PROSKAUER ROSE LLP®

Client Alert

A report for clients and friends of the firm

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SEC Proposals for Offering Reform

In recognition of evolving technological and capital markets developments, the Securities and Exchange Commission has proposed to relax restrictions on communications in connection with registered public offerings and to facilitate registration and other procedures in the public capital formation process.[1]

On November 3, 2004, the SEC issued extensive proposals to reform the public offering process (the "Offering Reform Proposals") under the Securities Act of 1933 (the "'33 Act") (Rel. 33-8501). Among other things, these proposals would permit freer communications during the "pre-filing," "waiting" and "quiet" periods of a public offering. The proposals would permit well known seasoned issuers, as defined, to market securities on their own time schedules and simplify compliance with the disclosure requirements of the '33 Act by other issuers, while imposing fewer restrictions on research reports by offering participants other than the issuer, including underwriters and dealers. The price for the relaxation of these '33 Act requirements would be increased filing requirements and liability exposure and, for some issuers, additional disclosure requirements under the Securities Exchange Act of 1934 (the "'34 Act").

The proposing release has 389 pages of text; contains 457 footnotes; includes proposals to adopt or amend 40 rules, to amend 12 registration or reporting forms, and to rescind two registration forms; and requests comments on hundreds of questions, the responses to which could result in significant changes to any rules that are finally adopted. The text and the footnotes include currently applicable SEC interpretations of provisions of the '33 Act and related rules, as well as interpretations of the proposed rules.

The 75-day comment period on these proposals will end on January 30, 2005. It can be expected that the SEC may need several months thereafter to digest the comments and act on the proposals. While we expect that many of the proposals will be well received, the proposals are lengthy, complex and interrelated and some may be controversial — particularly those relating to liability. Thus, while we expect some form of these proposals to be adopted in 2005, their final form cannot be predicted. Moreover, the makeup of the SEC could change significantly by the time any final rules are submitted for adoption, making any prediction of the ultimate outcome even more difficult. Accordingly, this Client Alert is only a brief summary of the proposals.

Background

To understand the SEC's proposals, one first must understand the provisions of Section 5 of the '33 Act. The basics, in simplified form, are:

- ***The pre-filing period.*** Before a registration statement is filed,[2] no "offers," written or oral, are permitted.[3]

- ***The waiting period.*** After a registration statement is filed but before it becomes effective, written offers must be in the form of a prospectus (either a "preliminary prospectus," "prospectus subject to completion" or "statutory prospectus") that satisfies the provisions of Section 10 of the '33 Act. Oral offers are permitted.[4]

1 The SEC separately is considering improvements in the private offering process.

2 Determining when the pre-filing period begins requires a facts and circumstances analysis. For example, beginning substantive discussions with a prospective underwriter may trigger the commencement of the period.

3 Publication of specified limited information about a proposed offer before a registration statement is filed is permitted by current Rule 135, which would still be applicable if the proposals are adopted.

4 Statements published after a registration statement is filed and conforming with current Rule 134 could be offers but are not prospectuses. As revised by the proposals, Rule 134 would continue in effect.

- *The quiet period.* After the registration statement becomes effective, written offers and delivery of the registered securities must be preceded or accompanied by a final prospectus that satisfies the provisions of Section 10(a) of the '33 Act. Moreover, during a specified period (the so-called "quiet period"), dealers selling the security must deliver a final prospectus to their customers in connection with the sales.

A violation of Section 5, at worst, can result in civil or even criminal liability and can delay an offering as the result of an SEC staff-imposed cooling-off period. In addition, the liability provisions of Sections 12(a)(2) and 17(a)(2) of the '33 Act apply to both written and oral offers, as well as to sales.

In the Offering Reform Proposals, the SEC has attempted to clarify the meaning of key terms — offer, written communication, prospectus and related terms — in a manner believed to facilitate capital formation without sacrificing investor protection. The SEC also has proposed amendments to its safe harbor rules for analysts' reports issued during a registered offering (Rules 137, 138 and 139 (the "130 Series Rules") and certain related rules). This Client Alert only addresses the 130 Series Rules as they directly affect issuers. The 130 Series Rules insofar as they affect other offering participants will be addressed more comprehensively in a separate Proskauer Rose Client Alert.

Some Important Definitions

The Offering Reform Proposals would define important terms, such as "offer" and "prospectus," that are critical to an understanding of the proposals and their impact on the public offering process.

Offer

The term "offer" is defined in Section 2(3) of the '33 Act as "any attempt to offer to dispose of, or solicitation of an offer to buy, a security or an interest in a security, for value." The SEC and the courts have interpreted this term broadly, and it clearly goes beyond the common law concept of an offer. Publicity efforts before the filing of a registration statement that have the effect of conditioning the market for the issuer's securities or arousing public interest in the issuer or its securities — so-called gun jumping — constitute offers in violation of Section 5.

The SEC observed in the proposing release that even "regularly released factual business information" and "regularly released forward-looking information" or a communication made more than 30 days before a registration statement is filed,[5] although not prospectuses, could be offers, as defined in Section 2(3) of the '33 Act and, thus, could be subject to liability under the '33 Act. However, proposed Rule 163A provides that, if they do not reference a securities offering, these communications would not constitute "offers" for purposes of Section 5(c) of the '33 Act, which prohibits offers during the pre-filing period. Moreover, these communications would not constitute prohibited prospectuses for purposes of Section 5(b)(1) of the '33 Act, which prohibits the use of a prospectus after a registration statement has been filed and before it becomes effective that does not satisfy the conditions of Section 10 of the '33 Act (*i.e.*, a prospectus that is not a "statutory prospectus"). Written offers by well known seasoned issuers within 30 days of the filing of a registration statement would be "offers" for purposes of Section 2(3) and would be prospectuses for purposes of Section 2(10), but would be "free writing prospectuses" exempt from Section 5(c). A "free writing prospectus" used by an eligible issuer after a registration statement is filed would involve an offer, but would be a permitted prospectus.

The proposed rules would create a safe harbor to permit all reporting issuers to continue to publish regularly released factual business information at any time during the offering process. Non-reporting issuers could publish this type of information at any time during the offering process, as long as it was regularly released to persons other than those in their capacities as investors or potential investors, *e.g.*, customers. Regularly released factual business information could not include information about the registered offering or "information released as part of the offering activities in the registered offering."[6] In order to qualify for the safe harbor, this information (and the "regularly released forward-looking information" discussed below) would have to be released "by or on behalf of the issuer," which, according to the proposing release, means that the issuer or its agent or representative authorized or approved it before its release or dissemination. This condition of the safe harbor is separate from the "regularly released" and "non-offering related" conditions.[7]

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5 An issuer, other than a well known seasoned issuer, would have to take reasonable steps to preclude the republication of this information during the 30 days before the registration statement is filed to avoid violating Section 5. The SEC has asked for comment as to how this requirement should apply to information on web sites. According to the proposing release, historical information on an issuer's web site that is not modified or updated or used or referred to (by hyperlink or otherwise) in connection with the registered offering would not constitute an offer, particularly if that information is identified as such and segregated in a separate section of the web site.

6 Presumably, the quoted phrase, although buried in footnote 84 of the proposing release, is intended to provide the SEC with the flexibility to deal with schemes to avoid the registration provisions of the '33 Act.

7 The proposing release, in Sections III.D.1.a(iii)(B) and (C), contains extensive interpretive guidance with respect to the two latter conditions to the safe harbor that is not included in the proposed rules.

The term "regularly released factual business information" would be defined as:

- ***business information*** — factual information about the issuer or some aspect of its business;
- ***advertisements*** — advertisements of, or other information about, the issuer's products or services;
- ***developments*** — factual information about the issuer's business or financial developments;
- ***dividends*** — dividend notices; and
- ***'34 Act reports*** — factual information set forth in the issuer's '34 Act reports.

The safe harbor for regularly released forward-looking information would not be available to non-reporting issuers. The safe harbor would permit eligible issuers to release this type of information at any time during the offering process. This proposed safe harbor would be in addition to the safe harbor from the anti-fraud provisions of the Federal securities laws for forward-looking information.[8]

The term "regularly released forward-looking information" would be defined as:

- ***projections*** — projections of the issuer's revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;
- ***plans*** — statements about the issuer's management's plans and objectives for future operations, including plans or objectives relating to products or services;
- ***future performance*** — statements about the issuer's future economic performance, including statements contemplated by the MD&A requirements; and
- ***assumptions*** — assumptions underlying or relating to any of the foregoing.

Ordinary course of business-related communications outside of the safe harbor would not be presumed to be offers, but nonetheless might be, depending on the facts and circumstances.[9] Also, communication of business or forward-looking information that does not satisfy the conditions of the safe harbor still may not constitute an "offer" and, in appropriate circumstances, could constitute a "free writing prospectus," rather than an illegal offer or a prohibited prospectus.

Communication of material, non-public factual business information and forward-looking information would continue to be subject to the SEC's "fair disclosure" regulation, Regulation FD, and, unless a safe harbor is available, the anti-fraud provisions of the Federal securities laws. In addition, there is an issue as to whether the SEC staff will require that these types of information, particularly forward-looking information, be included as part of the registration statement and thus subject to Section 11 liability, as well as possible liability under Sections 12(a)(2) and 17(a)(2).

Prospectus

The term "prospectus" is defined in Section 2(10) of the '33 Act as "any prospectus, notice, circular, advertisement, letter, communication, written or by radio or television, which offers any security for sale or confirms sale of any security," with an exception for communications after the effective date of a registration statement that are preceded or accompanied by a prospectus that satisfies the provisions of Section 10(a) of the '33 Act.

If a final prospectus has been filed, the proposals would except certain routine communications from the definition of prospectus or not require them to comply with Section 5(b)(1) of the '33 Act. These routine communications would include:

- ***confirmations of sale*** — confirmations of sale containing only the information required by '34 Act Rule 10b-10 and certain other routine information;
- ***allocations*** — notices of allocations of securities; and
- ***pricing and settlement*** — pricing and settlement information.

The SEC has proposed to expand the information permitted in notices pursuant to Rule 134, which are communications not deemed a prospectus after a registration statement has been filed.[10] The expanded information permitted in these notices includes:

- ***business*** — increased information about the issuer and its business;

8 *See* Section 27A of the '33 Act, Section 21E of the '34 Act, Rule 175 and related SEC rules and pronouncements. This safe harbor is not available for non-reporting issuers, but the SEC asked for comments as to whether it should exercise its rule-making authority to make this safe harbor available to non-reporting issuers.

9 Proposing release footnote 83.

10 The proposed amendments to Rule 134 would not be available to registered investment companies and business development companies.

- ***securities*** — more information about the securities being offered but not a detailed term sheet (under the proposals, such a term sheet could be communicated as a "free writing prospectus");

- ***offering*** — more information about the offering, including its mechanics and scheduling;

- ***customer accounts*** — offering participant customer account opening and other account-related information; and

- ***security ratings*** — additional information about security ratings.

Under the proposals (proposed Rules 163, 164 and 433), a "free writing prospectus" is a prospectus that, if used by a well known seasoned issuer before the filing of a registration statement, satisfies the conditions of Rules 163 and 433 and, if used by others after a registration statement is filed, satisfies the conditions of proposed Rules 164 and 433. A free writing prospectus is not part of the registration statement. As discussed above, the proposed rules would expand the use of a free writing prospectus to a varying extent, depending on the classification of the issuer.

A free writing prospectus used by an issuer would be required to be filed as described under "Other Pitfalls" below. A free writing prospectus would have to be retained for at least three years under the record retention proposals discussed below. A free writing prospectus also would be required to satisfy a legend condition.

The following would not be free writing prospectuses and thus would not be required to be filed with the SEC:

- ***historical information and regularly released information*** — historical information on an issuer's web site, "regularly released factual business information" and "regularly released forward-looking information," each discussed above under "Offer";

- ***certain permitted notices*** — notices permitted by Rule 134 or 135 and the routine types of information discussed above;

- ***research reports*** — research reports permitted under the 130 Series Rules; and

- ***term sheets*** — term sheets permitted by Rule 434 would not be free writing prospectuses, although the SEC has asked for comment on the possible elimination of that rule.

Underwriters and other market participants could use free writing prospectuses after a registration statement is filed. In the case of an offering by a non-reporting issuer, the free writing prospectus generally would have to be preceded or accompanied by a Section 10 prospectus. In the case of other offerings, such a prospectus (other than a summary prospectus, which would not satisfy this requirement) would have to be "available" (*i.e.*, on file with the SEC).

In order to qualify as a free writing prospectus, a communication must be written. "Written communications" would be all communications other than oral communications, including written, printed and broadcast communications. "Graphic communications," as defined in the proposals, would constitute written communications. "Graphic communications" would include all electronic communications, including audio tapes, video tapes, CD-ROMs, electronic mail, Internet websites, computers, computer networks and other forms of computer data compilation, except that, as indicated above, communications that are not broadcast or otherwise redistributed electronically are oral communications. Live communications, whether by telephone, the Internet or some other medium, would be oral communications. In addition, as discussed below, "live" road shows could be oral communications.

Since oral offers are permitted after a registration statement is filed, it is necessary to determine whether a road show constitutes a written communication, including a graphic communication, or an oral communication. Historically, road shows have been considered oral communications, if certain conditions are satisfied. Under the proposals, depending on the circumstances, a road show could be either a written communication, and thus a prospectus (possibly a free writing prospectus), or a permissible oral communication. For a road show to be deemed an oral communication, it would have to be a so-called "live" road show, which is not retransmitted and generally, except for a "*bona fide* electronic road show," as described below, with a limited audience and involving no distribution of written communications. Under the proposals, a "*bona fide* electronic road show" only would require a filing if it included material information not included in a filing with the SEC. The issuer would have to make at least one version of the *bona fide* electronic road show readily available to interested investors simultaneously, and file any previously unfiled material information used during the road show (but not the road show or the script itself). For it not to be deemed a free writing prospectus, a road show with media coverage would have to be a live, open access electronic road show.

Classification of Issuers

The benefits of these proposals, if they are adopted, would depend into which of five classes of issuers a company falls.

Well Known Seasoned Issuers

well known seasoned issuers would benefit the most from the offering reform proposals. A well known seasoned issuer (except for voluntary filers or an asset-backed securities issuer) would be an issuer that:

- ***form eligibility*** — is eligible to register a primary offering of its securities on Form S-3 or F-3 (foreign private issuers); and

- ***market capitalization*** — has outstanding a minimum of $700 million in market capitalization (as determined on the last business day of its second fiscal quarter before its latest annual report) held by non-affiliates or has issued at least $1 billion in debt securities in registered offerings during the past three years and registers only straight debt securities on an "automatic shelf registration statement"; and

- ***not ineligible*** — is neither an ineligible issuer nor engaged in an ineligible offering (*e.g.*, a business combination or asset-backed securities transaction).

Majority-owned subsidiaries of well known seasoned issuers also could qualify as well known seasoned issuers if certain conditions are satisfied.

Well known seasoned issuers, like all issuers, would be able to release information that does not refer to an offering for prior to 30 days before the filing of a registration statement without running afoul of the gun jumping provisions of the '33 Act (the "30-Day Safe Harbor"). However, unlike other issuers, a well known seasoned issuer could also use "free writing prospectuses" during the 30-day period before it files a registration statement. A well known seasoned issuer also could use free writing prospectuses after it files a registration statement and after that registration statement is effective.

Well known seasoned issuers, but not other issuers, could use "automatic shelf registration" procedures. These procedures differ from current "universal shelf registration" procedures in that:

- ***Automatic Effectiveness.*** Automatic shelf registration statements and amendments thereto would be effective on filing, would not be required to include an automatic delaying amendment and would be effective for three years, as long as the issuer remained a well known seasoned issuer at the time the registration statement is updated in accordance with Section 10(a)(3) of the '33 Act.

- ***"Pay As You Go."*** Well known seasoned issuers could pay registration fees as they sell securities "off the shelf," rather than at the time of the initial filing of the registration statement, provided that the registration fee calculation table is included in the prospectus filed under Rule 424(b). Well known seasoned issuers would have to pay a $100 fee when the automatic shelf registration statement initially is filed.

- ***Amounts of Securities.*** Well known seasoned issuers would not be required to specify the amount of securities of each class that they register and could include outstanding securities to be offered by selling security holders without initially identifying them or the amount of securities they intend to sell, which would be impermissible under current "universal shelf registration" rules that require a separate registration statement for these "secondary offerings."

- ***Changes in Classes of Securities and Registrants.*** Well known seasoned issuers could add additional classes of securities and subsidiary registrants by post-effective amendment if certain conditions are satisfied, including signatures by the appropriate officers and directors of the subsidiary registrants.

- ***Access Equals Delivery.*** Well known seasoned issuers and other eligible issuers and offering participants would not be required to deliver "preliminary" or "final prospectuses" if certain conditions were satisfied, including filing the prospectus with the SEC on EDGAR and the offering participants (or the issuer, if there were no offering participants), within two business days after the sale, send a notice to the purchasers that the sale was made pursuant to a registration statement. The purchaser then could request a copy of the final prospectus but it would not have to be delivered before settlement (the "Access Equals Delivery Rule").[11]

A final prospectus only filed would not be considered to be sent or given for purposes of the exception under Section 2(10) of the '33 Act. Therefore, non-reporting issuers and unseasoned issuers could only make written offers after the effective date of a registration statement, if the offer was preceded or accompanied by a paper or electronic copy of the final prospectus.

11 The Access Equals Delivery Rule would not relieve offering participants of their obligations under '34 Act Rule 15c2-8 to deliver copies of preliminary prospectuses in connection with IPOs. The Access Equals Delivery Rule would not be available to registered investment companies or business development companies or for offerings of securities registered on Form S-8, business combination transactions or exchange offers.

Well known seasoned issuers also would benefit from the Offering Reform Proposals that are described under the caption "Other Proposals That Would Benefit Eligible Issuers" below.

Seasoned Issuers

A seasoned issuer would be an issuer eligible to register securities on Form S-3 or F-3 for a primary offering. If certain conditions were satisfied, a majority-owned subsidiary of a seasoned issuer could qualify as a seasoned issuer. Seasoned issuers could benefit from the offering reform proposals described under the caption "Other Proposals That Would Benefit Eligible Issuers" below, but not from the "automatic shelf registration" provisions.

Seasoned issuers would be protected by the 30-Day Safe Harbor, could regularly publish factual business information and forward-looking statements at any time, and would be eligible to use free writing prospectuses after filing a registration statement and after it was effective. They also could rely on the Access Equals Delivery Rule.

Unseasoned Issuers

An unseasoned issuer would be an issuer required to file reports pursuant to Section 13(a) or 15(d) of the '34 Act that does not qualify as a well known seasoned issuer or a seasoned issuer. A "voluntary filer" would be treated as an unseasoned issuer. Unseasoned issuers would not benefit from all of the offering reform proposals described under the caption "Other Proposals That Would Benefit Eligible Issuers" below.

Unseasoned issuers would be protected by the 30-Day Safe Harbor, could rely upon the Access Equals Delivery Rule, with the exception noted above, and could use free writing prospectuses. Unseasoned issuers (and other issuers) ineligible to use Forms S-3 or F-3 also could incorporate previously filed '34 Act reports in Forms S-1 or, for foreign private issuers, F-1 registration statements to satisfy the disclosure requirements of those forms, but "forward incorporation" would not be permitted. Forms S-2 and F-2 would be rescinded.

Non-Reporting Issuers

A non-reporting issuer would be an issuer that is not subject to the reporting provisions of Section 13(a) or 15(d) of the '34 Act; *i.e.*, generally, an issuer making an IPO. Non-reporting issuers generally would not benefit from the offering reform proposals described under the caption "Other Proposals That Would Benefit Eligible Issuers" below.

Non-reporting issuers would be protected by the 30-Day Safe Harbor and could communicate factual business information during the 30 days before filing a registration statement and during the waiting period and the quiet period; could use free writing prospectuses under certain conditions (generally, if preceded or accompanied by a statutory prospectus, which could be satisfied by a hyperlink), and could rely on the Access Equals Delivery Rule, subject to the exception discussed above.

Ineligible Issuers

Ineligible issuers include SEC reporting issuers that have not filed all required reports and CEO and CFO certifications required to be included in those reports; issuers that within the past three years were "blank check companies," "shell companies" or issuers for offerings of "penny stock," all as defined in SEC rules; limited partnerships offering securities by other than firm commitment underwritings; issuers with "going concern opinions" from their auditors; registered investment companies and business development companies; issuers that had been subject to bankruptcy or insolvency proceedings within the past three years, unless the issuer has filed an annual report containing audited financial statements after emerging from such proceeding; issuers that within the past three years had been the subject, or whose subsidiary had been the subject, of specified proceedings for securities laws violations; or issuers registering securities for a business combination transaction. In addition, the SEC has asked for comment as to whether an issuer that has disclosed a material weakness in its internal controls over financial reporting should be treated as an ineligible issuer. Unless the SEC determines otherwise, ineligible issuers would not benefit from the Offering Reform Proposals.

Other Proposals That Would Benefit Eligible Issuers

The Offering Reform Proposals include a number of other offering reforms that would benefit eligible issuers including:

- ***Omissions from Prospectuses.*** The proposals would specify the types of information that could be omitted from the prospectuses for certain types of shelf offerings by well known seasoned issuers and seasoned issuers, including identities of selling security holders if the private offering to them is complete and the private transaction is identified in the prospectus. Selling security holders in "PIPES" offerings still would have to be identified when the registration statement is filed.

- ***Two-Year Limit on Amount of Securities.*** The rule limiting shelf offerings to the amount of securities expected to be sold within two years would be eliminated. However, registration statements for automatic shelf offerings and certain other shelf offerings would only be effective for three years.

- ***At-the-Market Offerings.*** Restrictions on at-the-market offerings would be eliminated.

- ***Convenience Shelf.*** Immediate takedowns off the shelf (a "convenience shelf") no longer would be prohibited.

- ***Plan of Distribution.*** Information about material changes in a plan of distribution could be incorporated by reference from a Form 8-K, rather than included in a post-effective amendment.

- ***Incorporation by Reference.*** All issuer information required by Form S-3 or F-3 could be incorporated by reference to '34 Act reports.

- ***Subsidiaries.*** The categories of majority-owned subsidiaries eligible to use Forms S-3 and F-3 would be expanded.

Research Reports

The proposed amendments to the 130 Series Rules, as they apply to research reports, have been coordinated with the SEC's Regulation AC ("Analyst Certification") and the terms of the so-called "Global Settlement" among various regulators and a number of investment banking firms. These proposals, as they relate to research reports and certain related relief under Rule 144A, Regulation S and the SEC proxy rules, will be the subject of a separate Proskauer Rose Client Alert and are addressed in this Client Alert only with respect to their direct effects on issuers.

Issuers cannot rely on the 130 Series Rules. Thus, if an issuer communication were hyperlinked to a research report, that report, depending upon the circumstances, would become either an issuer free writing prospectus or an impermissible prospectus.[12]

Other Proposals That Could Benefit Offering Participants

Underwriters, selling dealer group members and other offering participants also would benefit from the proposed relaxation of restrictions on communications during the offering process.

- ***Free Writing Prospectuses.*** These offering participants would not have to file free writing prospectuses that they prepare that do not contain information provided by the issuer and that are not designed to be broadly disseminated on an unrestricted basis. Research reports that do not satisfy the provisions of the 130 Series Rules could be free writing prospectuses.[13]

- ***Road Shows.*** Electronic road shows that do not qualify as "live" road shows or *bona fide* electronic road shows would constitute free writing prospectuses and would not have to comply with current SEC staff "no action" positions with respect to road shows. Those no action positions would be withdrawn if the proposals are adopted.

- ***Access Equals Delivery.*** Under the Access Equals Delivery Rule, these offering participants generally would not have to deliver final prospectuses.

- ***Proposed Amendments to Rule 153.*** The SEC has proposed to amend Rule 153 to provide that brokers and dealers effecting transactions on an exchange or through a trading facility (including Nasdaq and "alternative trading systems") registered with the SEC would satisfy their final prospectus obligations if the final prospectus has been filed with the SEC, and securities of the same class as those sold in the offering are traded on the exchange or through the facility.

- ***Confirmations.*** These offering participants generally would not have to deliver paper or electronic copies of final prospectuses with confirmations.

- ***Communications with Customers.*** These offering participants could freely provide their customers with pricing information, allocation information and other non-issuer information without violating Section 5.

New Liability Exposure

The price of public offering reform may be increased liability exposure, particularly for issuers.

Section 5

Failure to comply with the communication-related proposals, if adopted, including the filing, legend and record retention requirements applicable to free writing prospectuses, could result in a violation of Section 5. However, failure to provide a notice that a sale was made pursuant to a registration statement would not vitiate the exemption from prospectus delivery or result in a violation of Section 5.

Failure to comply with the record retention proposals could result in a retroactive violation of Section 5. The implications of such a retroactive violation are not addressed by the SEC. In addition, the consequences to an issuer of an offering participant failing to file a free writing prospectus, if required, are not clear.

12 Proposing release footnote 212.

13 Proposing release footnote 213.

Sections 12(a)(2) and 17(a)(2)[14]

The proposals would impose liability under Sections 12(a)(2) and 17(a)(2) on communications currently thought by many not to be subject to such liability. Since the culpability standard under these sections is negligence, this would represent a significant shift in liability.

Under the interpretation in Section IV.A. of the proposing release, liability under Sections 12(a)(2) and 17(a)(2) would be determined based upon the information provided to an investor before or at the time the investor enters into a contract to purchase, not at the time that information is subsequently conveyed to the investor or filed with the SEC. This interpretation would be codified in proposed Rule 159 and Rule 412 (dealing with superseded information) and would be amended accordingly. The undertakings required by Item 512 of Regulation S-K and Regulation S-B would be amended to complement this and the other liability-related proposals discussed in this Client Alert.

Free writing prospectuses could constitute offers subject to the liability provisions of Sections 12(a)(2) and 17(a)(2).

The proposals would make the issuer a "seller" for purposes of Section 12(a)(2), in circumstances where it currently is not thought by many to be a seller, *e.g.*, in a registered primary offering where the issuer "sells" to the underwriters, not to the ultimate purchasers. Also, communications by an underwriter or dealer, depending upon the circumstances, could be deemed to be by or on behalf of the issuer for liability purposes.

Proposed Rule 159A, coupled with Rule 159, the amended Item 512 undertakings and the Access Equals Delivery Rule, and the failure to define the terms "person purchasing from the seller" and "in connection with primary offerings," could result in virtually continuous issuer Section 12(a)(2) liability without any discernable cutoff. Moreover, the proposed requirement to update risk factors quarterly, discussed below, could transform what Congress (and the SEC) envisioned as defensive disclosure into liability exposure for negligently failing to update a risk factor.

Section 11

Section 11 liability is only imposed on materially misleading information or omissions that are part of the registration statement. The proposals would impose Section 11 liability on information in documents currently not considered by many to be part of a registration statement. Importantly, however, free writing prospectuses, even if filed with the SEC, generally would not be subject to Section 11 liability, as they usually would not be part of the registration statement. Prospectus supplements, including prospectus supplements used in connection with shelf takedowns, would be deemed to be part of the registration statement for purposes of Section 11. Each takedown off the shelf would trigger a new registration statement effective date for purposes of issuer Section 11 liability, which would then correspond to the current effective date for the underwriters' liability. This proposal also would result in a new effective date for purposes of the liability cutoff provisions of '33 Act Rule 158. However, this proposal would not result in a new effective date for registration form eligibility, and generally would not require that expert consents be updated.

Other Pitfalls

There are other pitfalls or traps for the unwary under the Offering Reform Proposals.

- ***Filing requirements.*** The proposals include some rather complex filing requirements for registration statements, post-effective amendments and prospectuses, including free writing prospectuses. An issuer would be required to file a free writing prospectus prepared by it or on its behalf; the information provided by an issuer for use in another offering participant's free writing prospectus, unless included in the registration statement or a previously filed free writing prospectus; any free writing prospectus prepared by an offering participant that the issuer disseminates; and any free writing prospectus that includes the final terms of the issuer's securities. A free writing prospectus prepared by a person other than the issuer, which is distributed in a manner reasonably designed by that person to lead to broad unrestricted distribution of securities, would be required to be filed by that person.

- ***Timing (Rule 424).*** Depending upon the circumstances, the proposals would impose different timing requirements for filing free writing prospectuses[15] as follows:

  - *Issuers.* A free writing prospectus would be required to be filed by issuers on or before the date of first use, except for final terms of securities. Free writing prospectuses used by well known seasoned issuers during the 30 days before the filing of a registration statement would be required to be filed when the registration statement is filed.

  - *Final Terms of Securities.* A free writing prospectus containing the final terms of securities would be required to be filed by the issuer within two business days of the later of the date on which such

14 The proposing release fails to mention that courts almost universally have found that there is no implied private right of action under Section 17. However, Section 17, and not Section 12(a)(2), is the statutory provision that the SEC is authorized to proceed under.

15 Filing a prospectus pursuant to Rule 424 would not satisfy the free writing prospectus filing requirements.

terms become final or it is first used. Free writing prospectuses describing non-final terms of securities would not be required to be filed.

- *Media.* Free writing prospectuses in the media for which an issuer has filing responsibility as discussed above would be required to be filed by the issuer within one business day of first publication or broadcast.

- *Others.* Offering participants that distribute a free writing prospectus designed to achieve broad, unrestricted distribution, such as through an unrestricted web site or through the media, would be required to file such prospectus on or before the date of first use. Free writing prospectuses provided only to an underwriter's or other offering participant's customers would not have to be filed.

In the proposing release, the SEC indicated that its staff, pursuant to Rule 418, could request a copy of any free writing prospectus not required to be filed to monitor its use.

- ***Legend requirement.*** Although there are no specific content requirements for a free writing prospectus, it must include the legend required by proposed Rule 433.[16] That legend would be required to state that it is a free writing prospectus used in connection with a registered offering.

- ***Safe harbors for immaterial or unintentional failures to file or include a specified legend.*** The SEC has proposed various safe harbors (or "cure provisions") for immaterial and unintentional failures to file free writing prospectuses or to include a legend on a free writing prospectus. These safe harbors can be summarized as follows:

  - ***Legends.*** There would have to have been a good faith, reasonable attempt to comply with the legend requirement; the free writing prospectus must be amended to include the required legend; and, as amended, as soon as practicable, it must be transmitted to potential investors to whom it was transmitted without the legend.

  - ***Failure to File.*** There would have to have been a good faith, reasonable attempt to file the free writing prospectus and it would have to be filed promptly after discovery of the failure to file.

- ***Safe harbor for omission of information.*** The SEC has proposed to amend Rule 408 to provide that a failure to include information disclosed in a free writing prospectus in a prospectus that is part of the registration statement would not, solely by reason of including that information in the free writing prospectus, be considered an omission of material information required to be included in the registration statement, although the anti-fraud provisions would apply. Nevertheless, the SEC staff could insist that information in a free writing prospectus be made part of the registration statement and, thus, subject to Section 11 liability.

- ***Document retention.*** The proposals would require that free writing prospectuses, including electronic road shows and non-final term sheets, be retained for three years by issuers or offering participants, as the case may be, regardless of whether the free writing prospectus was filed or contained issuer information.

- ***Relation to Regulation FD ("fair disclosure").*** The SEC's fair disclosure regulation currently provides that certain oral or written communications of material non-public information in connection with certain registered offerings of securities are not subject to that Regulation's public dissemination requirements. The proposals would amend Regulation FD to exclude the following communications:

  - ***Registration statements*** — a registration statement filed under the '33 Act, including a prospectus contained therein;

  - ***Free writing prospectuses*** — a free writing prospectus satisfying the conditions of proposed Rule 433 used after the registration statement is filed;

  - ***Section 2(10) exception*** — communications deemed not a prospectus by Section 2(10)(a);

  - ***Section 10(b) prospectuses*** — any other statutory prospectus;

  - ***Certain notices*** — communications permitted by Rule 134 or 135; and

  - ***Oral communications*** — oral communications made in connection with a registered offering after the registration statement is filed.

16 The SEC notes that disclaimers of responsibility or liability that would be inappropriate in a statutory prospectus or registration statement also would be impermissible in free writing prospectuses, including disclaimers of accuracy or completeness; statements requiring investors to read or acknowledge that they have read any disclaimers or legends or the registration statement; and language indicating that the communication is neither a prospectus nor an offer to sell or a solicitation of an offer to buy.

However, the types of offerings excluded from the dissemination requirements of Regulation FD would be narrowed to:

- ***Capital formation*** — capital formation transactions for the account of the issuer;
- ***Underwritten offerings*** — underwritten offerings that are both issuer capital-raising transactions and secondary offerings by selling security holders; and
- ***Business combinations*** — registered business combination transactions (a current exclusion).

Proposed Exchange Act Reports Amendments

To enhance '34 Act disclosure in support of relaxation of '33 Act restrictions on communications and other '33 Act reforms, the SEC has proposed that:

- ***All reporting issuers.*** All reporting issuers, except small business issuers, but including foreign private issuers, would be required to include risk factor disclosure, in "Plain English," in their annual reports on Form 10-K or Form 20-F in the case of foreign private issuers, and domestic issuers would be required to update those risk factors in their quarterly reports on Form 10-Q.
- ***Accelerated filers.*** "Accelerated filers," as that term is defined by the SEC, including foreign private issuers, would be required to disclose all unresolved SEC staff comments on the issuer's '34 Act reports issued more than 180 days before the filing of the latest annual report or Section 10(a)(3) post-effective amendment that the issuer believes are material. How disagreements with the staff as to the materiality of a comment would be resolved remains to be seen. Issuers could state their positions on the staff's comments, and "future comments," which have been agreed to be addressed in future reports, would not have to be disclosed.
- ***Voluntary filers.*** Voluntary filers would have to disclose their status as such in their annual reports filed with the SEC.

Conclusion

The SEC's Offering Reform Proposals, if adopted, would clarify and modernize the capital raising process but not without possible added liability exposure for issuers.

Client Alert

Proskauer's Capital Markets Group has extensive experience in all types of capital markets transactions, including both registered and exempt transactions. We represent domestic and foreign private issuers and underwriters in registered transactions and exempt Rule 144A, Regulation S and Regulation D transactions. We provide the full range of services required by our domestic and international clients to facilitate initial public offerings, follow-on offerings, investment-grade, convertible and high-yield debt offerings and real estate securities transactions.

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