ABA Committee on Federal Regulation of Securities

August 22, 2001

David B.H. Martin, Director,
Division of Corporation Finance,
Securities and Exchange Commission,
450 Fifth Street, N.W., Stop 4-1,
Washington, D.C. 20549.

Re: Securities Act Reform

Dear David:

In response to your invitation, we are taking this opportunity, as members of the ABA's Committee on Federal Regulation of Securities, to provide the staff with our suggestions as to revisions to the regulatory regime under the Securities Act of 1933 (the "Securities Act") needed to address current market realities and eliminate outdated requirements that impose substantial unnecessary costs and disrupt the efficiency of the capital-raising process. We appreciate your welcoming our ongoing dialogue about Securities Act reform. Nearly five years ago, this Committee described to the Commission how changing market realities were fast making the regulatory regime contemplated by the Securities Act an anachronism in the information age and how, as a result, that regime was imposing compliance burdens and costs that undermined the efficiency and cost effectiveness of the capital formation process.* We noted that these burdens and costs were not only unnecessary but were even counterproductive to investor protection interests. These concerns are all the more urgent today. We believe that Securities Act reform is essential to serve investors' interests, assure the efficiency of the capital-raising process for both investors and issuers, and maintain and enhance the preeminent competitive position of the U.S. capital markets.

We would like to acknowledge at the outset our appreciation for the efforts taken by the Division of Corporation Finance over the last 18 months to address specific troublesome issues. These initiatives have been helpful on the specific issues addressed. However, as we have discussed with you and the staff, we believe that fundamental reform is still critically necessary.

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* Letter, dated December 11, 1996, re Release No. 33-7314- Securities Act Concepts and Their Effects on Capital Formation (File No. S7-19-96). See also Letter, dated September 28, 1999, re Release No. 33-7606-The Regulation of Securities Offerings (File No. S7-30-98).

The existing regulatory regime based on a conceptual framework established more than 65 years ago no longer addresses the market realities of today's capital markets. These markets have been radically transformed by the information revolution and globalization, and the new market realities require a new conceptual framework for the regulation of capital raising. That framework should encourage the free flow of information to investors and allow investors and market participants to take full advantage of the benefits of electronic communications. Moreover, we believe that without the Commission reexamining the fundamental premises that underlie the regulatory regime, any initiatives will be too modest, will benefit only some issuers while leaving others to contend with the existing problems, and will continue and potentially increase the uncertainties of compliance, creating inordinate risks of liability for issuers and others for violation of Section 5. Any reform initiative should have as an objective reducing not increasing litigation risks to companies and others subject to the Securities Act.

Like the SEC, this Committee believes investor protection and investor confidence are fundamental to the preeminence and efficiency of the American capital markets, and that reform must be consistent with investor interests. We believe our proposal for reform outlined in this letter will substantially enhance the efficiency of the capital formation process, while continuing to assure the investor protection goals underlying the Securities Act. The needed modernization of the Securities Act can be accomplished by a series of targeted Commission initiatives that address fundamental anachronisms in the regulatory framework. We also believe the necessary actions can, and should, be tailored in scope, thus avoiding any major changes in market practice and encouraging acceptance by market participants. In our view, those initiatives need to be broad-based and available to small business as well as world class companies. Reform limited to big business will provide only modest benefits and fail to address the problems of those companies upon whom the Securities Act regulatory regime has imposed the greatest costs and burdens.

Our proposed model would remove regulatory restrictions on communications in registered and exempt offerings to reflect the current market realities of the information age and to provide investors the benefits of free and open flows of information and widespread use of electronic media; encourage use of registered offerings by streamlining the registration and review process for both seasoned and new issuers; and improve the efficiency and enhance the competitiveness of the U.S. private offering market. Our proposal is premised on the following basic principles:

- investors are best served by free and open flows of information;
- restrictions on communications add unnecessary costs and inefficiencies, particularly for smaller companies, in identifying potential investors without being necessary for investor protection;
- attempts to limit the availability of information in today's global market with nonstop reporting of financial news and instantaneous transmission of information are unworkable, and best efforts to comply with such restrictions are costly, largely ineffective and actually disruptive to capital raising by issuers;

- SEC oversight of corporate disclosures can be equally effective if focused on new and unseasoned issuers and ongoing Exchange Act reporting rather than on the episodic review of Securities Act registration statements;

- U.S. investors' interests are best served by capital markets that are the most attractive globally, thereby encouraging issuers to make their securities available onshore subject to U.S. securities laws and SEC oversight rather than causing them to raise funds offshore and relegating U.S. investors to secondary market purchases subject to foreign law;

- the U.S. economy, financial institutions and investor community are best served by continuing to assure the preeminence of the U.S. capital markets; and

- the continued preeminence of the U.S. capital markets will continue to encourage the development of high quality disclosure, accounting, auditing and governance standards internationally.

For ease of reference we have included in this letter a summary of the inefficiencies and costs resulting from application of a historic securities regulatory regime to today's global markets, many of which have been discussed in earlier letters. We have, as promised, reviewed our previous proposals and considered developments in regulation, communications and the financial markets since we made those proposals. This letter reflects our current recommendations taking into account those developments. As you will note, the updated proposal reflects several concepts proposed in the "Aircraft Carrier Release" and other SEC initiatives.

I. Current Problems under Securities Act §§ 5 and 11

The fault lines in the current regulatory system are illuminated most sharply by the explosion over the past 15 years of information technology and its application to the securities markets. The highlights of this information revolution include the SEC's introduction of EDGAR as a means of enhancing the value of the integrated disclosure system, the proliferation of private data bases, Websites and "portals" as vehicles for the delivery of corporate information and the use of electronic communication technology for the delivery of disclosure documents, research material, press reports and marketing information.

In effect, technology is further undermining the premises underlying the Securities Act, an erosion initiated years ago by market volatility, institutionalization and globalization. Examples of this stress in the regulatory regime include:

A. Private Placement Paradoxes

As recognized by the SEC, the private market is a vital component of the U.S. capital markets. In 2000, more than $400 billion were raised in the U.S. private market, close to one-third of funds raised in the U.S. capital markets.* The importance of the private market is not

* Based on information provided by Thomson Financial Securities Data.

new; as reported by the SEC in its 1988 release proposing Rule 144A, in 1987 approximately $140 billion, or just over one-third of funds raised in the United States, were raised in the private market. Efficiency of the private market is an integral component of a cost-effective capital-raising process. And it is key to assuring that the American private market maintains its competitive edge over offshore institutional markets.

Traditionally, exemptions from registration are strictly construed. Moreover, a failure to establish an exemption gives the purchasers a one-year "put" against the seller. The SEC has, therefore, assisted issuers and their advisers in this area by adopting safe harbors such as Regulation D and Rule 144A. However, these safe harbors include conditions that make compliance with the exemption difficult. In theory, at least in the case of institutional private placements, "offers" are made only to QIBs or accredited investors. Under Regulation D, "general solicitation" is prohibited, and under Rule 144A "offers" to non-QIBs are prohibited. In all cases, the buyers of privately-placed securities may not engage in a public redistribution of the securities. The difficulties with private placements, each of which can lead to the loss of the exemption, create inefficiencies for capital raising in the private markets.

First, prohibitions on general solicitation impose particularly significant inefficiencies and costs on small company and start-up capital raising. A key challenge is identifying and finding qualified and interested investors. The inability to use public, low-cost means of communications frequently limits the ability of those companies to reach potential qualified investors as well as precludes the use of effective, low-cost communications.

Second, there are several overlapping categories of persons to whom private placements may be sold pursuant to the SEC's safe harbors. Rationalization would simplify compliance and reduce the risk of inadvertent loss of the safe harbor.

Third, the concept of a "general solicitation" is a subjective facts and circumstances standard and unworkable under current conditions, including in particular the emergence of aggressive financial media, that make transactions unduly vulnerable to risks of rescission liability. For example, industry publications readily make available information on private placements. Press sources such as *The Wall Street Journal* no longer always bother to state whether new issues described in their pages are public or private. Issuers consider themselves under an obligation to inform their securityholders about their private transactions. Financial intermediaries wish to inform their clients about new financing techniques.

SEC positions have raised the concern that the manner of identifying permitted investors may result in a general solicitation, even though only permitted investors actually participate in the offering. Issuers and intermediaries have been told to identify offerees by identity or number. And it is suggested that it is relevant in a Rule 144A transaction whether the "initial purchase" from the issuer was accompanied by a "general solicitation" even though the securities are purchased only by QIBs.

The difficulties inherent in a regulatory regime that prohibits general solicitation also are illustrated in recent SEC initiatives. In the release adopting Regulation FD to encourage open public communications, the SEC felt compelled to caution that the public disclosure mandated for material nonpublic information provided in connection with private offerings could constitute general solicitation that would defeat the exemption. Clearly, investors' interests are best served by the information being made public; no one's interest is served by precluding the issuer from pursuing a private placement. Similarly, in the release adopting the Rule 155 integration safe harbors, in connection with requiring issuers to state in the withdrawal whether they may use the safe harbor to do a follow-on private offering, the SEC cautions issuers not to include the terms of the offering because that could be general solicitation.

Fourth, it should be possible for a purchaser in a private placement to sell the securities to another purchaser in a "secondary private placement," *i.e.*, a transaction that has the same conditions as the original sale. In fact, such transactions are commonplace notwithstanding the absence of any formal endorsement from the SEC (thus giving rise to the concept of a "Section 4(1-1/2)" transaction).

Fifth, uncertainty about the need to "police" resales limits the use of efficient depository systems such as DTC with a consequent need for paper settlements. The consequences of hedging transactions are similarly uncertain.

All this legal uncertainty, compliance costs and potential risks of rescission liability, in our view, are unnecessary to assure the basic purpose of the exemption: that the securities end up in the hands of investors who are able to "fend for themselves" as evidenced by their falling into a reasonably objectively-determined investor category such as "accredited investor" or "qualified institutional buyer." To measure compliance by the number of "offerees" or how they are identified, or whether or not there has been a "general solicitation," is unnecessary and imposes undue costs and liability risks.

B. <u>Integration</u>

There is great uncertainty with respect to which private offerings must be integrated with each other and as to which public offerings must be integrated with private offerings. While the SEC recently adopted a rule that addresses some of the uncertainties, additional issues remain such as (a) the treatment in registered M&A transactions of lock-up agreements reached prior to the filing of a registration statement, (b) the registered resale of privately-placed securities, (c) the integration of more than one private offering and (d) the integration of concurrent and sequential public and private offerings.

In addition, the SEC has not rescinded its position that the mere filing of a registration statement for a class of securities constitutes a "general solicitation" that may in some cases prevent a private offering of securities of the same or similar class.

C. <u>Offshore Transactions</u>

Similar uncertainties adversely affect offshore transactions, notwithstanding the SEC's adoption of Regulation S and its issuance of a 1998 interpretive release on electronic communications in the international context. The condition in Regulation S that bars the use of "directed selling efforts," like the condition in private placements that bars "general solicitation," is subjective and raises difficult compliance issues under current conditions. Information released outside the United States in connection with a Regulation S offering is almost instantaneously available in the United States through Reuters, Bloomberg and other media.

Information made available by U.S. or foreign issuers on the Internet or similar vehicles is also immediately available to persons in the United States.

The SEC attempted in its 1998 Internet release to relieve uncertainty about the use of electronic communications in the international context. While helpful, the relief was narrow. It offered no guidance where registered offerings were involved and provided substantially less relief to offshore securities offerings by U.S. issuers than it did to offshore securities offerings by non-U.S. issuers.

On a related front, the U.S. financial press protested some years ago to Congress and the SEC that it was being excluded from press conferences and interviews held outside the United States relating to securities offerings that were themselves made outside the United States. The Congress responded by requiring the SEC to adopt a rule that permits foreign issuers to provide journalists with access to offshore press conferences, press-related materials and interviews released outside the United States; the same communication with a journalist physically in the U.S. at the time of the communication would not be eligible for the exemption and would violate Section 5. Thus, for example, an issuer could allow CNN to broadcast into the U.S. a live interview with a CEO outside the U.S. about a global offering, but could not permit a Wall Street Journal reporter to participate in an offshore press conference about the offering by telephone from New York without violating Section 5. Nor is it clear why the rule should allow information about foreign issuers to be more available to U.S. investors than similar information about U.S. issuers. Indeed, the rule does not address at all U.S. issuers that wish to inform the offshore press about their offshore offerings. This distinction without a meaningful basis illustrates the need for the Commission to construct a new conceptual framework for the Securities Act.

D. Control Persons

One of the central concepts of the Securities Act is that sales by "control" persons (*i.e.*, affiliates) of an issuer are treated as if they were sales by an issuer. Given the serious consequences of a wrong judgment about whether a seller of securities is an affiliate of the issuer, many, including the Commission's Advisory Committee on Capital Formation, have recommended a regulatory safe harbor definition of non-affiliates. We strongly agree. As we stated in our 1996 letter, the definition of affiliate for Securities Act resale purposes should be narrowed and clarified for all issuers.

E. Publicity

The Securities Act's approach is that a preliminary prospectus forming part of a registration statement is the only permissible written offering document for a public offering of securities, at least until a "final" prospectus is available on which supplementary material may be "piggybacked." To support this approach, the SEC has developed the concept of publicity as constituting an illegal "prospectus" in violation of § 5 if it "conditions the market" for a registered offering.

The logic of the integrated disclosure system requires that issuers inform their investors about their financing activities. Concerns about U.S. companies filing reports under the

Exchange Act that refer to offshore or private offerings led the SEC to adopt a rule that expressly permits notice of these offerings. U.S. issuers are still unable, however, freely to place on their Websites information about their current and prospective offerings or even to update financial and business information during the pendency of private and public offerings if to do so could be construed as "conditioning the market" for the offering.

Further evidence of the problems in the current system is found in the treatment of roadshows under the Securities Act. The SEC has expressed concern for many years that institutional investors may obtain an advantage over individual investors by being invited to roadshows at which details of public offerings are discussed and issuer representatives make presentations that may not be available in the prospectus. Technology now makes it possible for every investor with an Internet connection, Bloomberg terminal or similar device to see and hear an audio and video playback at a time of the investor's own choosing. Notwithstanding staff guidance, ambiguities about whether such playback constitutes a "writing" and therefore an illegal prospectus are preventing investors' access to information that has historically been available to institutional investors.

The anomalies between oral and written statements have increased as a result of new regulations and new technology. The SEC has taken the position that limited electronic transmission of a roadshow, either real-time or on a delayed basis, may be oral, while unlimited replays convert it into a writing. In financing roadshows slides are part of the oral presentation. In the merger or proxy solicitation context the SEC has newly taken the position that the slides are writings that must be filed. If a financing transaction is taking place at the same time, those filings might become illegal offers. Issuers are thus faced with inconsistent regulation under the Securities Act and the Exchange Act.

Even the most routine modern communications are not immune from being characterized as illegal prospectuses. E-mail has replaced the telephone, for example, as the vehicle for routine business and social communication. However, under the Commission's position that all electronic communication is a writing, any e-mail constitutes an illegal prospectus if it refers to the offering and is not Rule 134 compliant or is deemed to condition the market for the offering. It should not be necessary under a statute that expressly exempts oral communications to treat all e-mail as "writings" for § 5 purposes.

F. <u>Research</u>

The position of the SEC is that research may constitute an illegal "offer" or "prospectus" in violation of § 5. The reality is that sell-side research departments have become extremely efficient in the dissemination of information on publicly-held companies and that interruptions in this research, or inhibitions on its updating, are not in the interests of investors. Research views are as much part of the "background noise" of a securities offering as the issuer's Exchange Act reports or its Website. Moreover, it is often the case that the offering itself (*e.g.*, in conjunction with a restructuring or acquisition) may be the material development on which the investing public most urgently requires the views of an analyst.

We largely supported the SEC's research proposals made in the Aircraft Carrier Release while expressing substantial concern about the SEC's proposal to impose Section 12(a)(2) liability on research issued while a company is in registration. The underlying premise for the safe harbors is that the exempted research is not part of the selling effort and is directed to the secondary market. There is still an urgent need to free communication in this area from content-based restrictions.

G. Registration Delays

Despite the best efforts of the SEC staff to provide timely reviews of registration statements, unpredictable delays still arise even in the case of seasoned reporting issuers. These can result from staff review of an issuer's or an industry's Exchange Act reports, concern about generic accounting or disclosure problems or concerns about securities with "novel and unique" features. In the meantime, volatile markets cause issuers to miss opportunities.

More to the point, the issuer's securities continue to be traded in the secondary market while the issuer and the staff try to resolve the concerns triggered by the Securities Act filing. We believe that SEC review of seasoned issuer's Exchange Act filings would provide adequate protection for investors.

H. Prospectus Delivery Requirement

Under the Securities Act, the delivery of a final prospectus is a condition to the sending of a confirmation (which is required by a rule under the Exchange Act) or to the delivery of the security after sale. In the case of IPOs, a final prospectus must be delivered for a specified period in connection with each secondary market transaction.

In theory, the prospectus delivery requirement is intended to provide investors with useful information (as well as, in the case of post-offering deliveries, to encourage the dissemination into the market of the information in the prospectus). In reality, the final prospectus arrives in each case after the investor has made his or her investment decision. Moreover, the prospectus for domestic registrants is now universally available through EDGAR and other sources shortly after its filing with the SEC. We understand that soon that will be the case for foreign registrants as well.

The prospectus delivery requirement actually results in delaying the sending of the confirmation, which is a document that serves important SEC and market clearance and settlement objectives. It also subjects market participants that use efficient settlement mechanisms such as DTC's Institutional Delivery system to the risk of potential "puts". Moreover, it prevents the furnishing of a term sheet to the investor immediately prior to or after the sale of the security for the purpose of updating information, communicating terms of complex securities and identifying any possible misunderstandings.

These problems have led to proposals by this Committee and others that the prospectus be incorporated by reference into a confirmation or that investors be "deemed" to have received the prospectus as soon as it is publicly filed with the SEC. Such accommodation to market practice will have to accompany any further reduction of the settlement period.

I. Section 11 Liability

For nearly 20 years, the SEC has taken steps to enable issuers to obtain "on demand financing," *i.e.*, the ability to access the securities markets immediately whenever capital needs arise or market opportunities present themselves. However, the benefits of "on demand financing" (subject, of course, to the potential registration delays described above when a new shelf is filed) are undermined by continuing to impose on financial intermediaries and other "gatekeepers" the responsibility to take the time necessary to do a sufficient due diligence investigation to assure quality disclosure without recognizing and making allowances for their difficulty or even inability to do so. It is not possible for underwriters and others to meet this standard in the current financing environment.

In theory, the liabilities of § 11 are imposed on those "gatekeepers" best able to ensure that the investor receives full and fair disclosure. In reality, most frequent issuers act as their own gatekeepers. Underwriters have little ability — because of integrated disclosure and shelf registration — to influence the issuer's disclosure. They nevertheless remain subject to § 11 liabilities, having only the defense that they conducted a reasonable investigation.

It is also anomalous that an underwriter's liability under § 11 in respect of a shelf registration statement is measured on the state of the facts at the time the underwriter becomes an underwriter, while the liability of the issuer, signing officers and directors is measured on the state of facts at the time the registration statement becomes effective or the filing of the last annual report, which may be months earlier.

II. Access Versus Delivery

Many of the problems described above would be significantly relieved if the SEC were to adopt the philosophy that an investor's access to a document would be deemed the equivalent of delivery of that document.

Congress in 1933 did not mandate the actual delivery of documents to investors. The point has been made elsewhere that a large part of the country in 1933 did not receive mail at home; rather, it was necessary to travel to a post office to pick up the mail (with whatever securities-related documents were included in that trip's pickup).

The time has surely come to recognize that the SEC's success with its EDGAR system means that investors can easily retrieve documents such as prospectuses.

Indeed, the SEC has assumed for more than three decades that investors have practical access to Exchange Act reports. This was surely the theory on which the SEC in 1970 based its Form S-16, which for the first time permitted the incorporation by reference of Exchange Act reports. The SEC vastly expanded incorporation by reference when it subsequently adopted Form S-3. The SEC permitted the technique of incorporation by reference notwithstanding that an investor would during most of the past 30 years have had to go to an SEC or stock exchange office in order to view the document in question.

To be sure, the technique of incorporation by reference depended less on actual delivery to investors and more on the efficient-market hypothesis by which information in an issuer's

Exchange Act reports was disseminated to investors through analysts, the financial press and other agents. Whatever the validity of that hypothesis in the 1970s and 1980s, it is surely more valid today than the SEC could ever have imagined. Even the "digital divide," whatever its existence or dimensions, could not compare to the practical difficulties of two or three decades ago of achieving direct access to the information. Today's real-time access to Exchange Act reports, whether through EDGAR or third-party information delivery systems, should surely permit removal of anachronistic roadblocks to the completion of transactions.

III. Investment Decision-Making

Under the current shelf takedown model, an issuer can cure a Securities Act disclosure deficiency in its Exchange Act documents by filing a current report on Form 8-K that is incorporated by reference into the registration statement before its underwriters orally confirm sales of the registered securities. More often, the disclosure is included in a supplement to the prospectus that is prepared and filed with the SEC after sales have been orally confirmed and that is delivered to investors shortly before payment is due. In either case, the investor has little practical ability to consider the information in the Form 8-K before paying for the securities.

Whether recent developments are communicated to potential investors in underwritten offerings before they decide to buy the securities depends largely on the good judgment of syndicate managers and their counsel, along with the issuer and its counsel. The system works as well as it does, notwithstanding the shortcomings of the model, because of the action of intermediaries (underwriters and dealers), research analysts, institutional investors, the financial press and the media in getting information out to the marketplace.

In other words, investment decision-making is already based on an "access-equals-delivery" model. An investor's decision to buy a security is not today based on a prospectus except possibly in the case of IPOs where Rule 15c2-8(b) requires delivery of a preliminary prospectus 48 hours in advance of pricing. Even in the case of IPOs, we suspect that relatively few investors actually read the preliminary prospectus provided pursuant to Rule 15c2-8(b). As for offerings other than IPOs, it is clear that investors do not make investment decisions based on the prospectus (which they will receive only with the written confirmation). Rather, they rely on information about the issuer that is disseminated to them from a multiplicity of sources, including sell-side and buy-side analysts, traditional and electronic news services, ratings agencies, salespersons, etc.

Also, the civil antifraud remedies are unaffected by an access-equals-delivery model. Section 11 remedies will still turn on the contents of the registration statement at the time it becomes effective, and Rule 10b-5 remedies make use of the "fraud-on-the-market" theory to substitute for delivery of a document or even reliance on the document. The delivery requirement today, in addition to holding up settlement of transactions and standing in the way of T+1, serves little purpose other than the creation of potential rights of rescission under § 12(a)(1) of the Securities Act.

IV. A New Model

We set forth below a proposed model for the regulation of public offerings and private placements that represents a logical evolution from today's regulatory regime that can be achieved by regulatory rather than legislative action.*

Our proposed model for SEC reform of the Securities Act builds on Commission initiatives over the last 25 years that have enhanced the efficiency of the capital-raising process, in both the public and private markets, by removing unnecessary regulatory burdens and adapting the Securities Act to new market realities. In summary, our proposal would

- extend the benefits of on-demand financing provided by universal shelf registration to all seasoned issuers;
- enhance the utility of universal shelf registration by
  - introducing pay-as-you-go filing fees;
  - allowing additional securities to be added to existing registration statements;
  - opening universal shelf registration to secondaries; and
  - eliminating limitations on "at the market" offerings.
- encourage more effective communications with investors about offerings and eliminate rescission liability risks by removing limitations on communications outside the prospectus and registration statement;
- remove unnecessary regulatory impediments and disincentives to taking full advantage of the efficiencies and cost effectiveness of electronic communications;
- enhance the efficiency and competitiveness of the U.S. private capital market by
  - eliminating prohibitions on soliciting communications that both impose substantial costs on issuers' efforts to find eligible, interested investors as well as expose such issuers to risks of rescission liability for public visibility of offering information; and

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* The model does not address the special problems of asset-backed securities. For proposals as to how structured finance should be treated under the securities laws, see Letter, dated June 29, 1999, of the ABA Committee on Federal Regulation of Securities, Letter, dated June 30, 1999, of the Bond Market Association (which includes leading underwriters of asset-backed securities) and Letter, dated June 30, 1999, of the Mortgage Bankers Association of America (which includes leading issuers of asset-backed securities) - all re The Regulation of Securities Offerings (File No. S7-30-98).

- streamlining and updating divergent tests for eligible purchasers of exempt offerings;

- reduce rescission liability risks arising out of prohibitions on directed selling efforts in offshore transactions;

- reduce legal uncertainty and risks of liability by providing a safe harbor definition of affiliate; and

- rationalize offering participants' liabilities to match market realities.

A. First-Time Registrants

The following regime would be applicable to public offerings of securities by first-time registrants.

More than 30 days prior to the filing of the registration statement: Oral, electronic and written communications would be permissible, as was proposed in the Aircraft Carrier Release (see proposed Securities Act Rule 167(c)), whether or not such communications amount to "offers". The presumption would be that the 30-day cooling off period, coupled with the subsequent availability of information in the preliminary prospectus, would cure any problems with the continuing effect, and accuracy and completeness, of any prior communications.

During the 30 days prior to the filing of the registration statement: Communications amounting to "offers" would be limited to those of a kind permitted by Rule 134, expanded to include ordinary course "factual business communications" as would have been contemplated by the Aircraft Carrier Release (see proposed Securities Act Rule 169).

After the registration statement is filed: Registration statements would be filed and subject to SEC review and being declared effective as at present. This "rite of passage" from private to public company is important and should be preserved.

Oral, electronic and written communications would be freely permitted. Thus, salespersons could communicate with prospective customers not only by telephone but also by voice mail, E-mail and fax as well. Terms sheets could be used. Roadshows could be broadcast to an unrestricted audience, both on real-time and delayed replay bases. Nothing other than the registration statement, and included preliminary prospectus, would be required to be filed with the SEC. However, hard and electronic copies of anything that might be deemed "offering material" would have to be kept for some prescribed period such as two years. From a regulatory and enforcement point of view, being able to obtain written evidence of what was said (particularly if sent to multiple recipients) would be better than faulty and perhaps conflicting recollections of many individual and different conversations.

The registrant or a dealer who prepares "offering material" to facilitate the sale of the registered securities, or uses for this purpose "offering material" prepared by another, would be subject to liability under Securities Act § 12(a)(2) for such "offering material". While the preparer and user of the same "offering material" would each be liable with respect to that "offering material" as at present, there would be no other cross-liability.

Preliminary prospectuses would be required to be delivered as at present under Exchange Act Rule 15c2-8 and distributed as a condition to acceleration under Securities Act Rule 460.

After the registration statement is effective: When the SEC record is complete (except for Rule 430A-type information), confirmations of sales could be sent to buyers. Hard copy final prospectuses would be required to be sent within [ ] days to buyers who do not have electronic access to the prospectus on file at the SEC.

Given the practical problem of getting copies of the final prospectuses to all dealers that may wish to deal in the registered securities and the immediate electronic accessibility of the final prospectus on file with the SEC, we recommend that the SEC modify Rule 174 to exempt all dealers (other than underwriters selling unsold allotments) from prospectus delivery obligations in the after-market.

B. Unseasoned Registrants

Unseasoned registrants would be those that have already registered securities under the Securities Act or Exchange Act and do not qualify for treatment as "seasoned registrants" as described below.

In the case of public offerings by unseasoned registrants, oral, electronic and written communications would be freely permitted at any time before the filing of a registration statement as well as after its filing. Treatment of "offering material" (*i.e.*, keeping copies and liability) would be the same as in the case of first-time registrants. Expanded Rule 134 would apply. Ordinary course research on the registrant would continue to be subject to liability under Rule 10b-5.

Rule 430A should be expanded to include the size of offering, estimated proceeds, maturity of debt and, possibly, other terms of the securities that are frequently subject to change at the time of pricing even though not "pricing-related" within the meaning of current Rule 430A, *e.g.*, non-call period, holder put rights, etc.

The registration filing and selective review system would continue as at present.

After the registration statement is effective and the SEC record is complete (except for expanded Rule 430A-type information), confirmations of sales to purchasers could be communicated orally, electronically or in writing without being accompanied or preceded by a prospectus or anything else.

C. Seasoned Registrants

"Seasoned registrants" would consist of all registrants that have been reporting on a timely basis under Exchange Act § 13 or 15(d) for one year except for "bad boy" registrants.

Seasoned issuers would be required to file any new registration statement as a universal shelf registration statement covering an unlimited amount of securities, specified and to be specified, to be sold by the issuer, affiliates and holders of restricted securities over an indefinite period. This should eliminate issuer concerns about "market overhang," because there would be no signal to the market if every issuer is required to do the same thing. There would be a small initial registration fee and pay-as-you-go fees on subsequent sales of securities. The registration statement would become effective automatically without staff review after a short period (*e.g.*, 10 days) unless within that time period the SEC acts to deny effectiveness for good reason. Issuers would be permitted to convert existing registration statements into universal shelf registration statements and credit unused fees against fees on subsequent takedowns.

Inasmuch as any securities described in the registration statement may be sold at any time in any manner contemplated by the prospectus, the limitations of Rule 415 would be eliminated. Seasoned issuers could change or add to the securities covered, change or add to the plan of distribution and add guaranteed affiliates as registrant — either by post-effective amendments or new registration statements that would become effective automatically without SEC review on filing or demand. Sellers who are not affiliates and will offer less than a specified threshold amount would not need to be identified.

Seasoned issuers would be subject to the continuous reporting system (annual, quarterly and current reports) as at present. Issuers that are delinquent or have been late in filing an annual or quarterly report can be excluded from selling securities off the universal shelf registration statement until some specified period (such as three months) after cure unless waived or shortened by the SEC for good cause shown. During ineligibility, the issuer could register on a non-shelf basis.

Before commencing an offering an issuer should be able to ascertain from the staff whether a review of Exchange Act filings is in process or impending. If the staff has reviewed and commented on Exchange Act reports and any comments have not yet been resolved, the issuer could proceed with offerings (if it feels comfortable doing so) unless the staff commences the equivalent of a stop-order proceeding.

Oral and written communications would be subject to the same preservation and liability regime as described under "Unseasoned Registrants" above.

In connection with offerings of securities, seasoned issuers would file with the SEC a notice of sale, pay a registration fee and update the SEC record to the extent necessary to satisfy § 11 as of the initial sale. For this purpose, the registration statement would include the registrant's annual, quarterly and current reports under the Exchange Act (accessible through the SEC's Website), which must contain all required information (except for expanded Rule 430A information) and be accurate and not misleading at the time of making sales. Expanded Rule 430A information could be subsequently transmitted to the SEC and retroactively included in the Exchange Act record and registration statement.

For purposes of § 12(a)(2), purchasers will be deemed to have purchased in reliance on the issuer's Exchange Act record, but, as between seller and purchaser, information included in the issuer's Exchange Act record since the opening of the last full SEC business day before acceptance of the purchaser's commitment to purchase (other than expanded Rule 430A pricing information) will not be deemed to be part of the issuer's Exchange Act record <u>unless</u>:

1. Actual Communication: Information is actually communicated to the purchaser before acceptance of commitment to purchase (see §§ 11(a) and 12(a)(2)) — whether orally or in writing to be determined by the seller, subject to the risk of proof. If the investor has consented, electronic delivery (*e.g.*, E-mail or posting on issuer's Website) can satisfy this requirement.

or

2. Constructive Communication: The information is "effectively disseminated" before acceptance of the purchase commitment. Information is "effectively disseminated" when it is reasonably likely to be reflected in the price potential investors aware of the information would be willing to pay for the securities. The SEC should evaluate (based on empirical data) when, given different modes of communication, information is "effectively disseminated" for this purpose, and the extent and circumstances under which a purchaser must be made aware of the availability (but not the content) of the information. We encourage development of rules with enough flexibility to accommodate automatically continued advancement in electronic communication. At the same time there would have to be bright-line tests due to the risk of liability.

For example, "effective dissemination" might be presumed if information:

a. is disclosed in a press release issued prior to 6:00 p.m., Eastern time, the day before acceptance of the commitment to purchase; or

b. disclosed in a press release issued more than three hours before acceptance of the commitment to purchase if the press release identifies the Website address where a copy of press release may be found; or

c. appeared in Dow Jones Broadtape, Bloomberg, *Wall Street Journal* (National Edition), *Financial Times*, etc. two hours before acceptance of a commitment to purchase (whether or not the purchaser has access to such information sources); or

d. in the case of an institutional purchaser, is included in the issuer's Website prior to acceptance of the commitment to purchase if the presence (but not the content) of such information on the Website is actually communicated to the purchaser prior to acceptance of the commitment to purchase.

After the SEC record is completed as above (except for expanded Rule 430A-type information), sales may be confirmed to purchasers orally, electronically or in writing without being accompanied or preceded by a prospectus or anything else.

This proposal is not new or revolutionary. In concept, it goes back at least as far as Milton Cohen's seminal article speculating on how our regulatory system might have worked if the Exchange Act had been enacted before the Securities Act and Professor Louis Loss' proposed Federal Securities Code. It capitalizes on the success of the SEC's shelf registration initiative and the universal availability of SEC filings made possible by Edgar.

D. Sales Not Requiring Registration

In view of the telecommunications and media revolution, the SEC should recognize that it is both unrealistic and unnecessary to restrict communications and, therefore, should eliminate all restrictions on "offers" and "general solicitation" with respect to securities being sold other than pursuant to registration under the Securities Act. Eligibility for exemption from registration should turn on the status of the purchasers and what they may do with their securities, not the number or status of offerees or the method of reaching eligible purchasers.

Rule 144A should be modified to establish a single class of "exempt purchasers" (which would be narrower than "accredited investors" under Regulation D and broader than QIBs under Rule 144A) to whom securities may be sold by all issuers, affiliates and holders of restricted securities, and among whom those securities may be resold, without registration. After one year in the case of reporting issuers and two years in the case of non-reporting issuers, those securities should be freely saleable in public markets.

Regulation D would continue to be available, subject to the following changes: The limitation on "general solicitation" should be eliminated. The limitation to use by issuers should be eliminated so that the safe harbor may be used by affiliates and by dealers intermediating between the issuer or affiliates on the one hand and "accredited investors" on the other. Consideration could be given to updating the requirements of "accredited investor".

In order to clarify the circumstances when neither registration nor compliance with Rule 144 or private placement requirements is required, a rule should be adopted under Securities Act § 2(11) providing that absent (a) 20% or more ownership of voting securities, (b) 10% or more beneficial ownership with representation on the board of directors or (c) status as a chief executive officer or inside director, there is a rebuttable presumption of absence of "control".*

E. Sales Outside the United States

Regulation S's limitations on "offers" and "directed selling efforts" should be eliminated. Existing legal requirements that sales into the United States must either be registered or satisfy an available exemption should be allowed to operate. If further definition of these requirements is necessary, that could be addressed separately.

F. Liability

The subject of underwriters' liability under §§ 11 and 12(a)(2) with respect to sales of securities off universal shelf registration statements needs to be re-examined, perhaps in a longer timeframe. Congress's assumptions in 1933 and 1934 about registrants working with individual underwriters in a relatively leisurely atmosphere are at odds with today's competition by

* See Report of the Advisory Committee on the Capital Formation and Regulatory Processes, at p. 24 (July 24, 1996).

multiple underwriters for high-speed transactions.* Relief could take the form of modification of Rule 176 into an expanded safeguard** or could involve seeking Congressional modification of §§ 11 and 12(a)(2).

In addition to addressing the problem of underwriters' liability in a streamlined registration system, consideration could be given to revising the liability regime for other parties, at least in the case of "seasoned registrants", to recognize the significance of the integrated disclosure system under the new model. For example, relief from the stricter liability standards of § 11 could be provided if certain procedures designed to enhance continuous reporting under the Exchange Act are followed.

This letter has been written by members of the Committee on Federal Regulation of Securities of the American Bar Association's Business Law Section. It does not represent an official position of the Association, the Section or any of its committees.

We urge the SEC and its staff to pursue a "no holds barred" re-examination of the regulatory regime applicable to both public offerings and private placements with a view to bringing it into conformity with the market realities of the 21st Century and the needs of market participants. In that connection, we have provided the foregoing recommendations, which we hope will be helpful and seriously evaluated.

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* See, *e.g.*, Committee on Federal Regulation of Securities, Report of the Task Force on Sellers' Due Diligence and Similar Defenses Under the Federal Securities Laws, 48 Bus. Law 1185 (May 1993).

** See, *e.g.*, draft Securities Act Rule 177, Reasonable Investigation, Reasonable Grounds for Belief and Reasonable Care Under §§ 11 and 12(2) of the Securities Act – Forms S-3 and F-3, proposed by five investment banking firms in the Letter, dated December 2, 1982, from Edmond N. Moriarty, Jr. (Merrill Lunch White Weld Capital Markets) to John S.R. Shad.

We would be pleased to meet with members of the staff and Commissioners to explain our concerns and recommendations and to engage in a dialogue on the best course to pursue for meaningful reform. We are available to assist the SEC and the staff in developing a regulatory initiative that modernizes the capital-raising process in light of the continuing development of technology and communications and recognizes further global competition for our capital markets and economy and the need to maintain effective investor protection.

Respectfully submitted,

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