SIMPSON THACHER

SEC LAUNCHES "AIRCRAFT CARRIER" RELEASE: PROPOSED MAJOR CHANGES IN REGULATION OF SECURITIES OFFERINGS IN THE UNITED STATES

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The U.S. Securities and Exchange Commission (the "SEC") has proposed a series of significant changes in the regulation of securities offerings in the United States (the "Proposals").[1] The Proposals are set forth in a release that the SEC staff has dubbed the "aircraft carrier" release—presumably, both as a reflection of the scope of the proposed regulatory changes and the 584-page length of the release.[2] The SEC has indicated that the Proposals, which will be subject to change after the customary comment process, are not likely to become effective until the year 2000.

EXECUTIVE SUMMARY

The Release proposes the following significant changes to existing SEC rules and regulations under the U.S. Securities Act of 1933, as amended (the "Securities Act"), the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the other U.S. federal securities laws:

- Replace most existing registration statement forms for domestic and foreign private issuers (Forms S-1, S-2, S-3, F-1, F-2 and F-3) with two basic forms (Forms A and B);

- Provide "large seasoned issuers" with more flexibility to craft disclosure about offerings;

- Allow most seasoned issuers to control the timing of filing and effectiveness of registration statements in respect of offerings;

- Repeal the *Exxon Capital* exchange offer procedure under which issuers are currently allowed to sell debt securities in a private offering and shortly thereafter register an

1 SEC Release No. 33-7606, 34-40632, IC-23519 (November 3, 1998) (the "Release").

2 Concurrently with the Release, the SEC issued a separate release proposing to update and simplify the rules and regulations applicable to tender offers, mergers, acquisitions and similar transactions. *See* SEC Release No. 33-7607, 34-40633, IC-23520 (November 3, 1998). This latter release will be the subject of a separate memorandum of our firm.

offering of substantially identical debt securities in exchange for such privately-offered securities;

- Ease existing restrictions on oral and written communications, including use of non-prospectus sales materials, by issuers and underwriters with respect to proposed and pending securities offerings;

- Relax existing prospectus delivery requirements for large seasoned issuers through, among other things, use of term sheets, while imposing specific timetables for delivery of preliminary prospectuses by both unseasoned and small seasoned issuers;

- Provide additional guidance to underwriters concerning the conduct of "due diligence" investigations;

- Liberalize existing restrictions on switching from a public offering to private offering, and *vice versa*; and

- Place increased emphasis on Exchange Act periodic reports by requiring additional and more timely disclosures in such reports.

The Proposals represent a major advance in the evolution of the "integrated disclosure" concept, with considerably greater focus on Exchange Act disclosure documents and streamlining of the Securities Act registration process.

KEY DEFINITIONS

The Proposals would significantly change—and generally liberalize—existing SEC rules and regulations. Many of the proposed changes to current practice would be predicated upon the Exchange Act reporting status and/or "size" of issuers (including domestic issuers, foreign private issuers and foreign government issuers).

As used in the Release as well as this Memorandum, the term "seasoned" issuer generally means (i) a domestic or foreign private issuer that has been an Exchange Act reporting company for at least one year, has filed at least one Exchange Act annual report and is current and timely in fulfilling its reporting requirements or (ii) a foreign government issuer as to which at least one year has passed since the effective date of its initial public offering of debt securities in the United States. By contrast, the term "unseasoned" issuer means any issuer which is not a seasoned issuer.

The term "large seasoned issuer" means (i) a domestic or foreign private issuer that is a seasoned issuer and that also has either a "public float"[3] with a market value of at least $250 million *or* a public float with a market value of at least $75 million and an average daily trading volume in the United States ("ADTV") of at least $1 million or (ii) a foreign government issuer that is a seasoned issuer and that also is offering securities in excess of $250 million on a firm commitment underwritten basis. The term "medium-sized" seasoned issuer, which is used in certain limited contexts in the Release, means a domestic or foreign private issuer that is a seasoned issuer and that has a public float of at least $75 million.

The above key definitions should be kept in mind in reviewing the Release as well as this Memorandum.

NEW SECURITIES ACT REGISTRATION STATEMENT FORMS

The Proposals would replace most existing registration statement forms for securities offerings with two main forms—Form B and Form A. Form B would be an abbreviated registration form similar to, but different in other significant respects from, Forms S-3 and F-3. Form A would replace Forms S-1, S-2, F-1 and F-2 and, to a degree, Forms S-3 and F-3 (all as discussed below). A third form, Form C, would be used for business combinations and exchange offers and would replace Forms S-4 and F-4. All of the proposed forms would be used by domestic and foreign private issuers alike (as compared with the existing system under which domestic issuers use the "S" registration statement forms and foreign private issuers, the "F" forms). Foreign government issuers would continue to file registration statements using Schedule B.

FORM B

An issuer (other than a foreign government issuer) would be permitted to use Form B to register only the following eligible offerings[4]:

- ***Offerings by Large Seasoned Issuers.*** A large seasoned issuer could use a Form B registration statement to register any primary or secondary offering of debt or equity securities. The SEC believes that large seasoned issuers are likely to have a wide market following, and, accordingly, should be allowed to use the more flexible Form

3 "Public float" is defined in terms of the aggregate market value of common equity securities held by non-affiliates of the issuer.

4 An issuer would be disqualified from using Form B if, among other circumstances, (i) it defaulted on material debt, (ii) it was the subject of bankruptcy or insolvency proceedings or of a "going concern" qualification in the audit report for its financial statements, (iii) it (or its directors or executive officers) were found to have violated the U.S. federal securities laws or were convicted of securities fraud or business fraud or perjury or (iv) it failed to resolve in good faith SEC staff comments on Exchange Act reports.

B for most offerings. Certain issuers that now qualify for Forms S-3 or F-3 because they meet the $75 million public float test of such forms would not be eligible to use Form B for all offerings unless they also have a $1 million ADTV.

- ***Offerings by any Seasoned Issuer to QIBs Only***. Any seasoned issuer could use Form B to register offerings limited to "qualified institutional buyers" ("QIBs").[5] The Proposals thus contain the innovative concept of a public offering limited to these major institutional investors, which are presumed to be able to fend for themselves and, accordingly, would not need the protections of Form A registration procedures in purchasing securities of smaller seasoned issuers. Securities offered to QIBs that were registered on Form B would not be subject to restrictions imposed by Rule 144A—in particular, such securities, unlike Rule 144A securities, would be freely resalable and also could be fungible with those listed on U.S. securities exchanges or quoted on NASDAQ.

- ***Offerings of Non-Convertible Investment Grade Securities***. Any seasoned issuer could use Form B for an offering of non-convertible investment grade debt or preferred stock securities. Such usage of Form B would correspond to the current eligibility standards for Forms S-3 and F-3, which permit issuers that do not meet the $75 million public float requirement of those two forms nonetheless to register non-convertible investment grade securities on such forms. The SEC continues to be comfortable that investors in highly rated debt and preferred stock securities do not need the protections of more complete, traditional prospectus documentation.

- ***Offerings to Existing Security Holders***. Any seasoned issuer could use Form B for specified offerings to existing security holders, including rights offerings, offerings pursuant to dividend reinvestment plans (DRIPs), offerings of securities upon exercise of outstanding transferable options or warrants, and offerings of securities issuable upon conversion of outstanding convertible securities. These types of offerings would be directed to investors who have previously invested in the issuer's securities and, accordingly, can be expected to be already familiar with such issuer. Forms S-3 and F-3 already accommodate some, but not all, of these offerings to existing security holders.

- ***Market-Making Transactions by Affiliated Broker-Dealers***. Broker-dealers which must prepare and deliver "market-making prospectuses" in market-making transactions in securities issued by its affiliates could use Form B. In order to use

5 The SEC proposes to use the QIB definition contained in Rule 144A to determine the universe of investors to which seasoned issuers could offer securities using Form B, with two major exceptions. QIBs that are dealers or investment advisors would not be eligible for these Form B offerings, as the SEC views such investors as being, in essence, distributors rather than end-investors. The SEC is concerned that QIBs that are dealers or investment advisors would attempt to resell immediately securities of small seasoned issuers not otherwise eligible to use Form B to other non-QIB investors.

Form B for such transactions, the issuer would have to be an Exchange Act reporting company, but would not need to be a seasoned issuer. Moreover, the transactions would have to be in the ordinary course of the broker-dealer's business as a market maker. By allowing Form B to be used for such transactions, the SEC believes that it will reduce burdens associated with existing registration and prospectus delivery requirements.

FORM A

Form A would be the basic form for registration under the Securities Act and could be used for any offering for which no other form is available.

CONTENTS OF NEW REGISTRATION STATEMENT FORMS

The Proposals would provide Form B issuers with more flexibility to craft disclosure about offerings. For these issuers, the registration system would move from the existing "exclusive" prospectus concept (under which the contents of each prospectus are strictly regulated) towards an "inclusive" prospectus approach (under which an issuer and its underwriters could use non-traditional offering materials in addition to the prospectus). Investors in any Form B offering would have access to not only required material company and transactional disclosures, but also to sales materials and other written communications used during the relevant offering period. By contrast, the SEC would continue to require use of a traditional prospectus for Form A offerings, although issuers in even these offerings would be permitted to communicate with potential investors using written information in addition to the prospectus.

FORM B

A Form B registration statement would include a prospectus containing the following information: "offering information"; the issuer's Exchange Act reports (incorporated by reference); in the case of a foreign private issuer, a reconciliation to U.S. GAAP; a "securities term sheet"; and undertakings to provide investors, upon request (and free of charge), with information incorporated by reference but not delivered. An issuer would also be required to disclose in its prospectus updated company information that describes any material developments not reflected in the incorporated Exchange Act reports.

The "offering information" included in the Form B prospectus would consist of disclosures of transactional information similar to the information currently required in a Form S-3 or F-3 prospectus. The SEC is considering two alternative approaches: the first approach would, while requiring all "material" transactional disclosures, limit the itemized requirements for such disclosures; and the second would continue to require most current itemized transactional disclosures. The purpose of the first materiality-based alternative is to provide issuers and underwriters with greater flexibility in customizing selling documents for offerings.

FORM A

A Form A registration statement would include a prospectus containing substantially the same information as current Forms S-1, S-2, F-1 and F-2. A seasoned issuer could incorporate by reference company-related information from its Exchange Act reports into the prospectus. For purposes of Form A, the term "seasoned issuer" differs from that generally used in the Proposals and would refer to an issuer that has been reporting under the Exchange Act for at least 24 months and either has filed at least two annual reports or has a public float of at least $75 million. A seasoned Form A issuer would be required to deliver any incorporated Exchange Act reports with its preliminary prospectus. Unseasoned Form A issuers would be required to set forth complete company-related information in the prospectus.

FREE WRITING MATERIALS

Both Form B and Form A issuers would be permitted to use, in addition to the specified prospectus, sales materials and other communications (so-called "free writing materials") in connection with their offerings, as discussed under "Easing of Restrictions on Communications During Offering Process" below. A Form B issuer would be required to file with the SEC free writing materials used during the "offering period".[6] Similarly, a Form A issuer, which could use free writing materials only after filing its registration statement, would be required to file such free writing materials. Free writing materials, whether or not filed as required, would be subject to liability under Section 12(a)(2) (but not the somewhat more stringent Section 11) of the Securities Act.

ISSUER CONTROL OF TIMING OF REGISTRATION PROCESS

The Proposals relating to the timing of filing and effectiveness of regulation statements are designed to provide more control over the registration process to large and medium-sized seasoned issuers as well as to small seasoned issuers whose Exchange Act reports have recently been reviewed by the SEC staff. The Proposals would enable these issuers to access rapidly the public capital markets to exploit "market windows". For these issuers, the Proposals would also eliminate the current timing advantages of Rule 144A offerings and even of the shelf registration procedure.

FORM B

Under the proposed registration system, a Form B issuer would be required to file a registration statement on Form B at any time before the first *sale* of securities.[7] Such an issuer

6 The term "offering period" means, in the case of a Form B offering, the period commencing 15 days before the first offer and ending upon completion of the offering.

7 *See* proposed Rule 166 under the Securities Act.

could commence making offers of its securities before the filing of the registration statement, including the distribution of a preliminary prospectus and free writing materials. This "deregulation" of offers by Form B issuers constitutes a major departure from the existing regulatory structure.

The Form B issuer would control timing of effectiveness of its registration statement.[8] The issuer could opt for effectiveness immediately upon filing or at a later specified date and time.[9] The SEC staff would not ordinarily conduct a formal review of Form B registration statements. However, the SEC staff would "screen" these registration statements shortly after filing to determine whether the offering was eligible for registration on Form B and also whether the disclosure raises any "red flags" in terms of the antifraud provisions of the U.S. federal securities laws.

FORM A

The SEC is proposing less radical deregulation of the offer process for Form A issuers. Issuers registering offerings on Form A registration statements would, as now, be required to file such registration statements before making first offers of the securities. The proposed rules for the timing of filing and effectiveness of a Form A registration statement are multi-tiered and, in large part, depend on the seasoned or unseasoned status of the issuer.

Medium-sized seasoned issuers and certain small seasoned issuers would control the timing of effectiveness of Form A registration statements.[10] A medium-sized seasoned issuer would be allowed to designate the time and date of effectiveness. In addition, a small seasoned issuer (*i.e.*, having a public float of less than $75 million) which incorporates by reference into its registration statement recent Exchange Act reports that have been fully reviewed by the SEC staff would similarly be permitted to specify the time and date of effectiveness.[11] As with Form B, the registration statements of these seasoned Form A issuers would not be reviewed by the SEC staff prior to effectiveness, although such filings would be screened shortly after receipt for disclosure "red flags".

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8 *See* proposed amendments to Rule 462 under the Securities Act.

9 In the case of an underwritten offering, the issuer would be required to obtain the concurrence of the managing underwriter with the designation of the time of effectiveness. *See* proposed amendments to Rule 461 under the Securities Act. The SEC continues to view such concurrence, which is analogous to the current underwriter acceleration request procedure, as an acknowledgment of underwriters' awareness of their statutory obligations under the Securities Act.

10 *See* proposed amendments to Rule 462 under the Securities Act.

11 *See* proposed amendments to Rule 462 under the Securities Act.

The SEC staff would continue to review—and, therefore, control the timing of effectiveness of—all other Form A registration statements. In particular, the SEC staff would continue to review all initial public offerings and, on a selective basis, "repeat" offerings by small unseasoned issuers.

CERTAIN IMPLICATIONS OF "TIMING" PROPOSALS

The SEC believes that the proposed approach to the timing of filing and effectiveness of registration statements should encourage issuers to register an increased number of offerings (rather than rely upon Rule 144A or other exemptions from registration). In addition, although seasoned issuers could continue to use shelf registration statements under the new registration system, the SEC anticipates that fewer issuers would elect to do so for various reasons, including the opportunity to use streamlined transaction documents (as compared with the existing shelf registration which requires extensive disclosure about the full range of potential securities to be offered), avoidance of concerns about market "overhang" effects on stock prices and the payment of registration fees on a transaction-by-transaction basis (as compared with the requirement to make an upfront filing fee for an entire shelf registration statement).

While the SEC's expectations as to more limited use of the shelf registration procedure may prove to be correct, we question whether the new timing procedures would—standing alone—materially affect the number of Rule 144A offerings by non-reporting companies. Non-reporting issuers have, in recent years, been the principal users of Rule 144A, as these issuers tend to be opportunistic in taking advantage of often short-lived market windows and have not wished to contend with the delays incumbent in the SEC review process. The Proposals would preserve the existing review and timing process for this category of issuers. However, the SEC is, as discussed below, planning to repeal the *Exxon Capital* exchange offer procedure, which has been a commonplace feature of "high yield" and, to a lesser degree, "emerging market" debt offerings by non-reporting companies. It remains to be seen whether such repeal would materially affect the willingness of QIBs to purchase Rule 144A or other restricted debt securities.

The post-filing "screening" process also raises some concerns in terms of the liability of issuers and underwriters which file and specify immediate effectiveness for a registration statement and then promptly price a transaction. If the screening occurs after pricing and results in SEC comments or challenges on disclosure issues, then the transaction participants would have the dilemma of deciding whether or not to proceed towards closing or, worse, what steps to take if the closing has already been consummated. In this era of T+3 closings, the proposed screening process could raise post-pricing or post-closing liability issues for transaction participants. Although a seasoned issuer runs some risk under the current registration system that the SEC staff will review and comment on incorporated Exchange Act reports after the registered offering is completed, such an issuer now at least has its Securities Act filing reviewed before effectiveness or else receives written confirmation as to the "no-review" status of its filing. The screening process as proposed thus may engender added uncertainty on the part of transaction participants as to post-pricing or post-closing review status.[12]

REPEAL OF *EXXON CAPITAL* EXCHANGE OFFER PROCEDURE

The SEC proposes to repeal the *Exxon Capital* exchange offer procedure under which an issuer may sell debt securities in a Rule 144A or other private offering and shortly thereafter register an offering of substantially identical debt securities to be exchanged for the original privately-offered securities. In recent years, the exchange offer procedure has become a commonplace feature of "high yield" offerings by domestic issuers and, increasingly, has been used in private offerings of debt securities by foreign private issuers incorporated in "emerging market" countries. The SEC believes the Proposals would eliminate delays associated with the registration process that have encouraged issuers to use the exchange offer procedure. In this regard, the Release cites the proposed seasoned issuer control of timing of the registration process as well as the proposed availability of Form B for QIB-only offerings by even small seasoned issuers. However, the Proposals would not accommodate non-reporting or newly-reporting issuers which have been significant—if not, the primary—users of the exchange offer procedure. These issuers would have to make a choice: either become a seasoned reporting issuer to access the QIB investor base using new Form B or else conduct a Rule 144A offering under which the securities would remain "restricted securities" for the two-year Rule 144 period.[13] In our view, the proposed repeal of the *Exxon Capital* exchange offer procedure constitutes a more significant departure from current market practice than the SEC appears to recognize in the Release.

EASING OF RESTRICTIONS ON COMMUNICATIONS DURING OFFERING PROCESS

The Proposals represent a radical departure from existing restrictions on the use of communications (other than the traditional prospectus) during the offering process. Currently, the Securities Act prohibits *any* offers to, or communications with, investors prior to filing of a registration statement. During the "waiting period" (*i.e.*, after filing, but before effectiveness of the registration statement), offers generally may be made by means of a preliminary prospectus, but not supplemental sales literature or other free writing materials. Subsequent to effectiveness, the final prospectus must be used to offer and sell securities, although other sales materials may be used in conjunction with such final prospectus. As discussed below, the Proposals would significantly ease these traditional restrictions on communications by issuers and underwriters with respect to proposed and pending securities offerings.

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12 The SEC proposes to allow issuers to request "voluntary pre-review" of Exchange Act reports by the SEC staff to reduce the risk of post-closing comment on disclosure. *See* "Expanded Exchange Act Disclosure Requirements" below.

- ***Communications During Pre-Filing Period***. The SEC would remove all existing restrictions on communications made by Form B issuers during the pre-filing period. The SEC is proposing an exemption to permit offers in the period before the Form B registration statement is filed. This exemption would cover any eligible Form B issuer, as well as its underwriters and participating dealers.[14]

  For Form A issuers, the SEC would also liberalize existing restrictions on pre-filing communications. The SEC would provide a safe harbor for all communications made by or on behalf of such an issuer more than 30 days before the date of filing of the registration statement.[15] An issuer and its underwriters thus could freely communicate with potential investors prior to such 30-day period, provided that they take reasonable steps to prevent *further* distribution or publication of any such communications during such period. Commencing on the 30th day before the filing date, the transaction participations would enter a "limited communications" period. During this latter period, issuers could continue to communicate with the public in certain respects, limited to (i) "factual business communications"[16], (ii) "regularly released forward-looking information"[17] and (iii) limited notices of proposed offerings (without naming the proposed underwriters) in accordance with current practice. The concept of these exceptions to the general prohibition on communications during the 30-day period is to balance the flow of "normal" corporate news, on the one hand, with a desire to control market conditioning activity by unseasoned and small seasoned issuers, on the other.

  Large seasoned foreign government issuers would be permitted to engage in the same pre-filing communications activities as Form B issuers. Other foreign government issuers would be subject to the same limitations on communications as proposed for Form A issuers.

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[14] *See* proposed Rule 166 under the Securities Act.

[15] *See* proposed Rule 167 under the Securities Act.

[16] The term "factual business communications" would include factual information about an issuer, advertisements of its products or services, factual business or financial developments about such issuer, dividend notices, factual information required in Exchange Act reports and responses to unsolicited inquiries from stockholders, analysts and the press. *See* proposed Rule 169 under the Securities Act.

[17] The term "regularly released forward-looking information" would include projections, statements about an issuer's future plans and statements about future financial performance of the type contemplated for management's discussion and analysis sections in Securities Act and Exchange Act registration statements and reports, but only if and to the extent that the issuer has customarily issued this type of information in the ordinary course of business during the last two full fiscal years. *See* proposed Rule 168 under the Securities Act.

- ***Communications During Waiting Period***. During the waiting period (*i.e.*, after filing, but before effectiveness of any registration statement), issuers would be permitted to make offers and disseminate offering information in any form or format.[18] Form B issuers and large seasoned foreign government issuers could, in theory, have limited waiting periods and would be permitted to engage in post-filing free writing, provided that such issuers (i) comply with the applicable prospectus delivery requirements (as discussed under "Changes in Prospectus Delivery Requirements" below), (ii) file free writing materials with the SEC and (iii) file a final prospectus before the first sale. These same conditions would apply to Form A issuers, many of which would be more likely to be marketing securities during a waiting period. All free writing materials and term sheets, whether used by Form B or Form A issuers, would have to include a prominent legend advising investors to read, before making an investment decision, the disclosure documents on file with the SEC and advising them on how to obtain copies of such information free of charge.

- ***Research Reports***. The SEC is proposing the liberalize Rule 139, which is the primary rule governing the publication of research reports by a broker-dealer participating in a distribution of securities.[19] Research reports that satisfy the conditions of Rule 139 do not constitute an impermissible "offer" or "prospectus" for purposes of the Securities Act.

  Under the Proposals, research reports could be issued without restriction in the case of Form B issuers and large seasoned foreign government issuers.

  For all other issuers, research reports could be published prior to the 30-day period before the filing of a registration statement. In addition, proposed Rule 139 would permit two types of research reports to be issued once the 30-day limited communications period commences: (i) "focused" reports about an issuer and its securities; and (ii) industry-related reports. Focused reports would be permitted with respect to any seasoned issuer (thus eliminating the condition in Rule 139 that now limits such focused reports to issuers meeting the Form S-3 or F-3 minimum float/investment grade eligibility criteria). In addition, as is now the case, focused reports could be issued about major non-reporting foreign issuers that meet the "size" tests otherwise applicable to large seasoned issuers. The amendments to Rule 139 would also replace the existing requirement that the focused report be published with "reasonable regularity" in the normal course of the broker-dealer's business with a simple condition that such report be distributed in the broker-dealer's ordinary course of business.

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18 *See* proposed Rule 165 under the Securities Act.

19 *See* proposed amendments to Rule 139 under the Securities Act.

In the case of industry-related reports, the revised Rule 139 safe harbor would apply to all issuers, regardless of reporting history or size (as compared with the present Rule which limits such reports to reporting issuers and to non-reporting foreign private issuers that meet the Form F-3 minimum float/investment grade eligibility criteria). The proposed revision of Rule 139 would also eliminate the requirement that the industry-related report not contain a more favorable recommendation than that in the last publication by the broker-dealer about the issuer or its securities. Instead, the broker-dealer would be required to disclose its last two opinions on the issuer or its securities if it wished to render a more favorable recommendation. Rule 139 would, however, retain the "reasonable regularity" condition (referred to above)—at least with respect to industry reports relating to unseasoned or non-reporting issuers.[20]

CHANGES IN PROSPECTUS DELIVERY REQUIREMENTS

One of the central goals of the Proposals is to provide maximum information to investors on a timely basis so as to facilitate investment decisions. Consistent with this goal, the Release de-emphasizes the importance of final prospectus delivery and "re-focuses" prospectus delivery requirements on disseminating disclosure documents to investors before investment decisions are made.

The SEC is proposing a new exemption which relaxes existing requirements that mandate delivery of final prospectuses to investors and which instead requires that investors be provided with preliminary information early on in the offering process.[21] The same conditions would apply to both primary and secondary offerings.

- ***Basic Conditions For Exemption.*** In order to take advantage of the exemption from the final prospectus delivery requirement,[22] an issuer would be required to (i) deliver the specified preliminary prospectus documentation (discussed below) and (ii) advise investors, prior to or at the time of confirmation of sale, where they can

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20 Rule 139 would also provide that its safe harbor is available for Regulation S and Rule 144A offerings. Currently, Rule 139 only applies, on its face, to registered offerings, although our firm has been of the view that it is "useful" even for such unregistered offerings. The SEC's proposal would expand the scope of the safe harbor to Regulation S and Rule 144A offerings.

21 Because of the proxy and tender offer rules, as well as state or foreign laws, that apply with respect to business combinations and exchange offers on Forms S-4 and F-4, the Release does not propose to eliminate final prospectus delivery requirements for these types of offerings.

22 In conjunction with this proposed exemption, the SEC would repeal existing Rule 434 for issuers (other than investment companies), which requires delivery of a final prospectus within a T+3 settlement cycle.

acquire the information that constitutes the final prospectus free of charge.[23] The latter requirement could be satisfied by making a final prospectus available in an on-line format, such as through EDGAR or an issuer's web site, and, absent specific requests by individual investors, does not require paper delivery of final documents. Under the Proposals, compliance with the requirement referred to in (ii) above would also serve to satisfy a dealer's after-market prospectus delivery obligations.[24]

- ***Form B Issuers***. The SEC is soliciting comment on two alternative Proposals with respect to the preliminary prospectus delivery requirements for Form B issuers. The first alternative proposal would mandate the delivery of only a "securities term sheet" prior to sale which would (i) summarize the material terms of the securities, (ii) identify a contact person to respond to questions and provide final documents, (iii) identify any person other than the issuer who is selling the securities and describe any material relationship between the issuer and such person, and (iv) contain a legend advising potential investors to read the issuer's documents on file with the SEC before making an investment decision.[25] The second alternative would require delivery of a traditional Form S-3/F-3-style prospectus, which would have to be filed prior to sales of securities.

- ***Form A Issuers***. In the case of Form A issuers, the Proposals would generally require delivery of a preliminary prospectus so that it is received by potential investors at least seven calendar days before the date of pricing of the offering. For more seasoned issuers, the delivery requirement would be reduced to three calendar days prior to pricing.[26] In determining whether to accelerate effectiveness of a registration statement, the SEC would consider whether adequate public information about the issuer had been made available, including through the timely delivery of preliminary prospectuses.

- ***Foreign Government Issuers***. Large seasoned foreign government issuers would be subject to the same prospectus delivery requirements as for Form B issuers. Other foreign government issuers would be required to comply with the requirements for Form A issuers.

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23 *See* proposed Rule 173 under the Securities Act.

24 The Proposals would set the length of the after-market delivery period at 25 days for both initial public offerings and "repeat" offerings. *See* proposed amendments to Rule 174 under the Securities Act.

25 *See* proposed Rule 172 under the Securities Act. An issuer could opt to use a preliminary prospectus to satisfy this obligation.

26 *See* proposed Rule 172 under the Securities Act. For purposes of this preliminary prospectus delivery requirement, a seasoned issuer would be an issuer whose initial public offering took place at least one year before the effective date of the registration statement for the current offering of securities.

UNDERWRITERS' DUE DILIGENCE INVESTIGATIONS

Underwriters currently experience difficulty in conducting comprehensive due diligence investigations in respect of seasoned issuers, particularly those that have established Form S-3 or F-3 shelf registration statements covering debt and/or equity securities. Frequently, such an issuer, in an effort to take advantage of a brief "market window", will provide its underwriters with an extremely short time frame in which to complete a due diligence review. The Proposals would further complicate the underwriter due diligence process not only by shortening the timing of the registration process for seasoned issuers (large and small alike), but also by relaxing existing restrictions on the use of non-prospectus communications during the offering process as to which underwriters would take on liability under the Securities Act and the Exchange Act. Underwriters could find it difficult to screen and "diligence" in advance every communication disseminated by the issuer.

The SEC recognizes in the Release that underwriters may experience "marginal additional timing pressures . . ." under the Proposals, but then warns underwriters "not to allow competitive pressures and issuers' demands . . . to lessen their due diligence investigations." The SEC believes that the liability provisions of the Securities Act and the Exchange Act provide underwriters with the "incentive to test the quality of the issuer's disclosure . . ." documents. The SEC then offers the following guidance to underwriters for conducting due diligence investigations in the proposed new registration system:

- ***Guidance for Underwriters' Due Diligence***. The SEC proposes to amend existing Rule 176, which identifies circumstances relevant in determining whether a person can properly claim a due diligence defense, by highlighting six practices that courts should view positively when evaluating an underwriter's due diligence defense: (i) review of the registration statement and inquiry concerning any fact therein that would cause a reasonable person to question whether the registration statement contains a material untrue fact or omission; (ii) discussions with the issuer's executive officers (including its chief financial officer or chief accounting officer) concerning the information in the registration statement; (iii) receipt of a Statement of Auditing Standards (SAS) No. 72 comfort letter from the issuer's auditors; (iv) receipt of a "10b-5 opinion" from the issuer's counsel; (v) employment of separate underwriter's counsel and receipt of a "10b-5 opinion" from such counsel; and (vi) employment of a research analyst who has followed the issuer or its industry for at least six months before the offering and who has issued a research report thereon within twelve months before such offering. The six factors would apply, on their face, only to offerings of equity and non-investment grade debt securities registered on Form B and that were marketed and completed in fewer than five days. The absence of any one or more of these six practices would not be considered definitive in assessing the adequacy of the underwriter's investigation.

In our experience, the first five practices are part of the due diligence process for substantially all offerings conducted by the leading U.S. investment banking firms. Most of these firms also employ analysts who are well-acquainted with, and who participate, to a degree, in the due diligence review of, issuers. Codification of current practices in Rule 176 would not necessarily ameliorate the increased liability exposure that is likely to arise under the Proposals.

- ***MD&A Review by Independent Accountants.*** The Release refers to the recently issued Statement on Standards for Attestation Engagements ("SSAE") No. 8. SSAE No. 8 contemplates that an issuer's independent accountants may examine or review an issuer's management's discussion and analysis ("MD&A") disclosures and issue an opinion confirming that (i) that MD&A contains the required elements of Item 303 of Regulation S-K, (ii) historical financial data contained in the MD&A is accurately derived from the issuer's financial statements and (iii) the issuer's underlying information, estimates and assumptions provide a reasonable basis for the MD&A disclosures. The Release indicates that SSAE No. 8 could be added to the enumerated practices in an amended Rule 176, but does not otherwise elaborate on this concept.

- ***Disclosure Review by Qualified Independent Professional.*** The Release discusses the possibility of having an underwriter, as part of its due diligence review, review a report on an issuer's Exchange Act annual report issued by a "qualified independent professional". The concept of a report of a qualified independent professional is not meaningfully developed in the Release, but appears to contemplate issuance of a "10b-5 opinion" by legal counsel or an accounting firm with respect to an issuer's annual report. In addition, the term "independent" is not discussed, making it unclear whether the issuer's counsel is sufficiently independent from its client in the light of, among other factors, such counsel's duty of loyalty to such client under the Code of Professional Responsibility. The Release also states that the qualified independent professional "would be subject to liability . . .", but does not delineate the statutory nature, if any, of such liability. Presumably, the SEC would resolve these and other uncertainties concerning the "qualified independent professional" before it adopts final rules implementing the Proposals.

In our view, the Proposals fail to respond to the realities of a marketplace that already make it difficult for underwriters to conduct comprehensive due diligence investigations of seasoned issuers. The Proposals would only exacerbate such problems and could lead to increased exposure to liability on the part of the underwriters. We believe that the SEC should take meaningful steps to lessen or otherwise mitigate the liability of underwriters—at least in the context of offerings by seasoned issuers.

LIBERALIZATION OF RULES GOVERNING "INTEGRATION" OF REGISTERED AND UNREGISTERED OFFERINGS

The SEC is proposing a series of rule changes to address prevalent problems that have arisen, in recent years, under the "integration doctrine" of the Securities Act. Simply stated, the integration doctrine prevents an issuer from splitting what is, in effect, a single offering that should be registered into small—and purportedly—separate private offerings exempt from such registration. Integration has deterred issuers from conducting relatively contemporaneous public and Rule 144A offerings, and has also prevented issuers from switching from public offerings to private offerings, or from private offerings to public offerings, even when market conditions would otherwise dictate. The integration doctrine has, in particular, prevented issuers from "testing the waters" as to potential investor interest before deciding whether to proceed with a public or a private offering. As discussed below, the Proposals would significantly liberalize existing regulatory restrictions arising under the integration doctrine.

- ***Successive "Completed" Offerings***. Under proposed amendments to Rule 152, a private offering that is "completed"[27] before a registration statement is filed would not be integrated with the registered offering regardless of the period of time between the two offerings (as compared with the minimum six-month period to avoid integration now in effect). In addition, in the case of convertible securities or warrants, the offering of the underlying securities issuable upon conversion or exercise would be deemed to have been completed when the offering of the convertible securities or warrants is completed. Under current practice, the underlying securities generally have been viewed as being the subject of a continuing offering—and, therefore, subject to integration with other offerings—during the entire conversion or exercise period.

- ***Switching from Private to Public Offering.*** Under the existing securities regulatory scheme, an issuer cannot commence a private offering and then seek to register the offering. Section 5 of the Securities Act prohibits offers in registered offerings before a registration statement is filed, such that "private" offers prior to filing a registration statement for a public offering of the same or similar securities would constitute impermissible "gun-jumping".

  Under the proposed registration system, a Form B issuer would be allowed to make offers before a registration statement is filed, with such filing required only at the time of sale. As a result, a Form B issuer could, prior to time of sale, switch a private offering into a public offering without restriction.

27 An offering would be deemed to be "completed" if all purchasers have fully paid, or are unconditionally obligated to pay, the purchase price for the offered securities.

By contrast, a Form A issuer would generally not be permitted to make offers before filing the registration statement. However, proposed amendments to Rule 152 would permit such an issuer to abandon a private placement and then conduct a public offering, subject to five conditions: (i) all "private" offerees are notified that the private offering has been abandoned; (ii) no securities were sold in the private offering; (iii) the securities involved in the private offering were not the subject of any general solicitation or general advertising; (iv) the issuer does not file a registration statement until at least 30 days after it notified the private offerees of abandonment of the private offering if securities had been offered in the private offering to an "ineligible" person; and (v) the issuer either files the selling materials used in the private offering as part of the registration statement *or* informs all private offerees that the filed prospectus replaces such prior selling materials and any indications of interest are rescinded.[28]

The above-mentioned 30-day requirement would not apply in the case of any private offering which has properly been limited to QIBs and accredited investors. As a result, an issuer ordinarily would not need to wait for the passage of any period of time before switching from a private to a public offering. It is also unlikely that an issuer would ever opt to file private offering selling materials as part of its registration statement (and, in so doing, take on Section 11 liability with respect to such materials). Undoubtedly, issuers would prefer simply to advise all private offerees that the filed Form A prospectus has, in effect, become the operative marketing/disclosure document.

- ***Switching from Public to Private Offering.*** An issuer that seeks to convert a public offering into a private offering generally has, under existing law and regulations, had to wait for six months to do so. The filing of a registration statement constitutes a general solicitation which taints the follow-up private offering, and retail and other investors ineligible to participate in such private offering may have received offers prior to abandonment of the public offering.

  The SEC is now proposing a safe harbor to permit a public offering (whether commenced by filing a registration statement or under Form B before filing a registration statement) to be switched into an unregistered private offering, subject to five conditions: (i) any filed registration statement is withdrawn by the issuer; (ii) if no registration statement had been filed (as could be the case for a Form B issuer), all "public" offerees are notified as to abandonment of the public offering; (iii) no securities were sold in the public offering; (iv) if the securities are then offered in the private offering more than 30 days after such abandonment or withdrawal, the issuer notifies the private offerees that, among other things, the privately-offered securities are unregistered "restricted" securities and the protections of Section 11 of

28 *See* proposed amendments to Rule 152 under the Securities Act.

the Securities Act are not available to such private offerees; and (v) if 30 or fewer days have passed since such abandonment or withdrawal, the issuer agrees to accept Section 11 and Section 12(a)(2) liability for material misstatements or omissions in the offering documents used in the private offering.[29]

The SEC has proposed the fifth condition because it is concerned that offerees in the private offering would still be influenced by the public offering and should, therefore, have the protection of the more stringent Securities Act liability provisions for public offerings. This condition is somewhat troubling because offering documents used in many private placements are more streamlined and less comprehensive than the prospectus documentation for public offerings—among other reasons, because of the sophistication and "clout" of the typical private placement investors. The effect of this fifth condition thus would be to require issuers to finalize and continuously update the former public offering disclosure documents during the course of the private offering. However, this additional burden should, in many cases, outweigh the negative consequences of having to wait for six months before switching from a public to a private offering.

EXPANDED EXCHANGE ACT DISCLOSURE REQUIREMENTS

The Proposals would place increased emphasis on Exchange Act periodic reports by requiring more prompt and complete disclosure in such reports. The focus on Exchange Act disclosure is inextricably linked to the proposed streamlining of the Securities Act registration process for seasoned issuers, but is also designed to "equalize" investor access to information about reporting issuers. The SEC has been, in recent years, trying to create a more "level playing field" for all investors—indeed, the Release states that the SEC is hoping to "decrease the information gap between the 'have' and 'have-not' investors."

The principal Proposals relating to Exchange Act disclosures are as follows:

- ***Risk Factor Disclosure in Periodic Reports***. Domestic issuers and foreign private issuers would be required to describe significant "risk factors" relating to future financial performance in Form 10-K and Form 20-F annual reports, as the case may be. Domestic issuers would also be required to update the annual discussion of risk factors in their Form 10-Q reports. Issuers could then incorporate such Exchange Act risk factor disclosures into their Securities Act registration statements. Consistent with the recently adopted "plain English" rules for Securities Act registration

29 *See* proposed amendments to Rule 152 under the Securities Act.

statements,[30] the proposal would require that the Exchange Act presentation of risk factors be in plain English.[31]

- ***Due Dates for Filing of Periodic Reports***. The Release proposes to accelerate the due date for the Form 20-F annual reports of foreign private issuers by requiring such reports to be filed within five months after the issuer's fiscal year end (as opposed to the existing deadline of six months).[32] The SEC is also soliciting comment on whether to accelerate periodic reporting requirements for domestic issuers to within 30 days after each fiscal quarter (as opposed to the current 45 days) and within 60 days after fiscal year end (as opposed to the current 90 days).

- ***Expanded Form 8-K Reports***. The Release proposes to expand the list of events that would require a domestic issuer to file a Form 8-K report to include the following: (i) "flash" reporting of selected financial data; (ii) material modifications to the rights of securityholders; (iii) departure of the chief executive officer, chief financial officer, chief operating officer or president of such issuer; (iv) material defaults on senior securities; (v) notification by its independent auditor that (a) such issuer may no longer rely on an audit report included in an Exchange Act report or (b) the auditor will not consent to the use of a prior audit report of such issuer in an Exchange Act report; and (vi) change in the company name of such issuer. The SEC would also accelerate the due date for the filing of Form 8-K reports from 15 calendar days to five calendar days after the occurrence of a reportable event. In addition, in the case of disclosures of material defaults and notices regarding the change of a company's independent auditors, the SEC would require the Form 8-K report to be filed one business day after the date of the reportable event.

- ***Additional Signature Requirements***. The Release proposes to revise the signature section of all Exchange Act periodic reports to require the specified signatories to certify that they have read the relevant document and that, to their knowledge, such document contains no material misstatements or omissions.[33] The proposal would also expand the number of persons required to sign Form 20-F, 10-Q and certain other reports to include the principal executive officers and a majority of the board of directors of the issuer. The SEC believes that these new signature requirements

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30 SEC Release No. 33-7497, 34-39593, IC-230112 (January 28, 1998).

31 *See* proposed Rule 12b-24 under the Exchange Act.

32 *See* proposed Rules 13a-10 and 15d-10 under the Exchange Act. The Release also proposes to encourage foreign private issuers to make voluntary disclosures of material information affecting such issuers on Form 6-K reports.

33 The new Securities Act registration statements forms would require corresponding certifications on the part of the specified signatories.

would encourage directors and executive officers to review more closely the contents of reports and discourage such persons from merely signing blank signature pages to be attached to reports that they have never reviewed. In addition, this proposal is intended to keep the board of directors apprised of material current events affecting the issuer. More generally, the SEC seeks to place more responsibility on management for the contents of Exchange Act reports.

- ***Plain English in Exchange Act Reports***. The Release requires plain English disclosure only with respect to the new risk factor section of Exchange Act documents. However, the SEC is soliciting comment on whether the plain English rules should apply to all materials that are a part of, or are incorporated by reference into, a prospectus.

In connection with the above-mentioned rule changes, the Release states that Exchange Act periodic reports will be subject to more frequent review and comment by the SEC and that the SEC will reallocate staff resources to the review of such reports. Accordingly, issuers should anticipate that their periodic reports will become subject to "selective review" on a regular basis. The Proposals also provide for voluntary pre-review of Exchange Act filings if an issuer is concerned about receiving a comment letter requesting changes to an Exchange Act document that would be incorporated by reference into, or would serve as the basis for company disclosure in, a Securities Act registration statement. The overall increased emphasis on review of Exchange Act documents is consistent with the increased role of Exchange Act documents in Securities Act offerings under the proposed registration system. By requiring reporting companies to detail risk factors in their periodic reports and to disclose material changes in a timely fashion, and by holding management accountable for the information contained in such filings, the SEC anticipates that more current and comprehensive information will be available to the full spectrum of investors.

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This Memorandum is intended to constitute only an overview of certain key aspects of the Proposals that are likely to be of interest to our clients at large. This Memorandum does not purport to discuss all of the substantial number of highly technical and lengthy Proposals set forth in the Release. We invite recipients of this Memorandum who are interested in discussing the Release, or who have questions concerning any aspect of the Release, to contact Glenn M. Reiter (212-455-3358) or Paul B. Ford, Jr., Raymond W. Wagner, D. Rhett Brandon, Arthur D. Robinson or Risë B. Norman of our New York office (212-455-2000); Walter A. Looney, Jr. or Gregory W. Conway of our London office (011-44-171-422-4000); John E. Riley or Andrew R. Keller of our Hong Kong office (011-852-2514-7600); David A. Sneider of our Tokyo office (011-81-3-5562-8601); or Alan G. Brenner of our Singapore office (011-65-430-5100).

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