

## SEC Approves Securities Offering Reforms

On July 19, 2005, the SEC released new rules and regulations governing registered securities offerings. The new rules, which will take effect in late November, address five principal areas: (1) communications; (2) liability; (3) registration procedures; (4) prospectus delivery; and (5) Exchange Act disclosure.

### Categories Of Issuers

The rules divide the world into several categories of issuers. How the rules affect an issuer depends upon the category in which it falls.<sup>1</sup>

- **Well-Known Seasoned Issuer.** A well-known seasoned issuer (a “WKSI”) is a company that has been timely in its Exchange Act reporting obligations for the preceding 12 months and either has at least \$700 million of public float or has issued \$1 billion aggregate amount of non-convertible securities, other than common stock, in registered offerings for cash during the past three years.
  - A company qualifying under the \$1 billion standard is a WKSI only for purposes of issuing additional non-convertible securities, other than common stock, unless it also qualifies as a seasoned issuer (see below).
  - Because they are not offerings for cash, exchange offers by high-yield issuers do not count for WKSI status.
- **Reporting Issuer.** A reporting issuer is a company that is required to file Exchange Act reports.
  - **Seasoned Issuer.** A seasoned issuer is a reporting issuer that is eligible to use Forms S-3 or F-3 to register primary offerings of securities (i.e., one-year reporting history and \$75 million of public float). A seasoned issuer is what we now refer to as a primary S-3 eligible issuer.
  - **Unseasoned Issuer.** An unseasoned issuer is a reporting issuer that does not satisfy the requirements of Forms S-3 or F-3 for primary offerings.
- **Non-Reporting Issuer.** A non-reporting issuer is a company that is not required to file Exchange Act reports.

### Communications

Perhaps the most significant changes are the new rules that provide relief from restrictions on pre-filing and waiting period communications in connection with registered capital-raising transactions. The new rules generally subject market participants to liability for the substance of these communications, unlike the existing rules which premise liability on the fact that the communications were made.

- **WKSI Pre-Filing Offer Exemption.** A WKSI is permitted to make oral and written offers at any time before a registration statement is filed.

<sup>1</sup> Investment companies, shell companies, blank-check companies, penny stock issuers, limited partnerships (other than in firm commitment underwritings), and issuers captured by “penalty box” provisions do not benefit from most of the liberalized communications, registration procedures, and prospectus delivery requirements.

- Any such written offer will be considered a free writing prospectus and must comply with the conditions for use of a free writing prospectus described below. The 30 day safe-harbor described below provides relief for all communications other than those that specifically refer to an offering.
- Pre-Filing Communications. Communications by any issuer more than 30 days before filing a registration statement will not violate the gun jumping rules if the communications do not reference a securities offering and the issuer takes reasonable steps to prevent further distribution or publication during the 30-day period.
- Safe-Harbor for Reporting Issuers. A reporting issuer is permitted to publish, at any time, regularly released factual business information and forward looking statements.
  - “Factual business information” is defined as (i) factual information about the issuer, its business or financial developments, or other aspects of its business; (ii) advertisements of, or other information about, the issuer’s products or services; and (iii) dividend notices.
  - “Forward looking information” is as (i) projections of the issuer’s revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items; (ii) statements about management’s plans and objectives for future operations, including those related to the issuer’s products or services; (iii) statements about the issuer’s future economic performance, including statements of the type contemplated by MD&A; and (iv) assumptions underlying or relating to any of the foregoing.
  - This rule essentially codifies existing practice and, importantly, is a safe-harbor, rather than an exclusive exemption.
- Safe-Harbor for Non-Reporting Issuers. A non-reporting issuer is permitted to publish, at any time, factual business information that is regularly released and intended for use by persons other than in their capacity as investors or potential investors.
- “Free Writing Prospectuses.” The rules establish a new category of written communications called “free writing prospectuses,” which are written offers that do not include all the information required in a statutory prospectus.
  - A WKSI may use a free writing prospectus at any time, including prior to filing a registration statement.
  - A seasoned issuer may use a free writing prospectus after filing a registration statement that contains a statutory prospectus.
  - An unseasoned or non-reporting issuer may use a free writing prospectus after filing a registration statement that contains a statutory prospectus but, generally, must deliver that prospectus to the recipient of a free writing prospectus prior to or concurrently with delivery of the free writing prospectus.
  - Most free writing prospectuses must include a legend directing investors to the registration statement and must be filed with the SEC.
- Recorded Road Shows. The new rules provide that recorded road show presentations are free writing prospectuses.
  - Recorded road show presentations used in an initial public offering of common stock or convertible equity securities must be filed unless the issuer makes a version available electronically to an unrestricted audience.
  - Recorded road shows used in other types of registered capital raising transactions generally do not need to be filed.
- Expansion of Rule 134 Notices. Rule 134, which provides for limited public notices about an offering after a registration statement is filed, has been amended to permit (i) increased information about an issuer and its business,

including where to contact the issuer; (ii) more information about the terms of the securities being offered; (iii) more factual information about the offering, including underwriter information, the mechanics of and procedures for transactions in connection with the offering process, the anticipated schedule of the offering, and a description of marketing events; (iv) more factual information about procedures for account opening and submitting indications of interest and conditional offers to buy; (v) more information about directed share programs, and (vi) the inclusion of the security rating that is expected to be assigned.

## Liability

The expanded communication methods come with some cost. The new rules clarify and, in some cases, expand Securities Act liability for written communications.

- **Free Writing Prospectus.** A free writing prospectus will be subject to prospectus liability under the Securities Act, but, because a free writing prospectus will not be deemed part of an issuer's registration statement, it will not be subject to the more stringent liability provisions relating to registration statements.
- **Liability Determined at Time of Sale.** New Rule 159 codifies the SEC's position that, for purposes of prospectus disclosure liability under Sections 12(a)(2) and 17(a)(2) of the Securities Act, liability is based on the information that has been conveyed to an investor at or prior the time of sale.
  - Information conveyed after the time of sale (e.g., an update made in a final prospectus, prospectus supplement, or Exchange Act filing,) is not taken into account in evaluating the adequacy of information available to the investor at the time the investment decision was made.
- **Rule 159 does not affect Section 11 liability.** Final prospectuses, prospectus supplements, and Exchange Act reports may be deemed part of the registration statement even though they are not made available to purchasers before the contract of sale.
- **Liability on Shelf Takedowns.** The new rules codify the SEC's position that a prospectus supplement for a shelf takedown is deemed part of the registration statement and, consequently, subject to Section 11 liability.
  - The undertakings required for use of Rule 430B provide that the issuer agrees that the date a prospectus supplement is first used or, if earlier, the time of the first contract of sale represents a new registration statement effective date for purposes of determining issuer and underwriter liability under Section 11.
  - The reference date for determining Section 11 liability of directors, officers, and experts - the most recent effective date or the filing date of the Form 10-K - does not change.

## Registration Procedures

The SEC has moved to modernize and streamline the shelf registration process for most types of reporting issuers by enacting the following reforms:

- **Rule 415 Amendments.** The SEC has made several revisions to the shelf offering process under Rule 415.
  - For offerings other than business combination transactions and continuous offerings not registered on Form S-3 or F-3, the SEC has eliminated the restriction that an issuer register no more than the amount it in good faith believes it will sell during the next two years. That restriction, however, has been replaced with a three-year expiration date.

- The SEC is permitting an issuer to conduct a primary offering on Form S-3 or F-3 immediately after effectiveness of a shelf registration statement that omits information permitted by Rule 430B, eliminating uncertainty about so-called “convenience” shelf registrations.
- The SEC is eliminating restrictions on at-the-market offerings for seasoned issuers.
- The SEC is expanding the classes of majority-owned subsidiaries of seasoned issuers eligible to register offerings of non-convertible securities or guarantees on Forms S-3 and F-3 to include direct and indirect “sister” subsidiaries.
- Automatic Shelf Registration for WKSIs. WKSIs will be permitted to register unspecified amounts of different securities for either primary or secondary offerings on Forms S-3 or F-3 that become effective upon filing. A WKSI may pay filing fees at the time of each takedown.
  - These rules will allow the base prospectus to omit the names of any selling security holders and the description of the plan of distribution.
    - As a result, only a barebones base prospectus will need to be included in these types of registration statements.
  - A WKSI also will be permitted to add by means of a post-effective amendment new classes of securities or securities of an eligible subsidiary to an automatic shelf registration statement at any time prior to the sale of those securities.
- Identification of Selling Security Holders Following Effectiveness. The new rules permit seasoned issuers to use prospectus supplements, rather than post-effective amendments, to identify selling security holders whose securities were outstanding before the initial filing of the resale registration statement but who were not named in the initial filing.
  - This welcome change will eliminate the requirement that the SEC staff has imposed in resale registrations for Rule 144A convertible note offerings, for example, to name subsequent selling security holders only by means of post-effective amendments.
- Expanded Use of Incorporation By Reference. The new rules amend Forms S-3 and F-3 to expand the information that may be incorporated by reference from Exchange Act reports or contained in a prospectus supplement.
  - The undertakings applicable to these forms, for example, generally will no longer require that a material change in the description of the plan of distribution contained in a base prospectus be reflected in a post-effective amendment.
  - An unseasoned issuer that has filed at least one annual report and is current in its reporting obligations will now be permitted to incorporate Exchange Act reports by reference into a Form S-1 or Form F-1.
    - Although marketing considerations will drive the level of detail an issuer and its underwriters choose to provide, this change substantially decreases the required disclosure in these registration statements.
    - As a result, Form S-2 has been eliminated.

## Prospectus Delivery

Under the current rules, a final prospectus has to accompany or precede both a written confirmation of sale and the delivery of the security. The new rules modify this regime through an “access equals delivery” policy for final prospectus-

es in most capital raising transactions. New Rule 172 provides that a final prospectus is deemed to precede or accompany the confirmation, an allocation notice, or delivery of a security if the final prospectus is filed within the time period contemplated by Rule 424. In addition, new Rule 173 allows a notice of the sale to be sent to purchasers within two days after the sale in lieu of a final prospectus.

## Exchange Act Disclosure

The rules mandate the following additional Exchange Act disclosures:

- **Risk Factor Disclosure.** Annual Reports on Form 10-K will now have to contain plain English risk factors, if appropriate. This risk factor disclosure is the same type required by Item 503 in a Securities Act registration statement and is consistent with the current practice of many issuers. Issuers do not have to repeat the risk factors in their quarterly reports but are required to provide quarterly updates of material changes.
- **Disclosure of Outstanding Staff Comments.** The new rules mandate that accelerated filers and WKSIs disclose in their annual reports on Form 10-K any unresolved material written comments of the Staff that were issued more than 180 days before the end of the fiscal year to which the report relates.
- **Disclosure of Voluntary Filer Status.** The cover page of Forms 10-K and 20-F will now include a box to be checked by any issuer that is filing such reports voluntarily.
- **Disclosure of WKSI Status.** The cover page of Forms 10-K and 20-F will now include a box to be checked by any issuer that qualifies as a WKSI.

