

## **Securities Offering Reform**

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On June 29, 2005, the Securities and Exchange Commission (SEC) unanimously adopted new rules, substantially in the form they were proposed in November 2004, modifying and significantly enhancing the communication, registration and offering process under the Securities Act of 1933. According to the SEC, the reforms are intended to eliminate “unnecessary and outmoded restrictions” on registered offerings. This White Paper highlights the key reforms that are likely to affect the conduct of registered offerings.

It should be noted that blank check, shell and penny stock issuers, delinquent filers, companies with “going concern” audit opinions in the last year, issuers that have filed for bankruptcy protection in the last three years, and those that have been found to have violated the antifraud provisions of the securities laws (“ineligible issuers”) will not be able to benefit from the new rules. With respect to securities law violators, the new rules base ineligibility on agency decisions, court orders or government settlements that involve anti-fraud violations, rather than on all violations as was previously proposed in November 2004. In addition, settlements entered prior to the effective date of the new rules would not be a basis for disqualification.

### Automatic Shelf Registration

A well-known, seasoned issuer (WKSI) is eligible to register securities under an “automatic shelf” registration statement. To fall into the WKSI category, an issuer must be eligible to register a primary offering on Form S-3 or F-3 (and thus must be current and timely on its Exchange Act filings during the prior 12 months), and as of a date within 60 days of the eligibility determination, either (i) have a \$700 million public float in common equity or (ii) in the case of other issuers, have issued \$1 billion in non-convertible debt or preferred stock, in primary registered public offerings for cash in the preceding three years. Issuers qualifying solely under the latter category will be able to use automatic registration only for non-convertible, non-common equity offerings, unless as of the issuance date the WKSI has \$75 million in public float. In that case, automatic shelf registration will be possible for common equity offerings as well. Majority owned subsidiaries of WKSIs also qualify as WKSIs for purposes of issuances of investment grade non-convertible securities, or other non-convertible securities, other than common equity, that are fully guaranteed by the WKSI parent.

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These new rules allow WKSIs to:

- register an unspecified amount of securities, of any type or class (without allocating between primary and secondary securities), on a Form S-3 or F-3 that will become effective automatically without staff review;
- add additional classes of securities to an already effective shelf registration statement;
- add additional subsidiaries as issuers to an already effective registration statement, provided they are majority owned;
- exclude, among other things, from the base prospectus a plan of distribution that can be included in a prospectus supplement; and
- use “pay as you go” registration fees, which can be paid in advance of or upon each takedown.

Under the new rules, WKSI shelf registration statements will not be reviewed by the SEC staff prior to becoming effective. Instead, the staff will continue to focus on reviewing the Exchange Act reports of these issuers, as it has been doing already. Thus, WKSIs will be assured ready access to the capital markets.

An automatic or other shelf registration statement will remain effective for three years. When combined with the liberalization of offering communications described below, the reforms for WKSIs are intended to permit offerings on demand without restriction other than a need to file offering materials and a prospectus supplement.

#### Additional Shelf Registration Improvements

The new rules improve the shelf registration process generally in the following additional ways:

- the information that may be omitted from a shelf registration statement at the date of effectiveness and added later by prospectus supplement, post-effective amendment, or an Exchange Act report, has been codified;
- instead of requiring issuers to register only securities intended to be offered within two years, as the current rules contemplate, registration statements will need to be updated by filing a new registration statement every three years;
- material changes to the plan of distribution may be made by prospectus supplement, rather than a post-effective amendment;
- the rules eliminate “at the market” offering restrictions that limited the dollar amount

registered for this purpose to 10% of the market value of the public float and required that sales be made through a registered broker-dealer named as an underwriter in the registration statement;

- immediate takedowns from shelf registration statements will be available under the new rules; and
- seasoned issuers with \$75 million in public float will be able to identify selling shareholders in a prospectus supplement instead of through a post-effective amendment, where the securities or securities convertible into them are outstanding at the time the registration statement is filed.

### Offering Period Communications

The new provisions liberalize written communications before and during registered securities offerings, effectively mitigating a significant number of the “gun-jumping” concerns. New safe harbors under Section 5 were created for public announcements of factual business information and forward-looking information during the offering.

Under the new rules, communications made by an issuer (but not an underwriter) more than 30 days before the filing of a registration statement will be exempt as long as they do not reference a securities offering that is the subject of a registration statement, including a shelf registration. The issuer must take reasonable steps to prevent further dissemination of the information within the 30-day period.

During the 30-day period before filing and through the offering period, all non-reporting issuers will be able to publish “factual business information,” which is information of the kind they have regularly released to persons other than those in the capacity of investors or potential investors. A non-reporting issuer includes for this purpose a voluntary filer not required to file periodic reports under Section 13(a) or Section 15(d) of the Exchange Act.

All reporting issuers, certain asset-backed issuers, and large non-reporting foreign private issuers that are widely followed in their home markets, may also publish “forward-looking information” without having that information deemed to be a “prospectus.” Under the new rules, in addition to WKSI, reporting issuers for these purposes include seasoned issuers – those issuers, not falling within the WKSI category, that are required to file periodic reports and are Form S-3 or F-3 eligible; and unseasoned issuers – those issuers that are required to file periodic reports but are not Form S-3 or F-3 eligible.

Rule 134 has been expanded under the reforms to permit notices or other communications regarding the proposed offering after the filing of a registration statement to include a broader range of information regarding the issuer, the securities, and the offering, and codifies the SEC’s position that routine communications, for example, offering schedules, procedures for opening accounts, and administrative

matters, are not considered an offer. Issuers and offering participants may rely on Rule 134 in connection with an IPO before a bona fide price range is included in the prospectus, except with respect to information relating to pricing and the rating of the security.

Offerings registered under Form S-8, business combinations, and offerings by registered investment companies and business development companies have been excluded from many of the new communication rules, because those offerings are subject to their own requirements regarding offering communications.

### Free Writing Prospectuses

Under the new rules, WKSIs will be allowed at any time (e.g., even before filing a registration statement) to make written offers in a new type of written communication called a “free-writing prospectus.” This type of prospectus is defined as any written offer, including electronic communications, other than a statutory prospectus.

After the registration statement is filed, all eligible issuers and underwriters are permitted to use a free-writing prospectus. This will open up the potential for marketing securities through many different mediums. The marketing material or free-writing prospectus must be filed with the SEC and contain specified legends, except in the case of underwriting materials that are not “broadly disseminated”. Acceptable mediums will include emails, faxes, term sheets, Web sites and, except in the case of offerings by non-reporting issuers, media interviews and advertising. A cure provision is provided for inadvertent failures to file the free-writing prospectus.

The substance of a live electronic road show (in “real-time”) will be considered an oral communication and, thus, will not be considered a free-writing prospectus that must be filed with the SEC. A recorded electronic road show that is played on a delayed basis, however, will fall under the free-writing prospectus category but need not be filed except in the case of an IPO. Bona fide electronic road shows used in IPOs made readily available to unrestricted audiences, however, need not be filed. The exemptions and filing requirements that apply to the electronic road show also apply to any slides or visual aids presented as part of the road show.

The use of a free-writing prospectus is conditioned on the filing of the registration statement, except in the case of WKSIs. Additionally, for unseasoned and non-reporting issuers, the statutory prospectus (which in the case of an IPO must include a price range) must accompany or precede the free-writing prospectus if an issuer or participant in an offering uses, pays for or prepares the free-writing prospectus.

## Liability Provisions

For disclosure liability purposes, under Sections 12(a)(2) and 17(a)(2) of the Securities Act, the determination as to whether a material misstatement or omission exists will be assessed by looking at the information conveyed to investors when the investment decision is made, which is usually before the final prospectus is available. In this regard, the free-writing prospectus is subject to liability under Sections 12(a)(2) and 17(a)(2) of the Securities Act. A free-writing prospectus will not be considered part of the registration statement and, therefore, will not be subject to Section 11 liability. The new rules make clear that issuers are deemed to be sellers for purposes of Section 12(a)(2) liability.

The new rules deem prospectus supplements to be part of the registration statement for the purposes of Section 11 liability and each filing of a prospectus supplement will establish a new registration statement effective date for Section 11 liability purposes for issuers and underwriters. However, a new effective date will not be triggered for officers, directors or named experts (e.g. auditors) as was originally proposed.

Thus, the timing discrepancy in application of Section 11 liability to issuers and underwriters has been mostly eliminated. As a consequence of these reforms, greater emphasis is being placed on completion of due diligence, the accuracy of preliminary prospectuses and the delivery of comfort letters at the time of sale, instead of or in addition to the time of effectiveness or closing.

## Access Equals Delivery

An “access equals delivery” model has been adopted for the final prospectus. The new rules assume that investors have Internet access. Issuers, underwriters, and dealers subject to a prospectus delivery requirement, will be deemed to have satisfied their final prospectus delivery obligations once a prospectus is timely filed with the SEC. A cure provision was added to the final rules for inadvertent failures to file.

There is also a separate requirement that investors be notified that they purchased securities in a registered offering. This is intended to make it easier for investors to trace securities to a registered offering. Offering participants and dealers, thus, must continue to identify those transactions that require prospectus delivery. A failure to provide the required notice, however, will not result in a Section 5 violation and give rise to a private right of action under Section 12(a)(1) of the Securities Act.

Another exemption allows written notices or confirmations to be sent after a registration statement has become effective without being preceded or accompanied by a final prospectus. Thus, the new rules eliminate the link between final prospectus delivery and delivery of the final confirmation of sale. Likewise, email allocations will now be possible.

## Incorporation by Reference

The new rules allow reporting issuers to incorporate by reference previously filed Exchange Act reports into a Securities Act registration statement on Form S-1 or F-1, after they have filed an annual report and if they make their Exchange Act reports available on their Web sites. Forms S-2 and F-2 have been eliminated entirely, as they are no longer necessary. Incorporation by reference of subsequently filed Exchange Act reports will not be allowed on Forms S-1 and F-1, as is permitted for Form S-3 and Form F-3 filers.

## Research Reports

Rules 137, 138 and 139 under the Securities Act currently permit a broker or dealer, under certain circumstances, to publish research around the time of a registered offering without violating Section 5. The new rules slightly expand the safe harbors available to broker-dealers for research reports under those rules.

The new rules define the term “research report” to include written communications (which encompasses broadcasts) that include information, opinions or recommendations with respect to the security of an issuer, even if it does not present sufficient information upon which to base an investment decision.

Rule 137, which provides that a non-participating broker or dealer that publishes research on an issuer in registration will not be considered to be an underwriter, will now apply to offerings by non-reporting companies. However, notwithstanding requests by commentators, the SEC did not extend the exemption provided by Rule 137 to dealers in the secondary market that are subject to a prospectus delivery obligation following the effective date of the offering.

Rule 138 currently allows a broker or dealer that participates in the distribution of one class of a specific issuer’s securities to publish or distribute research on a different class of that issuer’s securities. The amended rule broadens the safe harbor to cover research reports on all reporting issuers, rather than just Form S-3 and F-3 eligible issuers.

As amended, Rule 139 allows a broker or dealer participating in a distribution of securities of a seasoned issuer (*i.e.*, a Form S-3 or F-3 eligible issuer) to publish research regarding the securities being distributed if the broker-dealer publishes research reports in the normal course of business, and is not initiating coverage of the issuer. The “reasonable regularity” standard has been deleted. Under amended Rule 139, reports may only be published for issuers timely in their periodic reporting, with a minimum of one year of reporting history and Form S-3 or F-3 eligibility, and for large non-reporting foreign private issuers that are widely followed in their home markets.

With respect to industry reports, the amendment to Rule 139 removes the prohibition on a broker giving a more favorable recommendation than the one it made in a prior

publication. Under the new rules, however, the reports must contain information similar to the type contained in prior reports.

In addition, the new rules provide that research reports under Rules 138 and 139 will not be considered general solicitations in connection with Rule 144A offerings, directed selling efforts or an offer in the United States in Regulation S offerings, or a proxy solicitation in connection with a transaction subject to the proxy rules.

### Exchange Act Report Disclosure

The new rules make changes to Exchange Act reports as well. In particular, risk factor disclosure will now be required in Form 10-Ks, and voluntary filers must disclose that they are voluntary filers in their Exchange Act reports. Additionally, in what is probably the most controversial change in the Exchange Act report arena, an accelerated filer,<sup>1</sup> including a WKSI, must disclose written staff comments received 180 days before the issuer's fiscal year-end that the issuer believes are material and that are unresolved at the time of filing of the Form 10-K or 20-F, and will remain unresolved for a lengthy period of time.

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<sup>1</sup> An accelerated filer is defined as an issuer that has been subject to the reporting requirements for at least 12 months, has filed at least one annual report, and has a \$75 million public float in common equity (calculated as of the end of the most recently completed second fiscal quarter). This is consistent with the current definition of accelerated filer for the purposes of filing Forms 10-K and 10-Q.

Effectiveness of New Rules

The final rules will become effective 120 days after publication of the adopting release in the Federal Register, which is expected to be between the end of November 2005 and the beginning of December 2005.

For more information on these developments contact your primary Morgan Lewis attorney or one of the following:

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