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SEC Adopts Securities Act Reform

On June 29, 2005 the Securities and Exchange Commission ("SEC") adopted final rules modifying communications restrictions and registration procedures for securities offerings under the Securities Act of 1933 ("Securities Act"). You can access the final rule (Release No. 33-8591) on the SEC's Web site at http://www.sec.gov/rules/final/33-8591.pdf. The SEC's Division of Corporation Finance also published a Securities Act Reform Questions and Answers dated Nov. 30, 2005, available at http://www.sec.gov/divisions/corpfin/faqs/securities_offering_reform_qa.pdf.

These new rules became effective on Dec. 1, 2005 and will significantly change the registered offering process for all issuers and underwriters.

The new rules are designed to liberalize permitted communications, rationalize liability timing and improve offering procedures for all issuers. In addition, registration on demand without SEC review will be available for the largest 30 percent of public companies. Attached to this memorandum as Annex A is a list of the key Securities Act rules added or amended in connection with these reforms and the main topic areas they cover. The purpose of this article is to provide a brief summary of the key provisions of these new rules.

New Rules for All Registered Offerings

Overhaul of "Gun-Jumping" Restrictions

The new rules significantly relax restrictions on (1) communications made before the filing of a registration statement and (2) written communications during the period between a registration statement's initial filing and its effectiveness. Under the old rules, communications prior to filing were at risk of being treated as prohibited offers, and written communications after filing but prior to effectiveness were at risk of being treated as nonconforming prospectuses. Violations of these restrictions have historically been referred to as "gun-jumping."
Under the new rules:

- all issuers will be able to publish regularly released factual business information at any time during the registration process, and reporting companies (other than voluntary filers) will be able to publish regularly released forward-looking information while in registration;
- communications by issuers more than 30 days before filing a registration statement will not be considered a

prohibited offer, so long as the communications do not reference a securities offering and the issuer takes reasonable steps to prevent further distribution of the communication during the 30-day pre-filing period;

- communications about certain procedural matters after the filing of a registration statement will be expressly permitted, such as the anticipated schedule for an offering or instructions on how to open an account to purchase securities in the offering; and
- well-known seasoned issuers ("WKSIs") (as defined below on page 5 under "Special Rules for WKSIs") will be able to make pre-filing offers at any time without violating gun-jumping restrictions.

This new 30-day bright-line approach to gun-jumping questions, taken together with the other new permissive safe harbors, will make life much easier for all issuers.

Free Writing Prospectuses

Under the new rules, after the filing of the registration statement, all issuers and offering participants (other than certain "ineligible issuers")[1] will be able to use written or electronic communications as part of the sale process even if the communications do not meet the requirements of a statutory prospectus. These communications are known as "free writing prospectuses."

All free writing prospectuses will be subject to liability under the antifraud provisions of the federal securities laws, including Section 12(a)(2) liability. Free writing prospectuses will not, however, be subject to Section 11 liability unless filed as part of the registration statement.

Filing Requirements

The use of free writing prospectuses requires:

- filing any free writing prospectus prepared by or on the behalf of the issuer;
- filing information provided by and about the issuer and contained in anyone else's free writing prospectus;
- filing any free writing prospectus that an underwriter or other third party broadly disseminates (which does not include distribution via restricted Web site or via email to customers, regardless of the number of customers receiving the email distribution); and
- retaining copies of each free writing prospectus used and not filed for three years.

In other words, issuers will be required to file with the SEC (1) any written or electronic information distributed by them that constitutes an offer outside the statutory prospectus and (2) similar materials distributed by other members of the deal team, subject to one important exception. The exception provides that information prepared by someone other than the issuer merely on the basis of issuer information need not be filed.[2]

Finally, because a free writing prospectus cannot conflict with the registration statement, we expect that issuers will elect to include in a free writing prospectus the information in the registration statement in all marginal cases. As a result, the contents of any free writing prospectus will likely end up in the registration statement and, therefore, are subject to Section 11 liability in most cases.

Road Shows

Pre-recorded electronic road shows are considered free writing prospectuses but do not have to be filed (except in the IPO context under certain circumstances, as discussed below on page 4 under "New Rules for IPOs"). In contrast, a real-time communication to a live audience, including a road show presentation, is deemed to be an oral communication, whether via videoconference or otherwise, and is, therefore, not a free writing prospectus and is not required to be filed.

Term Sheets

With the introduction of free writing prospectuses, the new rules permit the use of term sheets in any securities offering (not just the Rule 434 term sheets used

principally in asset-backed securities offerings). Although all term sheets will be considered free writing prospectuses, only final term sheets will need to be filed. An issuer using a term sheet would have to file the final term sheet within two days after the date the terms became final or two days after the date of first use, whichever is later.

Cross-Liability

The rules as proposed raised significant questions regarding cross-liability issues that may arise where one member of the deal team uses a free writing prospectus that the other deal team members did not use. To address these concerns, the new rules provide that a member of the deal team (such as one member of an underwriting syndicate) will not be liable under Section 12(a)(2) of the Securities Act for a free writing prospectus used by another deal team member unless the first deal team member:

- used or referred to the free writing prospectus in offering or selling the securities;
- offered or sold securities and participated in planning for the other deal team member's use of the free writing prospectus; or
- is required to file the free writing prospectus (which for underwriters is limited to free writing prospectuses that are broadly disseminated on an unrestricted basis).

Liability at Point of Sale

Under the new rules, information conveyed to a purchaser only after the time of the contract of sale will not be taken into account for purposes of determining liability for a materially misleading misstatement or omission under Section 12(a)(2) or Section 17(a)(2) of the Securities Act.[3] Liability under Section 12(a)(2) or Section 17(a)(2) will thus be assessed based *only* upon information conveyed to investors *at* or *before* the time of an investment decision.

As a result, it will not be sufficient to deliver an accurate and complete final prospectus after pricing but prior to closing. Deal teams will need to conclude that prospective purchasers have received all relevant information before pricing the offering and confirming orders.

This change in liability timing introduces one potential use for free writing prospectuses that may become commonplace. When material developments arise between circulation of the preliminary prospectus and pricing, the issuer will need to communicate the new information to the market before entering into a contract of sale for the securities. We would expect to see free writing prospectuses used during this period in IPOs, in conjunction with a pre-effective amendment to the registration statement, to correct or update the information previously provided.

For example, if an issuer's earnings become available during the road show, a free writing prospectus could be circulated to all prospective purchasers including a copy of the earnings release or the recent results paragraph that will appear in the final prospectus. This approach would allow a preliminary prospectus to be updated by distributing a few changed pages rather than recirculating a complete new preliminary prospectus (and, if the distribution occurred electronically, the update could include a hyperlink to the corresponding pre-effective amendment to the registration statement). As a result, underwriters may begin to collect email addresses as part of their normal road show procedures to facilitate the electronic circulation of free writing prospectuses where necessary.

Issuers using incorporation by reference can satisfy their updating obligation simply by filing a Form 8-K or submitting a Form 6-K including a press release relating to the material development. We would expect this practice to continue for issuers using Form S-3 or Form F-3.

Incorporation by Reference into Form S-1 and Form F-1

The new rules will allow reporting companies (other than voluntary filers) that are current in their filings under the Securities Exchange Act of 1934 ("Exchange Act") to

incorporate previously filed Exchange Act reports into registration statements on Form S-l and Form F-1. The SEC is accordingly eliminating Form S-2 and Form F-2 (which were seldom used).

Prospectus Delivery

The new rules no longer require physical delivery of a final prospectus. Filing a final prospectus with the SEC via EDGAR will satisfy the delivery requirement, which means that issuers generally will no longer be required to print final prospectuses.

New Rules for IPOs

The new IPO rules provide that issuers:

- may continue to publish factual business information that is regularly released to persons other than in their capacity as actual or potential investors, consistent with past practice and with the same employees making the communications (which means that the CEO cannot suddenly start making statements that lower-level employees made previously);
- cannot use a free writing prospectus prepared or paid for by the issuer or any other offering participant unless a statutory prospectus accompanies or precedes the free writing prospectus (which means that free writing prospectuses cannot be used in an IPO until the issuer has filed a price range), although this requirement can be satisfied via hyperlink in a free writing prospectus distributed by e-mail; and
- must, in any IPO of common equity or convertible securities, file a copy of any pre-recorded electronic road show used in the marketing process (live road shows are not covered by this rule) unless the issuer makes at least one version of a bona fide electronic road show readily available to an unrestricted audience (for example, on its Web site).

As a result, every pre-recorded IPO road show will have to be either posted to the issuer's Web site or filed with the SEC.

New Rules for Shelf Registrations and Takedowns

The new rules contain a number of innovations designed to modernize the shelf registration process for all eligible issuers. These changes will eliminate previous barriers to the use of shelf programs and will make shelf registration significantly more attractive for all issuers, particularly for WKSIs (as discussed below on page 5 under "Special Rules for WKSIs").

The shelf changes available to all issuers include the following improvements:

- one rule (Rule 430B) now codifies the information that an issuer may exclude from its base prospectus in a shelf registration statement and include in later filings;
- issuers eligible to use Form S-3 or Form F-3 may keep a shelf registration statement in place for three years and are no longer required to register only securities that the issuer intends to offer within two years or any given time period (although the two-year rule remains in place for shelf registration statements that are not on Form S-3 or Form F-3);
- restrictions on Rule 415(a)(4) "at-the-market" offerings will be eliminated (which means that issuers will be able to conduct these offerings without identifying the underwriters in the registration statement and without any volume limitation);
- issuers eligible for a primary offering on Form S-3 or Form F-3 may use a prospectus supplement to:
  - make material changes to the plan of distribution described in the base prospectus; and
  - identify new selling security holders, provided that the securities they wish to sell were outstanding when the registration statement was filed; and
- issuers may make fundamental change disclosures via prospectus supplement, which will eliminate the

cumbersome post-effective amendment procedures previously required for such disclosures.

As a result of these changes, the shelf registration process will be more streamlined for all issuers and a number of procedural obstacles to assessing the public securities markets will be eliminated.

Special Rules for WKSIs

Some of the most dramatic changes in the new rules are available only to WKSIs. These are the select issuers that, in addition to being eligible for a primary offering on Form S-3 or Form F-3, have either:

- $700 million of unaffiliated public common equity float (on a worldwide basis); or
- $1.0 billion in aggregate principal amount of non-convertible securities (such as debt) registered and issued for cash in the preceding three years.[4]

Voluntary filers are excluded from the definition of WKSIs since they are not subject to the full range of investor protection regulation.

The special benefits afforded to WKSIs (which represent approximately 30 percent of all listed issuers) include:

- automatically effective shelf registrations (although issuers that qualify as WKSIs based on their registered debt will be limited to registrations of non-convertible debt unless they have an unaffiliated common equity float of $75 million or more) that require less information in the base prospectus (e.g., the base prospectus may omit the plan of distribution);
- the ability to register an unspecified amount of securities on an automatically effective Form S-3 or Form F-3 registration statement, with filing fees structured on a pay-as-you-go basis (i.e., payment will only be required at the time of each shelf take down); and
- the ability to use free writing prospectuses at any time (unlike other issuers, which can use free writing prospectuses only after filing of a registration statement).

In other words, WKSIs will be able to register securities offerings immediately without SEC review and will be free at any time to make offers to sell securities before filing a registration statement without regard to previously applicable gun-jumping restrictions.

New Exchange Act Reporting Requirements

The new rules also require additional disclosures in Exchange Act reports:

- risk factors will be required as part of the annual report on Form 10-K or Form 20-F (and will need to be updated in Form 10-Q filings);
- accelerated filers and WKSIs must disclose in their annual reports on Form 10-K or Form 20-F if, more than 180 days before the end of the fiscal year to which the Form 10-K or Form 20-F relates, the SEC staff issued material comments that remain unresolved at the time of the filing; and
- voluntary filers under the Exchange Act must disclose their status as such by checking a box on the cover page of their periodic reports.

Conclusion

These new rules significantly changed the existing securities offering regulations. Gun-jumping issues will be more limited and problems that arise will be easier to address. Free writing prospectuses will give issuers an unprecedented ability to communicate with investors during the offering process and, where necessary, will permit offerings to be updated in real time without recirculation. Road shows will likely become publicly accessible in IPOs. Offerings by WKSIs will not be subject to advance SEC review.

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To some extent, it remains to be seen whether the underwriting community will embrace these new freedoms, not all of which come without a price. For example, free writing prospectuses are subject to liability under Section 12(a)(2) and Section 17(a)(2) of the Securities Act, and it is unclear whether the new rules adequately address cross-liability for members of the deal team who are not involved with a free writing prospectus used by another deal team member. Free writing prospectuses could become commonplace or may be used only in isolated circumstances.

Taken together, the new rules are designed to make registered offerings more user-friendly. However, it will take some time for issuers and the underwriting community to adjust to these important regulatory changes.

[1] The free writing prospectus provisions do not apply to "ineligible issuers," which include issuers that (1) are not current in their Exchange Act reports (other than enumerated Form 8-K filings); (2) filed for bankruptcy within the last three years; (3) were, in the last three years, blank check companies, shell companies (other than business combination shells) or penny stock issuers; and (4) fall into other enumerated categories.

[2] Where the rules require a free writing prospectus to be filed, the free writing prospectus does not have to be filed as part of the registration statement, although the filing must identify the registration statement to which the free writing prospectus relates.

[3] The new rules provide that Section 11 liability will continue to be measured, consistent with current practice, based upon information provided at the time of effectiveness or when the information becomes part of the registration statement.

[4] In addition to debt securities, the $1.0 billion threshold will cover any non-convertible securities other than common equity. Both of the thresholds for WKSI eligibility will be measured as of a date within a 60-day window period (similar to the window used for Form S-3 and Form F-3 eligibility) of the latest of the issuer's most recent (1) filing of a shelf registration statement; (2) amendment to a shelf for Section 10(a)(3) purposes; or (3) Form 10-K or Form 20-F, if in the last 16 months the issuer has filed neither a shelf nor a Section 10(a)(3) shelf amendment.

Annex A

Securities Act Rule	Topic
Rule 134	Public notices regarding an offering not deemed a prospectus
Rule 163	Exemption of well-seasoned issuers from restrictions on offers before filing of a registration statement
Rule 163A	Exemption from restrictions on communications made more than 30 days before filing of a registration statement
Rules 168 and 169	Safe harbor for certain communications of regularly released factual business and forward-looking information
Rules 164 and 433	Free writing prospectuses
Rule 405	Definition of certain terms ("automatic shelf registration statement," "free writing prospectus," "ineligible issuer," "well-known seasoned issuer" and "written communication")
Rules 137, 138 and 139	Publications or distributions of research reports
Rules 415, 430B, 430C, 456 and 462	Shelf registrations (including automatic shelf registrations)
Rules 172 and 173	Prospectus delivery requirements

For further information regarding these rules and how they will affect your company, please contact Eric Schoenborn at 856-321-2413 or eschoenborn@stradley.com.

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