and penalties (administrative, civil, and criminal).[25] Moreover, the rules of the National Association of Securities Dealers, Inc. ("NASD"), a major self-regulatory organization ("SRO"), prohibit broker/dealers from "front-running" research.[26] Finally, all registered broker/dealers are required to have reasonable policies, procedures, and internal controls to monitor and regulate the flow of proprietary or inside information ("Chinese Walls") between the firms' investment bank and proprietary trading, brokerage, and research functions.

Third, any alleged "abuses" associated with "selective disclosure" are not sufficient to justify the sweeping changes proposed by the "Aircraft Carrier". While we are not aware of significant abuses, and the Commission has presented no evidence they exist, if the Commission perceives problems to exist,[27] it could use its existing powers under current law to bring enforcement actions. We believe enforcement action when abuses exist would be fully justified to protect not only investors, but also the fundamental integrity of our capital markets. Moreover, we believe that enforcement actions would offer a far more effective remedy (and deterrent) than a rulemaking proceeding that, at best, duplicates existing authority and, at worst, impedes information flows and capital formation.

C. OUR CAPITAL MARKETS HAVE BENEFITED FROM INTELLIGENT, RATIONAL ADMINISTRATION OF FEDERAL SECURITIES LAWS.

One of the enduring strengths of US capital markets for over 30 years has been intelligent, rational administration of federal securities laws. Working cooperatively with the private securities bar and representatives of the securities industry, the Commission has used its formal and informal rulemaking powers to adapt requirements of the Securities Act, the Trust Indenture Act of 1939,[28] and the Securities Exchange Act

---

recommendations, and the private, inside scoop that once set market-movers above ordinary Joes. In fact, the 'dumb money' — the mass of individual investors who once were viewed as putty in the hands of stockbrokers — today often can get information almost as soon as the 'smart money.' Even conference calls with corporate chieftains, once the reserve of selected analysts, today are being opened to the general public, at least on a listen-only basis. That helps explain why the stock market has become so volatile, and also why the 'dumb' individual sometimes has looked more adept than the 'smart' pro….*Now [good information] is presented to market-savvy grandmas in small towns in Arkansas first thing in the morning" (emphasis added). Id.* at col. 1-2.

[25] The Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) and The Insider Trading and Securities Enforcement Act, Pub. L. No. 100-704, 102 Stat. 4677 (1988).

[26] NASD Conduct Rule IM-2110-4.

[27] *See* Melody Petersen, "S.E.C. Considers Tightening Company Disclosure Rules," *The New York Times* (March 17, 1999) at C2, col. 1 ("Concerned that some investors may be getting key stock information before the rest of the market, Federal securities regulators are considering tightening disclosure rules so that companies will be forced to announce news to all investors at the same time"). According to Ms. Petersen, the Commission's General Counsel, Harvey J. Goldschmid, stated that "Regulators are worried that some investors have been able to profit by getting the information first."

[28] 15 U.S.C. § 77aaa, *et seq.* (1994, Supplemented 1996).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

of 1934 ("Exchange Act")[29] to evolving trends in capital formation, innovations in technology and telecommunications, and increasing competition in global capital markets.

The Securities Act provides the necessary framework for "full and fair disclosure" of the material terms of securities offerings, and proscribes fraud in the offer and sale of securities. Congress, however, expressly recognized that not all securities or offerings of securities are required to be registered under the Securities Act. Thus, in addition to various exempted securities[30] and transactions,[31] the Securities Act exempts non-public offerings[32] made to sophisticated investors who have no need for the protections afforded by a registered public offering.[33] For that reason, Congress left to the discretion of the issuer (and the business judgment of management) whether to make public offerings or private placements of its securities.

Congress did not attempt to legislate every particular of securities offerings (which would be impractical), but granted ample authority to the Commission,[34] as an independent regulatory agency, to adopt rules and regulations consistent with the purposes fairly intended by the statute.[35] The Wheat Report is the genesis of the Commission's modern approach to disclosure regulation, *viz.,* prior to adoption, proposed modifications would be tested and evaluated at each stage of development. In this manner, the Securities Act has retained its vitality notwithstanding unforeseeable changes in financial markets, capital-raising processes, technology, and telecommunications in the years since 1933.

The Committee is well aware that the Commission's use of this authority has generally served equity and debt capital markets exceedingly well.[36] The integrated disclosure system, shelf registration,

---

29 15 U.S.C. § 78a, *et seq.* (1994, Supplemented 1996).

30 Section 3 of the Securities Act, 15 U.S.C. § 77c.

31 Section 4 of the Securities Act, 15 U.S.C. § 77d.

32 Section 4(2) of the Securities Act, 15 U.S.C. § 77d(2).

33 *See SEC v. Ralston Purina Co.*, 346 U.S. 119 at 125 (1953) ("offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering'"). Indeed, when it adopted Rule 144A, the Commission recognized that because of their size and financial sophistication, certain institutional investors (who dominate equity and debt markets) are able to fend for themselves, and do not need the protection of Securities Act registration statements. *See* Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145. Securities Act Release No. 6,862 (April 23, 1990).

34 *See* House consideration and amendment of H.R. 9323, 73rd Cong., 2d Sess., *reprinted in* 78 *Cong. Rec.* at 7703 (April 30, 1934) (while the solutions offered in the original bill to regulate securities exchanges "might be correct, their effects were so far-reaching as to make it inadvisable to put these solutions in the form of statutory enactments that could not be changed in case of need without Congressional action").

35 *See, e.g.,* Section 19(a) of the Securities Act, 15 U.S.C. §77s(a) (rulemaking powers) and Section 28 of the Securities Act, 15 U.S.C. § 77z-3 (general exemptive authority).

36 John M. Liftin, *et al.,* Committee on the Federal Regulation of Securities of the Section of Business Law of the American Bar Association [File No. S7-19-96] (December 11, 1996) [Concept Release Public Comment File] ("ABA Letter") at 3

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

EDGAR, the Commission's Internet site, and the creation of "safe harbors" for institutional resales, offshore offerings,[37] and research activities[38] are products of the Commission's intelligent, rational administration of federal securities laws. The "fundamental reforms" envisioned by the Committee in 1996 would have been built on the current integrated disclosure system (and its "crown jewel", shelf registration) and reconciled Commission lore and statutory metaphysics with modern techniques of capital formation and communication practices.[39]

D. REGULATION CAN ACCOMMODATE INNOVATIONS IN CAPITAL FORMATION WITHOUT COMPROMISING INVESTOR PROTECTION OR THE PUBLIC INTEREST.

As members of the private securities bar, we remain committed to ensuring that rules and regulations promulgated under federal securities laws continue to be responsive to innovations in the capital markets without unduly burdening capital formation. We support regulation that is consistent with the Commission's mandate to act in the public interest and for the protection of investors.

The close of the second millennium has been a time of rapid technological development accompanied by an accelerated pace of innovative capital formation techniques. Issues associated with these developments are often complex. In order to maintain the preeminence of domestic capital markets, we recommend that the Commission avail itself of the resources and expertise of the securities industry and the private securities bar in its continuing review of disclosure policy.

We would be pleased to assist the Commission in this on-going review of disclosure policy. This could take the form of a regularly-convened Capital Formation Working Group ("Working Group") and be composed of representatives of each of the ABA (counsel to issuers, underwriters and investors), the Council of Institutional Investors, the American Society of Corporate Secretaries, the Business Roundtable, the Securities Industry Association and the Bond Market Association, and other professionals with recognized expertise in these matters (*e.g.,* accountants, economists and academicians).[40]

Due to its composition, the Working Group would offer the Commission a balanced perspective (market-oriented and theoretical). The Working Group could also prepare model rules, regulations and forms, thereby offering the Commission specific approaches for its consideration in connection with matters identified

---

("Without the SEC's achievements to date, US corporations (with the possible exception of those engaged in initial public offerings) would long since have found the Securities Act an impediment to their ability to raise capital").

37 Regulation S under the Securities Act, 17 C.F.R. § 230.901, *et seq.*

38 Rules 137, 138, and 139 under the Securities Act, 17 C.F.R. § 230.137 - 139.

39 *See* Proposing Release at n. 21 and accompanying text.

40 We anticipate that these convocations would be conducted under the provisions of the Government in Sunshine Act, and consider various issues associated with the Regulatory Flexibility Act Agenda published from time to time by the Commission.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

in the Regulatory Flexibility Act Agenda. This would be similar to the Commission's request for views on a regulatory framework for offerings of asset-backed securities (*see infra*). The Working Group would be similar to the Commission's long-standing commitment to small business initiatives. In order to ensure a broad spectrum of public awareness, we recommend that the Commission consider convening sessions of the Working Group in various geographical regions of the United States.

E. IRRESPECTIVE OF THE ULTIMATE FATE OF THE "AIRCRAFT CARRIER" PROPOSALS, THE COMMISSION SHOULD MAKE ADEQUATE PROVISION FOR OFFERINGS OF ASSET-BACKED SECURITIES.

We appreciate the Commission's request for views concerning a regulatory framework for asset-backed securities ("ABS")[41] in the context of the régime described in the Proposing Release.[42] We believe that it is extremely important that the Commission not engage in a fundamental revision to the registration process without making adequate provision for ABS.[43] Given the idiosyncrasies of registration and reporting for ABS offerings and issuers, respectively, and the enormous size of the ABS market,[44] we believe this is a propitious time for the Commission to formally promulgate rules, regulations, and forms for ABS irrespective of the ultimate fate of the "Aircraft Carrier". For example, there is widespread recognition that disclosure items applicable to ABS differ from those material to securities of operating companies.

In summary, we believe that the Commission should (1) adopt reasonable rules related to term sheets and computational materials and (2) codify current interpretive positions concerning Exchange Act reporting.[45] Finally, the Commission should assure that disclosure policies are communicated broadly to the industry at-large rather than on a selective basis in the context of comments on particular filings during the staff review process.

---

41 Unless otherwise noted, references in this letter to "ABS" include mortgage-backed securities and "asset-backed securities" as defined in General Instruction I.B.5 to Form S-3.

42 As noted elsewhere in this letter, many of the proposals in the Proposing Release raise significant issues within the public securities markets generally. We believe those concerns also apply to the ABS market, and our views on the regulatory framework for ABS are subject to those concerns.

43 The Commission noted that neither proposed Form A nor proposed Form B is currently designated for registration of offerings of asset-backed securities. In addition, the Commission is proposing*, inter alia,* to eliminate Forms S-1 and S-3 and to revise paragraph (a)(1)(x) of Rule 415 to replace references to Form S-3 (and Form F-3) with references to Form B. As proposed, there would not be a Securities Act registration form authorized or prescribed for offerings of ABS. In addition, many of the Commission's proposals depend upon whether a registrant would be eligible to use Form A or Form B, compounding the uncertainties with respect to ABS offerings under the proposed regulatory régime.

44 In 1998, ABS offerings on shelf registration statements exceeded $300 billion. *See* Securities Data Co. statistics for 1998 ABS Offerings.

45 *See* John M. Lifton, *et al.*, Committee on the Federal Regulation of Securities of the Section of Business Law of the American Bar Association [File No. S7-30-98 (Asset-Backed Securities)] (June 29, 1999).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

II. REGISTRATION AND DISCLOSURE POLICY

A. THE SHELF REGISTRATION PROCESS AND CURRENT REGISTRATION FORMS ARE SUPERIOR TO THE PROPOSED REGULATORY STRUCTURE.

The proposals would generally interpose regulatory delay into a capital-raising process that is noted for its efficiency.[46] In markets increasingly characterized by volatility (daily and intra-day), delay introduces substantial risk and is inimical to capital formation.[47] Indeed, when it considered adoption of shelf registration, the Commission thoroughly examined the impact of interposing regulatory delay in the rule, but ultimately rejected it as costly and unwarranted.[48] The Proposing Release does not specify abuses that justify this timing regression in regulation of our markets.

1. Proposed forms for Securities Act registration should not be adopted.

a. Proposed Form A.[49]

Proposed Form A, which is designated for domestic and foreign issuers, would be available to register offerings by unseasoned issuers and issuers that do not satisfy the minimum $1 million average daily trading volume or $250 million public float requirement for registration on Proposed Form B. Concurrent Exchange Act registration pursuant to paragraphs (b) or (g) of Section 12[50] could also be effected on the proposed form. The proposals do not make substantive changes to the current disclosure requirements; rather, the principal changes are (1) how that information is delivered, and (2) when Form A registration statements become effective. These changes, however, are significant.

i. A 7 or 3 calendar day preliminary prospectus delivery requirement would seriously impede the underwritten distribution process and place many offerings in jeopardy.

As proposed, a preliminary prospectus would have to be delivered to each investor at least seven calendar days before pricing in the case of unseasoned issuers and three calendar days before pricing in the case

---

46 For example, mandating term sheet delivery and finalizing prospectus disclosure before sale (Form B), mandating preliminary prospectus delivery seven or three business days before pricing (Form A), and relegating issuers currently eligible to effect shelf registration to proposed Form A (and the specter of delays resulting from the staff review process).

47 *See e.g.,* PSA The Bond Market Trade Association [File No. S7-19-96] (November 8, 1996) at 3 (imposition of "transaction-specific filing requirement prior to sale would significantly reduce the benefits of shelf registration"); Securities Industry Association [File No. S7-19-96] (November 13, 1996) at 9 (rejected "regulatory 'speed bump'"); ABA Letter, *supra* note 36 at 9 (earlier prospectus delivery period unnecessary).

48 *See* Shelf Registration Final Rule at n. 15 and accompanying text.

49 Form A would supersede current registration statements on Forms S-1 [17 C.F.R. § 239.11], S-2 [17 C.F.R. § 239.12], F-1 [17 C.F.R. § 239.31], and F-2 [17 C.F.R. § 239.32] under the Securities Act.

50 15 U.S.C. § 78l(d) and (g).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

of seasoned Form A issuers. If there are material changes, the information must be delivered at least 24 hours before pricing. A failure to satisfy these requirements would be a violation of Section 5 of the Securities Act.

These advance prospectus delivery requirements are impractical and would interfere with the successful completion of many underwritten offerings under Form A. While the objective of providing investors with the prospectus in a timely fashion before they make their investment decision is sound, the proposed approach is unworkable and is likely to result in excluding retail investors from offerings rather than affording them protection.

The underwriting process is an iterative one in which the pricing and sizing of an offering evolve as new investors come in to participate. It is all designed to culminate with the pricing of the offering to achieve maximum efficiency. It is not possible, and indeed would be counter-productive, to call a halt to the process for seven or three calendar days to allow newly identified investors to catch up. The markets are too volatile and the requirement for certainty in capital-raising is too important to permit this. The staff has recognized the need for speed and flexibility in the registered offering process in the recent *Wit Capital* no-action letter.[51]

If an offering is oversold, it might theoretically be possible to complete it with only investors lined up seven or three calendar days before. But even in that case, it would prevent newly identified investors, who are more likely to be retail customers, from participating. In many cases, the offering is not oversold in advance and the book is being compiled up to the time of pricing and even after. These offerings would have to be downsized, delayed or abandoned in a weak market or if the underwriters' book changed shortly before pricing.

The Securities Act from its inception has recognized that advance prospectus delivery to each investor cannot realistically be mandated. The statute requires that the prospectus accompany or precede the confirmation. The Commission administratively has sought to ensure adequate dissemination of the preliminary prospectus through Rule 460 under the Securities Act[52] and Rule 15c2-8 under the Exchange Act.[53] This approach has worked well but it is applied on an overall basis rather than with respect to each investor as proposed by the "Aircraft Carrier". There is no evidence that a change in approach is required. Quite the contrary, the availability of preliminary prospectuses electronically on the Commission's website through EDGAR, and frequently on issuer and underwriter websites makes it more likely that the preliminary prospectus will be readily available to an investor.

---

[51] Wit Capital Corporation (July 14, 1999).

[52] 17 C.F.R. § 230.460

[53] 17 C.F.R. § 240.15c2-8.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

ii. Issuers should be permitted to incorporate by reference or deliver company information.[54]

As proposed, "seasoned"[55] issuers could incorporate by reference company information. The Commission has noted that of the Securities Act registration forms filed in 1996, only 105 were filed on Forms S-2 and F-2.[56] We suspect that in many of these filings the issuer did not elect to deliver company information through separate incorporated documents.[57] We also suspect that this situation is unlikely to change if the rule proposals are adopted.

Smaller issuers may, for marketing purposes, still elect to include company information in the prospectus. Any estimates about cost savings would be wholly speculative. Nonetheless, we believe that the "incorporation/delivery" method can be a useful alternative to including all the company information in the prospectus and should be retained.

Form A may be more costly for smaller issuers in at least one respect. Currently, rather than delivering incorporated documents, issuers eligible to use Form S-2 may provide abbreviated company information that focuses on the information most important to investors. It permits the issuer to omit information (*e.g.,* executive compensation tables) that is arguably less important to an investor's decision to purchase the issuer's securities. The Committee believes that it would be a mistake for the Commission to abandon this approach. We suspect that, if asked, investors would say that they rarely review this "back of the book" information. In any event, should they want to see it, it is easily available from various sources, including the Commission's Internet site. Under the Commission's proposals, issuers that do not want to deliver incorporated documents but prefer to include all required information in the prospectus would have to provide the entire range of company information prescribed by Form A.

If the Commission elects to retain "Form S-2 type" disclosure for seasoned issuers, it would make sense to have the required business description refer to Item 101 of Regulation S-K ("S-K Item 101"),[58] rather than the abbreviated disclosure required by Rule 14a-3 under the Exchange Act.[59] The remaining disclosure items prescribed in Form S-2 could be imported into Form A as well. In this way, the Commission could be certain that investors were provided with more comprehensive information about the issuer. This level

---

54 The difficulties created by the absence of short-form registration based on incorporation for issuers not eligible to use Form B are discussed *infra* (*see* "II.A.4.a.ii. Smaller business issuers should be permitted to use Form B to register resales by selling security holders").

55 *See infra* page 18, "II.A.1.a.iii. Definition of 'seasoned' issuer should not be complex."

56 Proposing Release at n. 162. Forms S-2 and F-2 are presently available for smaller seasoned issuers.

57 An issuer filing a Form S-2 can omit certain information that would be required by Form S-1. Thus, Form S-2 has advantages irrespective of the issuer's ability to deliver already prepared documents to satisfy company disclosure.

58 17 C.F.R. § 229.101.

59 17 C.F.R. §240.14a-3.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

of disclosure would be consonant with the requirements of Form 10-K under the Exchange Act,[60] which an issuer can elect to deliver with the prospectus.

We think that the alternative of providing the glossy annual report to shareholders and quarterly reports, instead of Form 10-K and Form 10-Q under the Exchange Act,[61] provides a reduced measure of disclosure and ought not to be continued. In our experience, the business descriptions in glossy annual reports run the gamut from quite thorough to very brief. The requirement in Rule 14a-3 to provide a "brief description of the business" does not provide the same depth and quality of disclosure as that required by S-K Item 101. If the Commission reasonably concludes that seasoned issuers need to accompany the statutory prospectus[62] with a business description, the disclosure prescribed by S-K Item 101 is preferable.

iii. Issuer's ability to time effectiveness of registration statement is illusory.

The Commission proposes to permit an issuer to control the timing of effectiveness if (a) its public float is at least $75 million, or (b) the Form 10-K incorporated into the Form A registration statement has recently been fully reviewed by the staff, and all outstanding comments have been resolved.[63] As proposed, the issuer's registration statement may be subject to a post-effective review. However, the Proposing Release does not describe the consequences to the issuer, underwriters, or other offering participants if this review is negative. For example, would the offering be deemed to violate Section 5?

A public float test of $75 million is appropriate. In response to the Commission's request for comment, we see no reason to make the level higher or lower.

The "recently reviewed" alternative may be helpful, although it will depend to a great extent on whether the staff will accommodate an issuer's request to review its Form 10-K. The timeliness in completing this review will also be an important factor. It may force issuers, underwriters and their respective counsel to new heights of prognostication, speculating whether the statistical chance of a "no review" decision is greater than the almost certain pain that a requested staff review of the Form 10-K would likely inflict. Many issuers may, on balance, decide to "run for luck." If so, the "recently reviewed" alternative (at least in a voluntary setting) may be mere window-dressing. For those issuers whose Forms 10-K are selected for review, and who

---

60 17 C.F.R. §249.310.

61 17 C.F.R. §249.308a.

62 Section 10(a) of the Securities Act, 15 U.S.C. § 77j(a).

63 *See infra* page 82, "IV.B.1. Proposed staff review policy should be revised to provide a greater degree of certainty to the process." *See also* page 24, "II.A.1.b.iii.(B) The existence of unresolved comments in connection with staff review of Exchange Act filings should not block financings." The realities of the staff review process (*e.g.,* staff workload, "merit regulatory" focus of some comments, current heavy staff emphasis on complex accounting issues, legitimate disagreements about the necessity to amend the Form 10-K and civil liability that may arise from any amendment) are likely to significantly reduce the advantages of issuer-initiated effectiveness. Due to the uncertainty of the time within which the first comments would be given (could be well in excess of 30 days, currently 40-45 days in many cases) and the time frame within which comments are addressed to the satisfaction of the staff, issuers may not be able to afford a registered offering in rapidly moving markets.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

satisfactorily resolve the staff's comments in a timely fashion, it may be the equivalent of an *inoculation*, warding off the *review flu* for at least the ensuing nine months or so.

More importantly, the Form A on-demand effectiveness régime carries with it the requirement for a seasoned issuer to deliver a preliminary prospectus to each purchaser three days before pricing. This requirement is wholly incompatible with the quick market access of today's shelf system.

iv. Definition of "seasoned" issuer should not be complex.

The Commission has requested comment on several issues relating to the proposed definition of seasoned issuer. As proposed, there would be two ways for an issuer to become seasoned:

It has been reporting under the Exchange Act for at least 24 months and has filed at least two annual reports; or

It has been reporting for at least 24 months and has a public float of $75 million or more, regardless of the number of annual reports filed.

Given the complexity of the proposals, we are guided by one maxim: *Simpler is better.*

In our view, a three-year reporting history for smaller issuers is too long and one year is too short. Why add an extra layer of complexity by requiring issuers with less than $75 million in public float to have filed at least two annual reports? Two annual reports would admittedly ensure that the issuer's independent auditors had performed two audits after the IPO; however, we have serious doubts that this distinction would matter much in practice. Besides, an issuer would just have to wait a few extra months, depending on when in its annual reporting cycle it had become a public company.

We suggest that the Commission simply define "seasoned" as any issuer with a 24-month reporting history under the Exchange Act. Two years of reporting history also ought to be sufficient to allow issuers to be permitted to incorporate by reference,[64] without further qualifications.

v. Specific comments on the text of the proposed form.

(A) Should include definition of "seasoned issuer".

We believe that the term "seasoned issuer" should be defined in the form or in the rules, and not solely in the Proposing Release.

(B) "General Instructions" to the form should be revised.

64 Based on 1997 data, over 1,000 issuers presently eligible to use Form B for a shelf offering would be required to use proposed Form A. *See* Proposing Release at "Section I.C." In addition, the application of so-called "bad boy" provisions would render incorporation by reference unavailable for affected issuers. *See infra* page 23, "II.A.1.b.iii.(A) Disqualification under so-called 'bad boy' provisions should not be adopted."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

General Instruction II.B.4(b) refers to a registrant that has "caused any material delinquency with respect to preferred stock . . . ." What does this mean? What if the issuer did not "cause" the delinquency but one nonetheless exists?

In General Instruction VI.A., foreign registrants are instructed to "reconcile [their] financial statements. . . ." Would a foreign registrant understand what that means? We presume it means to reconcile financial statements to generally accepted accounting principles prevailing in the United States ("US GAAP"), but it would help to state explicitly "reconcile the financial statements to US GAAP" and cross-reference to the relevant provision of Regulation S-X if that is the intent.

General Instruction VIII.A.1 would be clearer if the instruction read that the Form would be effective automatically "upon filing or upon a specified date designated by the registrant, as specified on the front page of the Form . . . ."

General Instruction X.D states that issuers are to file at least one complete signed copy of the Form with each exchange or market. These filings are now deemed to be made *via* EDGAR, and paper copies need not be filed. The instruction should be revised to conform to the Commission's electronic filing rules.

(C) <u>The proposed certifications on the signature page should not be adopted</u>.

Under proposed Form A, a majority of the issuer's board of directors and each signatory to the registration statement (and amendments thereto) would have to certify that they have read the filing. In general, we believe these requirements are impractical and do no reflect the manner in which registration statements and amendments thereto are prepared and filed with the Commission.[65] Accordingly, the Committee believes that a "certification" requirement should not be adopted.

b. <u>Proposed Form B</u>.

i. <u>Shelf registration is without question one of the Commission's most successful regulatory innovations, and has operated without abuse since 1982</u>.

The Commission heralded proposed Form B as a major advance in capital formation on the theory that it would offer issuers quick market access while providing investors with more information on a more timely basis. The benefits, however, are illusory. Unlike the highly successful shelf rule, the Commission's proposals would obstruct market access by issuers and selling securityholders. The proposed free communications rules would not result in greater flows of information to investors, but would have a chilling effect on issuers, underwriters and broker/dealers, which presently provide much of the information investors now receive.

---

[65] *See infra* page 27, "II.A.1.b.iv.(A) The proposed certfications on the signature page should not be adopted."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Form B proposals ignore the way the public capital markets in the US currently operate. Ready access to capital markets already exists in the form of shelf offerings pursuant to Rule 415 for issuers eligible to use Forms S-3 or F-3. For example, in 1998, over $50 billion in equity (including convertible and preferred) and $350 billion in debt (excluding asset-backed)[66] were raised under a shelf registration system that has operated without identified abuse since 1982. The Commission's proposals will disrupt this significant and highly efficient market by delaying issuer access by at least one to two days. That delay undoubtedly has a real cost (and associated risk). We note, however, that the Commission has not analyzed or quantified the cost of that delay.[67]

The proposed structure of Form B offerings would also adversely impact how transactions are marketed. We expect issuers and underwriters to prohibit all written disclosures except those fully vetted by the legal and business representatives of the issuer and lead-managing underwriter, because of the onerous cross-liabilities the proposals would impose on offering participants for those written disclosures.[68] We expect the statutory prospectus and registration statement generally to become the only permitted disclosure documents. In other words, *investors would receive no additional information,* and potentially less. Road show[69] information would still be available only to institutional attendees. We predict that information presented at the road show would be reduced to ensure that it would be deemed only "oral" and thus not subject to filing under the new régime.

ii. Proposed Form B is fundamentally flawed and would disrupt capital formation.

(A) Current *sell, then document* process should continue to be permitted.

The Form B proposals would require all offering information to be on file with the Commission at the time of the first oral commitment by an investor (other than pricing-related information pursuant to Rule 430A under the Securities Act[70]), and would require Rule 430A information to be on file by the time written

---

66 Based upon statistics published by Securities Data Co.

67 *But cf.,* "Report of the Advisory Committee on the Capital Formation and Regulatory Processes," (July 24, 1996) at iii. The regulatory delays proposed to be imposed by the "Aircraft Carrier" stand in contradistinction to the flexibility recommended by the Advisory Committee, pursuant to which the "issuer would be able to offer and sell its securities without any regulatory delay in virtually all cases." *See also* page 108, Appendix I - "Walk-Through of a Form B Offering".

68 *See infra* page 84*,* "V. Liability."

69 "Road shows" are presentations made by the company's executives to potential institutional investors. The meetings are organized by the company's investment bankers. The only written information disseminated to the attendees is the statutory prospectus, although slides are often used to accompany the oral statements. Copies of the slides are not to be distributed outside the "road show".

70 17 C.F.R. §230.430A.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

confirmations[71] are sent to investors. While in the abstract this approach may seem innocuous, it disregards 17 years of shelf practice and would in our view likely disrupt the current multi-billion dollar corporate capital formation process. The proposals in effect demolish today's shelf registration system. However, the Proposing Release does not identify any abuses that would justify such a disruptive and costly change.

Under the current system, issuers and underwriters are accustomed to pricing and selling an offering, then documenting *via* completion of the prospectus supplement within one or two business days, as required by Rule 424 under the Securities Act.[72] This instant market access allows them to minimize exposure to market volatility and risk.

The pre-sale documentation requirements of the proposals would almost always cause some delay between the desired time of pricing and the time of sale to investors, while security-related information is documented. This delay would almost always be at least several hours, and seems likely to be at least a day or more. As noted in Appendix I, "Walk-Through of a Form B Offering", when Form B proposals are compared to typical offerings of investment-grade securities under the current shelf rule, investment-grade debt securities would probably have a one-day "speed bump," and equity offerings would either have a similar "speed bump", or the issuer would be forced to downsize the offering and risk a lower price.

While we cannot predict how the market exposure risk (which varies widely in daily and intra-day trading) would be allocated among issuers, underwriters and investors, it is obvious to us that the delay would introduce a real and new economic cost to capital formation in the United States. The Proposing Release does not address this allocation of risk. In view of the prominence and importance of US public markets to the corporate capital-raising process, we urge the Commission to conduct a serious economic study of the likely impact of the proposals on the costs of US capital formation.

The ability to postpone filing Rule 430A "pricing-related information" until confirmations are mailed would provide only partial relief. The scope of matters that are not finalized until pricing a security is much broader than the limited Rule 430A information, and can encompass the majority of transaction-related information — from covenants and redemption provisions in debt securities, to anti-dilution adjustments in convertible securities, to pro forma financial information. The Committee believes that maintaining the current post-sale documentation approach for *all* transaction-related information is the only way the proposals would avoid this adverse market impact on domestic capital formation.

The Form B proposals would also undermine forward incorporation by reference, a cornerstone of the current delayed shelf process. Requiring the listing of all previously filed Exchange Act incorporated documents at the time of each takedown would prohibit forward incorporation by reference. What must an issuer do if it files an incorporated document after a takedown but before the offering is fully sold (*i.e.*, before the end of the offering period)? Incorporation is automatic in today's system, and correctly so based on the efficient market theory which supports shelf registration and (presumably) the Form B proposals.

---

[71] Rule 10b-10 under the Exchange Act, 17 C.F.R. §240.10b-10.

[72] 17 C.F.R. §230.424.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Commission must also recognize that a significant change in the registration process, as proposed, that has adverse economic consequences could drive some issuers and underwriters to the unregistered market. The proposal's likely increase in capital-raising costs could narrow the pricing advantage of the public markets *versus* the Rule 144A market for fixed income securities. With the recent introduction of the Euro currency, the European capital markets can be expected to become more attractive for US issuers as well, through improved liquidity and a broader investor base.

We are not aware of any widespread or systemic problem with the current shelf system, and the Commission has not identified any such problem in the Proposing Release. Where the security is relatively straightforward, an oral description of terms to investors suffices. For more complex or novel securities, in our experience investors can be relied upon to require circulation of a preliminary prospectus or term sheet (if permitted) as part of the marketing process.

The Committee urges the Commission to reconsider implementing such a potentially disruptive change to the US capital formation process as would be caused by the "document-before-sale" proposal.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

(B) Term sheet delivery requirement should be eliminated.

Preparation and delivery of a term sheet before the investor makes an investment decision would unduly delay the offering process and provide no corresponding benefits.[73] The problem would be most acute for investment grade underwritten debt and medium term note ("MTN") programs, which are often sold from trading desks in the same manner as secondary market sales of similar securities (*i.e.*, on the basis of credit quality rating, interest rate and maturity). The term sheet delivery requirement would also be a problem for offerings of common stock that do not require a significant selling effort. For issuers of the high standing of those eligible for proposed Form B, the requisite information would either be readily available through previously filed information or else readily communicated orally. When used with potential institutional investors to develop the terms of a deal, the term sheet will necessarily vary from the final terms of the deal. Further, it seems inappropriate to subject the issuer or the underwriters to liability under Section 11 because indicative term sheets were required to be filed as part of the registration statement.

Preparing, filing and delivering of a term sheet would in most cases be an unnecessary impediment. In cases where the novelty or complexity of the offered security warrants a written summary, customary market pressures should be more than adequate to ensure investors receive whatever additional information they require.

If a term sheet delivery requirement of some sort is to be kept, it should be limited to complex or novel securities. What would be in a term sheet for common stock? Why would a term sheet be needed for traditional investment grade debt? Further, the proposed Form B certification of compliance with that requirement should not be adopted. The Form B cover sheet contains a certification by the signers of the registration statement of compliance with the term sheet delivery requirements. Obviously, this is not within their control (or even their knowledge) because delivery would be made by underwriters, *after* the filing of the term sheet. The certification would serve no purpose and would undermine the analytical integrity of the registration process.

iii. Form B's eligibility requirements should be revised.

(A) Disqualification under so-called "bad boy" provisions[74] should not be adopted.

The proposals introduce "bad boy" disqualification, a new and problematic concept, to "short-form" registration. Under these provisions, proposed Form B would be unavailable if the issuer, its executive officers or directors or its underwriters have been previously held to have committed specified securities fraud or been enjoined from future violations. To comply with this requirement, an issuer would have to verify the status of its underwriters, and the underwriters would have to verify the status of the issuer and its executive officers and directors, as well as each other. In the world of "on-demand" registration, this verification may be

[73] *See* Proposed Rule 172(a)(2).

[74] *See,* General Instruction I.B.6. to proposed Form B. *See also,* General Instruction II.B. to proposed Form A.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

difficult or impossible to complete in the required time frame. Offering participants can be added at the last minute, and time can generally be extremely tight. In practice, this requirement would make the notion of "on-demand" effectiveness of the registration statement illusory.

Contractual cross-representations and cross-indemnifications would not be an adequate substitute for due diligence in this area, given the potential downside risk if a disqualification were found to have existed after-the-fact. The penalty for proceeding on proposed Form B when not eligible would appear to be that the entire offering violates Section 5 of the Securities Act, for which the remedy is rescission under Section 12(a)(1) of the Securities Act.[75] We can envision an entire new industry of plaintiffs' lawyers focused on discovering latent Form B disqualifications.

Form B issuers are already expected to have high standing, based on their market prominence, which should offer sufficient safeguards against whatever unspecified abuse is of concern to the Commission. The Committee is not aware of any problems with today's shelf system that would justify a requirement as extreme as the Form B disqualification provisions, and we believe they should not be adopted.

(B) The existence of unresolved comments in connection with staff review of Exchange Act filings should not block financings.

The Commission proposes to make Form B "on-demand" registration unavailable if the staff has given the issuer comments on an incorporated Exchange Act report that have not been resolved to the satisfaction of the staff. Under the current shelf system, in such a situation the issuer and underwriters would assess the materiality of the affected disclosure comments and make a considered judgment to proceed or not to proceed with a takedown from an already-effective shelf. Given the potential liability if important disclosures were subsequently changed, these decisions would be weighed quite seriously and would err in the direction of awaiting resolution of the staff's comments. This balance, in our view, already provides adequate safeguards against unreasonable offering activity in the face of disclosure comments by the staff.

Many staff comments, initially phrased as requests for disclosure changes, are ultimately resolved through supplemental explanation to the staff. Instead, under the Commission's proposals, the mere issuance of a staff comment letter "blacks out" the issuer from conducting an offering unless it capitulates immediately on all points, irrespective of the validity of the comments or materiality of the disclosure sought. Furthermore, the "black out" would continue during any dispute between the issuer and the staff, even on immaterial matters. The time required to resolve these comments could be several months. This aspect of the proposals would give the Commission staff an unwarranted "choke-hold" over issuers. It could also drive issuers into the Rule 144A or foreign unregistered markets in cases where they would otherwise be comfortable with a public shelf takedown but would now be blocked from doing so because of unresolved comments. We believe this proposal is too extreme and should not be adopted.

(C) Penalty for filing on the incorrect form should be clarified and eased.

---

75 15 U.S.C. § 77l(a)(1).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Commission proposes to make paragraph (g) of Rule 401 under the Securities Act[76] unavailable for offerings filed on Form B. Currently, the rule deems the registration statement to have been filed on the correct form unless the staff objects before effectiveness. While we understand that application of the rule to an automatically-effective form may raise conceptual concerns, a more practical approach is called for than the one proposed. Given the potential liability to participants if an offering were retroactively deemed to have violated Section 5, it is essential that a bright-line standard exist. This is even more necessary to the extent the Commission determines to adopt "disqualification provisions" in proposed Form B.

Rule 401(g) currently serves the purpose of being such a bright-line standard. The inability of the staff to review a registration statement prior to an offering has already existed for every takedown under the current shelf registration system since 1982. What are the abuses that justify the proposed change? We are not aware of any abuses or other problems with this approach, and believe no change is warranted.

If Rule 401(g) is nonetheless amended as proposed, the Commission should at a minimum clarify that the penalty for inadvertently proceeding on Form B is limited to Commission administrative remedies against the non-qualifying issuer, and that no private remedies are available or implied. In other words, the rule should be clear that the Form B filing becomes effective as specified therein, even if the offering is ultimately found not to have been eligible for Form B for some reason.

(D) Financial eligibility criteria should not be changed.

The Form B proposals would add a $1 million average daily trading volume test ("ADTV") for issuers having under $250 million in market capitalization. This test would be applied solely to US trading volume. The Commission estimates that 30 percent of the 4,824 issuers eligible for Forms S-3 and F-3 in 1997 would have been forced into the Form A régime.[77] While some of these issuers would theoretically be eligible for automatic effectiveness and incorporation by reference, the other requirements of Form A procedures would either block this approach or make it much slower and more cumbersome than proposed Form A.[78]

The Committee notes that the Commission's analysis was based on 1997 data. Subsequent increases in general stock market price levels have no doubt pushed many of those issuers above $250 million in market capitalization. However, these increases have also created more Form S-3 and Form F-3 eligible issuers at the $75 million level, many of which would likely be ineligible for Form B due to the $1 million trading volume test. We are not aware of any abuses arising as a result of the $75 million level. Accordingly, we believe the financial eligibility standards for proposed Form B should remain as they currently are for Forms S-3 and F-3. At the very least, if the eligibility standards are raised, issuers who are now S-3 or F-3 eligible should be grandfathered.

(E) Secondary offerings should be permitted on Form B.

---

[76] 17 C.F.R. § 230.401(g).

[77] Proposing Release at n. 625 and accompanying text.

[78] *See also* page 17, "II.A.1.a.ii. Issuer's ability to time effectiveness of registration statement is illusory."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Form B proposals would eliminate short-form registration for secondary offerings on Form B if the issuer is not eligible for a primary offering on that Form. Form S-16 permitted short-form registration of secondary offerings from its initial adoption in 1970. When Form S-3 was adopted to replace Form S-16 in 1982, it also was available for secondary offerings without regard to the minimum public float requirement for primary offerings. As originally proposed, Form S-3 would have applied the same public float requirement to both primary and secondary offerings, similar to what the Commission now proposes for Form B.

The adopting release for Form S-3 noted that commenters had urged the Commission to make Form S-3 available for secondary offerings, as they had been under predecessor Form S-16, without regard to public float. In reconsidering its proposal and making the requested change in the final version of the form, the Commission stated it had concluded that "most secondary offerings are more in the nature of ordinary market transactions than primary offerings by the registrant, and, thus, that Exchange Act reports may be relied upon to provide the marketplace the information needed respecting the registrant."[79] Accordingly, the Commission eliminated the public float requirement for secondary offerings by non-affiliates on Form S-3.

Given this long-standing practice, the current proposals should permit delayed secondary offerings on proposed Form B to continue for all issuers having the requisite reporting history, even where the market capitalization or trading volume tests are not satisfied. Moreover, the Commission should continue to permit prospectus delivery obligations to be satisfied by delivery to a national securities exchange pursuant to Rule 153 under the Securities Act.[80]

In the Proposing Release, the Commission dismisses commenters' 1982 concerns on the original Form S-3 proposal as not relevant to the Form B proposal. The Commission asserts that venture capital financing and resale concerns can be addressed under the Form B proposals by an issuer's conducting venture capital financing on a registered basis on Form B to existing investors and qualified institutional buyers ("QIBs")[81], which remain eligible offerings on proposed Form B after the seasoning requirements are met even where the trading volume/public float test cannot be met.

This assertion discounts the potential significance to the resale process of non-QIBs (who are not already investors). Narrowing the resale market essentially to institutions would presumably adversely affect the pricing and thereby raise the "costs" of venture capital formation. Similarly, resale registration is an important component of acquisitions done for "speed and efficiency" as private offerings. Therefore, we believe resale registration should be permitted on proposed Form B once the issuer has been a public reporting company for 12 months. In the absence of resale registration, there will be a loss of liquidity which will increase the costs of non-institutional private offerings and private acquisitions.

---

79 *See supra* note 1 at n. 23 and accompanying text.

80 17 C.F.R. § 230.153.

81 Paragraph (a)(1) of Rule 144A under the Securities Act, 17 C.F.R. § 229.144A(a)(1).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

iv. Specific comments on the text of the proposed form.

(A) The proposed certifications on the signature page should not be adopted.

Form B would require the signers of the registration statement (including a majority of the issuer's directors) to certify they have read the registration statement. The same certification applies to every amendment. As a practical matter, the signers can be expected only to have read a *draft* of the original registration statement before filing.

They cannot be expected to gather at the financial printer and read pages as changes are made in the pre-dawn hours. They will not read multiple printer's proofs having only incremental changes as a document nears final form. They will not be able to read "offering information" prepared by underwriters and others, then filed immediately before first use in the fast-paced environment of "on-demand" registration. They will not have an opportunity to read last-minute amendments filed to reflect deal pricing. They will not read exhibits.

Including a certification requirement that the Commission knows cannot be observed is unreasonable and disrespectful to the signers. Moreover, this requirement could create additional liability, and would, in our view, undermine the analytical integrity of the registration process.

The proposed certification would require that the signer certify to his knowledge that the document contains no material misstatements or material omissions. How does this certification affect the relative liability of signers *versus* directors who do not sign? How will the signers conduct their own due diligence in a fast-paced offering process? If they do not, what does the certification mean? Disparate liability for signing and non-signing directors would create disincentives for signing the registration statement and would undermine the public policy served by the liability provisions in the Securities Act. Hence, we believe the proposed certification should not be adopted.

(B) Forward incorporation by reference should be permitted on Form B.

Item 3(b) appears to prohibit incorporation by reference into the registration statement and prospectus of any Exchange Act document filed after the time of delivery of the term sheet prescribed by proposed Rule 172(a) under the Securities Act (which must occur before an investor makes a binding investment decision).

We believe that Item 3(b) should be deleted. First, the term sheet delivery time would be different for each investor. Yet, whether or not an Exchange Act report is incorporated in the registration statement must be answered the same for all investors as of any given date.

Second, the principle of efficient markets, on which the current shelf system is based, is predicated on public dissemination of the information in Exchange Act filings. There is no reason why that should cease being true after delivery of any term sheet.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Third, the requirement creates a disincentive for early delivery of the term sheet. If the term sheet cuts off incorporation by reference, issuers would seek to delay delivery by underwriters and other offering participants until the last possible moment. This result is contrary to the interests of investors.

Fourth, the term sheet requirement emphasizes terms of the proposed offering, whereas incorporated Exchange Act documents are most likely to address information concerning the issuer.

Fifth, prohibiting incorporation by reference would not ensure that the investor physically receives information disclosed after delivery of a term sheet. Presumably, an issuer would file the information as a post-effective amendment and continue with the offering to other investors. We believe that an issuer's liability for its registration statement and prospectus would be the same whether the material is incorporated by reference or physically included in the registration statement and prospectus. If the Commission wishes to emphasize or clarify that forward-incorporated documents are also subject to Section 11 liability, we believe a specific rule to that effect would be a more direct and less problematic way to address the concern.

Thus, the prohibition on incorporating Exchange Act documents filed after term sheet delivery should be eliminated.

(C) Interim incorporated reports cannot be new registration statements.

The proposals would revise the undertaking in Item 512(b) of Regulation S-K[82] to provide that the filing of a Form 10-Q or Form 8-K under the Exchange Act[83] would be deemed to be the filing of a "new registration statement." While indisputably such a filing is a *part* of the registration statement, it is not a comprehensive document, and the Committee believes that it would be inappropriate to treat it as such.

Perhaps the intention of the undertaking is to provide that the Form 10-K should be considered a new registration statement as of the date of the Form 10-Q or 8-K filing (as modified by that filing). This approach is also flawed, because the Form 10-Q or 8-K filing would not comprehensively update the Form 10-K. The Committee believes the only approach that works analytically is the one in the current undertaking: that the Form 10-K filing is deemed the filing of a new registration statement.

We assume the Commission's goal in changing the undertaking was to subject the interim report to Section 11 liability and to extend the statute of limitations for purposes of liability under Section 11 to run from the most recently filed Exchange Act periodic report, rather than from the Form 10-K filing, if those dates are more recent than the effective date of the registration statement. The Committee suggests that this be addressed directly, if in fact any change is needed. In this connection, we note that many Form B offerings may be made through stand-alone, "on-demand" filings rather than through supplements to a previously effective shelf registration statement.

---

82 17 C.F.R. § 229.512(b).

83 17 C.F.R. § 240.308.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

(D) After-market prospectus constructive delivery creates an update problem in all offerings.

The proposed revisions to Rule 174 under the Securities Act[84] would create a prospectus "delivery" requirement for dealers after *all* offerings, not just IPOs. While the proposed revision avoids the mechanical burden of physical delivery through constructive delivery by reference to Commission filings, it does not address the question of updates during the 25-day period. If in fact the prospectus is deemed delivered throughout the 25-day period after the offering, then the issuer will be justifiably concerned about its liability under Section 12(a)(2) of the Securities Act[85] (as will any dealer that could be a seller) if any event occurs that would warrant a revision or addition to the disclosures. Furthermore, because any such update would most likely have to be reflected after the "offering period," incorporation by reference would not be available under Item 3(c) of proposed Form B or under Item 3(b) for the reasons noted above. This leaves the unattractive prospect of a post-effective amendment, and the attendant disruption of after-market trading.

Certainly, this result is unintended. The Commission indicates the rationale for the proposed amendment to Rule 174 is the decision in *Gustafson v. Alloyd Co., Inc.,*[86] which some lower courts have subsequently interpreted to mean that after-market investors do not have standing to assert Section 12(a)(2) claims. We suggest that the Commission address its concern through a request that the Congress amend the statute, rather than by creating confusion in the prospectus delivery rules.

c. Proposed Form C.

i. The Commission should adopt an *omnibus* Form M-A instead of proposed Form C.

Proposed Form C would be prescribed for business combinations and exchange offers and supersede current Forms S-4 and F-4.[87] Proposed Form SB-3 would be available for specified small business issuers. A special committee of the Committee has examined the proposed registration régime in the context of the Regulation of Takeovers and Security Holder Communications,[88] which was proposed concurrently with the "Aircraft Carrier".

In their view, the Commission's goal to integrate disclosure obligations (and thereby reduce filing obligations) could be accomplished with greater efficiency if the Commission were to adopt one form applicable

---

84 17 C.F.R. § 229.174.

85 15 U.S.C. § 77l(a)(2).

86 513 U.S. 561 (1995).

87 17 C.F.R. §§ 239.25 and 239.34, respectively.

88 Securities Act Release No. 7,607 [File No. S7-28-98] (November 3, 1998) [63 FR 67331 (December 4, 1998)] ("M&A Proposing Release").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

to any transaction involving an exchange offer, merger, or other business combination ("Form M-A") and prescribe related disclosure requirements in one regulation ("Regulation M-A").[89] Thus, if Proposed Form M-A were adopted as an *omnibus* Securities Act registration statement for exchange offers, mergers, and business combinations, there would not be a need to adopt proposed Form C or proposed Form SB-3 for offers registered under the Securities Act.[90]

The Committee concurs in this view, and encourages the Commission to adopt an *omnibus* Form M-A, irrespective of the ultimate resolution of proposals included in the "Aircraft Carrier".

2. The *metaphysics* of integration of private and public offerings.

a. Integration initiatives are a welcome response to a complex issue.

We applaud the Commission's efforts to provide greater clarity to issuers and their counsel on the circumstances under which ostensibly separate private and public offerings of securities would be deemed the same offering for purposes of satisfying the registration requirements of the Securities Act. In addition to clarifying its views of "integration", the proposals include safe harbors applicable to (1) integration of public and private offerings, and (2) voting commitments in connection with mergers and similar transactions (*i.e.,* "lock-up agreements"). In addition to our comments on the Commission's proposal, we recommend an alternative for the Commission's consideration, which we believe would address the integration issues in a more systemic way.

The Committee notes that proposed Form B would provide a larger, seasoned issuer with the ability to commence a private offering or "test the waters" to determine what type of offering to pursue without forestalling its ability to complete the offering as a public offering. In our view, this type of structural solution to the dilemma posed by integration issues is highly desirable. Similarly, an issuer using either proposed Form B or proposed Form A could use the proposed safe harbor to abandon a public offering and complete it privately.

Although the proposals do not provide guidance on "traditional" integration issues, we urge the Commission and the staff to further develop integration principles that enhance certainty and provide greater flexibility to issuers. Subject to our specific comments below, we believe that the proposed safe harbors would provide useful relief for issuers, particularly those ineligible for Proposed Form B, without compromising important investor safeguards for that class of investor for whom the registration provisions of the Securities Act were enacted. Moreover, the Committee believes that integration issues are of such a magnitude that the Commission should immediately adopt relief, irrespective of the ultimate resolution of other proposals included in the "Aircraft Carrier".

---

89 *See* John M. Liftin, *et al*., Committee on the Federal Regulation of Securities of the Section of Business Law of the American Bar Association [File No. S7-28-98 (M&A)] (April 30, 1999).

90 It is expected that Forms S-4 and F-4 would be rescinded upon adoption of an *omnibus* Form M-A.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Committee believes that the Commission should also clarify that the proposed integration safe harbor operates independently of the proposed communications safe harbor. For example, it appears that the proposal contemplates that an issuer using proposed Form A would be able to avail itself of the communications safe harbor prior to the 30-day period before filing in order to convert a private offering to a registered offering, without reference to the integration safe harbor. We believe that the Commission should clarify that this is the case, because communications that are not "offers" do not raise the "gun-jumping" concerns underlying the integration issue. Finally, we believe that the Commission should emphasize that the communications safe harbor in its proposed amendments to Rule 152[91] is non-exclusive; accordingly, any failure to satisfy the requirements of a safe harbor would not necessarily result in integration. The Committee's comments on the integration proposals are noted *infra.*

i. Completed private offering.

Subject to our suggestion below for a more comprehensive approach, we concur that an offering will be deemed complete when the purchase price has been fully paid or, in situations in which there has not yet been full payment, when the transaction cannot be renegotiated and the purchaser is unconditionally obligated to pay for the securities. We agree that the revised rule should make it clear that conditions that are not directly or indirectly within the control of the purchaser will not negate the availability of the safe habor. There is uncertainty, however, as to the conditions that are permissible.

We believe it would be helpful for the Commission to provide guidance on the type of conditions that are permissible because they are not deemed to be within the purchaser's control. For example, customary closing conditions for which there are objective standards (*e.g.,* "material adverse change"), or which the purchaser cannot assert without causing a breach of contract or a violation of law, would not be within its control. On the other hand, conditions that vest the purchaser with discretion, such as satisfactory completion of due diligence, would be within the purchaser's control. Furthermore, we note that the staff supplemental telephone interpretations state that a condition relating to market price (*e.g.,* a collar) is unacceptable.[92] Since market price is a non-discretionary, objective condition that is not within the control of a purchaser (except perhaps by manipulation, which would be illegal or a breach of a duty of good faith and fair dealing), this interpretation would seem to be incorrect.

We question the need for the blanket exclusion of "affiliates" and "dealers" from the resale safe harbor for completed offerings. It is not unusual, for example, that an existing investor or senior management would participate in a financing for which resale registration rights were granted, either on an immediate PIPE[93] basis or on a deferred demand or piggyback basis. Any concern that these persons may be acting as "conduits" (*i.e.,* as "underwriters") could be dealt with on a case-by-case basis with reference to the use of the form

---

[91] 17 C.F.R. § 230.152.

[92] Division of Corporation Finance Manual of Publicly Available Telephone Interpretations, Supplement - March 1999, #35.

[93] "PIPE" is an acronym for private-investment, public-equity. The obligation of an investor in a PIPE transaction to purchase securities in a private placement would be subject to satisfaction of the condition precedent that a resale registration statement has been filed or declared effective at the time of closing.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

available for a "primary offering" (and other consequences stemming from characterization as a primary offering). Rather, the focus should remain on the scope of protection for investors in a registered resale. Thus, the safe harbor for resales should neither be denied across the board, nor have any bearing on the validity of the private offering.

Similarly, we do not see the need to deny a private offering completed status because the purchase price is not fixed but rather may be tied to the market price. While we understand the staff's concern that equity lines may constitute delayed offerings, in our view this concern goes to whether the resale is in substance a primary offering. This factor should have no bearing on to the validity of the private offering exemption. Nonetheless, the Commission should clarify that this condition would not apply to a business combination. In this regard, we note that the number of shares to be issued in a business combination is often determined by a formula based on current market price. Moreover, because these transactions are not for capital-raising purposes, they should not be viewed as constituting delayed primary offerings.

The proscription on re-negotiation should be revised to clarify its application to re-negotiation only of a material term of the investment. The Committee notes that there may be many contractual terms, some of which are not material to the investment, that may need to be renegotiated (*e.g.,* exclusion from exercising board visitation rights when a matter involving the investor is being considered). In our view, overly broad application of this proscription would result in the loss of completed status for many private offerings that merit being considered completed.

We recommend that the proposal be expanded to provide that formation transactions (*e.g.,* private acquisitions) are within the ambit of protection under proposed Rule 152(a)(4) for modification of an issuer's capital structure in connection with an IPO. This would be consistent with existing staff positions. In this connection, it is unclear whether the provisions of proposed Rule 152(a)(2) also apply in the situation described under 152(a)(4), with respect to offerings which do not raise capital for the issuer, or described under 152(a)(4) is self-contained and stands alone. We believe the intent was that if a transaction met subsection (a)(4), it need not fit within subsection (a)(2). We agree with this approach and request that the Commission clarify this intent. We note, however, that subsection (a)(4)(iii), which provides that the private offering must not be a roll-up transaction under rule 901(c) of Regulation S-K, it is unworkable because it is circuitous. A private offering becomes a roll-up transaction if the private offering is integrated into the registered offering. Therefore, it is not possible to determine whether it will be a roll-up transaction unless you first know whether the private placement will be integrated. It should be sufficient that there is a bona fide private placement and such private placement is deemed "completed" within the other parameters of subsection (a)(4) of revised Rule 152.

ii. Abandoned private offering.

The Committee questions the need to require notification of all offerees that the private offering has been abandoned. Adoption of this provision would reintroduce the concept of "offerees," which was correctly abandoned with the adoption of Regulation D. This requirement would not only require keeping track of all offerees, but also of determining who in fact is an offeree. This disclosure would be relevant only for purchasers in the subsequent public offering, and would be obvious to such purchasers from their participation in the transaction. Similarly, purchasers in the after-market will know that a public market has been created

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

since they will be purchasing securities in the secondary market. Because of the difficulty of ascertaining who is an offeree, if the Commission nevertheless retained the notification requirement, we recommend making clear that giving the notice is not an admission that a person is an "offeree" and that a good faith effort, not perfect execution, is all that would be required.

The problem of tracking offerees is made worse by tying the "cooling-off period" to the nature of the offerees. We believe that the prohibition on general solicitation should provide ample protection against improper gun-jumping activity. Nevertheless, if the Commission were to require a cooling-off period, we recommend that it be a period of 30 days from the last offer to an ineligible person, unless the issuer can show that the private offering was directed solely to eligible persons or that the public offering is limited to eligible persons.

Rather than requiring filing of private offering selling material or the need to inform offerees, the requirement should only be to inform purchasers in the public offering who were offerees in the private offering that the prospectus included in the registration statement supersedes the offering material used in the private placement, and that any indications of willingness to purchase are deemed rescinded. In practice, issuers would include this notice in the prospectus delivered as part of the public offering.

iii. Abandoned public offering.

We do not believe that a compelling reason exists to integrate an abandoned public offering with a subsequent private offering in order to protect investors. Since the public offering was registered, there is little prospect of harm to investors from this activity. Any subsequent private offering would still have to meet the requirements for an exemption, the most significant of which is the nature of the purchasers and their ability (acting alone or with their respective purchaser representatives) to fend for themselves. Liability concerns could be addressed by disclosure of the differences between a public and private offering (*i.e.*, the restricted nature of securities and the absence of Section 11[94] or 12(a)(2) liability), unless all purchasers were "accredited" or otherwise "sophisticated" investors.

We note that the safe harbor would be available irrespective of marketing activity as part of the public offering and would not be limited to quiet filings as proposed by the SEC Task Force on Disclosure Simplification. We believe this is the correct approach. However, we believe that the Commission should formally withdraw the presumptive general solicitation interpretation,[95] in favor of a focus on actual marketing activity. In this regard, we note that the mere filing of a registration statement is no more "general solicitation" than a third-party listing of private offerings. It would be most unlikely that an issuer would file a registration statement in order to solicit investors for a private placement.

[94] 15 U.S.C. § 77k.

[95] *See* Letter of John J. Huber, Director of the Division of Corporation Finance, to Michael Bradfield, General Counsel of The Board of the Federal Reserve System (March 23, 1984); *see also, In the Matter of Traiger Energy Investments*, SEC Litigation Release No. 10,241 (December 19, 1983).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

If the focus were directed toward actual marketing activity, there would be no reason to require an issuer to withdraw the registration statement. For example, an issuer may desire to preserve its ability to resume a public offering after completion of the private offering. In this case, it would be able to use the filing fee already paid. Any required "cooling-off" period would commence after the last marketing activity.

The Committee does not support any requirement to notify all offerees of the abandonment of a public offering. As noted in "Abandoned private offering" *supra*, reintroducing the concept of tracking "offerees" would be an anachronism that would not provide any meaningful protection to investors. Furthermore, in the public offering context, it would be totally impractical to expect that an issuer would be able to identify all offerees. Rather, when a private placement follows an abandoned public offering, the issuer should only be required to inform potential investors in the private placement of the restricted nature of the securities and that the issuer and any other offering participant are not subject to liability applicable to an offering made pursuant to an effective Securities Act registration statement, specifying the particular abandoned public offering.

As proposed, an issuer that sells privately, even solely to a large mutual fund or an existing institutional investor, within the 30-day period would have to accept Section 11 liability. We do not favor using the proposed safe harbor in a way that would have the practical effect of reversing the holding of *Gustafson*,[96] which would be the effect of requiring a contractual undertaking of liability under Section 11 or Section 12(a)(2), in order to finance prior to the expiration of a 30-day "cooling-off" period. Instead, it would be preferable to impose a 30-day "cooling-off" period before private sales could be made to non-accredited investors, coupled with disclosure to all purchasers in the private offering of the liability consequences of the switch from a public to private offering.

Each underwriter would have to agree to Section 11 or Section 12(a)(2) liability for a private offering that commences within 30 days after notification of abandonment or withdrawal of a particular public offering. The Proposing Release refers to any underwriter involved in the private offering, which is an odd reference since — by definition — there is no "distribution". Presumably, the reference is meant to cover any "placement agent". If this provision were adopted, this should be clarified. As proposed, it is unclear who is intended to be covered by the term "underwriter". The Committee notes that it would not always be the case that an underwriter in the public offering would be involved in the subsequent private offering.

Moreover, the general reference to Section 11 or Section 12(a)(2) liability raises a further question. Does it mean the liability the issuer or underwriter would have had if the offering had been registered, subject to all the defenses and procedural protections? We request that the Commission clarify this provision if it is adopted.

The proposed safe harbor only addresses abandoned public offerings — it does not deal with pending or completed public offerings. We propose that the safe harbor be available for pending and completed public offerings. Just as Rule 152 applies whether a private offering is completed or abandoned, we see no reason that the rule should not apply in the case of an abandoned or completed public offering. With respect to

---

[96] 513 U.S. at 561.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

a pending public offering, at the very least the Commission should recognize and codify the *Black Box*[97] interpretation, thereby permitting certain private offering activity during a pending public offering. The Proposing Release, however, is silent on this important issue.

iv. Expanded Rule 152.

The Commission is correct to expand the coverage of Rule 152 to offerings under Section 4(6) and to clarify that the rule would apply to offerings under Rule 506. We believe the relief afforded by Rule 152 should also be extended to Rule 505 offerings.

Often there is little substantive difference between the conduct of a Rule 506 and Rule 505 offering, other than the $5 million offering limitation. The same policy reasons (and need for relief) that underlie permitting a public offering after a completed or abandoned private offering and *vice versa*, as contemplated by Rule 152 also apply to a Rule 505 offering. We recognize that there may be investors who do not meet the "accreditation" or "sophistication" standards of Section 4(2), Section 4(6), or Rule 506; however, the fact that the subsequent offering would be registered and limited to $5 million, as well as other protections of the proposed rule, should obviate this concern.

v. Lock-up agreements.

With some exceptions, the Committee believes that proposed Rule 159 reflects the staff's current pragmatic approach to voting commitments in merger transactions. One exception, for example, is that the persons from whom lock-up agreements could be obtained under the proposal would be narrower. Currently, lock-up agreements may be sought from venture capital investors (irrespective of the size of their holdings) and a few key employees (whether or not they are executive officers).

The proposed rule would require that votes be solicited from uncommitted shareholders who would not be eligible private offering purchasers. This would be inconsistent with the Commission's prior interpretation that a short-form merger involved a sale subject to Rule 145 under the Securities Act,[98] even though no shareholder vote was required.[99] We note that a similar circumstance might exist where there is a class of non-voting stock or where a majority of the shareholders effect the corporate action by written consent without the vote or consent of the other shareholders. We recommend that the Commission either clarify that this is no longer its position, or revise proposed Rule 159 to apply in these circumstances.

Proposed Rule 159 apparently is designed to address lock-ups in publicly-held companies. In this regard, we note that the current lock-up analysis also applies to private companies, if the lock-up were limited to the eligible group and the shares subject to the lock-up were insufficient to effect the corporate action. As proposed, the rule would not be available for the acquisition of a private company since it would require that

---

97 Black Box Inc. (June 26, 1990). *See also*, Squadron, Ellenoff, Pleasant and Lehrer (February 28, 1992).

98 17 C.F.R. § 230.145

99 Securities Act Release No. 5,463 (1974), Question C-1.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

there be shareholders ineligible to participate in a private offering. We believe that the Commission should clarify that the rule is merely a safe harbor, and that its existing position on lock-up agreements for private companies continues to apply. In the alternative, we recommend that the Commission revise proposed Rule 159 to cover private companies.

Finally, we believe that the lock-up safe harbor should be expanded to encompass tender offers and exchange offers. This change would permit the acquirer to obtain commitments to tender from the eligible group. We would condition availability of the safe harbor on a requirement that the acquirer must agree to accept the tendered shares, and that the committed shares would not satisfy the minimum shares necessary to consummate the tender or exchange offer. The Committee believes this revision would "level the playing field" for tender and exchange offers *vis-à-vis* mergers, as contemplated by the M&A Proposing Release.

vi. Withdrawal of registration statements.

The proposed amendment to Rule 477 under the Securities Act,[100] would permit an issuer to withdraw a registration statement upon filing without staff approval. We believe adoption of this proposal would streamline the procedure. Accordingly, we support the proposed amendment, whether or not the Commission conditions the safe harbor for abandoned public offerings on withdrawal of the registration statement.

b. We encourage the Commission to rationalize law and lore with more systemic revisions.

While we generally support the Commission's proposals concerning integration of private and public offerings, we encourage the Commission to further rationalize law and lore through a more comprehensive, systemic approach, which would be based on the following premises:

Integration principles should be applied only when necessary to protect investors who need the protection of registration.

There should be no penalty imposed when a public offering is abandoned or withdrawn, absent a showing that the procedure is part of a plan or scheme to evade the registration provisions of the Securities Act.

Accordingly, we recommend that the Commission abandon the "Five Factor Test"[101] and establish its guidance on integration in accordance with the following concepts:

(1) Integration would be inapplicable to an offering made to an "eligible investor" (*i.e.,* an "accredited investor", a QIB, or a Section 4(2) "sophisticated investor"). By definition, these are investors who do not need the protection of registration because they can "fend for themselves". Moreover, because of their status, they do not need to be shielded from "general solicitation" or "gun-jumping". Under our approach, an

---

[100] 17 C.F.R. § 230.477.

[101] 17 C.F.R. §230.502(a). *See also*, Securities Act Release No. 4,552 (November 6, 1962).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

issuer could make offers to these investors in any lawful manner and complete the transaction either privately or as a public offering. This proposal would be a reasonable extension of the *Black Box*[102] interpretation.

(2) A terminated private offering (including a Rule 505 offering) would not be integrated with a subsequent public offering that commenced within 30 days as long as the prospectus for the public offering informs investors (a) that the particular private offering is terminated, (b) that any indications of interest are deemed rescinded, and (c) that the prospectus supersedes any private offering selling material. Application of this guidance should be based on the private offering not being used as a device for "gun-jumping" in respect of the subsequent public offering (at least during the 30-day period not covered by the proposed communications safe harbor). As is now the case under Rule 152, a completed private offering would not be integrated with a subsequent public offering.

(3) A terminated or completed public offering would not be integrated with a subsequent private offering so long as (a) there is no marketing activity during the period beginning 30 days before commencement of the private offering through to its completion, and (b) there is disclosure to the private purchasers that the offered securities are "restricted", and that the issuer and other offering participants are not subject to the same liability régime applicable to public offerings. There would be no "cooling-off" period for offerings to "eligible investors" since, as provided under (1) *supra*, integration would not apply to them.

The Committee believes this guidance would rationalize the law and lore of integration, provide needed flexibility for issuers, and preserve statutory protections for that class of investors for whom the registration provisions were enacted.

3. Repeal of *Exxon Capital* A/B exchange offers is unwarranted.

The Proposing Release states that, if the proposals are adopted, the *Exxon Capital* line of no-action letters would be repealed.[103] We believe repeal would be ill-advised, as a policy matter, and would be premised on flawed perceptions of market practices and needs.

The Proposing Release states that issuers use the *Exxon Capital* exchange offer procedure, *"in part,"* because it allows them to avoid the delay associated with registration. We believe the *only* reason for use of this procedure is the avoidance of delay and the public availability of otherwise non-public information during the pendency of that delay.

Issuers and their underwriters do *not* avail themselves of this procedure for liability reduction purposes, notwithstanding that a lesser standard of statutory liability is applicable to the initial sale of the securities by the issuer and "underwriters" in a private (*Exxon Capital*-anticipatory) offering than in a public offering. The due diligence conducted by investment bankers in respect of these private offerings, the care with

102 Black Box Inc. (June 26, 1990).

103 Exxon Capital Holdings Corp. (May 13, 1988); Morgan Stanley & Co., Inc. (March 27, 1991); Mary Kay Cosmetics, Inc. (June 5, 1991); and Brown & Wood LLP (February 5, 1997).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

which offering documents are prepared and the quality of the disclosure in those documents are no less than that applicable to public offerings.

The Proposing Release also states that "more than one-third of all initial public offerings have been *Exxon Capital* exchanges."[104] This statement mischaracterizes the nature of the capital-raising process that is associated with the *Exxon Capital* procedure. The term "initial public offering" is commonly understood by everyone within the investment community and securities bar as descriptive of an initial offering of common stock to a broad segment of the public market, including so-called "retail" (*i.e.,* non-institutional) investors.

Based on the experience of Committee members who practice in this area, more than 95 percent (in both dollar amount and number) of private offerings made in anticipation of a registered *Exxon Capital* exchange offer are limited to debt securities, primarily high-yield debt securities, with a substantial percentage of those offerings being made by issuers having no publicly-owned equity securities. Nearly all of those offerings are made in compliance with Rule 144A and, therefore, offers and sales in the US are routinely limited to QIBs.[105] Most importantly, resales by those buyers subsequent to the *Exxon Capital* exchange offer continue to be confined to an institutional market comprised largely of the same types of purchasers that were eligible to participate in the initial private offering and to whom resales could be (and frequently are) made prior to the exchange offer in reliance on Rule 144A.

It is the essence of the secondary market for high-yield debt securities that participation is limited to sophisticated institutional investors, irrespective of whether those transactions occur prior or subsequent to registration, because the size of the typical resale transaction is in the seven and eight figure range. "Retail" investors (including high net worth individuals) are discouraged from direct participation in this market because of the illiquidity and substantial bid-and-asked spread associated with smaller transactions (to the extent, if any, that the transactions are available). Therefore, their participation occurs only indirectly through registered investment companies and, to a far lesser extent, hedge funds.[106]

The *Exxon Capital* line of no-action letters has been particularly critical to the enormous growth of the high-yield debt market because it facilitated the entry of institutions, particularly insurance companies and registered investment companies (popularly referred to as "high-yield bond funds") that may be subject to

---

104 *See also* note 18 *supra*.

105 As a result of the exemption in Regulation M under the Exchange Act for offerings made to QIBs, it is no longer the practice to include a "tranche" for "institutional accredited investors." *See* 17 C.F.R. § 242.101(b)(10).

106 *See* Latham & Watkins [File No. S7-30-98] (September 9, 1999), Appendix: Report of Charles C. Cox of Lexecon Inc. The comment letter which was submitted on behalf of 15 investment banks includes an economic study of trading during the entire 144A/*Exxon Capital* process from the private placement through secondary trading following the *Exxon Capital* exchange offer. The economic study was conducted by Charles C. Cox, former Commissioner and former Chief Economist of the Commission. After reviewing trading data for 98 Rule 144A/*Exxon Capital* exchange offers completed in 1997, former Commissioner Cox concluded that (1) *Exxon Capital* exchanges represent the predominant method of issuing high-yield securities; (2) roughly half of the high-yield issuers using *Exxon Capital* exchanges would be "unseasoned" and, thus, ineligible to use proposed Form B; and (3) post-*Exxon Capital* trading activity by retail investors averages approximately one percent of the volume and one-half of one percent of the amount of high-yield securities issued. *See* "II Introduction and Summary of Conclusions" at paragraph 9.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

constraints on the percentage of their portfolios that may be invested in "restricted securities." The effectiveness of a shelf registration statement and resale prospectus under current practice does not remove the "taint" of restricted security status from securities initially purchased in an exempt offering until those securities are actually sold.

Since the proposals would effectively eliminate existing practices for resale shelf registration, the negative implications of restricted security status would become even more pronounced if the proposals were adopted. The *Exxon Capital* exchange procedure, on the other hand, permits an investment institution to reclassify restricted securities held in its portfolio to unrestricted status upon the completion of the exchange offer, without the need to sell those securities to make capital available for additional investment in privately placed debt securities. Indeed, in most cases, there is no increase in the volume of resales of an issue of high-yield debt securities following completion of the exchange offer from the resale volume that existed in the so-called "Rule 144A market" prior to the exchange offer.

Several members of the staff have expressed the view that purchasers of securities resold in the secondary market following an *Exxon Capital* exchange are not accorded access to the information that otherwise would have been available to them following a public offering of those securities. We believe this view is incorrect.

Purchasers in the secondary market following a public offering do not receive a prospectus prior to their purchase but, should they desire the information contained in that prospectus prior to placement of an order, they can access the publicly-available registration statement (even prior to its effectiveness) through a variety of routes. Purchasers of high-yield debt securities in the secondary market following an *Exxon Capital* exchange are in exactly the same position, since the registration statement relating to the debt securities that are the subject of the exchange offer is publicly available. To the extent that, under existing procedures, the obligation of dealers to deliver a prospectus when effecting sales during a prescribed period following the date of a prospectus in a conventional public offering does not operate in the context of the post-*Exxon Capital* secondary market (because the date of the prospectus is usually 30 days prior to the completion of the exchange offer), this difference could be easily remedied by a simple rule change.

We recognize that, under the *Exxon Capital* procedure, purchasers acquiring the securities upon the initial resale by a holder that received those securities in the exchange offer do not have recourse to the same statutory avenues of redress (particularly, Sections 11 and 12(a)(2) of the Securities Act) that would be available to them were they purchasing the same securities under an effective registration statement. However, in a market that is almost entirely institutional in nature and that is served primarily by those investment banks whose size, reputation and resources (in terms of research, market-making, and execution capabilities) provide them the requisite access to those large institutions eligible to purchase under Rule 144A, we believe that the availability of a lower threshold of liability — although appealing in a theoretical sense — is not, as a practical matter, necessary or particularly important for investor protection. As previously noted, those investment banks — due to their concern to maintain their reputations as well as the high professional standards brought to bear in this market — devote no less care and exactitude in their due diligence and crafting of disclosure documents for so-called "Rule 144A offerings" than they accord to public offerings.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Commission also has stated in the proposing release that the proposals, if adopted, would create a registration system that "captures the speed and flexibility associated with private offerings…." The Committee disagrees with that conclusion. A substantial percentage of offerings of high-yield debt securities are made by non-reporting issuers who would not be eligible for proposed Form B. More importantly, as noted elsewhere in this comment letter, even Form B, as presently constituted, does not provide anywhere near the flexibility of the existing Rule 415 shelf registration system, particularly as applied to debt securities.

A significant number of offerings of high-yield debt securities are made to finance acquisitions and, therefore, must be conducted with sensitive coordination of timing. Given the delays and uncertainties associated with registration, particularly on proposed Form A, issuers would be forced to rely on other mechanisms of intermediate financing — including bridge loans and bank financing — with substantial incremental financing fees and associated legal expense in order to assure the availability of funds when required. Those whose businesses are being acquired are unlikely to accept those delays and uncertainties and, most importantly, would be unwilling to accept the public disclosure of the otherwise private details of their business operations during what might well be a substantial period of time between the filing of a registration statement and the date when the public offering could be completed and the acquisition consummated.

As a policy matter, the existing "Rule 144A/*Exxon Capital*" offering process has been, and continues to be, a major success of modern securities regulation in this country. Over the past 11 years, primarily as a consequence of the efficiencies associated with this process, debt financing in the United States has shifted dramatically — and with superb efficiency in terms of cost savings, speed of execution, liquidity and transparency — from an historical reliance on banks' off-shore offerings to increasing reliance on domestic capital markets.[107]

This transformation has been a major contributor to capital growth in the United States, and the Commission has not cited (nor do we believe there exists) any evidence of resulting harm to investors or the capital markets. Pricing in the Rule 144A market for securities that are expected to be the subject of an *Exxon Capital* exchange (as is almost universally contracted for under current practice) is essentially identical to that for public offerings of securities of like tenor and quality, and offering documentation for Rule 144A offerings is quantitatively and qualitatively identical (and has the same "look and feel") as that associated with public offerings. Opinions of counsel and auditors' comfort letters in these offerings are identical in scope to those associated with public offerings.

Repeal of the *Exxon Capital* line of no-action letters and forced reliance on proposed Form A for many high-yield issuers (or even proposed Form B for others) would significantly disrupt this marketplace and would result in a substantial increase in the costs of capital formation with no particular enhancement in investor protection other than the wholly-theoretical benefits associated with a reduced threshold for statutory liability.

For all of these reasons, we strongly urge the Commission to refrain from taking any action that would authorize the staff to rescind the *Exxon Capital* line of no-action letters. To do otherwise, in light of the

[107] In 1997, over $254 billion was raised through this process. *See* Proposing Release at n. 102.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

efficient market that currently exists and has served investors and issuers so well for the past 11 years, would be a profound disservice to the public interest.

4. Small Business Issuers.

a. Several of the Commission's proposals would have a disproportionate impact upon, and unduly burden capital formation by, smaller business issuers.

Regulatory reforms that differentiate between smaller business issuers and large business issuers create a disproportionate burden on smaller business issuers and place them at a distinct disadvantage in raising capital and in acquiring other companies. Proposals that would have this effect include differences between proposed Forms A and B, the restriction on short-form registration for resales currently permitted on Form B, the unavailability of a delayed shelf offering, the pre-filing communications limitations, and the prospectus delivery requirements.

Likewise, we believe that reforms applied across the board that are intended to speed up the process of getting information to the marketplace place a heavier burden on smaller issuers. The proposed Exchange Act reforms that would require pre-announcement of earnings, shorter filing deadlines, and an increase in prescribed disclosure items are examples of these burdens. Thus, the increased costs and liability, as well as the impracticability of implementing many of the proposals, are an increased burden on smaller business issuers.

i. Prospectus delivery requirements would prolong and delay offerings, thereby increasing the risk of missing market opportunities.

The Committee believes that the proposed changes in the prospectus delivery requirements would have a disproportionate impact on smaller business issuers because it would prolong and delay offerings for them, thereby increasing the risk of missing market opportunities. We also note that proposed Form A would require issuers to deliver incorporated documents, which is likely to be more costly for smaller business issuers. For example, the requirement to deliver a preliminary prospectus at least seven or three days before pricing is too long, and would require that everything grind to a halt after the last prospective investor has received a preliminary prospectus.

This requirement would be inconsistent with the way offerings are now priced and would render these offerings impractical. If the deal becomes hard to sell, the choice is to solicit more investors and wait seven days (a big risk in a volatile market) or price now at a small size and lower price. This consideration is especially a concern in a follow-on offering because the need to price quickly is more critical. Moreover, the 24-hour requirement for written disclosure of material changes does not take into account alternative means to notify potential investors of changes (such as by telephone or press release) and seek confirmation that the investor remains interested.

ii. Smaller business issuers should be permitted to use Form B to register resales by selling security holders.

The proposal to proscribe the use of proposed Form B for resales of securities by selling security holders would impose a disproportionate burden on smaller business issuers. The Committee is

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

mindful that over the years smaller business issuers have relied on short-form registration on Form S-3 to satisfy their obligations pursuant to registration rights agreements in connection with mergers and acquisitions or private placements.[108]

Moreover, smaller business issuers are more likely to utilize a private placement exemption for acquisitions and for capital-raising transactions than are large business issuers, for which shelf registration is available. Thus, the inability to use a short-form registration statement (which permits streamlined disclosure and automatic incorporation by reference of future filings under the Exchange Act) for resales by the security holders of the acquired company would seriously increase the expenditure of time, effort, and money necessary to maintain the effectiveness of a long-form registration statement through the numerous filings of amendments (*i.e.,* "evergreen" registration) required to reflect a smaller business issuer's acquisitions and other capital-raising transactions. The Committee is concerned that this could place smaller business issuers at a competitive disadvantage in bidding for other companies and in securing capital infusions from private investors.

iii. Pre-filing communications proposals would impose a greater burden on smaller business issuers.

We believe that the failure to extend the safe harbor for pre-filing communications that do not raise concerns of "gun-jumping" to smaller business issuers creates a further disparity *vis-à-vis* other issuers. For example, the 30-day safe harbor under proposed Form A is too long. The requirement to prevent further distribution or re-publication of communications initiated more than 30 days before filing the registration statement is a greater burden on smaller business issuers given their more limited resources to police third parties, and their need to rely on such cost-effective means of communication as their company Internet sites.

iv. The "free writing" and "offering information" proposals are especially burdensome for small issuers.

The threat of liability for a Section 5 violation for inadvertent failure to file all required writings will deter reliance on the proposed safe harbor. The prospect of potentially having to file under proposed Rule 425 all information on the company's Internet site (and each change to it) during the 30-day period is daunting at best and impossible at worst. The new liability imposed on filings will inhibit the flow of information.

v. Proposed Rule 152(b) is extremely helpful, but should be revised to provide greater flexibility for smaller business issuers.

Without reiterating our views on the integration proposals expressed *supra*,[109] we note that integration frequently has a profound impact on the conduct of an offering by smaller business issuers. In general, the proposed codification of safe harbors from integration for certain public-to-private transactions and *vice versa* would be extremely helpful, particularly for smaller business issuers that do not have a great deal of market visibility. Issuers would no longer have to rely on the vagaries of the traditional Five-Factor Test, and

---

108 *See also* page 26, "II.A.1.b.iii.(E) Secondary offerings should be permitted on Form B."

109 *See supra* page 31, "II.A.2. The *metaphysics* of integration of public and private offerings."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

the interpretations provided by the staff, when they have to abandon an IPO and quickly conduct a private offering, or when they commence a private offering and discover that there is sufficient interest to make a public offering.

The Commission, however, should expressly acknowledge that the existing no-action letters (in particular, *Black Box*[110] as supplemented by *Squadron Ellenoff*[111]) continue to represent the staff's view on integration outside of the proposed safe harbor. We believe this is especially important in the context of concurrent private and public offerings, which are addressed by these no-action letters but are not contemplated in proposed revisions to Rule 152.

vi. Definition of "small business" should not include a public float test.

We support the Commission's proposals to increase the revenue test to $50 million from $25 million and eliminate the public float test. A public float test is not within the control of the issuer, and volatility in secondary market trading of securities issued by small business issuers can make such a test problematic. We concur that removal of this test would simplify the regulatory scheme.

vii. Incorporation by reference should be permitted in Form SB-2.

The Proposing Release would expand incorporation by reference in Form SB-2 and would make the test for determining who is eligible for incorporation by reference identical to that proposed for Form A. We agree that the same definition is appropriate if for no other reason than simplicity. However, we question whether the addition of having filed two annual reports is necessary. The Committee also notes that proposed Form A would require issuers to deliver incorporated documents, which is likely to be more costly and burdensome for the smaller business issuer.[112]

viii. Exchange Act proposals would unduly burden smaller business issuers.

The acceleration of due dates on periodic reports (Forms 10-K, 10-KSB, 10-Q, and 10-QSB) and on current reports on Form 8-K would be an added burden for smaller business issuers that typically do not have resources comparable to other issuers or in-house staff to assist in preparation of these filings. Even under the current deadlines, these issuers are often hard pressed to make timely filings given the need for outside counsel and accountants to review and assist with the filing. The proposed one-day requirement for certain items under Form 8-K leaves no margin for error, and accordingly, is too short. Moreover, the Committee believes that any new disclosure items proposed to be added to Form 8-K should be filed no later than 15 days after the event being reported. In our view, the proposed signature requirements would not add appreciably to investor protection, and likely would only add an additional burden on smaller business issuers.

---

110 Black Box Inc. (June 26, 1990).

111 Squadron, Ellenoff, Pleasant and Lehrer (February 28, 1992).

112 *See supra* page 16, "II.A.1.a.i. Issuer should be permitted to incorporate by reference or deliver company information."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Committee does not support the imposition of a requirement for early disclosure of annual and quarterly financial information by smaller business issuers on a Form 8-K. Unlike larger companies, many smaller business issuers do not issue an earnings press release before filing Form 10-Q or Form 10-QSB. Open issues often exist up to the filing date, and smaller business issuers generally lack in-house staff solely dedicated to regulatory reporting and investor relations. Once again, the proposals would impose a disproportionate burden on smaller business issuers.

ix. Increased exposure to liability for directors and officers is a concern to smaller business issuers.

The increased exposure to liability has a two-fold impact on smaller issuers. Obtaining qualified directors, often without being able to offer any insurance coverage, is difficult now. This task is likely to become even more difficult given the increased exposure to liability under the proposals. Proposals that increase the number of persons that must read and sign documents and increase the writings that must be filed as part of an effective registration statement are especially burdensome and costly for smaller issuers. While "big business" can retreat to the private market to avoid exposure to increased liability this alternative is often not viable for smaller issuers.

5. Foreign Issuers.

a. Existing reluctance of foreign issuers to access US public capital markets may increase.

Since the mid-1980s, the Commission has actively pursued a policy of regulatory accommodation in order to facilitate and encourage access to the US capital markets by foreign issuers, both governmental and private. In part, that policy reflects a recognition that US investors (particularly larger institutional investors) increasingly desire to acquire the securities of foreign issuers, notwithstanding that the securities regulatory systems and disclosure requirements in most foreign markets are less "strict" than in the United States. It also reflects a recognition that US issuers have been accorded relatively facile access to offshore markets for capital-raising purposes.

With few exceptions, most of which are limited to larger or seasoned foreign government issuers, the Proposing Release does not attempt to distinguish between US and foreign issuers. However, the practical impact of certain provisions may well be more adverse for foreign issuers *vis-à-vis* US issuers, especially foreign private issuers. The proposals would effectively repeal the Commission's Multi-jurisdictional Disclosure System with Canada.

The consequence of adopting these proposals may be a marked heightening of the existing reluctance of foreign issuers to access the public capital markets in the United States. The Committee notes that as a result of the accelerated maturation of the capital markets in Europe and Asia, foreign issuers have less need to access US markets to satisfy their capital- raising requirements, and we note that their decisions to enter US markets have become increasingly discretionary. Accordingly, we believe that, rather than encouraging foreign issuers to register offerings of their securities in the United States and to become reporting companies under the

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Exchange Act, the proposed regulatory régime would result in an increased avoidance of the US regulatory scheme by those issuers.

In the discussion that follows, we do not propose to reiterate our detailed comments regarding each of the provisions of the Commission's proposals that we find problematic. Rather, we will limit our comments to what we believe to be the particular impact of those proposals on foreign issuers, namely,

- enhanced exposure to liability;
- reduced eligibility for short-form registration;
- elimination of *Exxon Capital* exchange offers;
- interference with multi-market timing constraints; and
- accelerated filing of annual reports.

i. Enhanced exposure to liability.

It is well recognized that the single greatest impediment to the willingness of foreign issuers to publicly offer their securities in the United States — or, indeed, to list their securities on a US securities exchange or register for quotation in the Nasdaq market — is their perception that their risks of liability (even for inadvertent errors and omissions) are far greater in the US than in their home jurisdiction or other foreign markets. Whether or not validly based, it is the view of most foreign issuers that, in the United States, litigation is a national sport and that exposure to our tort system is a "no win" situation.

As we have frequently observed throughout this comment letter, the Commission has crafted the proposals with the clear objective of expanding the exposure of issuers and, in some cases, their directors to potential liability under the federal securities laws. In that respect, the "Aircraft Carrier" can only be viewed by foreign issuers as singularly adverse to their interests and as raising to an unacceptable level the price — in terms of increased exposure to liability and litigation — for access to our public capital markets.

The proposals governing communications during the offering period (including the temporal boundaries of the offering period and the filing requirements under proposed Rule 425) represent a particularly broad enhancement of liability risk exposure for foreign issuers. With the exception of press conferences conducted offshore,[113] those provisions do not distinguish between communications made within and those made outside the United States or, in the latter case, between those that are likely to reach (much less condition) US markets and those with limited circulation outside the United States.

In crafting those provisions, no recognition appears to have been given to the far more "liberal" view of communications that has long prevailed in most major foreign markets, including communications that, in the United States, might well be deemed to have significant market conditioning potential. The distinctions in

113 *See* Proposing Release at n. 353 and accompanying text.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

European and US market practices with respect to publication of research, as well as what might be characterized as promotional communications, in connection with offerings of securities have always been problematic for US securities lawyers seeking to counsel foreign issuers and their investment bankers. However, the primary focus of concern has always been "gun jumping", and its potential impact on scheduling, as well as whether particular materials might be deemed a "prospectus." The focus of past efforts has now been further complicated by an expectation of enhanced exposure to liability for the content of the communications. That risk alone may represent an unacceptable price for access by a foreign issuer to our domestic capital markets.

The increased prevalence of "open" communications by and on behalf of foreign issuers in foreign markets also enhances the risk of an inadvertent violation of proposed Rule 425 (and therefore, Section 5) when a foreign issuer (as distinguished from a US issuer) proposes to effect a public offering in the United States. For example, there has been an increase in the use of Internet sites by foreign issuers; however, the proposals in the "Aircraft Carrier" (and the Commission's 1998 Internet interpretation) fail to address this issue in the context of public offerings.

The proposals to require a majority of the directors of a foreign private issuer to sign its annual report on Form 20-F under the Exchange Act[114] and to mandate disclosure certification by those directors who sign that report and a Securities Act registration statement will similarly fan the fire of foreign issuer "paranoia" regarding liability and litigation risk exposure in the United States. In addition, directors of a foreign private issuer are usually farther removed from detailed knowledge of the issuer's day-to-day operations than even their US counterparts, and it is unrealistic to characterize those directors as persons "who typically also manage and control the issuer." We note in this regard that the scheme of "corporate governance" prevalent in the United States is not necessarily replicated in foreign jurisdictions.

Lastly, a foreign issuer's directors are far less likely than their US counterparts to be familiar with Securities Act and Exchange Act forms and applicable disclosure standards. These proposals would neither increase the likelihood of actual director participation in the disclosure process nor enhance the quality of disclosure by foreign issuers. They would, however, unquestionably serve as additional deterrents to foreign issuer participation in the US capital markets.

ii. Reduced eligibility for short-form registration.

The proposal to increase the public float threshold for eligibility for "short form" registration (on proposed Form B *versus* Forms S-3 and F-3) from $75 million to $250 million, absent a US-only ADTV of $1.0 million, would result in a far greater proportionate reduction in the number of foreign private issuers than domestic issuers that are able to access US capital markets in an expedited and less onerous manner.

If the daily trading volume test is to be added, we urge the Commission to allow foreign issuers to count their *worldwide* trading volume. Since the stated purpose of the requirement is to ensure that Form B issuers are well-followed in the investment community, it would be illogical to limit the relevant community to the United States when the issuer likely has a global investor base.

---

114 17 C.F.R. § 249.220f.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

iii. Elimination of *Exxon Capital* exchange offers.

We do not propose to reiterate our extensive comments regarding the proposal to rescind the *Exxon Capital* line of no-action letters and to prohibit the availability of a public exchange offer to achieve unrestricted transferability for privately-placed securities.[115] However, the Commission's discussion of this issue in the Proposing Release makes virtually no mention of the use of this procedure by foreign private issuers, not only in respect of their debt securities but also for their equity securities.

We believe the assumption underlying the Commission's arguments in opposition to the *Exxon Capital* exchange offer procedure — namely, that it results in an extension of the trading market in the securities beyond the large, sophisticated institutional investor — to be no less flawed when applied to the equity securities of foreign private issuers than it is when applied to the debt securities of domestic (as well as foreign) issuers. Follow-on registration *via* an exchange offer is not undertaken for the purpose of expanding the trading market nor, to our knowledge, has it had this effect. Rather, the purpose has been to permit those institutions that are subject to restrictions on the percentage of their assets that can be invested and held in the form of "restricted securities" to reclassify those securities as "unrestricted."

Foreign private issuers usually access the Rule 144A market in order to include a US tranche in an offering that is primarily directed to foreign markets without compromising their control of timing and marketing practices. In virtually every instance, the underlying securities, in the case of an equity offering, also are listed on one or more foreign securities exchanges. Moreover, many foreign issuers would *not* pursue a US listing even after completion of the exchange offer.

We do not believe that the removal of the *Exxon Capital* exchange offer mechanism would result in an increase in registration of securities offerings in the US by foreign private issuers. Rather, it would simply serve as another reason for foreign issuers to abandon US markets. Indeed, the inability of a non-reporting foreign issuer to use proposed Form B for a QIB-only offering would only increase the likelihood that foreign issuers would simply avoid US markets.

Large institutional investors would not, however, be precluded from (nor would they cease) investing in the securities of those issuers. Rather, they would continue their offshore investment programs, albeit at higher costs (due to their inability, other than through an offshore vehicle, to invest at the initial offering price and without a brokerage commission), and with less "US-style" disclosure than would have been the case had they initially acquired the securities in a Rule 144A placement. The Committee believes this would be an unfortunate result.

iv. Interference with multi-market timing constraints.

The higher thresholds for proposed Form B eligibility would force an increasing percentage of foreign issuers to use the more burdensome proposed Form A to register a US tranche of a multi-market offering. The unusually rigorous preliminary prospectus delivery requirement for offerings pursuant to

115 *See supra* page 38, "II.A.3. Repeal of *Exxon Capital* A/B exchange offers is unwarranted."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

proposed Form A may well represent a significant impediment to smooth coordination of timing between the US and foreign tranches, particularly where the date for pricing is fixed in advance in accordance with foreign market or regulatory practices.

Access to proposed Form B would not alleviate these concerns, even for foreign government issuers. The effective elimination of traditional "shelf offering" procedures, combined with the new information completion and delivery requirements and the need for retrospective evaluations and possible filing of various written materials circulated during the "offering period," may substantially interfere with the ability of a foreign issuer and its investment bankers to coordinate a registered US tranche with an international offering that is otherwise being made "off the shelf."

As with the other aspects of the "Aircraft Carrier" proposals that we have discussed above, we believe the most likely consequence of their implementation would be a decline in the willingness of foreign issuers to extend their offerings to the US.

v. Accelerated filing of annual reports.

The proposal to advance the due date for filing annual reports on Form 20-F to within five months (from the current six months) following the end of a foreign private issuer's fiscal year may impose a burden on many issuers that is not offset by any meaningful gain to US investors. This would be even more the case were the due date to be accelerated to four months following the fiscal year-end.

The Proposing Release cites the fact that some foreign private issuers announce their results far sooner than five months (or even four months) after the year end, although no indication is given as to the percentage of reporting issuers that release their earnings in any particular time period. Irrespective of these percentages, however, the release of preliminary results based on applicable foreign accounting principles and practices is not a reliable indicator of an issuer's ability to prepare audited financial statements reconciled to US GAAP or to create a thoughtful and understandable management's discussion and analysis of financial condition and results of operations ("MD&A")[116] of those financial statements for inclusion in its annual report.

We believe an accelerated due date for the filing of a foreign issuer's annual report would impose a significant burden on many of those issuers that would not be justified by a corresponding benefit to the US investor. Accordingly, in our view the accelerated due date may be yet another reason for increased reluctance by foreign issuers to become US reporting companies.

---

116 Item 303 of Regulation S-K under the Securities Act, 17 C.F.R. § 229.303.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

III. COMMUNICATIONS WITH INVESTORS

A. BENEFITS OF THE COMMISSION'S "FREE WRITING" PROPOSALS ARE SERIOUSLY THREATENED BY FILING REQUIREMENTS AND INDISCRIMINATE APPLICATION OF CIVIL LIABILITIES.

1. Proposed framework for communications with investors.

The Commission's proposed elimination of the prohibitions on offering communications outside of the statutory prospectus and registration statement — a fundamental tenet of the Securities Act — would be the most profound change in the regulation of offerings in the 66 year history of federal securities regulation. Embracing the principle that investors are best served by ensuring that they and the "market have greater access to more timely information,"[117] the Commission proposes to permit free oral and written communications about the offering prior to the filing of, and outside, the registration statement and prospectus, subject to a limited 30-day quiet period for offerings on Form A (*i.e.,* those made by unseasoned or smaller companies). We strongly support, in principle, this change.

The utility of such so-called "free" communications rules, however, is seriously undermined by the Commission's proposals to (a) require that these newly-permitted free writings be filed, (b) extend liability under Section 11 or 12(a)(2) to all communications filed with the Commission, and (c) impose liability under Section 11 or 12(a)(2) for a single participant's written statements on *all* offering participants (issuer and underwriters).

The breadth of the proposed definition of "free writing" (*i.e.,* press releases that include forward-looking information, road show slides and flip books, *etc.*) threatens to require the filing of, and to impose new liabilities on, these informal communications. As a result, we note that the market views the proposals not as allowing new communication practices, but as threats to existing practices that would cause information flows to constrict radically.

Further exacerbating concerns about the communications proposals would be the Commission's use of the threat of a Section 5 violation for failure to comply with any provision of the proposed communications safe harbor. As with the imposition of liability under Section 11, the threat of a Section 5 violation would apply to all offering participants, and for the entire offering, not solely for the offending party's particular transaction. Thus, for example, if one member of the syndicate failed to identify "free writing" for filing, the proposed safe harbor for such "free writing" would be lost for the issuer and the entire syndicate.

Purportedly reflecting the realities of today's markets,[118] the Commission proposes to adopt an "inclusive prospectus" approach, under which a variety of communications about the offering could be used in

---

117 Proposing Release at "Section I.B."

118 *See* Proposing Release at preamble to "Section VII" (market developments cited by the Commission include "major advancements in technology and communications media," "increasingly complex and synthetic or hybrid securities" offerings, and the continuing "trend towards globalization of securities markets and multinationalization of issuers and offerings").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

addition to the statutory prospectus. This approach apparently reflects three goals of the Commission: (1) to increase "information flows" to investors, (2) to eliminate so-called "selective disclosure", and (3) to limit the effect of certain cases that apply the *Gustafson*[119] decision to restrict the availability of Section 11 and Section 12(a)(2) remedies. As a result, however, a wide spectrum of communications could be designated as "prospectuses" or Form B "offering information" (to be filed as part of the registration statement and subject to Section 11) by the Commission. In our view, the communications proposals are not viewed by the market as a progressive response to the information and technological revolution, but as part of an unwarranted regulatory retrenchment. The actual consequences of the proposals instead would chill communications and raise capital costs by providing a windfall to professional plaintiffs.

a. Proposals would have a chilling effect on communications with the market.

First, the Committee notes that large issuers currently eligible to issue securities pursuant to shelf registration statements, which typically have few concerns about limitations on publicity, are likely to conclude that the proposed framework for communications with investors would not provide additional flexibility or new opportunities to communicate with investors. Under the proposals, issuers would be required to file press releases and other materials that would not ordinarily be viewed as "offers" or communications "conditioning the market." Thus, failure to achieve compliance with the filing requirement would cause all "free writing" (including that filed in reliance on the proposed safe harbor) to lose the benefit of the safe harbor, thereby giving rise to a possible violation of Section 5.

Second, IPO and smaller business issuers, whose businesses are significantly impacted by current limitations on communications during an offering, are likely to view the threat of liability for a Section 5 violation for inadvertent failure to file a press release concerning matters unrelated to an offering a deterrent to widespread reliance on the proposed "free writing" safe harbor.

Third, underwriters for these issuers can reasonably be expected to discourage use of the "free writing" safe harbor, and, in view of their legitimate concerns about cross-liability, may pressure issuers to refrain from disseminating any written statements during the offering period (including press releases distributed in the ordinary course of business) because of the risk that these communications may subsequently be determined not to have satisfied the exemption for "factual business communications." Moreover, managing underwriters can be expected to strictly control the dissemination of written information by other offering participants.

Finally, we believe that any effort to extend the filing requirement to communications currently treated by market participants as "oral" (*e.g.,* road show materials) would be counterproductive, precipitating a return to less efficient (and, ultimately, less helpful) oral presentations.

Therefore, the Committee believes that notwithstanding the Commission's enunciated policy of encouraging the free flow of information, the reality is that the proposed safe harbors may in fact chill communications with the markets and cordon off US investors from updated information about issuers.

---

[119] 513 U.S. at 561.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

b. Proposals would re-define the offering period.

The proposed communication rules would change the traditional analytical structure[120] for applying the rules on communications. As proposed, the principal focus would be on a specifically defined offering period based on the registration form used for the offering:

- For offerings on proposed Form A, the offering period would commence 30 days prior to the filing of the registration statement and end at the completion of the offering.
- For offerings on proposed Form B, the offering period would commence 15 days prior to making of the "first offer" (which may occur before the filing of the registration statement) and end at the completion of the offering. The proposals, however, do not define when the first offer takes place, which will be analytically and practically difficult to ascertain in a free communications environment.
- For business combinations and exchange offers registered on proposed Form C, the offering period would commence with the first written or oral communication concerning the transaction to a non-participant and end at the completion of the transaction.

Any communication made outside of the offering period for the specified form would be protected by proposed Rule 167, which provides that such communication is not an offer for purposes of Section 5(c), thereby removing it from liability under Section 12(a)(2). The proposed rule would not limit the content of such communication,[121] and it would remain subject to the antifraud provisions of federal securities law.

i. "Factual business" and "forward-looking" communications during the offering period.

While the proposed safe harbors for factual business communications and regularly released forward-looking information in Rules 168 and 169, respectively, are intended to allow Form A issuers to continue to provide continuous disclosure to the market during an offering, the proposed safe harbors are so narrow as to actually interfere with current disclosure practices. For example, a "factual business communication" must not contain any offering information or any forward-looking information. Similarly, the proposed definition of "regularly released forward-looking information" would require that the release of information be consistent in the timing, manner and form with the company's practice for the preceding two

---

120 Traditionally, the offering process is divided into three periods: (1) *prefiling* — under Section 5(c), no oral or written offering communications (including market conditioning) may be made; (2) *post filing prior to effectiveness of the registration statement* (so-called "waiting period") —under Section 5(b)(1), oral communications are unrestricted and written communication is confined largely to the statutory prospectus; and (3) *post-effective* — under Section 5(b)(2), free writing that is accompanied (or preceded) by a statutory prospectus is permitted.

121 In this regard, we note that "test the waters" and other offering communications could be made in reliance on the proposed rule. *See* Proposing Release at "Section I.D."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

years. The definition would also require that the company have been a reporting company at the time of the communication.

The Committee notes that a limitation on inclusion of forward-looking information may prove troublesome since it is quite common to include some commentary in a press release that may be viewed as forward-looking (*e.g.,* announcements of new products, new business ventures, or "negative" news). Companies typically seek to put news in context and explain the implications for the company. We believe that the Commission should encourage that kind of disclosure.

Moreover, the problems inherent in the narrowness of the definition of "factual business communications" are not limited to communications made during the Form A quiet period. Written communications made in the ordinary course of business during the offering period would have to be filed as part of the inclusive prospectus, and thereby be subjected to liability under Section 12(a)(2).

Rather than expanding on its historical interpretative position that projections raise market conditioning issues,[122] and defining all forward-looking information as *per se* offering information, we urge the Commission to use this opportunity to break with this outmoded approach to forward-looking information. Characterization of projections as raising special market conditioning concerns was a policy articulated by the Commission at a time when such information was prohibited from inclusion in prospectuses as *per se* misleading. We believe that a policy of viewing forward-looking information as raising more significant market conditioning concerns than other corporate announcements is inconsistent with the market practices of many companies and with the Commission's and Congress' clear policy[123] of encouraging companies to provide information to investors and the market.

(A) <u>Written communications</u>.

During the offering period for a Form B offering, written communications may take the form of "offering information" or "free writing". "Offering information" would be filed as part of the registration statement, and would be subject to liability under Section 11 and Section 12(a)(2). "Free writing", on the other hand, would be required to be filed as a prospectus and would be subject to liability under Section 12(a)(2).

The Commission proposes to use Rule 425 as the basis for its inclusive prospectus approach. As proposed, the issuer would have the filing obligation; however, all offering participants that use non-filed "free writing" would be subjected to liability for non-compliance. Although the Commission views the proposal as a weapon in its campaign against so-called "selective disclosure", we believe the Commission should be cognizant of the danger that the proposed rule would ultimately have the opposite effect, and force communications back into antiquated forms of purely oral presentations, as well as stifling the flow of information.

---

122 *See* Securities Act Release No. 5,180 (August 16, 1971).

123 *See e.g.,* Securities Act Release No. 5,180 (August 6, 1971) [36 FR 16506] and Securities Act Release No. 5,009 (October 7, 1969). *See also*, Section 27A of the Securities Act, 15 U.S.C. Section 77z-2, and Section 21E of the Exchange Act, 15 U.S.C. Section 78u-5.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

In this regard, we note the Commission's concern that issuers "in registration" either shut off communications totally or continue communicating at "the cost of seeking legal advice and review of virtually any communication during the [offering] period."[124] We believe the proposals are not likely to engender any change in behavior or elimination of these costs. Rather, once an issuer decides to pursue an offering, it will effectively be required to view all of its communications *in hindsight* and do a sweep of materials used, so that counsel can do a Rule 425 review to determine which communications are required to be filed.[125]

Under proposed Rule 425 and the "offering information" provisions of Form B, issuers would, therefore, have to be as scrupulous about monitoring written communications as they are now about monitoring corporate communications to the public for purposes of avoiding gun-jumping and antifraud violations. Due to its potentially retroactive application, the Committee believes that proposed Rule 425 would introduce an unprecedented variable into the capital-raising calculus, and complicate a decision to proceed with a public offering, *to wit:* uncertainty arising from some errant or unidentified "free writing" or "offering information" used even before the decision to conduct a public offering was made.

Moreover, reluctance to file "free writing" or "offering information", particularly underwriters' intellectual property (*i.e.,* proprietary (or branded) materials) is likely to result in restrained use of the proposed communications safe harbor, as may any efforts to extend the filing requirement to communications currently viewed as oral (*e.g.,* road show materials). Despite the Commission's articulated interest in attracting issuers (domestic and foreign) to public capital markets by offering open communications and automatic effectiveness, proposed Rule 425 and its threat of increased liability may operate as a deterrent to registration.

c. Impact on electronic communications.

The Commission suggests large, well-followed issuers on Form B would be able to use the Internet and other electronic media to "test the waters" for a proposed offering before committing significant resources to it. Small business issuers and other smaller issuers would have to institute appropriate controls and procedures to monitor or limit their Internet use within the 30-day quiet period prior to filing a registration statement on Form A or Form SB-2. The proposed safe harbor for factual business communications made within the 30-day period would also provide more concrete guidance for determining what information may be posted on an Internet site during that time. We believe the Commission should expand its guidance to address our concerns about inappropriate restrictions on Internet use by foreign issuers.[126]

Notwithstanding these positive developments, the Committee is concerned about the impact of the proposals on electronic communications. For example, the accessibility of materials previously published by issuers (*e.g.,* press releases and Exchange Act filings) and underwriters (*e.g.,* research reports) could be considered to be continuous publication or republication of these materials. If this were the result, properly-

---

124 Proposing Release at "Section VII.A.1.c."

125 *See also* note 14 *supra*.

126 *See* Proposing Release at n. 325.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

dated materials posted during a period in which a Form A (or Form C) issuer may freely communicate could not continue to be posted on its Internet site during an offering (or on a third party's Internet site on its behalf), unless these materials satisfy the safe harbors for factual business communications or regularly released forward-looking information. Instead, these communications would either have to be removed from the Internet site to avoid republication for purposes of proposed Rule 167, or be treated as republished and subject to filing under proposed Rule 425. In our view, an issuer should not have to remove its Exchange Act filings from its Internet site for purposes of either proposed Rule 167 or proposed Rule 425. We believe these proposals ultimately limit the utility of electronic communications.

The proposals, if adopted, would obviate the need to seek no-action relief for electronic road shows based upon such communication not being a "prospectus" within the meaning of Section 2(a)(10) of the Securities Act,[127] because there would no longer be limitations on communications outside of the statutory prospectus during the waiting period.[128] Depending on the reach of proposed Rule 425, however, the proposals would potentially add a layer of regulation to current live and electronic road show practices, even to those directed solely to institutional investors. Moreover, any filing requirement would chill these forms of communication. In order to resolve any ambiguity and to preserve the continuing utility of electronic road shows, we believe the Commission should exempt electronic road shows from the definition of "prospectus" for purposes of Section 2(a)(10).

2. "Free writing" and "offering information".

a. "Free writing" materials should not be filed.

The proposed requirement that all "free writing" be filed creates both mechanical and liability problems. Mechanically, the variety and number of sources of "free writing" material is potentially large (ranging from underwriters and syndicate participants to registered representatives working for small brokerage firms in far-flung locations who create "marketing" materials). Keeping track of what has to be filed, when and by whom would be very difficult. Certainly no one other than the creator of the information should have responsibility for it. Nonetheless, under the proposals even the creator may have difficulty identifying when information constitutes "free writing" *versus* written material not associated with an offering, especially when produced at the level of a registered representative.

More significantly, the requirement to file "free writing" with the Commission could enable persons who obtain it from the public file to make civil liability claims, even though they were never intended as recipients. This expansion of potential liability is likely to have a chilling effect on the creation of "free writing". Many materials are targeted to specialized audiences able to understand and fairly evaluate the merits and risks set forth in that material. A filing requirement that would make the material generally available would

---

127 15 U.S.C. § 77b(10).

128 In this regard, we note that no-action requests for electronic road shows were premised on their not being "written" communications. *See also* note 129 and accompanying text, *infra*.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

either require such material to be recast for a general audience, stifle its use altogether, or require the parties to accept increased liability exposure.

Even if offering information were redefined, most written material would be "free writing", including such intellectual property as proprietary investment ideas. As described below, because mandatory filing of this information would be unfair and inhibit innovation (whether the filing is made as offering information or free writing), the proposal to file this material should not be adopted.

b. Concept of "offering information" should be narrowed.

The consequence under the Commission's proposals of information being deemed "offering information" is that all participants are liable for it under Section 11. The Commission's "offering information" concept is overbroad. We believe the Commission should retain the "exclusive prospectus" concept for all registration forms. All other written material should instead be treated as "free writing". The examples below illustrate the problem.

First, if an underwriter elaborates in writing on disclosure in the registration statement, that writing appears to be "offering information" under the Commission's proposals. On the other hand, if that underwriter merely repeats the information *verbatim*, then the information is "free writing." Suppose the underwriter is just explaining?

It seems inappropriate to charge the issuer and all other underwriters with liability for the explanation. If this cross-liability were to remain, we would expect underwriting arrangements would customarily prohibit the issuance of all written material by any underwriter or member of the selling group not approved by the issuer and covered by the underwriting group's contractual disclosure indemnity from the issuer.

Second, the Proposing Release implies that video presentations and slides at institutional investor road shows would be treated as "offering information" even though they are not distributed in written form. Today practitioners, with the long-standing acquiescence of the Commission staff, analyze these materials as oral, not written.[129]

If these materials are considered written, and hence "offering information", the result is likely to be less disclosure. The existence of a cause of action under Section 11 for all investors in respect of this material (not merely those sophisticated investors attending the road show) will certainly have a chilling effect. Some information will still be communicated at road shows, but would be limited to oral presentations not encompassed in the Commission's concept of "offering information".

---

[129] *See e.g.,* Thomson Financial Services, Inc. (September 4, 1998); Bloomberg L. P. (December 1, 1997); Net Roadshow, Inc. (September 8, 1997); and Private Financial Network (March 12, 1997) (no-action positions granted for electronic transmission of road shows to institutional investors based upon counsel's opinion that the transmissions are not a prospectus within the meaning of Section 2(a)(10) of the Securities Act). *See also* Net Roadshow, Inc. (January 30, 1998) (no-action relief granted in respect of road shows for Rule 144A transactions). The Committee believes that electronic road shows should continue to be treated as oral materials.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Third, many investment banks currently try to show novel proprietary investment ideas first to their most favored clients. This is a feature of our free market system, which fosters innovation and competition. Some of these proprietary investment ideas may involve new financial products. To the extent these product ideas are sufficiently identified with a particular issuer or group of potential issuers, they could be deemed "offering information". As a result, underwriters would be forced to share proprietary investment ideas immediately with their competitors and non-clients by virtue of the public filing requirement. This result would be unfair, and would likely impede innovation.

In summary, offering information, for which all offering participants would incur liability under Section 11, should be restricted to specified information, as under the current registration system. All other written information should instead be treated as "free writing".

c. Further comments on the Commission's proposed "free writing" and "offering information" standards.

i. Standard for identifying "first offer" is vague.

Under the "inclusive prospectus" approach of Form B, identifying the "first offer" is critical to determining what communications will be "offering information" that must be included in the registration statement. The Commission's proposals do not indicate what is meant by "first offer," but the Commission staff has stated that the concept it has in mind is broader than the first *bona fide* offering of the securities upon pricing. They have suggested the concept could be as broad as "offer" in Section 2(a)(3) of the Securities Act.[130] Such a vague "moving target" standard is unworkable.

In the new Form B-world of wide-ranging offering activities, there will be many participants engaged independently in many activities that could be "offers." Issuers may be testing the waters. Prospective underwriters may be gauging investor interest as part of convincing the issuer to give them a mandate. The time when one of these communications matures into an "offer" may not be clear. Much may be done only orally. It will be nearly impossible to know, and establish with any degree of certainty, who said what and when.

Rather, a bright line is needed. A bright-line standard would enable offering participants more readily to determine whether any of their communications constitute "offering information". This standard would also enable participants realistically to identify that information in the context of the accelerated offering schedules that are common for shelf takedowns.

ii. "By or on behalf of the issuer" should be narrowed.

Any "offering information" that is "disclosed by or on behalf of the issuer" during the offering period would be required to be filed as part of the Form B registration statement. Consequently, all underwriters (as well as the issuer, its directors and signing officers) will have potential Section 11 liability on that information.

---

130 15 U.S.C. § 77b(3).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

If one underwriter or a registered representative were to prepare and distribute written material at some time during the offering period, even prior to the informal organization of any underwriting effort, could this be "by or on behalf of the issuer"? The staff has indicated it could. If so, cross-liability will exist even though the other offering participants will have had no possibility of vetting that information. Furthermore, under such a broad notion of "by or on behalf", there is no effective way for the issuer, lead managing underwriter and their respective counsel to determine whether all "offering information" has been identified (and filed) before first use or upon filing of the registration statement.

Instead, the Committee believes that only the user of the information should be responsible for it in the above circumstances. We have heard it suggested that if user-only responsibility were imposed, underwriters may issue written information to insulate the issuer from liability. Because the underwriter would remain liable for this information, we do not believe this unduly jaundiced view is realistic. Thus, "offering information" (if the concept is retained) should be limited to written information prepared by the issuer and its lead managing underwriters, and should not include information prepared by individual registered representatives or by other underwriters or broker/dealers.

iii. Failure to file should not create civil liability.

If the requirement to file "free writing" were adopted, or if the prospectus were to remain an "inclusive" concept coupled with a requirement to file the triggering "offering information", then the consequences of the failure to file should be clarified. In any event, it should be clear that such failure would not give rise to a Section 5 violation or any other outcome that would permit any private civil remedy, such as rescission or damages. In our view, administrative remedies should be sufficient. Also, offering participants should not be responsible for filing failures by other offering participants — only the user of the information should be subject to the filing requirement.

iv. Clarify no "material change updates" are required.

We believe the material change update requirement of proposed Rule 172(e) would not be applicable to Form B offerings. As proposed, disclosure of material changes in prospectus information must be delivered to investors 24 hours before pricing. We reach this conclusion because paragraph (e) omits reference to paragraph (a) (Form B and Schedule B for seasoned registrants) of Rule 172, but specifically refers to the other paragraphs of Rule 172. However, Item 6 of Form B specifies that a Rule 172(e) document must be filed. We assume this is a drafting mistake and would ask that it be deleted. Also, if the Commission determines to adopt the rule, it would be helpful if the inapplicability of the material changes update to Form B and Schedule B were explicitly confirmed in the adopting release, and in the text of the rule.

3. Research Reports.

As noted in the Proposing Release, we have previously urged the Commission to minimize the scope of restrictions on research in order to reflect rapid advances in communications technology and the globalization of the securities markets.[131] We commend the Commission for its explicit acknowledgment of the

131 Proposing Release at n. 336 and accompanying text.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

important role of research reports in disseminating information to the securities markets. We also commend the Commission for its recognition of the fact that such reports consist not only of formal reports but rather the broad range of analyst communications about issuers, whether or not published in a report.

Before commenting on the Commission's specific proposals, we urge the Commission to take note of the significantly increased professionalism over the past 20 years of the research function as it is carried out in the securities industry. Broker/dealers have increased the number and quality of their analysts and more precisely targeted their coverage of economic and industry trends and issuer developments. Many analysts now have advanced degrees or professional certification. Their performance for their customers is a matter of public record and the subject of periodic and frequent surveys by independent publications covering the securities industry. It would be extraordinarily difficult for a prominent analyst to "hype" a security without putting his livelihood at risk. As for a less prominent analyst, it is at least a valid question whether any reasonable investor would respond to such an analyst's attempt to "hype" a security in connection with an underwriting.

In addition, standards of SROs provide important additional safeguards for investors. For example, New York Stock Exchange, Inc. ("NYSE") Rule 472 requires that research reports issued by member firms, whether or not the securities trade on the NYSE, be prepared or approved by supervisory analysts, who must meet the requirements of NYSE Rule 344. These requirements include a minimum level of experience, NYSE investigation of the individual's character and conduct, and the passing either of the NYSE's supervisory analysts examination or the successful completion of relevant parts of the Chartered Financial Analysts Examination. Rule 472 also prescribes substantive standards for research reports, including, *inter alia*, that recommendations have a reasonable basis, and that sources of potential bias be disclosed.

Similarly, the NASD Rule 2210 requires that research reports be approved by a registered principal of the member firm. The rule also prescribes substantive standards similar in scope to those of the NYSE and applies to all registered broker/dealers.

Both the NYSE and the NASD go beyond the specific disclosures referred to in their respective rules to require disclosure of additional facts that would be material to the reader, including facts relating to conflicts of interest. While customers probably do not have a private right of action for the omission of such facts, the requirements illustrate the high professional standards that the NYSE and the NASD have established for research reports.

Therefore, we believe the Commission can take substantial comfort from the standards described above in determining the degree of freedom it is willing to accord to research reports published during a Securities Act distribution.

a. Research safe harbors should be expanded for registered offerings.

We agree with the Commission's objective to allow investors to receive more information about companies that are in registration. We also agree that it is a relevant consideration that, in at least some global offerings, US investors are at a disadvantage when research is distributed to offshore investors but cannot be made available to US investors because of Securities Act prohibitions.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

i. Rule 137.

Rule 137 makes it possible for a broker/dealer not participating in a distribution to publish research on the securities that are the subject of the distribution. It does so by stating that a broker/dealer meeting the rule's conditions is not acting as an "underwriter". We note the Commission's observation in the Proposing Release that it is in the period following the initial offering of a security or the effective date of a registration statement that the investor may need most the research coverage provided by a non-participating dealer.[132]

We do not believe, however, that the Commission's proposals regarding Rule 137 make it possible for the non-participating dealer to publish research during this period. Even if the dealer is not an underwriter, it is still a dealer who must rely on the exemption afforded by Section 4(3) of the Securities Act.[133] As the Commission observed, that exemption is not available to any dealer — whether or not participating in the offering — during the prospectus delivery period following the offering. While a dealer may effect a transaction in the registered security by delivering a prospectus with the confirmation, it is ordinarily impractical for a dealer to distribute a copy of the prospectus with each research report.

Thus, in order for the Commission to accomplish its objective, it would therefore have to amend Rule 137 to state that the publication of a research report by a non-participating dealer is not a "transaction" for the purposes of Section 4(3). Alternatively, such a report could be exempted from the prohibitions of paragraph (b)(1) of Section 5.

The Committee agrees with the proposal to delete the condition that a report be published in the regular course of the dealer's business. This condition is difficult to apply in practice, as illustrated by the Commission's apparent assumption that Rule 137 currently prevents a dealer from initiating research on an issuer. We believe the condition is generally interpreted as requiring that a dealer be engaged regularly in publishing research reports, not that it have established a "track record" with respect to a given issuer (as currently required by Rule 139).

The Commission sought comment on various possibilities for reducing "unusual activity" by a dealer if the "regular course of business" condition were removed. For example, it suggested additional disclosure or minimum qualifications. We note that research analysts are almost invariably registered with SROs and subject to their standards and discipline. We believe that the Commission should continue to leave to the SROs the task of regulating disclosure concerning the identity and affiliation of preparers of research and the existence of possible conflicts of interest.

In principle, we commend the Commission's proposal to extend Rule 137 to non-reporting companies with the exceptions proposed by the Commission. As a consequence, non-participating dealers

---

132 Proposing Release at n. 337 and accompanying text.

133 15 U.S.C. § 77d(3).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

would be able to publish research on a private company at a time prior to the effective date of the registration statement and the pricing of the IPO (*e.g.,* during the marketing period for the IPO).

ii. Rule 138.

The Committee disagrees with the Commission's proposal to subject research reports exempted by Rule 138 to civil liability under Section 12(a)(2) by treating them as "prospectuses", because we believe the appropriate liability standard for research reports is Rule 10b-5 under the Exchange Act.[134]

On the other hand, we commend the Commission's proposal to extend Rule 138 to all US reporting issuers (with certain exceptions) and certain foreign private issuers. The premise of the rule is that a research report on an issuer's debt securities generally does not induce a reasonable investor to purchase the same issuer's equity securities, and that a research report on an issuer's equity securities generally does not induce a reasonable investor to purchase the same issuer's debt securities. While there is inevitably some overlap, the rule seeks to avoid the disruption of research on an issuer's debt (or equity) securities simply because the issuer is in registration for an offering of equity (or debt) securities. In our view, the length of the issuer's reporting history has little to do with the validity of this premise.

We encourage the Commission not to amend Rule 138 to require that non-reporting foreign private issuers have a specified trading history on a "designated offshore securities market" [135] approved by the Commission under Regulation S. If an issuer meets the ADTV and public float tests, it is likely to have a significant foreign research following that should provide the same scrutiny as a minimum trading history.

We question, however, why the availability of Rule 138 for reports on a foreign private issuer should depend on whether the primary market for the issuer's equity securities is a "designated offshore securities market". After all, a dealer can publish a report under current rules on the securities of any issuer anywhere in the world, whether its primary market is approved under Regulation S or not. When an issuer that meets the ADTV and public float tests has taken the added step of filing a registration statement covering its equity securities, it appears anomalous to prevent a dealer (now an underwriter) from publishing research on the issuer's debt securities (which by definition are *not* covered by the registration statement) simply because the primary market for the equity securities is not approved under Regulation S.

We note that the Commission proposes to condition availability of the rule on whether the research material is being distributed in the "ordinary course of … business" (*see* proposed paragraph (a)) or in the "regular course of … business" (*see* proposed paragraph (b)). As noted above, it is extremely difficult in practice to apply any test based on whether or not something is in the course of a dealer's "ordinary" or "regular" business. Given the different focus of reports on debt and equity securities, we believe that the "ordinary" or "regular" course of business conditions are unnecessary. Alternatively, if the tests are retained, they should be made uniform, and the Commission should make clear that it does not contemplate a "track

---

134 17 C.F.R. § 240-106-5.

135 Rule 902(b) of Regulation S under the Securities Act, 17 C.F.R. § 230.902(b).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

record" on a given issuer's securities but rather that the dealer be in the business of regularly publishing research on debt and equity securities in general.

Finally, the Proposing Release posits that availability of Rule 138 should be conditioned on "prominent" disclosure of the "capacity" in which a firm is participating in the offering. First, "prominent" is a vague term. Second, "capacity" is also vague (*e.g.,* does *capacity* include whether the firm is a manager or co-manager, or the amount of its participation?). Moreover, the proposed disclosure would create unwieldy mechanical problems, which would potentially require a sticker when the dealer is invited into the syndicate, and another sticker when its involvement (or non-involvement) is concluded. How could that be done given the automated processes and diverse sources of re-sending existing research? The solution is to reinstate Rule 138 research as being excluded from the term "prospectus".

Given the consequence that a wrong judgment on these issues may result in a violation of Section 5, we believe the Commission should continue to leave disclosure of sources of bias to regulation by the SROs.

iii. Rule 139.

We also disagree with the Commission's proposal to subject research reports exempted by Rule 139 to civil liability under Section 12(a)(2) as "prospectuses", because we believe the appropriate liability standard for research reports is Rule 10b-5.

The Committee notes an ambiguity as to the status of Rule 139 research reports under the Commission's proposed filing requirements relating to "offering information" as specified in proposed Form B and "free writing" as specified in proposed Rule 166. We assume that the Commission's intent was that research exempted by Rule 139 would not be required to be filed, and we recommend that this point be clarified.

We offer our comments separately on *focused* and *industry* reports.

(A) Focused reports.

We agree with the Commission's proposal to permit "focused" reports on securities of issuers with a one-year reporting history, certain foreign private issuers, and certain foreign government issuers. In each case, we believe the amount of information likely to be publicly available about the issuer justifies the Commission's judgment that investors will benefit from the additional availability of research reports.

As noted above under Rule 138, the Committee does not agree with the requirement that otherwise-qualifying foreign private issuers must have equity securities traded on a "designated offshore securities market" approved under Regulation S. We also disagree, for the reasons stated above, with the condition that the research report "prominently" disclose the "capacity" in which the broker/dealer is participating in the offering.

The Commission proposes to eliminate the current requirement of Rule 139 that exempted research be contained in a publication that is distributed with "reasonable regularity". We commend the Commission for proposing to eliminate one of the most vexing conditions faced in making judgments in the

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

research area (*e.g.,* Is the test the same for debt and equity securities? What about interruptions in research as the result of a security's appearance on a firm's restricted list?).

On the other hand, the Commission proposes to retain the requirement that exempted research be contained in a publication that is distributed in the "ordinary course of business". The Proposing Release suggests that this condition means that the broker-dealer "has a history of distributing similar focused reports on other issuers or securities." The Committee would not object if this were the Commission's intent. However, we recommend that the Commission state clearly that it does not mean to create any other distinction (*e.g.,* one based on the manner in which research is distributed). In our view, research should be excluded from the term "prospectus".

(B) Industry reports.

We commend the Commission for proposing an extension of the "industry report" exemption to all issuers. In particular, we believe it is a step forward to delete the current "no more favorable recommendation" condition and to substitute a requirement to disclose previous opinions or recommendations. We believe this approach is more likely to benefit investors than a condition that flatly prevents a broker/dealer from stating its true opinion. On the other hand, we foresee logistical difficulties in a broker/dealer's complying with this condition in connection with an industry report that is prepared at a time when there is no prospect of a distribution (and that therefore does not contain the contemplated disclosure). For the reasons stated above, we do not believe the industry report exemption should be conditioned on the disclosure of the broker/dealer's capacity in the offering.

Finally, we urge the Commission to reconsider the condition that information, an opinion or a recommendation relating to a particular issuer be given "no materially greater space or prominence" than that given to other securities or registrants. This subjective and arbitrary condition has proved extremely difficult to apply in practice and is primarily responsible for many firms' unwillingness to rely on the current provision in paragraph (b) of Rule 139.

(C) IPOs and unseasoned issuers.

The Commission requested comment on whether Rule 139 should also permit underwriters to publish focused reports on IPOs and repeat offerings by large unseasoned companies that have been followed by the underwriters in the ordinary course of their business.

We understand the Commission to be proposing that an underwriter should be permitted to *continue* — as opposed to *initiate* — research on such an issuer. We agree that investors would benefit from a continuation of such coverage. We do not understand, however, why such continuation should be permitted only where the issuer is "large" or is offering more than a certain amount of securities. It may be the smaller issuers or offerings where continuation of previous coverage is especially important to investors.

The Committee does not believe that such (or any) research should be "filed" with the Commission as part of the registration statement or prospectus. First, we reject any notion that it constitutes *selective disclosure* — whatever that term may mean — for a broker/dealer to make research available to some

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

investors and not to others.[136] This is the essential attribute of research: that it is made available to customers who are willing to pay for it by hard or soft dollars. Second, we believe that any concern the Commission may have about "subjective reports that are not balanced by regulated public disclosure" would be alleviated by a requirement that the reports be provided on request to the staff as supplemental information to assist in the staff's review of the pre-effective registration statement.

b. Research safe harbors should encompass all unregistered offerings.

We commend the Commission for its interpretation, effective immediately, that research reports covered by current Rules 138 and 139 may be published and distributed without constituting "directed selling efforts" within the meaning of Regulation S. We believe that the Commission should also extend this relief to Rule 144A offerings.[137] The limitation of this position to research reports of the of the nature described in paragraph (b) of Rule 139[138] was a hindrance for many years to the dissemination of research material of great benefit to investors.

The Committee also commends the Commission for proposing to amend Rules 138 and 139 to make clear that research covered by those rules, as proposed to be amended, will not undermine reliance on relevant provisions of Regulation S and Rule 144A.

We note that the Commission does not propose to create an exemption pursuant to Rule 139 for reports on small or unseasoned issuers making Regulation S or Rule 144A offerings. As we observe above, it may be precisely these issuers as to which investors most need continued research coverage. In view of the Commission's proposal to condition the Rule 139 exemption on a "reasonable regularity" standard (*i.e.,* a "track record" indicating continuity rather than the mere initiation of research), we believe the Commission could reasonably extend this exemption to small or unseasoned issuers.

As noted above, the "reasonable regularity" condition of Rule 139 has proved difficult to apply in the past. While we understand the Commission's reasons for proposing the condition under Rule 139, we do not believe that it is a necessary ingredient under the more limited exemption of Rule 138. As for the Commission's request for comment on whether it should better define "reasonable regularity", we believe that the variety of possible scenarios is so great that the Commission should leave this judgment to broker/dealers.

---

136 *See also* I.B., *supra* page 8, and V.C*., infra* page 87.

137 Initially, the staff orally clarified that publication and distribution of research reports conforming to Rules 138 and 139 would not constitute "directed selling efforts" for offerings made in reliance on Rule 144A. *See* Remarks by Brian Lane, Director of the Division of Corporation Finance, at The Practising Law Institute's 30th Annual Institute of Securities Regulation (November 5, 1998). However, in his remarks at the ABA Business Law Spring Meeting in April 1999, Mr. Lane tempered his prior clarification.

138 *See* Offshore Offers and Sales, Securities Act Release No. 6,863 [File No. S7-7-90] (April 24, 1990) [55 FR 18306] ("Adopting Release") at n. 59 and accompanying text.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

c. Safe harbors for proxy solicitations should encompass all transactions.

The Committee commends the Commission for proposing to codify the staff's position that the publication and distribution of research under the conditions set forth in Rules 138 and 139 would be permitted in connection with a registered securities offering that is subject to the proxy rules[139] under the Exchange Act. The safe harbors for research would continue to operate independently of the safe harbors for communications made on behalf of the participant to any business combination, proxy solicitation, or tender offer.

Research is an activity inherently separate from the offering, solicitation, or tender offer and is not issued on behalf of any party to the transaction, but rather is issued on behalf of the broker/dealer for the use of its clients (institutional and retail investors). In this regard, we believe that consistent with its efforts to rationalize and coordinate the Securities Act, proxy and tender offer[140] regulatory schemes, the Commission should make clear that its research safe harbors under the Securities Act apply equally and fully as safe harbors under the proxy and tender offer rules. Thus, the current interpretive extension of Rules 138 and 139 to offerings pursuant to Regulation S and Rule 144A announced in conjunction with the Securities Act reform proposals should apply equally for purposes of the proxy rules and tender offer rules.

Likewise, we do not see a need to preclude reliance on the research safe harbors afforded by Rules 138 and 139 for proxy solicitations or exchange offers involving public securities offerings exempt from registration, such as those made in reliance on Sections 3(a)(9)[141] or 3(a)(10)[142] of the Securities Act, or in connection with a spin-off transaction. As proposed, the codification of the staff's position in *Merrill Lynch*[143] would not extend the safe harbor for research to these public transactions because they are not required to be registered. This distinction, however, does not seem to be supported by any particular policy reasons or to be otherwise required for the protection of investors.

---

139 17 C.F.R. § 240.14a-1, *et seq.*

140 17 C.F.R. § 240.13d-1, *et seq.* and 14d-1, *et seq.*

141 15 U.S.C. § 77c(a)(9).

142 15 U.S.C. § 77c(a)(10).

143 Merrill Lynch, Pierce, Fenner & Smith Incorporated (available October 24, 1997).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

IV. PERIODIC EXCHANGE ACT REPORTS

A. ISSUER PRESS RELEASES AND ANALYSTS' REPORTS ASSIST INVESTORS AND ENHANCE EFFICIENT MARKETS.

1. Investors rely on information disseminated by a company's press releases and conference calls with research analysts.

We support the concept of enhancing the quality and timeliness of information contained in the periodic reports filed by issuers subject to Section 13[144] or 15(d)[145] of the Exchange Act ("reporting companies"). The Committee, however, questions the Commission's implicit assumption throughout this section of the Proposing Release that investors rely, to a large extent, solely on Exchange Act filings in making investment decisions, and that somehow press releases are either not available to investors or are not generally relied upon by them.

The Committee notes that most press releases are available through services offered by P. R. Newswire and Business Wire to newspapers and other media; through Internet portal services which provide stock quotations, such as Yahoo! Finance and Excite-Quote; through Internet sites operated by, *inter alia*, Nasdaq, CNNfn, America Online, and Microsoft; and often through a reporting company's own Internet site. Moreover, press releases are typically covered in The Wall Street Journal, Financial Times, and other newspapers of general circulation.[146]

Thus, we believe that press releases are widely available and very much relied upon by investors as part of the mix of information available to them with respect to a reporting company's activities. The Committee also believes that the Commission should not attempt to blunt or otherwise derail the increasing use by reporting companies of press releases and conference calls with analysts and investors as a means of promptly disseminating information about the companies' activities.

For many reporting companies, conference calls with research analysts have become an increasingly important factor in the entire process of disseminating significant financial information to the investment community. This is true not because of any declining relevance of historical financial information (as suggested by the Commission in the Proposing Release) but rather because research analysts and their clients,

---

144 15 U.S.C. § 78m.

145 15 U.S.C. § 78o(d).

146 Indeed, investors in securities traded on the Nasdaq-Amex market have real-time access to issuers' conference calls announcing earnings information, which are made available through the Nasdaq-Amex Internet "Quarterly Earnings Conference Calls" site. The site includes a schedule of upcoming calls and archived conference calls. The Internet address is as follows:

http://www.nasdaq-amex.com/reference/conf_call_chart.stm.

In addition, many issuers provide investors with real-time access to their earnings conference calls via 800 dial-in numbers or via streaming audio over the Internet.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

and in many cases small investors, desire more detailed support for and a deeper understanding of the historical financial information and an analysis of the potential future impact of the historical financial information. We understand that, in many instances, research analysts' reports based on information made available in company conference calls are released by analysts shortly after the conference call, and that such reports are generally available to investors through multiple sources. These reports help the investing public filter the information being provided by companies in their Exchange Act filings and press releases by providing meaningful third-party interpretation, thereby helping to create an efficient securities market.[147]

As a result, the Commission's assertion that analysts' conference calls widen the information gap between large and small investors is questionable. Generally, small investor clients of brokers/dealers can access analysts' reports if they so desire. Moreover, many reporting companies also permit small investors to participate in (or at least listen to) the conference calls, often providing toll-free numbers for their use. Where small investors are not given direct access to such communications, analysts' reports act as an interpretive conduit of such communications to the marketplace. We believe that this is an area that continues to evolve, generally in the direction of broader dissemination, especially in light of the increasing use of technology. Therefore, in our view, the Commission should not seek to regulate the practice at this time.

2. Proposed revisions to disclosure required in annual and quarterly reports.

a. Risk factor disclosure should apply solely to a company's business and not to the terms of its securities or offerings.

The Committee generally supports the concept of adding risk factor disclosure in annual and quarterly reports where risk factor disclosure would be required in the particular reporting company's Securities Act filings, and supports the proposition that such risk factors be drafted in plain English. The Committee acknowledges that it did not support a similar proposal two years ago in commenting on the Concept Release. However, in the interim we have seen significant changes in risk factor disclosure, in the form of meaningful cautionary statements to forward-looking information. We also believe that many thoughtful practitioners already recommend that their clients provide risk factor disclosure (even if not so denominated) relating to their business in reports filed on Form 10-K or Form 10-KSB under the Exchange Act.[148]

We see no need or advantage, however, to expand or contract the required risk factors disclosure from the specific matters already contained in Item 503 of Regulation S-K.[149] Furthermore, we believe that the Proposing Release should make clear that the risk factors which are to be included in the risk factors section of a Form 10-K (or in a periodic or current report updating the information, to the extent of a material change) are the risks relating to the reporting company's business as described in response to Item 101 of Regulation S-K,[150]

147 *See infra* page 84, "V. Liability."

148 17 C.F. R. § 240.310b.

149 17 C.F.R. § 229.503.

150 17 C.F.R. § 229.101.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

and not risks relating to the terms of the reporting company's outstanding securities or to the terms of a particular offering of the reporting company's securities.

b. Quarterly information should not be subjected to liability under Section 18 of the Exchange Act.[151]

One of the proposals would eliminate the existing exemption from liability under Section 18 of the Exchange Act for quarterly financial information and related MD&A. Presently, this information is subject to liability under Sections 11 and 12(a)(2) of the Securities Act to the extent incorporated in a registration statement or used to sell the securities, respectively; but otherwise is subject to Rule 10b-5.

If this proposal were adopted, the potential exposure to liability would be increased in at least two ways. First, *anyone* who *purchases or sells* a security in reliance on the information could argue they are entitled to institute suit under Section 18, and not solely purchasers of the securities registered under the Securities Act. Second, pursuant to Rule 10b-5, the plaintiff has the burden of proving *scienter* or possibly recklessness, whereas under Section 18 the defendant has the burden of proving good faith and the absence of knowledge that a statement was false or misleading.

We do not believe that the addition of liability under Section 18 for reporting companies' financial information or MD&A will cause reporting companies to take their Form 10-Q disclosure more seriously. We believe that the obligation to file complete and accurate Forms 10-Q is already taken seriously by most reporting companies. In our view, companies are mindful that there are significant securities law remedies in the event of inaccuracy or incompleteness of their Form 10-Q filings, and there is not likely to be a difference in the quality of disclosure based on the application of Section 18.

Moreover, such a change would be inconsistent with the Congressional mandate expressed in recent securities legislation to reduce frivolous lawsuits.[152] Therefore, lessening the level of proof for liability based upon Form 10-Q disclosure would not further that Congressional intent.

The Committee also does not understand what the Commission believes will actually be gained by investors from this change, and does not believe that investors will be aided by this change in any meaningful way. We are also concerned that if this change is made, there may be a perception that the quality of Form 10-Q disclosure would be enhanced and investors would be better protected. If we are correct in our view that this change would not enhance the quality of disclosure in any meaningful way, then we are concerned that this inaccurate perception would be misleading.

Presumably, when it adopted amendments to the form as part of its implementation of the integrated disclosure system,[153] the Commission believed that disclosure in the Form 10-Q was entitled to a

---

151 15 U.S.C. § 78r.

152 *See generally* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998); Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

lesser scope of liability due to the summary, interim and unaudited nature of the financial information and the soft nature of MD&A. The Commission, however, does not set forth any abuses that reasonably justify extension of liability as proposed.

c. Requiring a filed "Management Report to Audit Committee" would not enhance the quality of Exchange Act reporting.

The Committee does not believe that a management report to the audit committee setting forth the procedures taken by management to assure the accuracy and adequacy of the particular reporting company's Exchange Act reports would enhance the quality of Exchange Act disclosure. The real issue to be considered is the accuracy and adequacy of reporting companies' financial statement disclosure.

However, we do not believe that requiring management to include a report to the audit committee in Exchange Act filings setting forth the procedures which it is following to make the reporting company's disclosure accurate and adequate would further that effort in a meaningful way, since each management's and audit committee's procedures will vary from reporting company to reporting company and from time to time based on the individual strengths and weaknesses of each reporting company's financial and legal staff, and the participation in the disclosure process, *if any,* by outside securities counsel.

The Committee sees no benefit in creating procedural standards which would be applicable to all, and which we believe would quickly devolve to relatively meaningless boilerplate disclosure. We are also concerned that this requirement would create an additional and unnecessary basis for litigation when an Exchange Act filing is inaccurate or incomplete.

On the other hand, we believe that the role of a reporting company's audit committee, including its role in reviewing and overseeing the preparation of Exchange Act filings, is a developing one, and that the Commission should wait to see what practices develop in this area in the absence of regulatory control before requiring reports of such activities to be included in a reporting company's Exchange Act filings.

[153] *See* New Interim Financial Information Provisions and Revision of Form 10-Q for Quarterly Reporting. Securities Act Release No. 6,288 [46 FR 12480 (February 17, 1981)] ("Final Rules"). *See also* Integrated Disclosure: Proposed Implementing Amendments to Rules, Forms and Schedules Under the Securities Exchange Act of 1934; Proposed Clarification of Safe Harbor rules *[sic]* for Protections Under the Securities Acts. Securities Act Release No. 6,338 [46 FR 42042 (August 18, 1981)] ("Proposing Release").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

3. Interim reports on Form 8-K.

a. Timely disclosure of annual and quarterly results of domestic companies is desirable.

i. Requiring S-K Item 301 information in Form 8-K would delay release of earnings information.

The Committee concurs with the Commission's assessment that quarterly and fiscal year-end earnings information is important to the financial markets and that investors demand this information at the earliest time it is available. However, as more particularly described below, the proposal to require reporting companies to include disclosure required by Item 301 of Regulation S-K[154] under the Securities Act information in Form 8-Ks that disclose earnings information would likely delay the release of earnings information for many reporting companies, rather than speeding up and enhancing its delivery. Accordingly, the Committee does not support this proposal.

We concur with the Commission's view that the dissemination of earnings information through the issuance of press releases gives rise to the possibility that all investors are not informed of a company's financial results at the same time, although, as set forth above, the Committee is not convinced that, with the availability of various on-line Internet services, analyst networks and company Internet sites, dissemination through the EDGAR system is necessarily the best or only way of assuring that all participants in the markets learn of a company's financial results at the same time.

The Committee notes that reporting companies should retain the discretion to file their earnings information under cover of a Form 8-K. If it were feasible to make these filings by the end of the EDGAR day (currently 10:00 p.m. Eastern Time) on the business day after the date the earnings press release is first issued, then such information could be made available through EDGAR on a timely basis.[155] We could not support a requirement to file the earnings press release under cover of a Form 8-K because it may inadvertently create liability under Section 12(a)(2) when the Forms 8-K are incorporated by reference into prospectuses.

We are concerned, however, that the goals of fostering the disclosure of earnings information at the earliest possible time and of ensuring that the earnings information is accompanied by meaningful analytical information may be inconsistent. The Committee believes that the Commission will need to make a judgment as to which of these goals is more important, since the focus on one will clearly impact the other.

For example, if the Commission adds a requirement that press releases must include S-K Item 301 information, the Committee believes that this would, in many instances, result in the later disclosure of

154 17 C.F.R. § 229.301.

155 We assume that the Commission would take steps to eliminate the current one-day delay in making EDGAR information available on the Commission's website. We note that this delay does not occur with EDGAR data the Commission makes available to third-party vendors, many of whom charge their customers for real-time EDGAR information.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

earnings information than would otherwise be the case. Such later disclosure of earnings information may increase the risk of "leaks" and the differential access to information that the Commission seeks to avoid.

In that regard, the instructions in S-K Item 301 require disclosure not only of the items of selected financial data specified in Instruction 2, but also a description of factors that materially affect the comparability of the information reflected and a discussion of or reference to "any material uncertainties" which might cause the data not to be indicative of future financial condition or results of operations. The instructions also suggest that the selected financial data should include items which would highlight significant trends in financial condition and results of operations. Preparation of this disclosure often requires significant analysis of extensive and complex data by company personnel, external auditors and legal counsel. Most companies combine their response to the disclosure requirements of S-K Item 301 with their MD&A, because of the time required to gather and interpret this data. In summary, the goal of earlier disclosure of earnings information should trump the goal of more uniform and more complete disclosure in press releases.

If the Commission disagrees with our position and, nonetheless, determines to require certain S-K Item 301 information in press releases, we recommend that the Commission delineate what specific items of selected financial data referred to in Instruction 2 to S-K Item 301 would be required in press releases (and in a corresponding filing under cover of Form 8-K), while making clear that there is no obligation to provide either trend information or descriptions of factors affecting comparability or material uncertainties. Furthermore, if contrary to our view, the Commission requires trend information or a description of factors affecting comparability or material uncertainties to be reported with earnings information in a Form 8-K, then the filing would essentially be the same as the Form 10-Q, since reporting companies would never prepare MD&A without financials.

Finally, the Committee also recommends that regardless of the proposal adopted, the Commission should make clear that it intends that these new rules apply only to reports and press releases disseminating a full presentation of earnings information for a particular historical period, and not to early alert press releases which disclose that a particular reporting company's earnings will likely be lower or higher than analysts' expectations, or that disclose only revenues but not operating or net income.

ii. Current due dates for Forms 10-K and 10-Q should be retained.

The Commission seeks comment whether, as an alternative to adding a selected financial data reporting requirement and adding a Form 8-K requirement, the due dates for annual and quarterly reports should be accelerated. While the Committee has not sought to determine the number of reporting companies that announce unaudited information earlier than 45 days after the end of a fiscal quarter, we believe that there are a significant number of reporting companies that are unable to file their Form 10-Q reports earlier than the current 45-day maximum.

Thus, the focus should not be on the 45-day time limit, but rather on the time period between the dissemination of an earnings press release and the time that a Form 10-Q is filed with the complete analysis of the financial information being reported. In that regard, we would urge retaining the 45-day limit for filing Form 10-Q, but would not object to a requirement that companies file their quarterly reports by the earlier of 45 days after the end of the fiscal quarter or 15 days after the first release of earnings information for such quarter.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

In making filing deadline decisions based on the public release of earnings, we urge the Commission to recognize (a) the impact on the ability to meet such deadlines of requiring additional signatories on Exchange Act reports, (b) the impact on reporting companies of increased costs due to the necessity of hiring the additional staff to meet accelerated reporting deadlines, and (c) the potential delay in reporting of earnings so that companies will have time to complete these additional steps. For example, some reporting companies may need to use the maximum time in order to reflect mergers or other complex transactions.

The maximum 90-day period for the careful preparation of a Form 10-K, including the completion of fiscal year-end audited financial statements, should be retained, since we are concerned that many smaller reporting companies and their auditors may not be in a position to complete their fiscal year-end audited financial statements more quickly. However, for the reasons set forth *supra,* and subject to the same *caveats*, the Committee would also not object to a change in the filing deadlines that would require the filing of a Form 10-K by the earlier of 90 days after fiscal year-end or 45 days after the first release of year-end earnings information.

b. Form 8-K should be amended to require disclosure of a limited number of specified corporate events.

Generally, the Committee concurs with the Commission's proposals to expand the items of disclosure that reporting companies must file on Form 8-K, subject to certain modifications described below. We are concerned, however, that adding too many obligations for required reporting under Form 8-K may diminish the importance currently attached to these filings by investors and analysts.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Committee has the following specific comments on the Commission's proposals:

i. Material modifications to the rights of security holders.

We agree that reporting companies should be required to report the implementation of any material modifications in security holder rights on Form 8-K. Presently, this disclosure is required on a quarterly basis under Item 2 of Form 10-Q or Form 10-QSB under the Exchange Act.[156] Thus, the disclosure could be made from one-and-one-half to four-and-one-half months (or in the case of a modification that occurs in the reporting company's fourth quarter, three months to six months) after the modification was made. We concur with the view of the Commission that this is too long.

The Committee believes, however, that most security holders know about proposed modifications in their rights before the modifications are implemented, since such modifications usually require a favorable security holder vote or at least a notification to security holders. Thus, security holders are usually advised of such proposed modifications in advance through the delivery of a proxy statement.

The Commission has solicited comment with respect to whether this proposed disclosure obligation should be expanded to cover specific events other than those that are now required by Item 2 of Forms 10-Q and 10-QSB that could materially affect security holder rights, such as re-incorporation from one state to another, elimination of pre-emptive rights, or adoption of an anti-takeover plan. We interpreted this latter event to mean the adoption of a shareholders' rights plan (*i.e.,* a poison pill) and not other normal corporate matters — such as an increase in authorized shares or the availability or authorization of blank check preferred stock — that are generally considered by the Commission to have a potential anti-takeover effect. In most instances, these events will already have been required to be disclosed to security holders in a proxy statement or through a required dissemination of information under the stockholders' rights plan. Therefore, we believe that the requirement of a Form 8-K report would be duplicative of current disclosure requirements and, therefore, unnecessary.

In any instance where a modification to security holder rights that now is required to be reported on Item 2 of Forms 10-Q and 10-QSB — *e.g.,* a re-incorporation or the elimination of pre-emptive rights — has not previously been the subject of an Exchange Act filing, we agree with the Commission that Form 8-K disclosure of the kind proposed in the Commission's proposed Item 10 to Form 8-K would be appropriate. We do not believe that the mere adoption, however, of a shareholders' rights plan should be the subject of required disclosure, unless adoption of the rights plan is otherwise material under the circumstances.

Finally, the Committee suggests that the Commission should consider moving the reporting requirements for submission of matters to a vote of security holders found in Item 4 of Forms 10-Q and 10-QSB to Form 8-K, because quarterly disclosure of security holder votes may not be timely.

[156] 17 C.F.R. § 308b.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

ii. Departure of chief executive officer, chief financial officer, chief operating officer, or president.

While the Committee concurs with the Commission's assessment that reporting companies should be required to report the departure of key executives promptly, for purposes of this proposed change, we believe that the category of "key executive" should be narrowed to include only the chief executive officer ("CEO"), the chief operating officer ("COO"), and the chief financial officer ("CFO"). We do not believe that the departure of any other key executive is so likely to be material that its reporting should be mandated.

The Commission also has requested comment on whether this proposal should be extended to include more persons than those serving as a reporting company's CEO, CFO, COO, president or anyone serving in similar capacities. For the reason stated above, the Committee does not believe this proposal should be extended to include more persons.

The Commission's proposed Item 12 of Form 8-K also would mandate disclosure of the reason for a key officer's departure. The Commission says that "[w]hether the departure is the result of resignation or termination or another reason also would be of interest to investors." The Committee believes that the reason for a key officer's departure ordinarily should not be the subject of required disclosure. On many occasions, the reason for departure may be personal or otherwise not material to investors or the market. In those instances where the reason for departure could have a material impact on the reporting company and could otherwise be important to an investment decision, the mere announcement of the departure would probably be legally inadequate, in any event.

The Committee believes that a better approach to determining whether to require disclosure of the reason for a key executive's departure (which for purposes of this reporting requirement should include the departure of the CEO, COO, and CFO) would be application of the standard already contained in Item 6 of Form 8-K, which sets forth the circumstances under which disclosure of a director's departure is mandated. Under that standard, before a report of a director's departure and the reason for such director's departure is required, the departing director must send a letter to the reporting company describing a disagreement with the company and requesting that the matter be disclosed. The Committee believes that a similar standard should be applied to the requirement to disclose the reasons for the departure of a key executive officer.

iii. Material defaults on senior securities.

The Commission proposes a new Item 11 of Form 8-K entitled "Defaults, Dividend Arrearages and Delinquencies." The information that would be required and the circumstances that would trigger its reporting are, with one important exception, substantively the same as those currently required by Item 3 of Forms 10-Q and 10-QSB. The Committee agrees with the Commission that material defaults on senior securities should be reported on Form 8-K rather than Form 10-Q or Form 10-QSB. As noted previously, quarterly reporting can result in an event not being reported until one-and-a-half to four-and-a-half months after it occurs (or in the case of an event in the reporting company's fourth quarter, three to six months after the event has occurred).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

While the narrative portion of the Proposing Release makes no mention of it, the accompanying text of proposed Item 11 of Form 8-K deletes the provision now found in Item 3 of Forms 10-Q and 10-QSB that non-payment defaults (such as breaches of financial, affirmative or negative covenants) do not become reportable events unless they are not cured within 30 days. This raises the question of what should be considered a "material" default.

In those instances where the reporting company has a good faith belief that the default can and will be cured, or that the default will be waived, or a right to accelerate will not be exercised pending the default's cure, the default should not be viewed as "material" and no disclosure should be required unless and until the reporting company determines that the default will not be cured or waived, or that the right to accelerate will be exercised. Finally, the Committee concurs in the Commission's continued recognition of the "grace period" concept to the extent that a pendent default under one instrument does not cause a material acceleration under another instrument.

iv. Reliance on prior audit.

The Committee agrees with the Commission's proposal to require the company to report under Item 4 of Form 8-K any notification by the principal independent accountant of the reporting company (or one of its significant subsidiaries) that reliance on that accountant's prior audit report is no longer permissible. On the other hand, we believe that the determination of an auditor that it will not consent to the use of its prior audit report should be a reportable event only if the auditor's position is based upon a potential discrepancy in the report or prior audit or upon an issue of management integrity. Since such events often are viewed as significant and adverse by the investment community, and ordinarily such information would be material to investors and the market, we are concerned that such disclosure only be mandated when the accountant's notice is, in fact, based upon a reason that is material. We understand that some accounting firms may, as a matter of policy unrelated to the merits of a particular situation, decline to allow use of their prior audit reports under certain circumstances, (*e.g.,* when the firm ceases to be the auditor of the surviving entity in a merger).

The Commission also has solicited comment about whether a company should always be required to report that it is seeking to have another auditor re-audit a prior audited period. The Committee does not believe that such an undertaking should be the subject of required disclosure, because sometimes companies pursue a re-audit for reasons other than potential discrepancies in the company's audited financial reports. For example, the company may have been using a smaller independent accounting firm on which third parties, such as potential underwriters or lenders, are unwilling to rely due simply to their lack of familiarity with such auditors. A re-audit of a prior audited period may also arise because the company acquired another entity and prefers that its auditors perform the audit rather than relying on the audit performed by the acquired entity's auditors (or, as noted *supra*, because the former auditor has a policy of not allowing its report to be used in those circumstances).

Moreover, even in those instances where the reporting company is seeking a re-audit of a prior audited period by another auditor because the company has some concerns about the prior audit, the search may not presage a discrepancy in the company's prior audited period (*e.g.,* the new auditors may agree with the prior audit). The Committee is concerned that if reporting companies are required to report that they are

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

seeking to have another auditor re-audit a prior period, the disclosure could alarm the investment community unnecessarily and inappropriately, and could discourage companies from obtaining re-audits.

v. Name changes.

The Committee agrees with the Commission's proposal to add a new Item 13 of Form 8-K requiring that a reporting company disclose its former name and new name upon a change of name. We do not believe that this reporting requirement is unduly burdensome, and agree that notice of a reporting company's change of name may be of importance to investors.

The Commission also has solicited comment as to whether a change of name resulting from a business combination that was previously publicly announced should be required to be reported. The Committee believes that, ordinarily, such changes of name occur simultaneously with the consummation of the business combination. The consummation of a business combination is usually the subject of a current report under Item 2 or Item 5 of Form 8-K, and any change of name made in such business combination could be reported on the same Form 8-K. Furthermore, even in those circumstances where a separate Form 8-K would have to be filed to report the change of name, such a filing would not be burdensome and should be required.

vi. Due dates for reporting events.

Consistent with our earlier comments, we are very concerned about the Commission's various proposals to accelerate many of the deadlines for various reports on Form 8-K. While we generally concur with the Commission's view that the longer the period of time between the occurrence of a material event and the public reporting of the event, the greater the likelihood that, over the course of that period, certain security holders will be selectively informed of that material information, we also recognize that in this new age of computers, electronic filing and instantaneous communications, companies can file reports with the Commission more rapidly than was the case when the currently required filing deadlines were established.

The Committee, however, believes that the care and diligence required to ensure that reports satisfy the requisite standard of completeness and accuracy, and the potential loss of eligibility to use Form S-3 (or proposed Form B) resulting from late filings, necessitates that sufficient time be provided to prepare and file these reports. Members of the Committee have seen too many Exchange Act reports and press releases that were incorrect, confusing or misleading because the pressure to distribute information quickly did not permit adequate time for review and consideration of the issues giving rise to the required disclosure and the exercise of due care in the preparation of the report or release.

For example, filing reports about a change in certifying accountants (proposed Item 4), defaults, *etc.,* (proposed Item 11) or the departure of a key officer (proposed Item 12) within one business day after their occurrence would usually be impractical. Dealing with the event itself generally requires the immediate, undivided attention of those of the reporting company's executives who also need to give careful attention to any reports or press releases about those events. These senior executives are the persons who have access to the information necessary to ensure the accuracy and completeness of reports about those events.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Many public companies do not have a full-time internal public or investor relations staff to address these matters. In those companies, it is often the same senior executives who deal both with the business aspects of the event and also the preparation of the reports and press releases. These officers must be given a reasonable period to deal with the event before they are obligated to prepare an Exchange Act report. In the case of companies whose stock is traded on a national securities exchange and/or the Nasdaq National Market System, the events with respect to which Form 8-K disclosure would be required are events that are currently required to be announced to the public promptly.

The Committee is also concerned that the Commission's proposed reporting régime may be too complicated and could lead to inadvertent violations of reporting deadlines — with the attendant consequences for the reporting company arising from the fact that it is no longer current in its Exchange Act filings (the most drastic being loss of Form S-3 (or proposed Form B) eligibility for 12 months). The Committee believes that these competing concerns can be balanced best as follows:

- With respect to Items 1-4, 6, and 8-13 of Form 8-K, reports should be required by the earlier of: (i) five business days after the event occurs (or, in the case of Item 8, within five business days after the date on which the reporting company makes the determination to use a fiscal year-end different from that used in its most recent filing with the Commission); or (ii) the end of the EDGAR day on the business day following the date of a reporting company's dissemination of a press release or other information relating to such event.

- Whatever the deadline, we believe it should be the same for all events, so that business executives can readily remember the deadlines without having to consult securities counsel upon the occurrence of any covered event.

- The Committee also believes that in those instances where any Form 8-K reportable event occurs on a day that is not a business day,[157] then the five-business day period should begin to run on, and include, the first business day thereafter. This is consistent with the approach currently taken under Form 8-K. We note that reporting companies are already familiar with this approach, which has worked well in the past.

- No change should be made in the filing deadline for reports under Item 5 or Item 7 of Form 8-K.

- The proposed filing deadline for new Item 14 (annual and quarterly financial information) has already been discussed *supra*.

---

[157] *See* Rule 110 under the Securities Act, 17 C.F.R. § 230.110 (business day excludes Saturday, Sunday, and Federal holidays).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

4. Signatures.

a. Exchange Act reports and registration statements.

The Commission proposes to require all persons signing registration statements and periodic reports filed under the Exchange Act to certify that they have read the filing and know of no untrue statement of a material fact or omission of a material fact necessary in order to make the statements made in such filing not misleading. In support of this change, as well as other proposed rule changes, the Commission notes the difference in the quality of disclosure between Exchange Act and Securities Act filings.

We believe that any such discrepancy results largely from the outside review of Securities Act filings (as compared to Exchange Act filings) by investment banking firms, auditors and counsel for the parties — driven by the transactional nature of the process and the significantly enhanced liability standards imposed on disclosure under Securities Act registration statements — rather than from a lack of attention or review of Exchange Act filings by senior management. For that reason, we question whether the proposed additional certification would have a significant impact on the quality of Exchange Act reports. Furthermore, if the Commission is concerned about signatories signing blank signature pages without even reviewing a draft of the substantive document, we do not believe that this additional certification by the officers or directors who engage in such conduct will likely modify their behavior.

The Committee believes that the substance of the statement proposed to be certified is already implied by the signature on the report, and that the liability standard already inherent in executing the filings is sufficient. We are also concerned that certifying that the person signing has "read the filing" may lead to unintended consequences, since it would require the recirculation of the report to be filed to all signatories when changes are made, no matter how immaterial the changes.

We note that in most cases the Form 10-K report which is read by those company officers who are not directly involved in preparing the filing (or by directors) is not the final report, but rather a substantively complete earlier draft, and that timing deadlines will not allow many companies to have final versions of these documents circulated for signature. In our view, the proposed requirement will add significant costs to the filing process without adding significant benefit to the review of such documents by the signatories thereto, or the likelihood of more accurate disclosure.

The Commission also proposes to expand the individuals required to sign many Exchange Act reports (including Forms 10-Q and 10-QSB) to the reporting company's principal executive officers and a majority of the board members. The Committee supports the concept that the CEO, the CFO and the chief accounting officer should be required to execute interim reports under the Exchange Act, as is currently required for a Form 10-K. While these added signatures will impose some additional burden for some reporting companies, we believe the benefits of ensuring that all three of these officers have reviewed the filing outweighs any such inconvenience.

In contrast, we are concerned that requiring signatures of board members on Forms 10-Q and 10-QSB poses significant logistical problems and is unnecessary and unduly burdensome. Moreover, if certification is retained regarding *reading* the document, there may be a disclosure disparity between signing and

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

nonsigning directors. The Committee notes that many reporting companies presently find it difficult to prepare substantially final disclosure and circulate it to its key executives within the time now permitted for filing. Many directors have very heavy travel schedules, and securing signatures from those persons (particularly far-flung outside directors) during the short window between finalizing a draft Form 10-Q or Form 10-QSB and filing may often be impossible — and not just inconvenient — especially if they are expected to read the document. Additionally, the Commission's proposed shortened filing deadlines for certain Exchange Act filings would significantly exacerbate this problem.

The Commission also proposes requiring the officers signing a Form 8-K and 6-K to certify that they have provided copies of the filing to the company's board of directors. We support the requirement that the signatory confirm that delivery of copies to the directors' current addresses is being made at the time of filing, and we believe that this is already standard practice in many reporting companies.[158] The Committee concurs that such a requirement will help to ensure that the board of directors has immediate access to the information included in current reports, in the case of reporting companies that do not presently follow this practice.

b. Securities Act filings.

The Commission also proposes to require signatories to Securities Act registration statements to certify that they have read the document and do not know of any material misstatement or material omission. The Commission has requested comment on whether this certification requirement would cause signatories to read disclosure more carefully or participate more actively in the preparation of the filing. The Committee does not believe this would be the case. We believe that the "strict" liability imposed by Section 11 on issuing companies and signatories to registration statements under the Securities Act provides the most effective motivation for active review and oversight of disclosure. As previously noted, the Committee does not believe such certification is appropriate or necessary.[159]

5. Proposed expansion of disclosure in Form 6-K submissions is relatively benign.

Although the proposed changes for reporting by foreign private issuers are relatively benign, we again raise for consideration by the Commission the issue of whether these filing requirement expansions would be inconsistent with the Commission's initiative to encourage foreign issuers to register public offerings under United States securities laws.

6. Potential liability and other valid concerns militate against extending "plain English" requirements to Exchange Act reports.

The Commission seeks comment on whether the "plain English" requirements should be extended to all parts of the prospectus, including Exchange Act reports that are incorporated by reference into that

---

158 Or, alternatively, that the document has been made available (*e.g.*, on the issuer's website) or sent *via* electronic means (*e.g.*, electronic mail) to those directors who have previously consented to that delivery method.

159 See, *supra* page 27, "II.A.1.b.iv(A) The proposed certifications on the signature page should not be adopted."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

document. Comment is also sought on the appropriateness of extending the "plain English" requirements to all Exchange Act periodic reports, regardless of whether they are incorporated by reference into a Securities Act registration statement or only to certain parts of Exchange Act periodic reports, such as a description of the reporting company's business or MD&A.

In commenting on the original "plain English" proposal, the Committee recommended a voluntary rather than a mandatory approach to improving the readability of prospectuses. The Committee argued against mandating "plain English" primarily due to new concerns about increased liability arising from the possibility that issuers may omit material information in the course of simplifying the language.

Rather, we suggested that a safe harbor rule from legal liability be considered to cover the sections of the prospectus that must be in "plain English". In adopting its "plain English" requirements, the Commission responded that "plain English" does not mean omitting important information, but rather only requires the issuer to disclose information in words investors can understand and in a format that invites them to read the document. The Commission stated it did not believe that a safe harbor rule was necessary or appropriate.[160]

The Committee continues to have concerns about liability and whether it is possible to summarize all complex matters in "plain English". For that reason, we do not favor expanding "plain English" beyond what is currently required (except for adding the requirement of "plain English" risk factors to the Form 10-K and Form 10-KSB as proposed above) until a greater body of experience is created with the current "plain English" requirement.

B. NOTWITHSTANDING ITS UNFETTERED RIGHT TO REVIEW EXCHANGE ACT REPORTS, THE STAFF SHOULD WORK EFFICIENTLY AND EXPEDITIOUSLY IN ORDER NOT TO IMPEDE AN ISSUER'S ACCESS TO CAPITAL MARKETS.

1. Proposed staff review policy should be revised to provide a greater degree of certainty to the process.

The Committee supports the Commission's efforts to bring more certainty to the review process of Exchange Act filings. While we had hoped that the Commission would have determined to disclose its review criteria to provide more predictability and efficiency in the offering process, the Committee understands and appreciates the Commission's view that the positive effects on disclosure that result from the possibility of staff review outweigh the cost of uncertainty. Nonetheless, the Committee believes that bringing more certainty to the review process is both important and necessary.

The Committee supports the Commission's decision that the Division staff would notify an issuer as soon as its Exchange Act reports are selected for review and of the Commission's decision that the staff would begin to consider requests by issuers for the staff to review their Exchange Act disclosure because the issuer is planning an offering in the near future.

---

160 Plain English Disclosure. Securities Act Release No. 7,497 [File No. S7-3-97] (January 28, 1998) ("Final Rules") at "Section VII.A."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

However, we recommend the following modifications to the Commission's proposal, in order to bring a greater degree of certainty to the review process:

1. If an issuer requests a review, and the staff declines to review the issuer's Exchange Act filings, or if the staff elects to and completes a review of the issuer's Exchange Act filings, and either

   (a) the issuer's securities have been registered under Section 12 of the Exchange Act for more than one year, or

   (b) the issuer has been reporting under Section 15(d) of the Exchange Act[161] for at least one year,

then the staff shall not review the issuer's Securities Act registration statement when it is filed if the issuer's Exchange Act filings are incorporated into (or serve as the basis for disclosure in) the registration statement; *provided that*, the registration statement is filed within six months after the staff declines to make such review or within six months after the completion of such review.

2. The staff shall promptly notify the issuer when it has no further comments to the issuer's Exchange Act filing under review.

3. An issuer that requests a review shall certify in such request that it reasonably believes that it will make an offering of its securities in the next six to nine months.

4. Any such request by an issuer would be deemed to be a filing for which confidential treatment[162] shall be granted for at least one year. Unless an issuer's request could be made as a confidential filing, we are concerned about the impact on secondary market trading if the issuer's reasonable belief were made known.

The Committee believes that the staff should have the right to complete its review of an issuer's Exchange Act filings over a reasonable period of time and nothing in this letter is intended to indicate that the Committee believes that the staff's review time of an issuer's Exchange Act filings should be limited in any formal manner.[163] However, the resolution of outstanding staff comments on its review of Exchange Act filings should not be a formal impediment to market access through the loss of short-form eligibility. The Committee also recommends that the release adopting this policy (as modified to reflect our recommendation) remind

---

[161] 15 U.S.C. § 78o(d).

[162] 17 C.F.R. § 200.83.

[163] Obviously, the time within which this review is completed will have a profound impact on the likelihood that the issuer would be able to avail itself of prompt access to public capital markets. *See supra* page 17, "II.A.1.a.ii. Issuer's ability to time effectiveness of registration statement is illusory" at note 63, and page 24, "II. A.1.b.iii.(B) The existence of unresolved comments in connection with staff review of Exchange Act filings should not block financings."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

issuers that they should make their requests for review of their Exchange Act filings sufficiently in advance to allow the staff to complete the review of the issuer's Exchange Act filings in the ordinary course. In this regard, we urge the Commission to specify the period of time generally necessary for staff review of Exchange Act filings in the "ordinary course."

V. LIABILITY

A. THE COMMISSION'S PROPOSALS WOULD ALTER THE LIABILITY RÉGIME WITH INAPPROPRIATE AND UNPREDICTABLE CONSEQUENCES.

The Commission's proposals would change the current liability régime in many different ways with unpredictable consequences. Together, these proposals would increase the exposure to liability for all participants in the securities distribution process — without any evidence that such increased liability is needed or would indeed serve any useful purpose. These proposals generally would drive securities transactions into the unregistered market and increase the costs of capital formation. In addition, if adopted, the proposals would in our view be bad legal and economic policy, because liability would be incurred by one who is not in a position to prevent the problem giving rise to the potential violation.

In order to achieve access to all written "offering material" on an equal basis for all investors ("equal access"), the Commission proposes to change the liability matrix, thereby creating uncertainty and increasing liability.[164] We believe that the Commission's effort to eliminate so-called "selective disclosure" on a systematic or program basis is not worth the cost of uncertainty and increased liability to participate in the offering process.

1. Issuers would be subjected to unforeseen liability arising from a latent violation of Section 5 of the Securities Act.

Issuers on Form B would have registered on the wrong form if, unbeknownst to them, any underwriter is disqualified under the General Instructions. Issuers on Form A or Form B would not comply with the registration requirements if they fail to file in a timely manner any "offering information" or "free writing" used by any underwriter. In any case, would sales as a result violate Section 5 and be subject to rescission?

Issuers would be subject to strict liability under Section 11 for road show information if it constitutes "offering information" and, accordingly, is filed as part of an effective registration statement. Issuers would also be subject to strict liability under Section 11 for any "offering information" used by an underwriter and filed with an effective registration statement. What would be the liability of the issuer with respect to "free writing" that is used by underwriters and is filed with the Commission but not as part of the registration statement? Is the issuer using the "free writing" or associating itself with the "free writing" by filing it with the

---

164 For example, to ensure all investors have equal access to "free writing", the Commission would require that these materials be publicly filed. As a consequence, "free writing" materials could constitute liability documents for all participants in the offering. "Offering information" must also be filed as part of the Form B registration statement, thereby subjecting all offering participants to liability for it.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

registration statement and thereby making it publicly accessible? What is the issuer's liability if it erroneously files as "free writing", and not as something that should have been filed as part of the registration statement and identified as "offering information"? What is the issuer's liability if its representation on the cover of the registration statement that preliminary prospectuses or term sheets will be delivered to purchasers proves to be wrong because one or more underwriters fail to do so in one or more cases?

2. Directors and officers would incur increased liability.

It would not be feasible for directors to *read* every registration statement (including exhibits) and amendment thereto before its filing. Outside directors frequently travel, and have primary responsibility to other organizations. Even inside directors may not always be available.

Is the director who permits his name to be used as a signer of the registration statement without having read it guilty of a false filing with the government under 18 U.S.C. § 1001? Does the director who reads and signs subject himself to a liability greater than the director who doesn't subscribe his name to the registration statement? If so, how do the directors decide among themselves who are the lucky ones who get to sign the registration statement?

Directors would be liable, subject to a due diligence defense, for all "offering information" prepared by the issuer or any underwriter and filed as part of an effective registration statement. How does a director establish a due diligence defense with respect to this information? What is the responsibility of a director (whether a signer or not) for "free writing" filed with an effective registration statement?

Moreover, directors who sign an effective registration statement may be subject to greater class action vulnerability because their act of signing and certifying the registration statement will permit pleading of particularized allegations that they are participants in alleged disclosure violations.

3. Underwriters would have increased exposure to liability for latent violations of Section 5 of the Securities Act.

What is the liability of an underwriter if an issuer filing on Form B is not entitled to use that form because, unbeknownst to the underwriter, the issuer, a director or executive officer or another underwriter is disqualified under the General Instructions?

An underwriter would be liable, subject to a due diligence defense, for all "offering information" prepared by the issuer or another underwriter and filed as part of an effective registration statement. Presumably it will not be liable for "free writing" prepared and used by the issuer or another underwriter and not used by it, even though the "free writing" is filed with an effective registration statement and publicly accessible.

Given the elimination of the word "prospectus" from Rules 138 and 139 under the Securities Act,[165] when does research become "offering information" or "free writing" required to be filed, and what is an

165 17 C.F.R. §229.138 - 139.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

underwriter's liability if it erroneously decides that the research is not "offering information" or "free writing"? What is an underwriter's liability if its own or another underwriter's document is erroneously filed by the issuer as "free writing" rather than "offering information"?[166]

B. PROPOSED GUIDANCE CONCERNING "REASONABLE INVESTIGATION" AND "REASONABLE GROUNDS FOR BELIEF" DEFENSES UNDER SECTIONS 11 AND 12(a)(2) OF THE SECURITIES ACT IS DEFICIENT.

1. Rule 176 should provide a rebuttable presumption that underwriters have met "due diligence" obligations.

The expansion of Rule 176 to include Section 12(a)(2) is a decided improvement. The proposed additions to the rule (review of specified documents, pursuit of "red flags", discussions with management, auditors' comfort letters and opinions of counsel[167]) would generally codify existing practices and should always be relevant as to whether an underwriter has made a reasonable investigation or exercised reasonable care.

Accordingly, it is unclear why the proposal arbitrarily eliminates them from consideration in the case of investment grade non-equity securities and offerings that take more than five days from start to finish. For example, due diligence is conducted periodically on MTN programs by the lead agent. We note, however, that the proposed guidance would not offer any benefit for an investment bank invited to become a selected dealer under the issuer's existing MTN program. These limitations should be eliminated. Moreover, the Commission should revise its proposal to clarify that the views of rating agencies would also be a positive factor for this analysis. In the case of "fast offerings", adherence to these procedures should create a rebuttable presumption that the underwriters made a reasonable investigation or exercised reasonable care.

While consultation with a research analyst may offer analytical support in the conduct of due diligence, it may require the broker-dealer to bring the research analyst "over the wall" and cease on-going research coverage provided by that research analyst. In the short term, this may not be of any consequence; however, if an extended period elapses from when the research analyst is brought over the wall until the offering is closed or abandoned, it may be a problem for the broker-dealer. Thus, we note that "bringing an analyst over the wall" is considered fairly controversial by affected broker-dealers.

As a practical matter, consultation with a research analyst should only be relevant where the underwriter has a relevant research analyst, and the analyst's participation complies with such underwriter's Chinese Wall policies and procedures. The Commission, however, should clarify that an underwriter is not required to consult with a research analyst in order to avail itself of the proposed guidance.

Finally, we note that if the proposal is adopted, the Commission would publish "additional guidance in the adopting release" delineating the difference between the reasonable care standard of Section

---

166 *See also* page 69, "IV.A.2.b. Quarterly information should not be subjected to liability under Section 18 of the Exchange Act."

167 We do not understand a proposed requirement that underwriters' counsel state that they have reviewed *five* years of material contracts, since that is not the general practice.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

12(a)(2) and the investigation standard of Section 11.[168] It is our view that any such guidance should be published for notice and comment prior to adoption.

C. ABUSES ARISING OUT OF "SELECTIVE DISCLOSURE" ARE NOT PERVASIVE AND DO NOT JUSTIFY THE SWEEPING CHANGES PROPOSED.

1. The Commission inappropriately seeks to resurrect a "parity-of-information" theory rejected by the Supreme Court in *Chiarella v. United States*,[169] and impose liability for violation.

The Commission has identified "selective disclosure" as a particular abuse warranting further regulation. Although the Proposing Release does not define the term, selective disclosure may include, *inter alia,* conference calls with research analysts, meetings with large institutional investors,[170] and road shows attended by institutional investors.[171] We note that these are customary, ordinary, and effective channels of communication used by companies to communicate with the market.

Apparently some Commissioners believe that research analysts conference calls with institutional investors may also constitute "selective disclosure".[172] This view apparently calls into question the legitimate practice of securities firms disseminating proprietary research to their customers. Such a position ignores the tremendous investment of human and financial capital in research departments made by many full-service broker-dealers. It also disregards the legitimate property interests in proprietary research, which is generally protected by copyright and other laws protecting intellectual property. This protection also provides an incentive for broker-dealers and their analysts to continue to provide research coverage.

To the extent that these recipients use material non-public information to their advantage and thereby harm other investors and the integrity of our markets,[173] we believe the Commission has the authority

---

168 Proposing Release at n. 460 and accompanying text.

169 445 U.S. 222 (1980).

170 Petersen *supra* note 27 at col. 1-2 (noting Chairman Levitt's criticism of companies that "selectively disclose key information to certain investors," and discuss "earnings" with their "favorite stock analysts" before publicly releasing this data).

171 *See, e.g.,* Hunt *supra* note 20 at 2-3. Commissioner Hunt expressed his concern that information presented at road shows was provided "to the privileged few." He further stated that the filing requirements proposed in the Aircraft Carrier "should shine some 'sunlight' on these roadshows." *Id.* at 3.

172 *See, e.g.,* Unger *supra* note 20 at 1 (March 10, 1999) ("SEC Chairman Arthur Levitt has spoken out about market movements in connection with analysts' conference calls to institutional investors"). However, we note it is common practice for broker/dealers to prohibit trading and any other activities associated with an issuer's securities if one of its research analysts has received material non-public information from the issuer until that information has been widely disseminated in the market and the market has had an opportunity to absorb the information.

173 *See, e.g.,* Levitt *supra* note 20.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

to bring enforcement action based on the remedies already provided by Rule 10b-5 and a long line of case authority interpreting that liability.[174] The current practice is to publicly disclose information furnished to analysts and investors that could directly affect the market price — and such information is not received on a confidential basis — at least contemporaneously when the disclosure is planned, and promptly if it is inadvertent.

However, we note that market volatility is not necessarily driven by the initial disclosure to a predetermined audience (whether research analysts or institutional investors), but often by the speed with which the market reacts to any development. For example, there is a plethora of company and market information (domestic and international) available in the market provided by public broadcasting and cable financial news stations (*e.g.,* PBS' "Wall Street Week with Louis Rukeyser", CNN's "Moneyline", and CNBC), popular print publications (Fortune, Barrons, Money, Financial Times, The Wall Street Journal, *etc.*), on the radio (*e.g.,* Bloomberg) for those investors who do not subscribe (or have access) to Internet service providers,[175] and on the Internet. This volatility is apparently exacerbated by electronic trading, "day traders", and greater use of technology by investors (particularly, retail investors)[176] to engage in "momentum"[177] investing.

The Securities Act clearly requires that prescribed *minimum* information be made available to *all* potential investors in the offering: *viz.,* that required by the applicable form and that required to make the statements made not misleading. Thus, issuers are obligated to disclose specified information, together with any

---

174 *See, e.g., In the Matter of Cady Roberts & Co.*, 40 SEC 907 (1961); *SEC v. Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968), *(en banc) cert. denied* 394 U.S. 976 (1969). *See Dirks v. SEC*, 463 U.S. 646 (1983) (upon his discovery of fraud at Equity Funding of America, investment analyst was not subject to requirement to disclose or abstain from trading because he owed no fiduciary duty to issuer's equity security holders). *See also In the Matter of Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 SEC 933 (1968) (Merrill Lynch tipped certain institutional investors about an offering it was underwriting); *In the Matter of Investors Management Co., Inc.*, 44 SEC 633 (1971) (institutional investor held liable for trading on information obtained from Merrill Lynch); and *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 288 (2d Cir. 1974) (Merrill Lynch held liable to investors in the market).

175 Other events in the market also have a bearing on how investors perceive (and react to) company information. For example, through real-time coverage by C-SPAN, investors can see the Congressional testimony of officials of The Board of Governors of the Federal Reserve System, Department of the Treasury, and many others whose testimony may have an impact on the trading market in equity and fixed-income securities.

176 Browning, *supra* note 24 at C1, col. 3-4 ("When Federal Reserve Chairman Alan Greenspan tells a Senate committee that he is worried about inflation, when Prudential Securities technical analyst Ralph Acampora turns bullish or bearish, when Merrill Lynch Internet analyst Henry Blodget revises targets for Amazon.com, the news flashes across television screens and the Internet before it hits many pros' desks. Millions of ordinary investors, including small-time 'day traders' who sit at computer terminals buying and selling stocks, can react faster than the pros did just 10 or 20 years ago. Now it is the pros who can be taken by surprise").

177 Browning observed that the "simple concept of momentum" has replaced elaborate investment models. "Stocks rise because, as long as they look strong, investors pile in. As soon as a stock looks weak, investors pile out. And professionals, who try to foresee a trend by examining price-to-earnings history and other once-useful barometers, can get burned. Momentum-based investing, which has taken the market up, down and sideways in recent months, is just the most prominent of the new market drivers." *Id.* at col. 4.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

other information necessary to avoid material misstatements or materially misleading statements[178] to offerees for particular securities transactions.

However, with the exception of rules applicable to tender offers,[179] the provisions of federal securities law neither *create nor imply* a right on the part of all potential investors in the issuer's securities to equal access to *all* available information (or even all material information) or a corresponding obligation on the part of issuers or anyone else to provide it.[180] While the Commission may desire to establish a right of equal access, we are not aware of any authority supporting that view. Clearly, after *Chiarella,*[181] any obligation based on "parity of information" or "equal access" theories has no statutory basis under Section 10(b). Accordingly,

---

178 *See* Rule 405 under the Securities Act defining *material* ("when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered").

179 For example, the Commission's promulgation of Rule 14e-3 [17 C.F.R. § 240.14e-3] under Section 14(e) of the Exchange Act [15 U.S.C. § 78n(e)], the general antifraud provision applicable to tender offers, may be distinguished from a parity of information theory predicated on Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder, which was criticized by the court in *Chiarella*. "But one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'" *Chiarella,* 445 U.S. at 228.

When it adopted Rule 14e-3, the Commission premised its authority on "existing statutory requirements." *See* Tender Offers, Securities Exchange Act Release No. 17,120 (September 4, 1980) ("Final Rule") at "Summary". The Commission noted that the court in *Chiarella* did not "suggest[ ] any limitation on [its] authority under Section 14(e) to adopt a role regulating trading while in possession of material, nonpublic information relating to a tender offer. *Id.* at n. 21 and accompanying text. The rule does not require any violation of a breach of fiduciary duty as would be customary to establish common law fraud. When it considered a challenge to the rule's validity because this common law element was missing, the Second Circuit looked to the "plain language" of the provision and stated that "It is difficult to see how the power to 'define' fraud could mean anything less than the power to 'set forth the meaning of' fraud in the tender offer context….Because the operative words of the statute, 'define' and 'prevent,' have clear connotations, the language of the statute is sufficiently clear to be dispositive here." *See United States v. Chestman*, 947 F.2d 551 at 558 (2d Cir. 1991) *(en banc) cert. denied,* 503 U.S. 1004 (1992). Furthermore, the court noted that the language and legislative history of Section 14(e), as well as congressional inactivity toward it since the SEC promulgated Rule 14e-3(a), all support the view that Congress empowered the SEC to prescribe a rule that extends beyond common law." *id.* at 559. More recently, the Supreme Court has also held that the Commission did not exceed its authority in promulgating Rule 14e-3. *See United States v. O'Hagan*, 521 U.S. 642 at 750 (1997). The Court agreed that, as applied to tender offers, Rule 14e-3 is reasonably designed to prevent "fraudulent trading on material nonpublic information;" however, its decision did not reach the issue of whether the power granted to the Commission under Section 14(e) to define "such acts and practices as are fraudulent" is broader that that delegated to it under Section 10(b) of the Exchange Act. *Id.* at 754.

180 Two recent cases have confirmed that the Securities Act does not require disclosure of <u>all</u> material information, but rather only information specified by statute or rule and such other information necessary to make the information that is provided not misleading. *See Cooperman v. Individual*, 171 F. 3d 43 (5th Cir. 1999); *In Re N2K Inc. Securities Litigation*, 1999 U.S. Dist. LEXIS 7669 (S.D.N.Y. 1999).

181 445 U.S. at 233 ("We cannot affirm petitioner's conviction without recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information. Formulation of such a broad duty, which departs radically from the established doctrine that duty arises from a specific relationship between two parties…should not be undertaken absent some explicit evidence of congressional intent. As we have seen, no such evidence emerges from the language or legislative history of § 10(b)").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

we believe that the Commission would exceed its authority if it were to attempt to resurrect this obligation and impose liability for its breach.

In attempting to prohibit "selective disclosure", the Commission is seeking to create liability for the violation of a non-existent duty to make all written offering material equally available to everyone, by mandating that written "offering information" and "free writing" be filed with it under penalty of violation of Section 5. Using its rulemaking authority, the Commission is attempting to impose on all participants in the distribution process an obligation to make publicly available all written "offering information" and "free writing" (whether used before or after effectiveness), and to impose liability under Section 11 on issuers, directors, executive officers signing the registration statement, and underwriters for all Form B "offering information", irrespective of who prepared and used it.

Obviously, in permitting the use of written offering material (in addition to the statutory preliminary prospectus) before effectiveness, the Commission may clarify that such offering material, when used to offer and sell the securities being registered, subjects the user to liability under Section 12(a)(2). However, we believe that the Commission exceeds its authority when it attempts to create the entirely new obligation to file publicly this information, impose liability for its breach, and extend the reach of Section 11 to certain of this information.

In any event, this effort is likely to be self-defeating. In order to avoid the uncertainty and risk of liability, distribution participants will refrain from creating written offering material and will continue to rely (as they have in the past) on oral communications. They can also be expected to reduce the amount of information made available. Under the circumstances, we respectfully submit that this channel of communication is already subject to appropriate regulation.

VI. STATUTORY AUTHORITY

A. THE COMMISSION HAS NOT IDENTIFIED BASES FOR ITS PROPOSALS TO "*MODERNIZE*" AND "*RATIONALIZE*" ITS REGISTRATION AND DISCLOSURE POLICY.

1. Legislative history.

The Commission was established by the Congress as an independent regulatory agency.[182] Like other regulatory agencies, it derives its power from the statutes it administers. Under our federal republican system, the Constitution created a tri-partite government separating the exercise of legislative, executive, and judicial powers. From the beginning, however, the Congress' ability to delegate certain functions to the executive or other boards, where the exercise of this delegated authority is within the confines of legislative policy, has been recognized by the judiciary.[183] Nevertheless, the rise of new independent regulatory agencies,

[182] Section 4 of the Exchange Act, 15 U.S.C. § 78d. Prior to its establishment, the Federal Trade Commission administered federal securities law.

[183] *See e.g., Field v. Clark*, 143 U.S. 649, 692 (1892) (although it affirmed the lower court, the Supreme Court observed: "That Congress cannot delegate legislative power to the President is a principle universally recognized as vital to the integrity and maintenance of the system of government ordained by the Constitution").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

in the aftermath of the Crash of 1929 and the Great Depression, presented special Constitutional issues,[184] which have been resolved generally in favor of the new agencies.[185]

In its consideration of legislation to regulate national securities exchanges, the House Report specifically addressed the "constitutional significance" of the broad delegation of legislative powers to the Federal Trade Commission (which initially administered the Exchange Act), noting that delegation was made based on "maximum standards for discretion as, in the considered judgment of the committee, the technical character of the problems to be dealt with would permit."[186] Representatives of securities exchanges also supported a broad delegation of authority to the administrative agency charged with regulation of their members and markets. Ultimately, the committee recognized that "broad discretionary powers" were essential for a "field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means…."[187] In addition, with the adoption of the Federal Administrative Procedure Act ("APA"),[188] "due process" safeguards were codified, and limitations imposed upon agency action, in recognition of the unique role of regulatory agencies in our federal system.

Generally, the statutory authority of the Commission requires that it act in the public interest and for the protection of investors.[189] As it relates to the Aircraft Carrier, the Commission's authority to promulgate rules arises, *inter alia,* under Sections 19(a) and 28 of the Securities Act,[190] and Sections 3(f), 13, 23(a), and 36 of the Exchange Act.[191]

---

184 *See e.g., Panama Refining Co. et al. v. Ryan et al.*, 293 U.S. 388, 432 (1935) (Executive Order was unconstitutional). "In creating such an administrative agency the legislature, to prevent its being a pure delegation of legislative power, must enjoin upon it a certain course of procedure and certain rules of decision in the performance of its function. It is a wholesome and necessary principle that such an agency must pursue the procedure and rules enjoined and show a substantial compliance therewith to give validity to its action." *See also A.L.A. Schechter Poultry Co. v. United States*, 295 U.S. 495, 541-42 (1935) (attempted delegation of legislative power was unconstitutional). Chief Justice Hughes writing for the Court stated: "In view of the scope of that broad declaration, and of the nature of the few restrictions that are imposed, the discretion of the President in approving or prescribing codes, and thus enacting laws for the government of trade and industry throughout the country, is virtually unfettered."

185 *See NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 47 (1937) ("We construe the procedural provisions as affording adequate opportunity to secure judicial protection against arbitrary action in accordance with the well-settled rules applicable to administrative agencies set up by Congress to aid in the enforcement of valid legislation").

186 *See supra* note 34.

187 *Id.*

188 5 U.S.C. § 551, *et seq.* (1994, Supplemented 1996).

189 Notwithstanding legislative powers generally delegated under the Securities Act, the legislative history indicates a reluctance to invest "any Federal agency [with] the duty of passing judgment upon the soundness of any security." *See* Senate Report No. 47 at 2, 73rd Cong., 2d Sess. [to accompany S. 875] (April 17, 1933).

190 15 U.S.C. §§ 77s and 77z-3.

191 15 U.S.C. §§ 78c(f), 78m, 78w(a), and 78mm.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The Commission has rather broad rulemaking authority under Section 19(a) of the Securities Act in respect of registration statements and prospectuses, which may be exercised "as necessary to carry out the provisions" of the statute. Under Section 28, the exercise of the Commission's expansive exemptive powers is subject to a public interest and investor protection standard.

The rulemaking powers vested in the Commission under the Exchange Act are similarly broad. Section 23(a)(1) authorizes the Commission to classify, *inter alia,* persons, securities, transactions, and reports and to prescribe greater, lesser, or different requirements for each. In accordance with Section 13(b), the Commission may prescribe forms and information (including financial statements) to be disclosed in reports filed under Section 13 of the Exchange Act. Under Section 13(c), the Commission may require submission of reports of "comparable character" if those ordinarily required by Section 13(a) would be inapplicable to any specified class(es) of issuers. This power is complemented by the exemptive authority of Section 36, under which the Commission may exempt, *inter alia,* any person, security, or transaction from any provision of the Exchange Act (including any rule or regulation thereunder) if necessary or appropriate in the public interest and for the protection of investors.

However, the Commission's rulemaking authority under the Exchange Act is subject to important limitations. For purposes of determining the "public interest" standard, Section 3(f) requires the Commission to consider both the protection of investors *and* whether its action "will promote efficiency, competition, and capital formation." Finally, Section 28(a)(2) requires the Commission to consider the impact on competition, and mandates that no rule is to be adopted that would impose a "burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act."

2. Federal Administrative Procedure Act.

The exercise of legislative, executive, and judicial powers by the Commission is subject to the provisions of the APA. Among the agency powers governed by the APA is the promulgation of rules ("rulemaking").[192] Under the APA, a rule is defined, in relevant part, as the "whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy…."[193]

a. Formal rulemaking.

Under Section 553, an agency is required to publish a proposed rule in the *Federal Register*,[194] and afford all interested persons an "opportunity to participate in the rulemaking through submission of written

192 5 U.S.C. § 553.

193 5 U.S.C. § 551(4).

194 5 U.S.C. § 553(b). An agency's action (*e.g.,* proceedings, rulemaking, *etc.*) becomes "official" upon publication in the *Federal Register*. *See* 49 Stat. 500 (1935).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

data, views, or arguments with or without opportunity for oral presentation."[195] Prior to final action on the rule, the APA requires an agency to consider comments submitted by the public.

Upon adoption of a rule, an agency must set forth a "concise and general statement of [the rule's] basis and purpose."[196] Under Section 706 (2) of the APA,[197] judicial review of agency action is circumscribed and generally limited to determining whether the agency's action was within the scope of its statutory authority,[198] and was not otherwise arbitrary and capricious.[199]

3. Cost-benefit analysis.

We note that the "Cost-Benefit Analysis" included in the Proposing Release does not provide any hard economic data on the costs of many of the proposals. The Commission has not clearly articulated the harm to investors, abuses in the present regulatory régime, or any public interest to be served that would justify imposition of these burdens on, and impediments to, capital formation in the United States.

We believe that many of these proposals would increase the costs of, and unduly burden, capital formation in US capital markets. Our concerns may be summarized as follows:

a) An entirely new (and untested) registration system that mandates a prospectus delivery period of three or seven calendar days before pricing in Form A and delivery of a term sheet and completion of disclosure prior to sales in Form B, thereby severely limiting quick access to capital markets. The Commission proposes to adopt this new system, which would have a profound adverse impact on domestic capital formation, without

---

195 5 U.S.C. § 553(c). This process is known as the "notice and comment" requirement.

196 5 U.S.C. § 553(c).

197 5 U.S.C. §706(2). The section provides, in relevant part, that "[t]he reviewing court shall …hold unlawful and set aside agency action, findings, and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (B) contrary to constitutional right, power, privilege, or immunity; (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (D) without observance of procedure required by law…."

198 *See e.g., Securities and Exchange Commission v. Chenery Corporation et al.*, 318 U.S. 80, 63 S.Ct. 454, 462 (1943) ("administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained"); *Securities and Exchange Commission v. Chenery Corporation et al.*, 332 U.S. 194, 67 S.Ct. 1575, 1582 (1947) ("Our duty is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress"); *American Bankers Association v. Securities and Exchange Commission*, 804 F.2d 739 (D.C. Cir. 1986) (Rule 3b-9 under the Exchange Act held unlawful because the Commission lacked authority to regulate banks as "brokers").

199 *See e.g., Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971) ("Section 706(2)(A) requires a finding that the actual choice made was not "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law *(citation omitted)*. To make this finding the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."); *ITT World Communications, Inc. v. FCC*, 725 F2d 732, 741 (D.C. Cir. 1984) (standard of judicial review applicable to notice and comment rulemaking is "whether the agency's decision is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law'").

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

setting forth objective evidence of *abuses* or harm to investors that justify such a radical departure from the integrated disclosure system adopted in 1982, and shelf registration, which was adopted as a final rule in 1983. As we noted in our discussion of proposed Form B, delaying an issuer's access to capital by seven days, three days or even one day has real costs (and associated risks), which the Commission has neither acknowledged nor analyzed. At a minimum, the Commission should provide hard economic data by which the costs of its proposed regulatory régime may be measured.

b) Repeal of *Exxon Capital* transactions, another highly-effective financing technique for institutional markets, for which no abuse or harm to investors has been demonstrated. Instead, the market and QIBs would be subjected to inefficiency and illiquidity, with no corresponding benefits that outweigh the burdens on capital formation.

c) Public filing of "free writing" and the vaguely-defined "offering material" would subject offering participants to increased exposure to liability, including that arising under Section 11 of the Securities Act. Moreover, mandating that underwriters share proprietary investment ideas immediately with their competitors and non-clients would be unfair and impede innovation — all to the detriment of our capital markets. Again, no justification has been given for a proposal that would have a *chilling effect* on offering participants and increase the likelihood of frivolous litigation, contrary to the intent of recent legislation designed to curb these activities.

d) The Commission's effort to eliminate "selective disclosure" is generally focused on ordinary means of disseminating information to investors and the market. This apparent repudiation of the efficient market theory would result in less efficient capital markets and greater exposure to liability by offering participants. Less efficient markets and greater liability (*i.e.,* risk) usually translate as increased costs. Moreover, there is no statutory authority for the Commission to resurrect a "parity of information" or "equal access" obligation on issuers or other market participants to provide all available information. Given the reality of today's markets, it is disputable that small investors are harmed as a result of exclusion from road shows and other issuer communications with institutional investors or research analysts.[200]

e) As noted above, delivery of a prospectus (or term sheet) three or seven calendar days before pricing provides no special benefit to investors, since the almost uniform experience is that retail investors do not read them anyway unless they become dissatisfied with the performance of the investment. Currently, the final prospectus is delivered concurrently with the written confirmation of the trade. Obviously, if the prospectus included in the registration statement contains a material misstatement or material omission, offering participants would be subject to liability under Section 11 of the Securities Act. If there were a material change after distribution of the preliminary

---

200 *See* Browning *supra* note 24 and accompanying text.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

prospectus of which the investor was not informed, we seriously question that a revised prospectus would not be circulated — and in the absence of re-circulation, the underwriters would not insist on the investor taking and paying for the securities.

f) We note that the proposal would permit greater use during the time of an offering of research reports if conflicts of interest of the broker/dealer were disclosed. There would not appear to be any additional benefit from this disclosure requirement since applicable SRO rules already require disclosure of conflicts (including material interests in the issuer or its securities) and the mechanics of stickering every time a broker/dealer is invited into a deal, and unstickering when done for all research and other communications with the public would impose additional costs and burdens on capital formation.[201]

The Commission has not made available for public review or comment any empirical analyses that quantify the impact of its proposals on competition, efficiency, and capital formation. Certainly, the absence of economic data and rational bases in the Proposing Release raise substantial issues concerning whether these proposals — which we believe would have a substantial, adverse burden on capital information — were a proper exercise of the Commission's statutory authority, and were not otherwise arbitrary and capricious.

201 *See* NYSE Rule 472, Supplementary Material .40 (2) Disclosure (where a recommendation is made, requiring disclosure of status as market maker in recommended security (or of intention to buy or sell securities in principal transactions with customers); firm's status as manager or co-manager of underwritten offering of issuer; whether firm or employees have positions in securities recommended; and whether employee is director of issuer).

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

4. The Commission should publish notice of, and solicit comment on, incremental revisions to registration and disclosure requirements under the existing integrated disclosure system.

Listed below are some general proposals that we believe should receive further consideration by the Commission. We provide some specific proposals in Part VII, *infra*. We believe that greater coherence in consideration of these proposals and future interpretation of their requirements *(if adopted)* would be enhanced through publication in a separate release.[202] If these proposals are revised in accordance with our recommendations, we believe the Commission should adopt them as part of the existing integrated disclosure system.

- *More efficient registration*. Short-form registration would be effective upon demand without staff review. Any seasoned issuer could (irrespective of the Securities Act form used for registration) determine the effectiveness of its registration statement without staff review.
- *No delivery of final prospectuses*. Final prospectuses (including pricing information) would not have to be delivered.
- *Market-maker prospectus requirements would be revised*. There would be no requirement to deliver market-making prospectuses.
- *Increased marketing flexibility*. During the "pre-filing" period, issuers and underwriters could market securities to be offered pursuant to short-form registration.
- *Bright lines for gun-jumping*. Communications occurring outside of sharply defined time periods would not constitute gun-jumping.
- *Free writing*. Term sheets and other written materials (other than the statutory prospectus) could be used prior to effectiveness of the registration statement, but there would be no requirement to publicly file free writing.
- *Advances in integration*. An issuer would enjoy greater flexibility to switch between a private and a public offering, or *vice versa*, or to engage in concurrent public and private offerings. However, the issuer and its underwriter(s) would not have to assume Section 11 liability in respect of disclosure documents used in the private offering.
- *Due diligence guidance to underwriters*. Revisions to Rule 176 to provide greater clarity to underwriters and guidance to courts regarding the interpretation of the "reasonable investigation" standard for Section 11 of the Securities Act and the "reasonable care" standard for Section 12(a)(2) of the Securities Act.

---

202 We believe the proposals would have to be modified in a substantial manner; therefore, it would be insufficient under the APA to attempt to cure defects through multiple interpretive letters, no-action positions, staff legal bulletins or other means short of a re-proposing release.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

VII. AN ALTERNATIVE PROPOSAL

Notwithstanding our view that the proposals in the "Aircraft Carrier" are fundamentally flawed, we believe that publication of the Proposing Release significantly contributed to the climate for meaningful reform of the regulation of public and private securities offerings. In the Proposing Release, the Commission identified many of the profound changes that have taken place in the capital markets, and persuasively made the case for modernizing rules and regulations to reflect the impact of the following developments:

- As a result of the electronic communications revolution, more investors have access to greater amounts of information faster than ever before.
- Global securities markets render national borders less significant and increase the competition to supply capital; additionally, internet communication is not limited by national borders.
- The marketplace is dominated by institutional investors, and the role of market intermediaries has expanded.
- Innovation, spurred by competition, results in a proliferation of new financial products, thereby expanding financing opportunities.
- The public and private markets area converging, driven by the economic efficiency of combining the speed of a private offering with the liquidity of a public market.

Elements of the "Aircraft Carrier" seek to address these changes, although the Proposal, taken as a whole, harkens back to an outdated model of the capital markets and the securities offering process.

By identifying in the Proposing Release the need for change, the Commission carries forward the effort to achieve meaningful reform advocated by the Advisory Committee, the Task Force on Disclosure Simplification and this Committee, as well as by numerous other commentators. This is a propitious moment to reform the public and private securities offering processes to comport with current market realities and strengthen the US system for capital formation and its competitiveness *vis-à-vis* other markets.

Despite our criticism of proposals in the "Aircraft Carrier," we applaud the Commission's willingness to confront these issues. In our view, any proposals for further rulemaking should be premised on the Commission's integrated disclosure system and the existing shelf registration process. In this regard, we note that certain revisions proposed by the Advisory Committee, the Task Force on Disclosure Simplification, and the Commission in the "Aircraft Carrier" provide a useful framework for a more effective public securities offering system that comports with the realities of the present marketplace and methods of communication.

We believe that the opportunity for important and meaningful reform, which typically occurs only once a generation, should not be missed. In this spirit, we offer the following alternative proposal, which

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

we believe would enhance the competitiveness and efficiency of capital formation in the US, recognizes current market realities and is consistent with the protection of investors and the public interest.[203]

A. THE UNDERLYING PREMISE OF THE COMMITTEE'S ALTERNATIVE PROPOSAL IS THAT NO SERIOUS PROBLEMS EXIST WITH THE REGISTRATION PROCESS THAT WARRANT MAJOR OVERHAUL AND DISRUPTION OF CURRENT PRACTICES. THERE ARE PROBLEMS THAT SHOULD BE CORRECTED; HOWEVER, MOST OF THESE CAN BE ADDRESSED THROUGH FOCUSED RULEMAKING OR CHANGES IN ADMINISTRATIVE PRACTICE.

1. The current regulatory regime, particularly the integrated disclosure system and shelf registration process, works reasonably well and serves the needs of issuers, selling security holders and investors. There are no serious problems warranting major overhaul and disruption of current practices. Problems that do exist can be corrected by focused rulemaking and changes in administrative practice.

2. There are serious problems with the existing regulation of communications, which arise from applying a structure developed when the model was physical delivery of rigidly circumscribed written information to predominantly individual investors at the time of an offering. This structure impedes the free flow of information and circumscribes oral and written offers during the registration process. The impact of technology, however, results in a dramatically changed paradigm of expanded information increasingly disseminated electronically on a continuous basis to a diversified investor base (including small investors and institutional investors). These problems need to be corrected.

3. Current regulation does not adequately recognize that the dividing line between public and private offerings has blurred, and that the need for flexibility to shift from one to another has increased.

4. The efficiency of US capital formation, both public and private, must be maintained and if possible enhanced if US capital markets are to compete effectively with growing foreign capital markets. Public capital formation should be made more efficient to encourage migration from the private market to the public market.

5. Capital markets, and investors overall, are best served by the expansion of the orderly flow of information. Accordingly, actions that stifle that flow should be avoided and the free flow of timely and accurate information should be encouraged.

6. In the case of seasoned issuers, reliance should be placed to a large extent on the accessibility and timeliness of information generally available about the issuer through press releases, electronic media, Internet access to filings made with the Commission, and analysts' and other intermediaries' assessments. This recognizes the validity of the efficient market theory upon which the integrated disclosure system has operated

---

203 This proposal is based upon the concepts outlined in our comment letter in response to the Concept Release as further developed in an outline entitled "The Aircraft Carrier — A New Starting Point for Discussion," which was submitted to the Commission under cover letter dated September 14, 1999 and is being considered by the Committee's Task Force on Review of Federal Securities Laws. The Committee generally subscribes to the approach taken in the outline. Our proposal does not differ in overall approach from that outline, but rather seeks in some areas to suggest changes to accommodate Commission concerns reflected in the "Aircraft Carrier", and to cover areas not covered or fully developed in that outline. However, on the substance of the underlying premises and overall approach, the two proposals are in accord.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

well for over 15 years. The accessibility of information electronically should also be recognized as an important factor in the case of unseasoned issuers.

7. Investor protection, particularly as it relates to the quantity, quality and timeliness of information, must remain paramount in order to maintain investor confidence in capital markets, to provide investors with the information needed to make investment decisions for primary offerings and trading in the secondary market, and to afford them quality and diverse investment opportunities.

8. Our proposal seeks to utilize the best of the Advisory Committee proposals, those of the Task Force on Disclosure Simplification and those in the "Aircraft Carrier". As the Task Force recognized, although the existing integrated disclosure system and shelf registration process work well, the shelf registration process should be streamlined.

B. THE COMMITTEE'S ALTERNATIVE IS BASED UPON FURTHER ENHANCEMENT OF THE COMMISSION'S INTEGRATED DISCLOSURE SYSTEM AND EXISTING SHELF REGISTRATION PROCESS.

1. The existing registration process, which is based on the efficient market theory, should remain the basis of the system, and should be enhanced to reflect technological advances in electronic communications. We do not see any advantage to redesignating forms from the familiar and widely accepted S-1, and S-3 and S-4 format (and their F-1, F-3 and F-4 counterparts). The number of forms could be streamlined by eliminating Forms S-2 and F-2. If the forms for foreign registrants were eliminated, special provisions would need to be made in the remaining forms or Regulation S-K to accommodate foreign issuers.

2. For seasoned issuers, this means continuation of universal shelf registration on Forms S-3/F-3, together with preservation of Rule 415.

- Permit issuers that meet an appropriate threshold for seasoning to go effective on demand for all registration statements including shelf registration.
- Permit use of shelf registration for secondary resales without allocation between primary and secondary or identification of sellers who are not affiliates and who will offer less than a specified threshold amount.
- Permit addition of new classes of securities, plans of distribution, indentures and guaranteed finance subsidiaries by post-effective amendments that become effective automatically upon demand.
- Permit addition of other related company co-registrants (*e.g.*, subsidiary guarantors) by post-effective amendments that become effective automatically on demand when eligible or otherwise when declared effective by the Commission.
- Permit increase in the amount of securities on the shelf by post-effective amendment, or eliminate the amount requirement entirely.
- Provide for "pay-as-you-go" fees.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

3. An issuer's Exchange Act record, as it relates to purchasers of the registered securities, must contain all required information (except for expanded Rule 430A information) and not be false or misleading at the time of accepting commitments to buy.

- Outstanding Exchange Act comments from the staff will not prevent proceeding with the offering unless the Commission takes affirmative stop-order action.
- Expanded Rule 430A information may be subsequently transmitted to the Commission and retroactively included in the Exchange Act record. This record will constitute the "registration statement" for purposes of Section 11.
- This contemplates continued utilization of forward incorporation by reference from the time of effectiveness to the times of accepting commitments to buy (*i.e.* while distribution is in process), and with all Exchange Act reports to the time of acceptance (taken as a whole) subject to Section 11 liability.
- Rule 430A should be expanded to include the size of offering, estimated proceeds, maturity and, possibly, other terms of the securities that are frequently subject to change at the time of pricing even though not "pricing-related" within the meaning of current Rule 430A (*e.g.*, non-call period, holder put rights).
- Written term sheets containing Rule 430A information may, if the seller so chooses, be delivered, but without being required to be filed in advance.
- Issuers should be encouraged to include their Exchange Act filings on their generally accessible websites.
- The Commission should eliminate the one-day delay in posting EDGAR filings on its website.
- Foreign issuers' participation in the new system would be conditioned on their joining the EDGAR system.

4. For purposes of Section 12(a) (2), purchasers will be deemed to have purchased in reliance on the issuer's Exchange Act record, but, as between seller and purchaser, information included in the issuer's Exchange Act record subsequent to the opening of the last full Commission business day before acceptance of purchaser's commitment to purchase (other than expanded Rule 430A pricing information) will not be deemed to be part of the issuer's Exchange Act record for purposes of assessing the adequacy of disclosure, *unless* there exists either of the following:

a. *a. Actual Communication:* The information is actually communicated to the purchaser before acceptance of its commitment to purchase (whether orally or in writing to be determined by the seller, subject to the risk of proof). If the investor consents (which may be in blanket form), electronic delivery (*i.e.*, posting on issuer's website) can satisfy this requirement.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

a. *b. Constructive Communication:* The information is effectively disseminated before acceptance of the purchase commitment. Information is "effectively disseminated when it is reasonably likely to be reflected in the price most potential investors aware of the information would be willing to pay for the securities. The Commission should evaluate (based on empirical data) when, given different modes of communication, information is "effectively disseminated" for this purpose, and the extent and circumstances under which a purchaser must be made aware of the availability (but not the content) of the information. We encourage development of rules with enough flexibility to accomodate automatically continued advancement in electronic communication.

5. Define "prospectus" in Section 12(a)(2) to include term sheets used to offer and sell registered securities. Consider permitting the use of other written offering material which would also be included in the term "prospectus" in Section 12(a)(2). Neither term sheets nor other written offering material would be required to be filed with the Commission (unless required to complete the Exchange Act record as revised with 430A information). State that the accuracy and misleading character of this supplemental information can be measured against the issuer's Exchange Act record on the Commission's website.

6. Amend Rules 137 through 139 under the Securities Act, as proposed in the "Aircraft Carrier", except that research in the ordinary course will not be a "prospectus" subject to Section 12(a)(2) liability.

7. Eliminate the requirement to deliver final prospectuses with confirmations. Instead, amend Rule 15c2-8 to require delivery of a final prospectus (promptly after availability) to all purchasers who request.

8. Form S-1

- Expand Rule 15c2-8 to include blank check, "microcap" and partnership roll-up securities. It would also be possible to recast proposed Rule 172 to provide for advance preliminary prospectus delivery limited to these offerings.
- Exempt from Section 5 communications more than 30 days before filing of a registration statement, and information released in the ordinary course of business consistent with past practice.

9. Form S-3/F-3

- The Commission should conduct further economic studies to determine the appropriate public float for use of Forms S-3 and F-3.
- Issuers, directors, signing officers and underwriters would be liable under Section 11 for the issuer's Exchange Act record on the Commission's website that is incorporated by reference into the Form S-3/F-3, and users would be liable under Section 12(a)(2) for oral and other written communications used to offer and sell the securities.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- Retain availabilty of Forms S-3/F-3 for true secondary offerings for seasoned issuers not eligible to use the form for primary offerings.

- Exempt S-3/F-3 eligible issuers from Section 5 restrictions on oral and written offers generally. These would continue to be subject to Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.

- Form S-3/F-3 would be available to non-S-3/F-3 issuers in limited circumstances as provided in the Proposing Release, such as for certain offerings to QIBs (see paragraph 16 *infra*) rights offerings, DRIPS, conversion or exercise of outstanding convertible securities, warrants and options, and certain offerings to existing holders.

10. Rule 176

- Receipt of SAS 71 and 72 letters of auditor and disclosure letters of issuer's and underwriters' counsel should be relevant in all offerings.

- Consultation with the research analyst (if any), subject to any Chinese Wall limitations in place, should be relevant in all offerings.

- Review of registration statement and incorporated documents, discussions with management, pursuit of "red flags" and obtaining certification of management should create a favorable presumption in sales off S-3/F-3 shelf and should be relevant in other cases.

11. Private Placements

- Eliminate restrictions on offers (including general solicitation) for S-3/F-3 eligible issuers; eliminate restrictions on offers (including general solicitation) to eligible investors for other issuers.

- Eliminate integration of (a) the terminated private or limited offering with subsequent public offering that commences within 30 days, as long as the prospectus used in the public offering informs investors of the change, and (b) the private or limited offering with a prior terminated or completed public offering if made solely to eligible investors or there was no marketing activity for 30 days and there is disclosure of the change.

- Confirm continued permissibility of concurrent public offering of a security and a private offering of the same security to eligible investors.

12. Eligible Purchasers

- Consolidate and rationalize the definitions of "accredited investor" (Reg. D), "QIB" (Rule 144A) and "qualified purchaser" (Investment Company Act). Consider a broader category for direct placements by smaller or start-up issuers with family, friends, customers, *etc.*

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

13. Rule 506

- Eliminate restriction on "general solicitation" for S-3/F-3 eligible issuers; eliminate restrictions on "general solicitation of eligible investors for other issuers.
- Permit purchases by registered broker-dealers for resales to eligible purchasers.

14. Rule 144A

- Eliminate restriction on offers.
- Liberalize definition of QIB as proposed in paragraph 12 *supra*.

15. Regulation S

- Eliminate restrictions on "directed selling efforts" in parallel with treatment of offers, *i.e.,* no restrictions for S-3/F-3 eligible issuers, inapplicable to communications 30 days prior to Regulation S offering, and inapplicable to offers to eligible purchasers.

16. *Exxon Capital* Offerings

- Retain *Exxon Capital* A/B exchange offers for non-convertible debt and preferred stock and foreign issuer equity as now permitted. This recognizes the efficient capital-raising market that has developed, its institutional base, the absence of significant abuse and the attractiveness of introducing foreign issuers to our system and private issuers into the reporting régime.
- Provide an attractive registered alternative that would exist side-by-side with *Exxon Capital* A/B exchange offers. Our recommended alternative is Form S-3/F-3 availability for sales to QIBs as proposed by the "Aircraft Carrier" (a) of any security by "seasoned" issuers, and (b) of non-convertible debt and preferred stock and foreign issuer equity by "unseasoned" issuers, whether or not reporting companies, in both cases without the "presumptive underwriter" doctrine or "come to rest" concept of the "Aircraft Carrier".
- Reaffirm the *American Council of Life Insurance* no-action letter and confirm the end of the "presumptive underwriter" doctrine.

17. Exchange Act Enhancements

- Recognize that workable Exchange Act enhancements provide a basis for expanded reliance on integrated disclosure and freer communications.
- Expand the events reportable on Form 8-K generally along the lines proposed in the Aircraft Carrier, but with realistic and workable filing deadlines.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

- Consider requiring prompt filing on Form 8-K of voluntary made earnings releases, but without being deemed "filed" for purposes of Section 18 of the Exchange Act or incorporated by reference into Securities Act registration statements unless issuer so designates (so as to provide liability protection premised on Form 10-Q as the definitive financial report). These filings would be subject to liability under Section 10(b) of the Exchange Act.

- The current provisions of Form 10-Q "filed" status for purposes of Section 18 of the Exchange Act should not be changed, but these reports, if incorporated by reference into Securities Act registration statements, would continue to be subject to Securities Act liabilities, as well as Section 10(b) of the Exchange Act.

- Requiure inclusion of company-related risk factors (similiar to meaningful cautionary statements) in Form 10-K.

- Consider requiring SAS 71 limited reviews and reports as a condition to primary S-3/F-3 eligibility.

- Do not establish any additional certification or signature requirements, or accelerate any filing deadlines.

VIII. CONCLUSION

We have limited our comments to the most salient points of the Proposing Release. The Committee strongly urges the Commission to withdraw the Proposing Release from further consideration because of the serious, irremediable conceptual and structural flaws described in our letter. In this regard, we note that the Commission has not clearly articulated the harm to investors, abuses in the present regulatory régime, or any public interest to be served that justify the imposition of these burdens on, and impediments to, capital formation in the United States. Nor has the Commission quantified through empirical studies the impact of its proposals on competition, efficiency, and capital formation.

If rulemaking is necessary, we urge the Commission to conduct an economic study and consider proposing an alternative approach along the lines we have suggested. This alternative builds on the effective operation of the current shelf registration system, adopts the efficiencies identified by the Advisory Committee, the Task Force on Disclosure Simplification and the "Aircraft Carrier" and recognizes the realities of the current

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

marketplace. We recommend that the reproposal be accompanied by an economic study. In the interim, we also recommend that the Commission proceed with the proposals regarding asset-backed securities and deal with the issues surrounding the integration of private and public offerings. These are subjects that can stand alone and need to be addressed.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

The members of the Committee would be pleased to meet with the members of the staff to discuss our concerns and the recommendations in our letter. We remain available to assist the Commission and its staff in developing regulatory initiatives that modernize the current integrated disclosure system in light of the continuing development of technology and communications, as well as further global competition for our capital markets and economy.

Respectfully submitted,

Stanley Keller
Chair, Federal Regulation of Securities Committee

John J. Huber
Chair, Subcommittee on Securities Registration

cc: The Honorable Arthur Levitt, Chairman
The Honorable Paul R. Carey, Commissioner
The Honorable Isaac C. Hunt, Jr., Commissioner
The Honorable Norman S. Johnson, Commissioner
The Honorable Laura S. Unger, Commissioner
Mr. Brian Lane, Director of the Division of Corporation Finance

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

APPENDIX I

"WALK-THROUGH OF A FORM B OFFERING"

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

WALK-THROUGH OF A FORM B OFFERING

INTRODUCTION

Purpose

These timetables are intended to illustrate the substantial additional requirements that the Form B proposals will impose on the offering process, as compared with today's shelf registration system. These requirements will slow down offerings, add burdensome new steps to the process and impose additional potential disclosure and rescission liabilities on issuers, directors, signing officers and underwriters. The new requirements will probably not have the intended effect of making more information available more broadly.

Two typical types of offerings have been selected to illustrate these effects – an investment grade debt offering (scenario 1) and a syndicated common stock offering (scenario 2). While there are many variables that make every offering different, these scenarios are believed to be representative and fair examples of how these two types of offerings would proceed under the Form B proposals, as compared with today's shelf system.

Conclusions

The investment grade debt scenario (scenario 1) shows that a Form B offering differs in the following ways from today's shelf system:

- Pricing for the issuer is delayed by a full day under Form B, even though launched at the same time as the comparable shelf take down.
- Underwriter oral sales to investors and closing with the issuer are similarly delayed under Form B.
- More retail investors may be excluded from the Form B offering.
- Deal size must be fixed the evening of the day before pricing under Form B (*versus* at pricing under today's shelf system).

The common stock scenario (scenario 2) shows that a Form B offering differs from today's shelf system in the following way:

- If the Form B offering is oversubscribed, the issuer will have to choose between skipping the opportunity to upsize or delaying pricing by a full day and assuming the risk that the market and investor demand could move adversely during that delay. In today's shelf system, deal size can be increased at pricing without delaying the offering.
- If any disclosure event occurs during the day of pricing in the Form B offering, the pricing will have to be postponed a day to allow time for prospectus supplement revisions to be implemented, even if the changes are relatively modest.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

FORM B ASSUMPTIONS

No Pricing Until Prospectus Supplement Is Complete. Implicit in the Form B timing for both offering scenarios is that the underwriters will not be willing to agree on a price with the issuer until they are clear to make immediate oral sales to investors after pricing. (Otherwise, they take on additional underwriting risk as compared with today's shelf system.) Under the Form B régime, they may not make sales until the complete prospectus supplement has been filed with the SEC, other than Rule 430A information. That means deal size and, for debt offerings, maturity, which are not Rule 430A information, must be agreed upon sufficiently in advance of this filing to have the necessary information reflected in the filing. These scenarios assume, perhaps aggressively favoring Form B, that this can be accomplished within a few hours. If extensive pro forma information must be calculated, the deal size and maturities would probably have to be fixed even earlier in the Form B examples.

***No Pricing Until Term Sheet Delivery Is Complete*.** Also implicit in the Form B timing is that the term sheet must be physically sent to investors in a manner reasonably designed to *arrive* at or before the time they are asked to make a binding investment decision, which in practice is the same time as oral sales. Because this will physically take time, underwriters will want to initiate this process at least several business hours before pricing and complete it by the time of pricing. The term sheet may exclude Rule 430A information, but deal size is not that kind of information. Therefore, practical reasons relating to term sheet delivery also require that the deal size be fixed several business hours before pricing in the Form B scenarios.

***Shelf Filings Will Still Be Made*.** The Form B timelines assume a basic shelf-type registration statement will have been filed. In theory, it would be permissible under Form B to omit all registration statement and post-effective amendment filings until just before the first oral sale is to be made. However, this would require finalization, EDGARization and SEC filing of a document of substantial length (including exhibits) at a critical time in the offering process. The timelines assume that for maximum timing flexibility issuers and underwriters will prefer instead to have filed this information in advance, as under today's shelf system. Filing in advance also obviates the need to send drafts of the unfiled basic prospectus material and exhibits to prospective underwriters well prior to any offering in order to enable their legal and documentation groups to conduct the internal review of those materials that their underwriting policies require. They can instead review the public filings, as they do today. In any event, deferring the filing of any of the pre-sale Form B registration statement material would not affect the relative timing of the Form B process *versus* today's shelf system with respect to important milestones, such as fixing deal size, pricing, making sales and closing. (In other words, file-and-go is a myth.)

***Director and Officer Reading of Each Amendment Will Not Be Required*.** The Form B timeline unrealistically assumes that the issuer's signing directors and officers will be able to receive and read each post-effective amendment within 5 minutes. This is to avoid distorting the timeline against Form B for this impractical requirement (which it is assumed would be deleted from any final rules), while illustrating just how impractical it is.

Term Sheet Delivery the Day Before Investment Decision Will Not Be Required. Proposed Rule 172(a)(2) requires term sheet delivery in a manner reasonably designed to arrive "before the date" an investor makes a binding investment decision. The Form B timeline assumes this requirement will be changed or clarified

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

in the final rules to require delivery only "before the time" of the investment decision. The SEC staff has previously stated this to have been the intended meaning. If not, and it is to be read literally, then one more day should be added to the delays in pricing under Form B (*i.e.*, to two days).

Material Changes Disclosure 24 Hours Before Pricing Will Not Be Required. It is assumed that the requirement of Rule 172(e) to deliver 24 hours before pricing a document setting forth material changes to the disclosures will not apply to Form B offerings. This seems to be the case because subsection (e) does not refer to subsection (a), which describes Form B offerings. However, Form B itself specifies in Item 6 of "Information Required in the Prospectus That Is Part of the Effective Registration Statement" that the Rule 172(e) material changes document must be filed. It is assumed this is a mistake in Form B that will be removed (or changed to a reference to the securities term sheet) in the final rules. If it is intended that a Rule 172(e) material changes document be delivered in Form B offerings, this will in many cases add an additional day to the delay.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Scenario 1: Investment Grade Shelf Take-Down

A. There is a high state of readiness for both the Form B version and today's shelf:[204]

1. A shelf registration statement covering a sufficient principal amount of unsecured senior debt securities is on file and effective, including
   - Basic prospectus
   - Open-end indenture
2. An underwriting agreement is on the "shelf."
   - Not a required exhibit under the Form B proposals.
3. Forms of comfort letter and opinions are already negotiated.
4. Underwriters' counsel has been designated.
   - Counsel is familiar with the registration statement and related documents.
   - Background documentary due diligence is complete.

B. There will be no lengthy marketing period.

C. For the reasons described above in the Introduction under "Form B Assumptions," the deal size and maturities must be fixed in the Form B offering in the afternoon of the day before pricing, whereas they do not have to be fixed until the time of pricing under the existing shelf system.

Timing	Form B	Today's Shelf
Day 1		
9:00 am	Issuer calls 10 investment banks. Asks for price bids on 5- and 10-year maturities to be communicated on Day 2 at 9:00 am.	
9:01 am	The 10 investment banks sticker their research on the issuer to indicate possible involvement in the offering.[205]	—

[204] For the reasons described in the Introduction under "Form B Assumptions," file-and-go is not a practical alternative under Form B.

[205] This timetable assumes the research stickers themselves (and the research to which they are attached) would not be considered "offers" for purposes of the 15-day look-back for "offering information" or the filing requirement for "offering information."

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
9:05 am	The 10 investment banks (potential underwriters) start calling customers to assess appetite for 5-year and 10-year maturities at various interest rates.	
10:00 am	Issuer alerts its accountants and counsel and underwriters' counsel.	

11:00 am	Issuer asks 10 investment banks to formally confirm the absence of prior "offers" at any time (which would cause the 15-day look-back of the "offering period" to start earlier than Day 1) and the absence of written "offering information" or "free writing" in the past 15 days.
	• Any such information would have to be filed.
	  • Offering information as part of the registration statement
	  • Free writing as a Rule 425 prospectus
	• Participants expect no future written material unless approved by the issuer and each underwriter.
		—

11:01 am	Issuer's and underwriters' counsel begin to prepare "Recent Developments" for prospectus supplement to reflect any important recent information to be emphasized, such as recently announced quarterly earnings.[206]	

206 In the Form B scenario, the issuer would have previously filed a Form 8-K containing specified quarterly earnings information on the same day it publicly announced its quarterly earnings. This timetable assumes the Form 8-K in the Form B scenario would include the entire earnings release, even if it contained more than the minimum earnings information required by Form 8-K.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	—	If the earnings release was not previously filed and (as in the usual case) it contains greater detail than the summary earnings information in the prospectus supplement, the issuer files its earnings release with the SEC under cover of a Form 8-K.
	Underwriters' counsel begin to update their documentary due diligence.	
	Issuer's accountants begin their procedures required to prepare and issue their comfort letter on the prospectus supplement, basic prospectus and incorporated documents.	
	Accountants begin procedures to issue their consents for various post-effective amendment filings.	—
	Issuer's and underwriter's counsel informally ask the issuer to confirm it has no "unresolved" SEC comments. Counsel also telephones the SEC staff for confirmation.	—
	Issuer's and underwriter's counsel start drafting the relevant documents needed for this issue of securities:	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	• Securities term sheet (needed in 24 hours)	—
	• Prospectus supplement (needed before pricing)	• Prospectus supplement
	• Post-effective amendment(s)	—
	• Underwriting agreement/terms agreement	• Underwriting agreement/terms agreement
	• Officers' certificate or supplemental indenture establishing terms of securities	• Officers' certificate or supplemental indenture establishing terms of securities
4:30 pm	The 10 potential underwriters assess investor interest solicited during Day 1.	
Day 2		
9:00 am	The 10 potential underwriters submit their bids or other terms proposals to the issuer.	
10:00 am	Issuer selects 5 underwriters (no syndicate) and all agree orally on approximate deal size and all other terms except price and other Rule 430A information.	Issuer selects 5 underwriters and all agree orally on all terms including price.[207]
10:01 am	The 5 selected firms re-sticker their research to reflect their definite involvement in the offering. The 5 firms not selected remove the previous stickers from their research.	Issuer and underwriters sign the underwriting agreement and exchange signature pages by fax.

207 As a business matter, in today's shelf system the issuer and underwriters could instead agree to postpone pricing and signing the underwriting agreement until 12:01 pm, after completion of the due diligence conference call.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
10:02 am	Underwriters continue to solicit indications of interest from investors, but may not make sales.	Underwriters telephone investors to make offers and orally confirm sales (settlement in T+3 on Day 5).
10:05 am	Issuer obtains written concurrence to effectiveness of the contemplated post-effective amendments from the "managing" underwriter or "principal underwriters."	—
10:06 am	Issuer obtains written consents from accountants for continued incorporation by reference of their audit report in the post-effective amendment.[208]	—
10:07 am	Issuer and underwriters issue to each other formal written confirmation as to absence of "bad boy" disqualification.	—
	Issuer formally confirms to underwriters absence of "unresolved" SEC comments and absence of any prior "offers," written "offering information" or "free writing."	—

208 Current SEC staff practice and the policies of the major accounting firms require the filing of a new accountant's consent at the time of each amendment to the registration statement, even if the amendment does not affect the audited financial statements.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
11:00 am	A one-hour due diligence conference call is held for the underwriters and counsel to discuss relevant matters with management of the issuer.[209] As a result of this discussion, it is agreed that one or more matters will be added to the "Recent Developments" section of the prospectus supplement and that additional details will be filed via Form 8-K.	
12:01 pm	Upon completion of the due diligence call, issuer, underwriters, counsel and accountants work to prepare and finalize the Form 8-K disclosure.	
12:02 pm	Issuer, underwriters, counsel and accountants review proofs and work to finalize prospectus supplement.	
3:00 pm	Issuer EDGARizes and files the Form 8-K with the SEC reflecting the additional disclosures discussed during due diligence. Appropriate highlights may also be included in the "Recent Developments" section of the prospectus supplement	
	—	If the prospect of a post-due diligence Form 8-K filing is known the day before, this Form 8-K could also include the earnings release information otherwise contemplated for 8-K filing at 11:01 am the previous day.
3:05 pm	Signing directors and officers "read" the term sheet post-effective amendment so their signature page certification will be true.	—

[209] Because this is investment grade debt, the additional (protective) due diligence guidance included in Rule 176 would not be applicable.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
3:10 pm	Finalize term sheet and file with SEC as post-effective amendment via EDGAR.[210] If deal size changes before prospectus supplement is filed tomorrow at 8:30 am, a revised term sheet must be prepared, filed with the SEC and sent to investors to arrive before they commit.	—
3:15 pm	Underwriters fax and e-mail term sheet to investors so it will arrive before investors make binding investment decisions tomorrow morning. Retail investors may be excluded if too numerous or not equipped to receive term sheets by fax or e-mail.	—
	Incorporation by reference is not permitted after this time.	
	Underwriters continue to solicit indications of interest but may not make sales. (Sales started earlier today at 10:02 am under the existing shelf system.)	—

[210] This is the earliest the term sheet can be used, because incorporation by reference of the post-due diligence Form 8-K is not permitted after term sheet delivery starts. Even if no Form 8-K were to be filed, the term sheet process could not start until this morning (*i.e.*, a few hours earlier). This is because the participants cannot know enough terms to do the term sheet until the underwriters have been selected *and* have a reaction from investors. For example, the maturity could be 5 years, 10 years, or 5 years extendible at the issuer's option to 10 years. There could be two tranches of different maturities (*i.e.*, both 5 years and 10 years). The term sheet may exclude Rule 430A information. However, maturity is not Rule 430A information. The deal size must also be fixed in the term sheet because it is not Rule 430A information.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	**Form B**	**Today's Shelf**
7:30 pm	—	Accountants deliver to the underwriters their signed comfort letter, as required by the underwriting agreement, covering the prospectus supplement, basic prospectus and all incorporated documents.
8:00 pm	—	Issuer and underwriters authorize printing of the final prospectus supplement, which is dated Day 2, the trade date for sales of the offered securities.
Day 3		
8:25 am	Signing directors and officers "read" the post-effective amendment containing the prospectus supplement.	—
8:30 am	Prospectus supplement (excluding Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including underwriters' concurrence and accountants' consent).[211]	—
8:31 am	Issuer and underwriters agree on price.	—

211 If for some reason it is considered desirable in the Form B offering not previously to file the basic prospectus, related shelf registration statement, exhibits and term sheet, these would all have to be filed as part of the registration statement at this time.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
8:32 am	Issuer and underwriters sign the underwriting agreement and exchange signature pages by fax. (This occurred at 10:01 am yesterday under the existing shelf system.)	—
8:33 am	Underwriters make oral sales (settlement in T+3 on Day 6). (This occurred at 10:02 am yesterday under the existing shelf system.)	—
8:34 am	Underwriters may start sending confirmations to investors (without prospectus supplement).	Underwriters mail confirmations to all investors with the prospectus supplement.
	—	Prospectus supplement is filed with the SEC via EDGAR under Rule 424 (could also be filed on Day 4).
8:35 am	Working group prepares final prospectus supplement during the course of the day, including Rule 430A information.	—
5:25 pm	Signing directors and officers "read" the post-effective amendment.	—
5:30 pm	Final prospectus supplement (including Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including underwriters' concurrence and accountants' consent).	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
7:30 pm	Accountants deliver to the underwriters their signed comfort letter, as required by the underwriting agreement, covering the prospectus supplement, basic prospectus and all incorporated documents.	—
8:00 pm	Issuer and underwriters authorize printing of the final prospectus supplement, which is dated Day 3, the trade date for sales of the offered securities.	—
Day 4		
9:00 am	Underwriters send hard copies of the prospectus supplement to any investors that have requested it.	—
Day 5		
9:00 am	—	Closing (T+3)
Day 6		
9:00 am	Closing (T+3)	
Days 4-28		
	File post-effective amendment(s) to update the prospectus supplement if necessary. Signing directors and officers must "read" before filing. Accountants' consent and underwriters' concurrence may be required. Incorporation by reference is *not* permitted	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Scenario 2: Primary Offering of Equity or Other Securities

A. There will be an active marketing effort, including a one-week road show, and a full underwriting syndicate.

B. There is a high state of readiness (as for the debt shelf take-down scenario).[212]

1. A universal (or common stock) shelf registration statement covering a sufficient amount of securities is on
file and effective.
2. An underwriting agreement is on the "shelf".
3. Forms of comfort letter and opinions are already negotiated.
4. Underwriters' counsel has been designated.

C. For the reasons described above in the Introduction under "Form B Assumptions," the deal size must be fixed in the Form B offering at the beginning of the day of pricing, whereas it does not have to be fixed until the time of pricing at the end of the day under the existing shelf system.

Timing	Form B	Today's Shelf
Day 1		
9:00 am	Issuer selects a managing underwriter and two co-managers from many that have been pitching the business.	
	The three selected investment banks sticker their research to indicate their involvement in the offering.	—
10:00 am	Issuer and underwriters alert issuer's and underwriters' counsel and accountants.	

212 For simplicity, this timetable assumes the offering is for common stock. If the offering involves a more novel security, there will have to be extra up-front time spent to develop the necessary documentation and prospectus disclosure to be ready in time for the various on-demand filings.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
11:00 am	Issuer and the three investments banks formally confirm to each other the absence of prior "offers" at any time (which would cause the 15-day look-back of the "offering period" to start earlier than Day 1) and the absence of written "offering information" or "free writing" in the past 15 days. • Participants agree to use only mutually approved material.	—
	Issuer and underwriters issue to each other formal written confirmation as to absence of "bad boy" disqualification.	—
	Issuer formally confirms to the underwriters the absence of unresolved SEC comments. Counsel also telephones SEC staff for confirmation.	—

Days 2-9

Working group prepares preliminary prospectus supplement to use for marketing.

Form B	Today's Shelf
•Also prepare any required exhibits	—
•Will be "offering information"	—
•Will include term sheet	—
Working group prepares supplemental written marketing material.	No written marketing material.[213]
• Intended to be "free writing"	—

Underwriters and issuer prepare road show speeches and slides.

---

213 Under the existing shelf system, any written marketing material must be accompanied or preceded by a final prospectus. Even though the registration statement is effective, the prospectus may not be considered final because pricing has not yet occurred. Due to these concerns, no written marketing material other than the preliminary prospectus supplement itself will be used in the offering under the existing shelf system.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Underwriters and their counsel conduct business and documentary due diligence.[214]

Issuer's accountants begin their procedures required to prepare and issue their comfort letter on the final prospectus supplement, basic prospectus and incorporated documents (including substantive work on the preliminary prospectus supplement).

Day 9

9:00 am Issuer publicly announces quarterly earnings via press release and also files the results with the SEC under cover of a Form 8-K. Summarized quarterly results are also reflected in the preliminary prospectus supplement.

	Form 8-K is mandatory and must be filed on Day 9.	• Form 8-K is optional, but practically speaking is required in order to achieve incorporation by reference of full earnings release so that preliminary prospectus supplement may limit disclosure to summary information.

8:00 pm Issuer, underwriters, counsel and accountants sign off on the preliminary prospectus supplement.

8:05 pm	Signing directors and officers "read" the preliminary prospectus supplement so their certification will be true.	—

Day 10

9:00 am	Preliminary prospectus supplement and term sheet are filed with the SEC as a post-effective amendment via EDGAR (including managing underwriters' concurrence and accountants' consent).	Preliminary prospectus supplement is filed with the SEC under Rule 424 (could also be filed on Day 11 or 12).
	Written marketing material is filed with the SEC as free writing under Rule 425.	—

214 Because this offering is "marketed and priced" over a period of more than five days, the additional (protective) due diligence guidance included in Rule 176 would not be applicable.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	Issuer files its listing application with NYSE, including a copy of the preliminary prospectus supplement.	
10:00 am	The road show begins. This consists of meetings in various major cities by the issuer and managing underwriters with institutional investors in both group and one-on-one formats. Projections may be part of the presentation material to these institutional investors, but will *not* be included in the prospectus or otherwise disclosed to retail investors.	
	Road show slides will not be used if required to be filed with the SEC as free writing. Instead, presentations (including discussion of projections) would be made exclusively orally.	Road show slides may be used.
	Filed written material may be distributed, but is not required to be distributed.	—
Days 11-16		
	Road show continues. Syndicate members are invited by the managing underwriters, subject to approval of these additional underwriters by the issuer.	
	Each new syndicate member must formally confirm to the issuer and other underwriters the absence of "bad boy" disqualification "offers" prior to Day 1 (to ensure "offering period" is not expanded) use of unapproved "offering information" or "free writing"	—
	Each new syndicate member must sticker its research to reflect its involvement in the offering.	—
Day 16		

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	If ready, the issuer files its quarterly Form 10-Q report, and any corresponding updates are worked into the draft of the final prospectus supplement. If the Form 10-Q report is not ready, the issuer, underwriters and counsel confirm that the final prospectus supplement (or a special Form 8-K to be filed today) will otherwise appropriately reflect any material developments.	
	If the offering involves a new class of securities (instead of common stock) that would be exchange-listed:	
	The Form B filings already also constitute the required Exchange Act registration statement.	Issuer files its Form 8-A with the SEC and exchange, prospectively incorporating the final prospectus supplement.
	The exchange certifies to the SEC its approval of the listing, subject to notice of issuance. The Exchange Act registration statement thereby automatically becomes effective.	
Day 17		
8:30 am	**Issuer and underwriters agree on tentative deal size, so necessary information can be included in term sheet.** Because a deal cannot be later downsized without disastrous marketing consequences, the parties will err on the side of a smaller deal.	—
9:55 am	Signing directors and officers "read" the post-effective amendment before filing.	—
10:00 am	Term sheet (excluding Rule 430A information) is filed with SEC as a post-effective amendment via EDGAR (including managing underwriters' concurrence and accountants' consent).	—
10:01 am	Underwriters start faxing, e-mailing and mailing the term sheet to investors.	—
	No more incorporation by reference after this point.	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
10:02 am	Underwriters continue their marketing efforts and the lead managing underwriter continues the process of compiling investor interest and managing the order book.	
10:30 am	Issuer, managing underwriters, counsel and accountants work during the day to finalize the final prospectus supplement.	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	If any event occurs today that requires changes in the prospectus disclosure:	
	The pricing will likely need to be delayed until tomorrow. Even relatively modest disclosure changes can be expected to require several hours to prepare and be reviewed by the issuer, managing underwriters and counsel.[215] Examples of these events are: •Regulatory development •Litigation development •Small acquisition •New material contract	The pricing may continue today as scheduled. The prospectus disclosure changes do not need to be finalized and filed until late tonight (or even tomorrow if the underwriters are willing to delay sending confirmations). The disclosures could also be incorporated by reference from a special Form 8-K filing. The underwriters will use their business judgment in deciding whether the event is significant enough to orally disclose to investors when making oral sales.
4:00 pm	Managing underwriters assess the status of the order book and prepare deal size and pricing recommendations for the issuer. As long as the deal size is at least equal to the size used in the term sheet (for the Form B offering) or in the preliminary prospectus supplement (for the shelf offering), there will be no adverse marketing impact. These early deal size indications were intentionally established at conservative levels. Hence, the recommended deal size at pricing will most likely be *greater* than those levels, but in any event should not be smaller.	

215 Although not particularly relevant to the timing question, because the disclosure would require preparation and review in any event, it should be noted that subsequent to term sheet delivery incorporation by reference is not permitted, so the full disclosure must be included in the prospectus supplement.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
	If there is sufficient demand to upsize the deal, the managing underwriters will give the issuer two choices: (1) price now at the smaller size or (2) delay pricing until tomorrow so that revised term sheets can be distributed to investors. The first choice means completing a smaller offering than the market could support. The second choice involves the risk that adverse market conditions could develop the next day and force the offering to be reduced, delayed or even canceled. The remainder of this timeline assumes the issuer prefers certainty and makes the first choice of a smaller offering priced today.	If there is sufficient demand to upsize the deal, this can readily be done at pricing.
4:25 pm	Signing directors and officers "read" the post-effective amendment before filing.	
4:30 pm	Final prospectus supplement (excluding Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including managing underwriter's concurrence and accountants' consent). This will include final deal size, which is not Rule 430A information.[216]	No need to finalize the prospectus supplement until later this evening.
5:00 pm	**Issuer and underwriters agree on the public offering price and underwriting discount.**	**Issuer and underwriters agree on deal size, as well as public offering price and underwriting discount.**
5:02 pm	Issuer and the underwriters sign the underwriting agreement and exchange signature pages via fax.	
5:03 pm	Underwriters start making oral sales to as many investors as they can reach by telephone (settlement in T+4 on Day 21).	

216 If for some reason it is considered desirable in the Form B offering not previously to file the basic prospectus, related shelf registration statement, exhibits and term sheet, these would all have to be filed as part of the registration statement at this time.

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
5:04 pm	Underwriters start sending confirmations to investors (without prospectus supplement).	
9:30 pm	Accountants deliver to the underwriters their signed comfort letter, as required by the underwriting agreement, covering the prospectus supplement, basic prospectus and all incorporated documents.	
9:55 pm	Signing directors and officers "read" the post-effective amendment before filing.	
10:00 pm	Final prospectus supplement (including Rule 430A information) is filed with the SEC as a post-effective amendment via EDGAR (including managing underwriters' concurrence and accountants' consent).	
10:05 pm	Issuer and managing underwriters authorize printing of final prospectus supplement, which is dated Day 17, the trade date for the first sales of the offered securities.	
Day 18		
9:00 am	Underwriters send hard copies of the final prospectus supplement to any investors who have requested it.	Underwriters mail confirmations to all investors with the final prospectus supplement.
	—	Final prospectus supplement is filed with the SEC via EDGAR under Rule 424 (could also be filed on Day 19).
	Issuer files a copy of the final prospectus supplement with the NYSE.	
Day 21		
9:00 am	Closing (T+4). If the underwriters have decided by Day 20 whether to exercise any part of their 15% overallotment option ("Green Shoe"), then the closing for the sale of those shares may also occur on Day 21.	

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).

Timing	Form B	Today's Shelf
Days 18-43		
	File post-effective amendment(s) to update the prospectus supplement if necessary. Signing directors and officers must "read" before filing. Accountants' consent and underwriters' concurrence may be required. Incorporation by reference is not permitted.	—

This material is protected by copyright. Copyright © 1999 various authors and the American Corporate Counsel Association (ACCA).