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SEC PROPOSES REFORM OF SECURITIES OFFERING PROCESS

By Dionne M. Rousseau and Celeste E. Rasmussen

On October 26, 2004, the Securities and Exchange Commission proposed reforms to the securities offering process. The proposal is the SEC's most significant effort in this area since the 1998 "Aircraft Carrier" proposal that was not adopted. These new proposals have a better chance of being adopted in substantially the form proposed. The release describing the proposed rules is almost 400 pages long and involves reforms in three main areas: (1) communications related to registered securities offerings, (2) simplification of shelf registration procedures and (3) modernization of prospectus delivery procedures. The proposed rules also would require public companies to make additional disclosures in Form 10-K. ([Click here to link to the SEC's release regarding the proposed rules.](#)) The proposals generally relate only to capital formation transactions and not to business combination transactions, for which the SEC already adopted more liberalized rules in 1999. This E*Zine will touch only on some of the most significant changes proposed. For further information, please contact the authors of this E*Zine.

Categories of Issuers

The amount of flexibility that would be granted to issuers would largely depend on which of the following four categories the issuer falls into:

- A "well-known seasoned issuer" would be a new class of issuer that is eligible to register a primary offering of its securities on Form S-3 and has either (1) \$700 million or more market value of its outstanding common equity held by non-affiliates, or (2) issued at least \$1 billion of registered debt in the past three years and is only registering debt securities. These issuers would enjoy the most flexibility. The SEC believes that these issuers represent approximately 95% of the U.S. equity market capitalization and 30% of listed issuers.
- A "seasoned issuer" would be one that is eligible to use Form S-3 to register a primary offering of securities but does not meet the other "well-known seasoned issuer" requirements.
- An "unseasoned issuer" would be one that files reports with the SEC but does not satisfy the requirements of Form S-3 for a

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primary offering of its securities. Issuers filing SEC reports voluntarily would fall into this category.

- A “non-reporting issuer” would be one that is not required to file reports with the SEC.

Liberalizing Communications Around the Time of Registered Offerings

Currently, the Securities Act of 1933 (1) prohibits all offers of securities prior to filing a registration statement, (2) prohibits written offers other than by means of a statutory prospectus after the filing, and (3) prohibits written offers after effectiveness of the registration statement unless accompanied or preceded by a final prospectus. The proposals would liberalize communications permitted around the time of a registered offering:

- Well-known seasoned issuers would be allowed to engage at any time in oral and written communications, including use of a new type of written communication called a “free writing prospectus,” subject to certain conditions that include filing with the SEC in some cases.
- All issuers and other offering participants would be allowed to use a free writing prospectus after the registration statement is filed, subject to certain conditions that include filing with the SEC in some cases.
- Information permitted in post-filing notices under Rule 134 would be expanded.
- The exemptions for research reports would be expanded.

The SEC has also proposed some new safe harbors, which we believe are consistent with current practice, that are intended to encourage continued dissemination of regularly released information, with some restrictions for IPO issuers. In addition, communications by issuers more than 30 days before filing a registration statement would not be considered prohibited offers as long as they did not reference a securities offering and the issuer takes reasonable steps to prevent further distribution of the information during the 30-day period immediately before filing the registration statement.

In an attempt to resolve ambiguity over whether certain types of

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electronic communication constitute a "writing," the proposed rules would classify all communications as written (including communications by e-mail and information posted on a company's website), other than purely oral communications. Telephone conversations would be considered oral. The rules would, however, liberalize the permitted uses of written communications.

A "free writing prospectus" would be defined as a written offer that is not a statutory prospectus (and is beyond those writings that are currently permitted). Use of the free writing prospectus for issuers would be conditioned upon filing it with the SEC, usually on or before the date of first use. It would also have to contain a legend that, among other things, would notify recipients how to find the statutory prospectus. Underwriters would not generally be required to file a free writing prospectus that they prepare, as long as it is not distributed in a manner reasonably designed to lead to its broad unrestricted dissemination. Free writing prospectuses would not be deemed to be part of the registration statement or subject to liability under Section 11 of the Securities Act of 1933, but would, however, be subject to liability under Section 12(a)(2) of the Securities Act of 1933 and the anti-fraud provisions of the federal securities laws (as are prospectuses).

Issuers other than well-known seasoned issuers could not use a free writing prospectus prior to filing their registration statement with the SEC. IPO issuers and unseasoned issuers could not use a free writing prospectus unless it were accompanied or preceded by the most recent statutory prospectus, which for an IPO would have to include a price range. This could be achieved in an electronic free writing prospectus by means of a hyperlink to the statutory prospectus. Seasoned issuers could use a free writing prospectus without this restriction. Well-known seasoned issuers could use a free writing prospectus at any time, including before filing the registration statement; pre-filing written communications would be filed upon filing the registration statement.

A problem area for many issuers has been news articles reporting comments made in interviews with executives; the SEC has often taken the position that these are prohibited written offers. The proposed rules would allow these communications and articles pre-filing for well-known seasoned issuers and post-filing for them and other issuers, as long as the issuer files the article with the SEC as a free writing prospectus within one business day of publication.

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Under the proposed rules, electronic road shows would be free writing prospectuses. However, they would not be required to be filed if the issuer (1) makes at least one version of a bona fide road show readily available electronically to any potential investor at the same time as the electronic road show and (2) files any issuer free writing prospectus or material issuer information used at the road show.

Modernization of Shelf Registration Process

The proposals would update and in some cases liberalize the shelf registration process. Among other things, the proposals would:

- Establish a more flexible version of shelf registration, referred to as “automatic shelf registration,” for offerings by well-known seasoned issuers, that would feature automatic effectiveness and “pay-as-you-go” registration fees.
- Replace the requirement that issuers register only securities they intend to offer within two years with a requirement that the issuer update the registration statement with a new one filed every three years.
- Permit immediate takedowns of securities off a shelf registration statement.
- Permit the use of prospectus supplements to make material changes to the plan of distribution.
- Liberalize the circumstances under which prospectus supplements may be used to identify selling security holders.

Prospectus Delivery Reform

The proposals would create an “access equals delivery” model for final prospectuses, which would generally eliminate the requirement for physical delivery to investors of a final prospectus filed with the SEC. The rules would also allow written confirmations and notices of allocation to be sent after effectiveness of a registration statement without being accompanied or preceded by a final prospectus.

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Clarifying and Modifying Liability

The proposals address the different liability standards under the Securities Act of 1933 and, in some cases, change the times that they would apply.

Elimination and Modification of Forms

The proposed rules would eliminate the Form S-2 registration statement. Also, Form S-1 would be amended to permit expanded use of incorporation by reference to previously filed SEC filings by all issuers that have (1) filed at least one annual report and are current on their reporting obligations and (2) made their SEC filings readily accessible on their websites. Information filed after the effective time of the Form S-1 could not be incorporated by reference.

Expanded Disclosure in Exchange Act Reports

The proposed rules would require issuers to include in their reports filed under the Exchange Act: (1) risk factor disclosure (similar to the type currently required for registration statements) in Form 10-K; (2) for accelerated filers, disclosure in annual reports of certain material unresolved SEC staff comments; and (3) disclosure of the issuer's status as a "voluntary" filer of Exchange Act reports, if applicable.

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Please remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues you may contact the head of our Corporate and Securities practice group:

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