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Securities Offering Reform Proposal

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Background

The Securities and Exchange Commission has proposed significant changes to the registration and offering process under the Securities Act of 1933. According to the Commission, the proposed changes are intended to eliminate "unnecessary and outmoded restrictions" on registered offerings. This White Paper highlights the key provisions contained in the new rule proposals 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" 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 securities laws ("ineligible issuers") will not be able to benefit from the new rule proposals.

Registration of an Automatic Shelf

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, having been reporting under the Exchange Act for at least one year and timely in its filings under that act; and either (i) have $700 million of public float in common equity or (ii) in the case of debt issuers, have issued $1 billion of registered public debt securities in the preceding three years.

This type of registration would allow a WKSI 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 securities of additional classes to an already effective 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 could be included in a prospectus supplement; and
- use "pay as you go" registration fees, which could be paid in advance or upon

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each takedown.

Under the rule proposals, WKSI registration statements would not be reviewed by the SEC staff prior to going into effect. Instead, the staff would continue to focus on reviewing the Exchange Act reports of these issuers, as it has been doing already. Thus, WKSIs would be assured ready access to the capital markets.

The registration statement would 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 proposals improve the shelf registration process in the following additional ways:

- the information that may be omitted from a shelf registration statement at the date of effectiveness and added later has been codified;
- instead of requiring issuers to register only securities intended to be offered within two years, as current law requires, registration statements will need to be updated by filing a new registration statement every three years;
- the proposals eliminate "at the market" offering restrictions;
- immediate takedowns from shelf registration statements will be available under the proposals; 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.

Offering Communications

The new provisions will liberalize written communications before and during registered securities offerings, effectively removing a significant number of the "gun-jumping" prohibitions. New safe harbors under Section 5 will be created for factual business information and forward-looking information.

Under the proposals, 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.

During the 30-day period before filing, 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 in the capacity of investors or potential investors. A non-reporting issuer is one that is not required to file periodic reports under Section 13(a) or

Section 15(d) of the Exchange Act.

All reporting issuers will be able to publish "factual business information" and "forward-looking statements without having that information deemed to be a "prospectus." Under the proposals, in addition to WKSIs, reporting issuers 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. The proposals consider voluntary filers to fall under the category of reporting, unseasoned issuers.

Under the proposals, WKSIs would be allowed at any time (e.g., even before filing a registration statement) to engage in oral and written offers in a new type of written communication called a "free-writing prospectus." This type of prospectus would be defined as any written offer that includes electronic communications, other than a statutory prospectus.

After the registration statement is filed, all issuers and underwriters will be permitted to use the free-writing prospectus. This will open up the potential for marketing securities through many different mediums as long as the marketing material or free-writing prospectus is filed with the Commission, with the exception of underwriting materials. 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. Electronic road shows will also fall under the free-writing prospectus category and, unless made generally available to investors, must be filed with the Commission.

Rule 134 would also be expanded under the proposals to permit offering participant communications to be disseminated more broadly. In this regard, routine communications, for example, offering schedules, procedures for opening accounts, and administrative matters, would not be considered a prospectus.

Liability Proposals

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 will be subject to liability under Sections 12(a)(2) and 17(a)(2) of the Securities Act.

The proposals also would include prospectus supplements in the registration statement for the purposes of Section 11 liability. As a result, the timing discrepancy in application of Section 11 liability to issuers, underwriters and others will mostly be eliminated.

As a consequence of these reforms, greater emphasis will be 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 is being proposed for the final prospectus. The proposals assume that investors have Internet access. Once a prospectus is timely filed with the Commission, issuers, brokers and dealers can satisfy the final prospectus delivery requirements.

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 will thus be required to identify those transactions that require prospectus delivery. A failure to provide the required notice, however, would 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 proposed exemption would allow 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 proposals would eliminate the link between final prospectus delivery and delivery of the final confirmation of sale. Likewise, email allocation will be possible under the proposals.

Incorporation by Reference

The proposals will 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, subject to certain conditions. Forms S-2 and F-2 will be eliminated entirely, as they will no longer be necessary. As now proposed, incorporation by reference of subsequently filed Exchange Act reports will not be allowed on Forms S-1 and F-1; it would continue to be 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 that constitutes an offer around the time of a registered offering without violating Section 5. The proposals would expand slightly the safe harbors available to broker-dealers for research reports under those rules.

The proposals provide a definition of the term "research report." Moreover, the circumstances under which offering and non-offering participants may disseminate reports during an offering have been expanded.

A broker or dealer that is not participating in a registered offering will not be considered to be engaged in a distribution and, thus, will not be considered an underwriter under Rule 137. The proposals seek to expand the rule to apply to securities of any issuer, including non-reporting ones.

Rule 138 allows a broker or dealer that participates in the distribution of one type of a specific issuer's securities to publish or distribute research on a different type of that

issuer's securities. The proposals seek to expand the categories of eligible issuers. The proposed amendment to Rule 138 would cover research reports on all reporting issuers, rather than limiting coverage to Form S-3 or F-3 eligible issuers, as the rule stands currently.

Rule 139 allows a broker or dealer participating in a distribution of securities of a seasoned issuer to publish research regarding the issuer of any class of securities if distributed with "reasonable regularity in the normal course of business." Under the proposals, reports could 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.

The proposals also seek to remove the prohibition on a broker giving a more favorable recommendation than the one it made in a prior publication. Under the proposals, however, the reports must contain information similar to the type contained in prior reports.

In addition, the proposals provide that research reports under Rules 138 and 139 will not be considered general solicitations or offers in connection with Rule 144A offerings. The proposals also seek to codify the SEC's current position that publication or dissemination of research under Rules 138 and 139 is permitted in connection with registered offerings, subject to the proxy rules.

Exchange Act Report Disclosure

The proposals make changes with respect 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, a requirement is proposed that an accelerated filer, including a WKSI, 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.

Submission of Comments

In order to be given consideration, comments on the proposals must be received by the Commission on or before January 31, 2005.

Lack of Private Offering Proposals

It is worth noting that there are no proposals related to private offerings or integration concepts of offering reform. The Commission staff has indicated that reforms to private offerings may be proposed in the future.

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

Washington, D.C.	David A. Sirignano	202.739.5420	dsirignano@morganlewis.com
New York	Stephen P. Farrell	212.309.6050	sfarrell@morganlewis.com