

2006 Seminar Series:

Securities Offering Reform – The First 100 Days

Revolution or Evolution?

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Overview

Overview

- **Streamline the Securities Act registration process**
 - **Automatic shelf registration statements for well-known seasoned issuers (WKSIs)**
 - **More abbreviated base prospectuses permitted, particularly for WKSIs**
 - **New Rule 430B permits information that is “unknown or not reasonably available” to be omitted from a base prospectus**

Overview

- **Liberalize communications to investors during offerings**
 - **Free writing prospectuses**
 - **Communications safe harbors**
 - **Expansion of permitted scope of Rule 134 communications**
 - **Series of safe harbors that ease “gun-jumping” restrictions**

Overview

- **“Clarify” (change?) the Securities Act liability framework:**
 - Section 11/Rule 430B
 - Section 12(a)(2)/Rule 159
- **“Access equals delivery” for filed final prospectuses**
- **Procedural enhancements for Securities Act shelf registration statements**
- **Additional Exchange Act disclosure requirements: “risk factors” and unresolved SEC staff comments on Exchange Act reports**

Overview

- **Categories of issuers under Securities Offering Reform:**
 - **Well-known seasoned issuer (WKSI) – chief beneficiary of new regime**
 - **Seasoned issuer – non-WKSI issuer that is eligible to use Form S-3 or F-3**
 - **Unseasoned issuer – issuer that must file periodic reports under Exchange Act, but not eligible to use Form S-3 or F-3**
 - **Non-reporting issuer (including voluntary filer) – issuer that is not required to file periodic reports under Exchange Act**
 - **Ineligible issuer – primarily an issuer that falls within specified “bad boy” categories**

Overview

- **Securities Offering Reform has resulted in new transaction practices:**
 - **New focus on preliminary prospectus/pricing disclosure package**
 - **Increased use of term sheets, chiefly for offerings of debt and complex securities**
 - **Modifications to underwriting agreements**
 - **Changes in comfort letter and legal opinion practices**

Overview

- **Securities Offering Reform has been responsible for more divergent documentation and practices**
 - **Trend in recent years had been towards more uniformity**
 - **Documentation and other practices less consistent since December 1:**
 - **Forms of underwriting agreements**
 - **10b-5 disclosure letters**

Overview

- **Due diligence obligations largely unchanged under Securities Offering Reform**
 - *WorldCom* case
- **New measurement dates for Securities Act liabilities**
- **Streamlined registration process puts pressure on timing/completion of due diligence investigations**
 - **“Bought deals” under shelf registration statements pose particular challenges**

Overview

- **Our main focus today is on the following:**
 - **New Securities Act liability framework**
 - **Underwriting agreements**
 - **Comfort letters**
 - **Legal opinions/10b-5 disclosure letters**
 - **Use of free writing prospectuses**
 - **Road show practices**

New Securities Act Liability Framework

New Securities Act Liability Framework

- **Section 11 of Securities Act/Rule 430B**
 - **Liability measured based on information included or deemed included as of the actual or deemed “effective date” of the registration statement**
 - **Reforms change measurement dates for Section 11 liability in relation to S-3 shelf takedowns, but not for S-1 or S-4 offerings**

New Securities Act Liability Framework

- **Section 11 liability for shelf takedowns**
 - **Issuers and underwriters – new effective date is established at the time of each takedown**
 - **Under new Rule 430B, a prospectus supplement filed in connection with a shelf takedown is part of the shelf registration statement as of earlier of the time of sale or first use**

New Securities Act Liability Framework

- **Section 11 liability for shelf takedowns**
 - **Directors, officers and experts - liability still measured as of later of effective date of registration statement and date of the most recent Form 10-K**
 - **Consideration must now be given to form of corrective disclosure so that all potentially liable parties will benefit**

New Securities Act Liability Framework

- **Section 12(a)(2) of the Securities Act**
 - **Most significant liability development – new SEC interpretation**
 - **Liability may be premised on oral or written disclosures**

New Securities Act Liability Framework

- **Section 12(a)(2) of Securities Act /Rule 159 –**
 - **Information conveyed to investors prior to or at the time of sale, including oral commitment, forms basis for potential liability**
 - **Information conveyed to investors after time of sale is disregarded unless new contract of sale is established after investor access to the additional information**

Underwriting Agreements

Underwriting Agreements

- **Impact of Securities Act Reform:**
 - **Pricing disclosure package – information utilized to meet new Section 12(a)(2) standard**
 - **Control over, and indemnification for, information contained in free writing prospectuses**
 - **Representations and warranties and indemnification relating to road shows**
 - **Comfort letters**
 - **Legal opinions/10b-5 disclosure letters**

Underwriting Agreements

- **Components of pricing disclosure package:**
 - **Statutory prospectus uniformly included**
 - **Term sheets**
 - **Generally expressly contemplated**
 - **Customary in debt offerings; less so for equity**
 - **Other issuer free writing prospectuses included if scheduled**
 - **Underwriter free writing prospectuses generally not included**

Underwriting Agreements

- **Components of pricing disclosure package (cont'd):**
 - **Oral pricing information**
 - Many underwriting agreement forms contemplate use of oral information if no term sheet is used
 - If contemplated, the information to be conveyed orally is attached to the underwriting agreement
 - **Road shows**
 - Generally, electronic road shows are *excluded* from pricing disclosure packages

Underwriting Agreements

- **Issuer free writing prospectuses:**
 - **Typically, issuer free writing prospectuses comprising part of the pricing disclosure package are specifically identified in the underwriting agreement**
 - **After pricing, additional issuer free writing prospectuses require prior underwriter review and/or approval**
 - **Issuers uniformly provide indemnification to underwriters for issuer free writing prospectuses**

Underwriting Agreements

- **Underwriter free writing prospectuses – issuer consent and approval**
 - **Generally, no issuer consent is required for underwriter use of information included in the preliminary prospectus or a previously-filed issuer free writing prospectus**
 - **A common approach permits underwriter free writing prospectus without issuer consent so long as the underwriter free writing prospectus is not required to be filed with the SEC**
 - **Less commonly, all underwriter free writing prospectuses require issuer consent, other than free writing prospectuses not inconsistent with the term sheet**

Underwriting Agreements

- **Underwriter free writing prospectuses – indemnification**
 - **Do issuers indemnify underwriters?**
 - **Generally, information contained in preliminary prospectus, prospectus or issuer free writing prospectus is covered if used in an underwriter free writing prospectus**
 - **Less commonly, issuer indemnification also covers information in an underwriter free writing prospectus based upon or derived from issuer information**
 - **Do underwriters indemnify issuers?**
 - **Not market practice**

Underwriting Agreements

- **Limits on underwriter indemnification for failing to deliver corrective disclosure:**
 - **Section 12(a)(2) problems are not solved by post-time of sale “corrective” disclosure unless new contract of sale is entered into**
 - **Under Rule 172, access equals delivery for final prospectuses – the underwriters have no obligation to physically deliver a final prospectus**

Underwriting Agreements

- **Are road shows covered by representations and warranties? By issuer indemnification?**
 - **“Live” road shows**
 - **Not covered by disclosure representations and warranties**
 - **Generally, not covered by issuer indemnification**
 - **Electronic road shows**
 - **Covered by disclosure representations and warranties**
 - **Covered by indemnification**

Comfort Letters

Comfort Letters

- Prior to Securities Offering Reform, “circle-ups” in comfort letters covered final prospectus/offering memorandum
- Recently, circle-ups are covering the financial data in time of sale information (*i.e.*, preliminary prospectus/offering memorandum)
 - Most accountants have agreed to such coverage, although a few have resisted this change
 - Comfort letters are still delivered at pricing
 - Negative assurance “change period” is unchanged after Securities Offering Reform

Comfort Letters

- **Issue: should accountants be requested to deliver comfort letters upon printing of preliminary prospectus/offering memorandum?**
 - **Given current trends with accountants – White Papers I and II – could be difficult**
 - **Current practice is to agree final draft before pricing to avoid changes in final prospectus/offering memorandum**
 - **Problem is that until comfort letter is signed, auditors may change letter**
 - **Auditors do not receive management representation letter prior to delivering comfort letter, so draft may not contain up-to-date information for change period paragraph**

Legal Opinions and Disclosure Letters

Legal Opinions and Disclosure Letters

- **Opinion practices have been a key focus under new Securities Act liability framework**
- **Section 11 and Section 12(a)(2) of Securities Act**
- **Principal issues have related to pricing disclosure package**
 - **New approaches being applied to registered offerings and, increasingly, Rule 144A offerings**

Legal Opinions and Disclosure Letters

- **Legal opinions and 10b-5 disclosure letters still delivered at closing**
 - **Heightened sensitivity to changes from disclosure contained in preliminary prospectuses**
 - **Opinions are being prepared earlier and scrutinized more closely due to changes in law firm practices and opinion recipient expectations**

Legal Opinions and Disclosure Letters

- Practices relating to legal opinions (as opposed to 10b-5 disclosure letters) are little changed
 - Some opinions regarding descriptions of securities and tax disclosure relate to both pricing disclosure package and final prospectus
- 10b-5 disclosure letter practices have been adjusted
 - Statements regarding compliance as to form:
 - Questions concerning appropriate measurement point for registration statement compliance

Legal Opinions and Disclosure Letters

- **Disclosure/negative assurance letters**
 - **New coverage as to the absence of material misstatements or omissions in the time of sale information**
 - **Measurement time for negative assurance**
 - **Time of pricing or specified time**
 - **Conveyance of information is assumed**

Legal Opinions and Disclosure Letters

- **New coverage as to the absence of material misstatements or omissions in the time of sale information**
 - **Need to define “pricing disclosure package”**
 - **Commonly, preliminary prospectus + term sheet or other means of disclosure of pricing information**
 - **Challenges presented by significant variation in terms and disclosure from pricing**
 - **Reliance on subsequently filed documents**

Liberalized Communications Regime

Liberalized Communications Regime

- **Securities Offering Reform expands categories of information that will not be deemed to constitute offers**
 - **Regular publication of factual business information and forward-looking information**
 - **Communications by issuers more than 30 days before filing a registration statement**
 - **Expanded Rule 134 permits more information to be provided about issuers and offerings**
 - **Distribution of research reports on more issuers**
- **Reform relaxes the prohibitions on communications viewed as offers both before and after the filing of a registration statement through use of free writing prospectuses**

Liberalized Communications Regime

- Information permitted in Rule 134 notices expanded to include:
 - Increased information about the issuer and its business
 - More information about the terms of the securities, including credit ratings
 - Underwriter information
 - Anticipated timetable for the offering
 - Procedural information
- Limitations remain under Rule 134 (*e.g.*, redemption provisions)

Liberalized Communications Regime

- Free writing prospectus is permitted so long as:
 - The issuer is not an ineligible issuer
 - Unless the issuer is a WKSI, a registration statement has been filed
 - In the case of an unseasoned or non-reporting issuer, statutory prospectus accompanies or precedes the free writing prospectus
 - Filing and legend requirements are satisfied
 - The free writing prospectus does not conflict with the statutory prospectus

Liberalized Communications Regime

- To date, most free writing prospectuses filed with the SEC have been term sheets conveying pricing information to investors at the time of sale
- Term sheets have primarily been used for offerings of debt securities and structured/complex securities – limited usage so far in offerings of common stock
- Use of term sheets builds upon pre-December 1 use of Bloomberg communications – prior use had been predicated on Rule 134

Liberalized Communications Regime

- **New term sheet practice reflects the following factors:**
 - **Limitations of newly expanded Rule 134 (*e.g.*, redemption provisions)**
 - **Section 12(a)(2) liability at time of sale**
 - **10b-5 disclosure letter coverage of time of sale information**
- **Still emerging practices regarding preparation process for term sheets:**
 - **“Speed bump” concerns**
 - **Issuer filing requirement under Rule 433/issuer liability**

Liberalized Communications Regime

- Besides term sheets, free writing prospectuses have included:
 - Prior to IPO pricing, summary of changes made to the preliminary prospectus by pre-effective amendment to the registration statement
 - Spansion Inc. – summary containing revised disclosure as a result of a change in the pricing range
 - Valera Pharmaceuticals – summary containing revised disclosure on management compensation arrangements

Liberalized Communications Regime

- **Proposed terms of a shelf takedown**
 - **Citicorp Funding – descriptions of the proposed terms of equity-linked notes**
- **Supplemental marketing materials**
 - **As part of road show –**
 - **Central Federal Corporation – sales slides including information not in the registration statement, such as market share information and competitors' market capitalizations**

Liberalized Communications Regime

- **Distributed with the preliminary prospectus**
 - **DB Commodity Index Tracking Fund - sales brochure containing investment highlights and list of risk factors**
 - **Digital Music Group IPO - two-page summary of investment highlights that was distributed electronically with a link to preliminary prospectus**

Liberalized Communications Regime

- **Management media communications:**
 - **Johnson Controls – newspaper articles on its urban renewal business strategy that were published a few days prior to a shelf takedown**
 - **ICICI Bank Limited – information provided to media as well as the transcript of a management interview and included additional disclosure to put the statements made by management in context**

Liberalized Communications Regime

- **Written materials distributed at investor conferences during registration:**
 - **Xoma - presentation made at an investor conference while in registration for offerings**

Liberalized Communications Regime

- **Experience under Securities Offering Reform to date:**
 - **Extensive use of free writing prospectuses in the form of term sheets**
 - **Limited but evolving uses of other free writing prospectuses in the marketing process**

Road Shows

Road Shows

- **Key effects of Securities Offering Reform on road shows:**
 - **Prior SEC no-action letters relating to electronic road shows in registered offerings withdrawn**
 - **Electronic road shows generally considered to be free writing prospectuses**
 - **Important exception for an electronic road show, even if transmitted graphically, that originates live, in real-time to a live audience**

Road Shows

- Road shows that are free writing prospectuses do not need to be filed except in connection with equity IPO unless issuer makes a *bona fide* electronic road show available
- “Step backwards” – ineligible issuers cannot use electronic road shows

Road Shows

■ Current practices:

- Reporting issuers continue to use electronic road shows without filing them as free writing prospectuses
- IPO issuers have been posting a *bona fide* version on unrestricted websites (issuer or third-party vendor)
 - Generally, the presentation appears to be equivalent to the actual live road show presentation
 - IPO issuers generally are removing the road shows from their websites after transactions are priced

Electronic Road Show

- Go to: <http://www.retailroadshow.com/>
- Follow the link, click “Continue”
- Click link for Sealy Corporation.

Where Do We Go From Here?

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- **More consistency in Underwriting Agreement provisions?**
- **Increased use of free writing prospectus (in addition to term sheets)?**
- **Upcoming SEC release on reforms to Rule 144A and other private offerings?**

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