SEC Approves Securities Act Rules Reform

On June 29, 2005, the SEC adopted revisions to the rules and regulations governing registered securities offerings. Although at the open meeting the SEC indicated the rules were being adopted substantially as proposed in the Fall of 2004, because the SEC has not yet published the final rules, the information in this SEC Alert is based on the proposed rules and the discussions at the open SEC meeting at which they were adopted.

The new rules address five principal areas:

- communications;
- liability;
- registration procedures;
- prospectus delivery; and
- Exchange Act disclosure.

The rules divide the world into several categories of issuers, and how the rules affect an issuer depends upon the category in which they fall.

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).

Seasoned Issuer
A seasoned issuer is a company 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).

Reporting Issuer
A reporting issuer is a company that files Exchange Act reports, including a voluntary filer. A subset of reporting issuers are "unseasoned issuers," which are companies that do not satisfy the requirements of Forms S-3 or F-3 for a primary offering.

Non-Reporting Issuer
A non-reporting issuer is a company that is not required to file Exchange Act reports and is not filing such reports voluntarily.

I. Communications

The new rules provide relief from restrictions on pre-filing and waiting period communications in connection with registered capital-raising transactions. The focus of the new rules is generally on subjecting market participants to liability for the substance of communications rather than the fact that the communications were made.

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

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.

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 in the proposing release as (i) factual information about the issuer or some aspect of its business; (ii) advertisements of, or other information about, the issuer's products or services; (iii) factual information about business or financial developments of the issuer; (iv) dividend notices; and (v) factual information set forth in the issuer's Exchange Act reports.
- "Forward looking information" is defined in the proposing release 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) any assumptions underlying or relating to the foregoing.

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 permit use of "free writing prospectuses" which are written offers that do not include all the information required in a preliminary or base prospectus.

A WKSI is allowed to 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 qualifying preliminary or base prospectus.

An unseasoned or non-reporting issuer is permitted to use a free writing prospectus after filing a registration statement that contains a qualifying preliminary or base 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.

Use of a free writing prospectus generally must include a legend directing investors to the registration statement. Most free writing prospectuses also must be filed with the SEC.

Recorded Road Shows
The new rules provide that recorded road show presentations are considered 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 process, including underwriter information, the anticipated schedule of the offering and information relating to road shows; (iv) more factual information about procedures for account opening and submitting indications of interest; and (v) the inclusion of the security rating that is expected to be assigned. The SEC reaffirmed its position that an issuer may not rely on Rule 134 until it has filed a registration statement that contains a qualifying preliminary or base prospectus. In an IPO, for example, Rule 134 is not available until the prospectus includes a price range.

II. Liability

These expanded communication methods come with some cost. 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.

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, the assessment of whether a communication contains a material misstatement or omits to state a material fact necessary to make the statement not misleading is made based on the information conveyed to an investor at the time of the contract of sale. Information conveyed after the time of the contract of sale (e.g., a final prospectus) is not taken into account in evaluating the adequacy of information available to the investor at the time the investment decision was made. Accordingly, any modifications, corrections or additions that are made available subsequent to the time of the contract of sale, including information contained in a final prospectus, prospectus supplement, or Exchange Act filing, will not be taken into account in determining liability under these sections.

Rule 159 does not affect Section 11 liability. Final prospectuses, prospectus supplements, and Exchange Act reports may still be deemed part of the registration statement even though they are not made available to purchasers before the contract of sale.

New Rule 430B codifies 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. Furthermore, the undertakings required for use of Rule 430B mandate that the issuer agree 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 original effective date, the effective date of the most recent post-effective amendment, or the filing date of the Form 10-K - does not change.

III. 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.

First, for offerings other than business combination transactions and continuous offerings, 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. Accordingly, a new shelf registration state-

ment will need to be filed every three years, but unused securities and fees may be carried over. (The transition provisions, if any, for existing shelf registration statements are not yet known.)

Second, 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 regarding so-called "convenience" shelf registrations.

Third, the SEC is eliminating restrictions on at-the-market offerings for seasoned issuers.

Finally, 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 either pay the entire filing fee in advance or pay the filing fee 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 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 144A convertible note offerings, for example, to name subsequent selling security holders only by means of a post-effective amendment.

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, will no longer require that a material change in 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.

IV. 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 prospectuses. New Rule 172 provides that a final prospectus is deemed to precede or accompany the confirmation or delivery of a security if the final prospectus is filed within the time period required under 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.

V. 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. 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 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 File 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.

Contact Information

If you have any questions or would like to learn more about these rules, please contact your usual legal advisor at Ropes & Gray.