

AMERICAN BAR ASSOCIATION
Section of Business Law
Chicago, Illinois

December 11, 1996

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549.

Attention: Jonathan G. Katz, Secretary

Re: Securities Act Concepts and Their Effects on Capital Formation -- Release
No. 33-7314 (File No. S7-19-96)

Dear Mr. Katz:

The undersigned are responding on behalf of the Committee on Federal Regulation of Securities (the "Committee") of the Section of Business Law of the American Bar Association to the request of the Securities and Exchange Commission ("SEC" or "Commission") for comments on the above-captioned release (the "Release").

The comments presented in this letter have been prepared by certain members of the Committee. A draft of this letter was circulated for comment among numerous members of the Committee and has received the general agreement of a majority of those who responded. This letter, however, does not represent the official position of the American Bar Association, the Section of Business Law or the Committee, nor does it necessarily represent the views of all those who reviewed it.

This letter responds to the Release under the following headings:

[Footnote: Like the Release, our comments focus on the general securities distribution process, and we are not commenting specifically on particular situations such as structured financings and asset-backed securities.]

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I. Introduction

The principal premises of the Securities Act of 1933 (the "Securities Act") and its regulatory regime for the U.S. capital markets were (1) the use of a discrete, exclusive and mandatory disclosure document for public offerings, (2) the filing of this document with, and its review by, the SEC, (3) a prohibition of sales until expiration of a mandatory waiting period (subject to acceleration by the SEC) and (4) civil liabilities for disclosure deficiencies in the offering document.

Over 60 years after the enactment of the Securities Act, the statute's premises have been rendered essentially irrelevant by changed market realities. The explosion of information technology, the volatility of securities prices, the dominant role of institutions and the globalization of the markets have forced the SEC to take administrative action to rationalize the public offering process. Notable SEC achievements to this end include the integrated disclosure system,

shelf registration and the creation of safe harbors for institutional resales, offshore offerings and research activities.

Without the SEC's achievements to date, U.S. corporations (with the possible exception of those engaged in initial public offerings) would long since have found the Securities Act an unacceptable anachronistic impediment to their ability to raise capital.

Now that Congress has provided the SEC with broad exemptive authority under the Securities Act, the time has come to recognize that the current jury-rigged system requires fundamental reforms.

The Release seeks comments on both changes to the existing registration system to address the current problems and on the development of a new conceptual framework for regulation of the capital formation process. We have responded to this request by first addressing the immediate actions we recommend to deal with the problems of the current system and then proposing a possible new regulatory model for the capital formation and securities distribution process. [Footnote: Given the diversity of perspectives of our members, not all members of the Committee agree with every action we propose for dealing with the problems of the current system. Similarly, not all members endorse every aspect of the new regulatory model suggested in Part V of this letter. For example, some believe that more attention is needed with regard to the treatment of non-public and unseasoned issuers under the model. However, there is a consensus among our members in favor of the overall approach recommended by this letter.]

We strongly believe that it is critical to address the problems of the current system without delay while concurrently moving down the path toward implementing a comprehensive solution that simplifies and rationalizes the structure of the securities regulation system. The pilot program recommended by the Advisory Committee on the Capital Formation and Regulatory Processes (the "Advisory Committee") in its Report dated July 24, 1996 (the "Advisory Committee Report") is one way to begin the process of changing the conceptual framework. Some of our members support the implementation of the Advisory Committee's pilot program; others favor using the broad exemptive authority recently granted to the Commission under the National Securities Markets Improvement Act of 1996 ("NSMIA") to develop a program that goes even further; and some would move more directly to a new model of regulation. We are all in agreement that (i) the present system, although it has served us well over the years, is now an anachronism that needs to be fixed without delay and (ii) efforts must take place concurrently to reformulate the current system so that it is rationalized under a conceptual framework that recognizes the dramatic

changes that have taken place and anticipates those that are likely in the coming years.

The problems under the present system are confronted every day and impose serious impediments to ongoing financing transactions. Any fundamental reformation of the system, whether it is the Advisory Committee proposal or the comprehensive model described in Part V of this letter, will take time to fashion and implement. Since the Advisory Committee proposal would initially involve only seasoned issuers, which need the reform the least, it would be some time before its coverage would be extended to the issuers which need reform the most. Additionally, since participation in the pilot program is voluntary, it is likely that most eligible issuers would remain subject to the present system. Accordingly, regardless of what model the Commission adopts, we urge that prompt action be taken to deal with the problems of the present system. At the same time, we feel equally strongly that action proceed concurrently to implement a comprehensive solution that changes the conceptual framework for regulation of the capital formation process and securities distributions. As important as are immediate fixes to the current system, they will only add to the patchwork nature of the changes that have evolved. Only a comprehensive solution will ultimately produce real reform, streamline the system and create true efficiency, while protecting the interests of investors.

We are also unified in our belief that it is important, in both dealing with the present system and formulating a conceptual solution, to address the liability problems that we identify below. It should be a widely accepted axiom that the liability of participants in the distribution process should match the actions they can reasonably be expected to take. If there is to be a debate, it should focus on what can reasonably be expected in particular circumstances. We suggest one approach for dealing with this issue in the model described in Part V.

II. Current Problems under Sections 5 and 11

The fault lines in the current regulatory system are illuminated most sharply by the explosion over the past ten years of information technology as applied 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 for 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 completing the demolition of the structure of the Securities Act that was initiated years ago by market volatility, institutionalization and globalization. The evidence of this demolition is apparent in the following areas.

A. Publicity

The theory of the Securities Act has been 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 theory, the SEC has developed the idea of publicity as constituting an illegal "prospectus" in violation of § 5 if it "conditions the market" for a registered offering.

The reality is that the logic of the integrated disclosure system requires that corporations inform their investors about their financing activities. Efforts by the SEC to discourage U.S. companies from filing reports under the Securities Exchange Act of 1934 (the "Exchange Act") that refer to offshore or Rule 144A offerings have run up against this paradox, leading to the adoption of a new rule that expressly permits notice of such offerings in the form of Exchange Act reports, press releases or otherwise. U.S. issuers are still unable, however, to freely place on their Websites information regarding their current and prospective offerings or even to update financial and business information during the pendency of private and public offerings.

Further evidence of the contradictions inherent in the current system may be found in the way that roadshows are treated under the Securities Act. The SEC has expressed concern for many years that institutional investors may obtain an advantage over individual investors by their being invited to roadshows at which details of public offerings are discussed and issuer representatives make presentations that may include information not available in the prospectus. Technology now makes it possible for every investor with an Internet connection, Bloomberg terminal or VCR to see and hear an audio and video playback of the roadshow at a time of the investor's own choosing. Ambiguities about whether such playback constitutes a "writing" and therefore an illegal prospectus are holding up investors' access to information that the SEC has long believed they should have.

B. Research

Again, the position of the SEC is that research may constitute an illegal offer or "prospectus" in violation of § 5. The reality is that broker-dealer research departments have become extremely efficient in the dissemination of information on publicly-held companies (as the SEC intended they should) and that interruptions in this research, or inhibitions on its updating, are counterproductive and 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. 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.

C. Offshore Offerings

Regulation S contemplates that there will be no "directed selling efforts" in the United States during an offshore offering. "Directed selling efforts" are defined by reference to the concept of "conditioning the market". In reality, information released outside the United States by issuers, underwriters and others is almost instantaneously available in the United States through Reuters, Bloomberg and other media. Information made available by foreign issuers on the Internet or similar vehicles is also immediately accessible to U.S. persons. And, in the case of a Regulation S offering abroad concurrently with a registered or Rule 144A offering in the United States, selling efforts in the United States are legitimate and permissible, as they must be.

D. Registration Delays

Despite the efforts of the SEC staff to provide issuers with information relevant to their ability to proceed with a registered public offering, unpredictable delays still arise because of staff review of an issuer's or an industry's Exchange Act reports, staff concern about generic accounting or disclosure problems in Exchange Act reports or staff concerns about securities with "novel and unique" features. In the meantime, volatile markets cause issuers to miss opportunities.

E. Private Placement Paradoxes

Traditionally, exemptions from registration are strictly construed. Moreover, a failure to establish an exemption gives the purchaser 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. In theory, at least in the case of institutional private placements, "offers" are made only to QIBs or institutional 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.

In reality, information on private placements is readily available from industry publications. There is substantial uncertainty about whether issuers and intermediaries need to be able to identify offerees by identity or number. The notion of "general solicitation" is vague. Uncertainty about the need to "police" resales limits the use of depository systems such as DTC with a consequent need for paper settlements. There is great uncertainty with respect to what private offerings must be integrated with each other and as to what public

offerings must be integrated with other offerings. The consequences of hedging transactions are similarly uncertain.

F. Prospectus Delivery

Under § 5, an investor must be mailed a final prospectus with the confirmation. Also, the investor must receive the prospectus before the security is placed in his/her account. Finally, a dealer must deliver a prospectus for a fixed number of days following an initial public offering. In theory, these requirements are intended to provide investors with useful information. In reality, the prospectus always arrives after the investor has made his/her investment decision. Moreover, the prospectus is now universally available by means of EDGAR shortly after its filing with the SEC.

The prospectus delivery requirement only holds up the sending of the confirmation, which is an essential document to the SEC's clearance and settlement objectives. Moreover, it prevents the furnishing of a term sheet to the investor immediately prior to the sale of the security for the purpose of updating information, communicating terms of complicated securities and surfacing any potential misunderstandings.

G. "Gatekeepers" Liability

Since 1982, when it implemented Rule 415 to permit shelf registration, the SEC has undertaken to facilitate capital formation by providing a regulatory process that not only permits but encourages "on demand financing," i.e., the ability of companies to access the securities market immediately whenever capital needs or market opportunities present themselves. The 1992 adoption of the universal shelf process underscored the SEC's continuing commitment to expanding this financing option. "On demand financing" also is the basic regulatory model underlying both the Advisory Committee's recommendations and those of the SEC's Task Force on Disclosure Simplification (the "Task Force"). It is simply no longer tenable for the SEC to promise to issuers the benefits of "instant financing" while continuing to assert that financial intermediaries and other gatekeepers have the responsibility to take the time necessary to do a sufficient due diligence investigation to assure quality disclosure. It is not possible for underwriters and others to meet this obligation in the financing environment the SEC has created and seeks to expand.

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 -- thanks to integrated disclosure and shelf registration -- to influence the issuer's disclosure but remain subject to the § 11 requirement that they demonstrate 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, whereas the liability of the issuer, signing officers and directors is measured on the state of facts at the time the registration statement became effective or the filing of the last annual report, which may be months earlier.

III. Addressing the Problems of the Current System

A. Basic Concepts

As discussed in Part I, we believe that steps should be taken without delay to deal with the problems of the current system, even as efforts are made to develop a new regulatory model. Our recommendations for dealing with these problems are guided in large measure by the following concepts, many of which are reflected in the Task Force Report, the Advisory Committee Report and the Four-Part Approach of the former Director of the Division of Corporation Finance:

- The mandated disclosure system should be issuer-based rather than transaction-oriented.
- The mandated disclosure should be updated at the time of the transaction, and that disclosure, regardless of the document through which it is provided, should be subject to comparable liability standards.
- Limitations on offering activity, as opposed to sales, in the context of both private and public offerings, should be eliminated or narrowly tailored.
- Regulation of offering activity should be based on the nature of the particular investors and their need for the protection of registration.
- Increased accessibility and broader dissemination of information should be recognized by permitting delivery of mandated disclosure through incorporation by reference.
- For seasoned issuers, the availability of quality Exchange Act reporting disclosure should be substituted for other protective mechanisms such as prior SEC review of registration statements and traditional gatekeeper involvement.
- The liability of participants in the distribution process should be based on the conduct that they can reasonably be expected to follow in the circumstances.

- Impediments to resales of unregistered securities should be reduced in view of the improved quality of information in the marketplace.

B. Streamlining the Registration Process

We believe that steps should be taken to streamline and increase the efficiency of the current registration process consistent with the need to protect investors, while efforts continue concurrently to revise the system in more fundamental ways. By improving the present system without waiting for more fundamental changes to be made, the Commission can address the problems of the current system and, at the same time, place the regulatory system on the path to achieve those more fundamental changes. The new grant of broad exemptive authority under NSMIA should make it easier for the Commission to deal with these problems.

1. Shelf Registration System

The existing shelf registration system has worked well to facilitate the registration of securities and to provide an efficient way for companies to come to market without unnecessary delay. We support the following improvements to the shelf system:

a. Pay-as-you-go. The shelf system should be put on a "pay-as-you-go" basis with respect to filing fees. Such a system would allow issuers to avoid funding the costs of offerings months or years before the proceeds of those offerings become available to offset those costs. A "pay-as-you-go" system is consistent with a transition from a transactional-based to an issuer-oriented system and would eliminate the cost impediment to meaningful use by issuers of universal shelf registration.

b. Shelf Secondary Sales. We support an expansion of the universal shelf registration system to permit the registration of secondary sales of outstanding securities. Universal shelf registration presumes that adequate information about an issuer is available to the public; there should be no need for greater protection to investors in the context of secondary offerings, and there is no meaningful reason to distinguish between universal shelf registration of primary offerings and secondary offerings. This change would permit greater unification of registration statements, thereby moving the system closer to issuer-oriented registration.

Additionally, the system for registration of resales should be streamlined by eliminating the need to identify selling security holders, except possibly in the case of affiliates of the issuer. Such information is of limited benefit to investors and is almost impossible to keep current to the extent that securities have been transferred.

c. Shelf Availability for Smaller Issuers. The Task Force Report suggests that shelf registration for delayed primary offerings should be available to smaller issuers. We support that position and believe that smaller issuers with a one-year reporting history should be able to use shelf registration for delayed offerings. The costs of a public offering are often much greater for a smaller issuer than for a larger one. [Footnote: See Advisory Committee Report, Appendix A, table 1 (showing that issuers using Form SB-2 have significantly greater costs as a percentage of offerings than those using Forms S-1, S-2 and S-3).] The requirement that issuers have a \$75,000,000 float before they can use shelf registration increases the cost to smaller issuers -- those least able to bear such costs -- of accessing the capital markets and limits their flexibility to do so.

We believe the one-year reporting history requirement provides adequate protection to investors, and that the float requirement should be lowered or, possibly with a longer reporting history, eliminated entirely. We do not, on the other hand, support expanding the availability of shelf registration by eliminating the requirement of a one-year reporting history. First, shelf registration is premised on the likelihood of some level of market following, and a period of time is required for that to occur. In addition, shelf registration statements rely heavily on the incorporation by reference of Exchange Act filings, and issuers that have had less than a year of reporting history may experience more difficulty in preparing timely Exchange Act reports that fully and adequately disclose material developments than more seasoned issuers will experience. Experienced "gatekeepers" -- outside accountants, underwriters and lawyers -- may be less involved in the preparation of Exchange Act reports than they are in Securities Act filings. Accordingly, it is not recommended that shelf registration be available to issuers before they have had time to develop the internal procedures to provide comprehensive disclosure (i.e., through Exchange Act reports) without the assistance of those gatekeepers.

d. At the Market Restrictions. We believe that current "at the market" restriction of Rule 415(a)(4) should be eliminated. Such restrictions limit issuers' flexibility with regard to these offerings without providing any meaningful investor protections. Moreover, various interpretations of these rules by the Staff have already limited the scope of their application.

e. Updated Disclosure at Takedown. As part of the steps taken to streamline the shelf registration process, we believe that it would be appropriate to provide for any necessary updating of information at the time of a shelf takedown through the filing of a Form 8-K to be made by the time of confirmation of sale, except for Rule 430A-type information which would be due within two business days. By using Form 8-K, the information would be incorporated by reference into the registration statement and subject to liability under §11. Such a filing would also

give the secondary market access to the information. [Footnote: See Advisory Committee Report at 5-6.]

There has been a suggestion that a pre-takedown filing should be required in order to provide information about material proposed takedowns. Although we recognize that a proposed offering may itself be material, and might therefore impact the secondary markets in an issuer's securities, such a requirement could significantly restrict issuers' ability to access the capital markets quickly. Often, the proposed terms and size of an offering are not finalized until immediately prior to commencement of the offering. Moreover, advance notice of an equity offering may exacerbate the "market overhang" problem for issuers, forcing down the price of their stock and limiting the success of the offering. [Footnote: See Advisory Committee Report, Appendix A at 17-18.] Rather, the issue of informing the markets of the takedown should be left to prevailing standards for disclosure of material information.

2. Additional Disclosure Measures

a. Form 8-K Expansion. We believe that the Commission should expand the list of circumstances in which a Form 8-K will be required to be filed to cover disclosure of material modifications of the rights of security holders, material defaults on senior securities and the withdrawal of a prior audit report.

b. No Mandated Form 8-K for Material Developments. We believe it would be inappropriate to require disclosure of all material developments on Form 8-K. Under the current system, public companies have the discretion generally to refrain from announcing material developments as long as they do not attempt to access the public markets prior to disclosing such developments and have no reason to believe there is insider trading based on the information. Frequently, a company may have sound business reasons for deciding to delay an announcement of a material development -- for example, a company may be unable to complete a pending acquisition if it is disclosed prematurely. Any general requirement to disclose all material developments would impose a significant level of uncertainty on disclosure requirements. Rather, timely disclosure of material information should be left to the existing pressures of the marketplace, the requirements of the stock exchanges and NASDAQ, and the quarterly and annual periodic disclosure regime.

c. Timing of 8-K Filings. We do not believe that there is any need to shorten the time period for Form 8-K filings. Press releases provide prompt disclosure to the public of material matters, and are often filed under Item 5 on Form 8-K.

d. Risk Factors in Form 10-K. We believe that disclosure of material investment risks, or risk factors, should not be required in a Form 10-K. Such disclosure

should be left to the discretion of individual companies. Most of the information that would appear in such risk factors should be discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operation (the "MD&A"), which already is required in the Form 10-K. Moreover, the MD&A discussion is less likely to include the boilerplate that we are concerned would result from a "Risk Factors" requirement.

e. Particular Disclosure Proposals. The Commission has raised the question of how to ensure better oversight of Exchange Act filings by senior management, suggesting management certification, required disclosure of management procedures to review such filings, a "disclosure committee" of the board of directors, or increased oversight by gatekeepers. Although we are sympathetic to the Commission's concerns, we do not believe that any of these measures is appropriate.

(i) All Exchange Act reports must now be signed by an authorized officer of the registrant; additionally, the Form 10-K must be signed by a majority of the directors. Although the signing officer should fully review the reports that he or she has signed, the officer clearly accepts responsibility for the content of the filing by signing it. Any further certification will, in all probability, receive no greater or lesser review than the filing itself, and probably will add little to the process.

(ii) Similarly, a management report on disclosure procedures is likely to result in boilerplate disclosure without any real insight into or improvement in review procedures.

(iii) The Advisory Committee proposal for recognizing the role of a "disclosure committee" should an issuer choose to use one is intended to encourage centralization of the diligence function and to acknowledge the principle of reasonable delegation by directors to a committee. However, we have two concerns about this proposal: first, that a disclosure committee would shift liability for disclosure away from the entire board of directors; and second, that such a shift (or perceived shift) would make it difficult, if not impossible, to find individuals willing to serve on such committees. [Footnote: See Advisory Committee Report, Separate Statement of John C. Coffee, Jr., Edward F. Greene, and Lawrence W. Sonsini, at 43-44.]

(iv) We recommend encouraging, but not requiring, SAS 71 reviews of interim financial information. Companies should be allowed to decide for themselves, based on their own circumstances, whether SAS 71 reviews will be part of their disclosure regime.

(v) With the adoption of Rule 415, the role that gatekeepers -- particularly underwriters -- play in reviewing disclosure has diminished. [Footnote: See Advisory Committee Report at 29 ("Although the current system expects outside parties to act as gatekeepers in the offering process, in practice and for a variety of reasons, such roles are not necessarily being fulfilled in the manner anticipated when the Securities Act was adopted"). See also ABA Task Force Report on "Sellers' Due Diligence and Similar Defenses Under the Federal Securities Law," 48 Business Lawyer 1185 (1993).] We believe that this was an inevitable and foreseeable consequence of the shift to permit shelf registration of delayed offerings, and that no steps to involve gatekeepers more thoroughly can be taken without impeding the accessibility of the capital markets.

3. General Registration Procedures

a. Staff Review. We support continued pre-effective review of Securities Act registration statements by the staff for specified categories of issuers and transactions, including initial public offerings, Rule 13e-3 going private transactions and other identified problem areas such as blank check offerings, penny stock issuers and certain direct participation investment programs. Prior SEC review brings an added discipline to the process that helps to improve disclosure and the integrity of the securities markets. In this regard, we would also favor preserving SEC discretion to review other filings in advance, but these would be on a limited basis pursuant to previously disclosed criteria. On the other hand, in order to add certainty to the process and remove unnecessary impediments to timely access to the capital markets, we would eliminate advance review for other categories (subject to discretionary review in exceptional cases), such as those meeting Form S-3 criteria and straight debt issues by reporting companies. In these cases, staff reviews would be made after-the-fact with emphasis on the Exchange Act reports. In this connection, since such review would be after-the-fact, except in egregious situations, comments should be future oriented.

b. Adequacy of Prospectus Delivery. We strongly believe that the current disclosure system has worked well and does not need to be modified to require earlier prospectus delivery than now required. The mechanisms in place, such as Rules 460 and 461 under the Securities Act and Rule 15c2-8 under the Exchange Act, as well as the applicable liability regime, adequately insure that investors receive or have access to the relevant information and any material modification of that information on a timely basis.

On the other hand, we believe that final prospectus delivery requirements should be more flexible. The advent of electronic confirmation systems and the acceleration of settlement, together with the current ability to electronically access the final prospectus have made the requirement that a final prospectus

be delivered with or before the confirmation both unworkable and unnecessary. We suggest (i) permitting delivery (physically or by electronic access) post-confirmation if there is no material change from the previously delivered preliminary prospectus (e.g., 430A-type information) or where straight debt is taken down from the shelf without use of a preliminary prospectus and (ii) permitting use of a term sheet with essential information (delivered either with the confirmation or prior to settlement) where a preliminary prospectus was available earlier or, in the case of a straight debt takedown, was not used. The availability of this final prospectus delivery relief could be limited to seasoned issuers and its use in troublesome areas and transactions could be excluded.

c. Restrictions on Offering Material. Another area that has proven to be troublesome as methods of communication and free flow of information have expanded has been the restriction under §5(b)(1) of the Securities Act on free-writing or supplemental information during the pendency of a registration statement. Examples are contemporaneous research reports, otherwise required public announcements, the electronic dissemination (by telecommunication, video and on-line access, either contemporaneously or subsequently) of road show presentations and communications between brokers and customers by e-mail. In many cases, the restriction does not serve the interest of investors, causing information to be provided orally rather than in a more useful writing and resulting in selective access to road show presentations. One approach would be to expand the types of communications that are excluded from the term "prospectus" (although possibly only for purposes of §5 and not §12(a)(2)). Again, relief in this area could be limited to seasoned issuers, with appropriate exclusions for problem situations.

In the case of research reports, we recommend expanding the safe harbors under Rules 137, 138 and 139 to broaden the circumstances under which publication of research reports is permissible. These reports play an essential role in the efficiency of the securities trading markets. The safe harbor should apply to regular research reports prepared in the ordinary course of business for any issuer that files periodic reports pursuant to §13 or 15(d) of the Exchange Act and for foreign issuers whose securities are publicly traded.

The Commission should also clarify the status of information about the issuer previously published on the Internet. Increasingly, companies have home pages on the World Wide Web (as does the Commission) where they post material about the company. Similarly, analyst research reports may be posted and available on the Internet. There is confusion over the status of such postings in the context of pending securities offerings. The Commission should make clear that, like other forms of previously published information, unless the information was posted in connection with the offering or is referred to and incorporated as part of the offering, electronically available information is not part of the offering

material. Internet information should be treated like information about the company (even if supplied by it) that can be found on the shelves of a library.

d. Test-the-Waters Activity. We favor permitting test-the-waters activity before the filing of a registration statement under appropriate circumstances. Such activity will facilitate the ability of an issuer to decide the best course to pursue in raising capital and to properly structure the offering before incurring the significant expense and effort attendant to filing a registration statement. This relief should not be limited to initial public offerings as proposed by the Commission in Release No. 33-7188 (1995), but should apply as well to public companies. Some of our members would require a notice filing prior to test-the-waters activity, at least in the case of non-public companies, but most would not impose such a condition and certainly would not require it for seasoned issuers which already have public information adequately available. We refer to our letter dated October 25, 1995 responding to the foregoing release (File No. S7-18-95) and to our comments below regarding private offerings.

C. Dealing with Exempt Offering Difficulties

The ability of companies to raise capital through exempt private or limited offerings as an alternative to registration has become increasingly difficult as a result of current Commission rules and Staff interpretations. This difficulty is attributable in part to the erosion in recent years in the distinction between private and public offerings. This erosion has been caused in part by issuers seeking to have the flexibility to quickly access the private or public markets, both domestically and offshore, and attempting to combine the speed and certainty of a private placement with the pricing benefits that flow from the greater liquidity of having registered securities. These trends are typified by such techniques as "PIPES" and "A/B Exchange Offers," as well the use of Rule 144A offerings; at the same time there are registered offerings to single investors and block takedowns from shelf registrations. Efforts by the Commission and the Staff to restrict the erosion of the distinction between public and private offerings have led to uncertainties in the application of existing rules that fail to take into account the changes in the markets and the methods of communication and have created difficulties for issuers, particularly smaller companies, seeking to finance their businesses. We consider it critical that the Commission deal with these difficulties; and the broad new exemptive authority expands the Commission's opportunity to do so.

1. General Solicitation

The broad prohibition of general solicitation creates serious problems for companies seeking to raise private capital efficiently and imposes significant complexities on the system as a whole. With the shift in focus over the years

from offerees to the nature of the actual purchasers, the time has come to eliminate this vestige of private placement lore by removing or narrowing the prohibition on general solicitation as a condition to the Regulation D exemptions under Rules 505 and 506. Similarly, the comparable restrictions on offering activity, as opposed to sales, under Rule 144A (prohibiting solicitation of nonqualified institutional buyers) and Regulation S (prohibiting directed selling efforts in the United States) should be eliminated or narrowed.

At the very least, the prohibition on general solicitation should not apply in the case of sales exclusively to "qualified investors" (which may be coextensive with, a subset of or different from "accredited investors" under Regulation D). By definition, these investors do not need the protection of registration and therefore do not need to be protected from unregistered solicitation activity. A basic principle, which could rapidly be implemented through Staff or Commission interpretation, is that the manner of locating "qualified investors" should not affect the ability of a company to complete sales to them either privately or pursuant to a registration statement. These investors do not need to be protected against soliciting activity in the case of exempt private sales or against "gun-jumping" in the case of a registered offering. In addition, so long as they are not market intermediaries and there is no plan to act as conduits for the issuer or affiliates, there should be no concern that allowing completion of private offers to these investors as registered sales will erode the distinction between public and private offerings by allowing them to resell to the public without registration.

If a prohibition on general solicitation is to remain in place for non-qualified investors, we believe there should be a mechanism to permit broad solicitation of potential investors which may then be completed either as a registered offering to any investors or as a private offering to qualified investors. One such mechanism, at least in the case of non-public or unseasoned issuers, could be a notice filing like a "test-the-waters" notice. A notice filing for these types of issuers would help to address enforcement concerns about an indiscriminate unregistered offering. If a company wishes to sell privately to non-qualified investors eligible under an exemption, it could limit its manner of offering.

We refer to our letter dated October 25, 1995 responding to Release No. 33-7185 (File No. S7-15-95) in which we discuss the prohibition on general solicitation and our belief that the prohibition is not statutorily required if other conditions are in place to insure a private offering.

2. Conversion from a Private to Public Offering

Rule 152 was designed to permit a company that initiates a private offering to switch to a registered public offering. As interpreted by the Staff, however, the private offering must be terminated or completed before Rule 152 can be relied

upon to permit the registered offering to be filed without being integrated with the private offering. We believe that this is an unnecessarily narrow interpretation that defeats legitimate financing arrangements.

It should always be possible to convert a private offering to a registered offering given that investor protection is enhanced by registration. Although there is the potential for gun-jumping, this should not outweigh the benefits of permitting registration, particularly inasmuch as the private offering itself must have been undertaken in good faith in compliance with applicable requirements for an exempt private offering. Companies often have compelling business reasons for switching from the private to the public markets. For example, a company that seeks to raise money privately may find that investors are interested only if they can purchase registered shares (e.g., funds that have used up their restricted securities allotment), may not be able to find sufficient eligible investors to complete the offering or may decide to raise the size of the offering above the exemption limit. Under present interpretations, the company would have to terminate the offering and begin again with a registered offering, while dealing with uncertainty as to what is needed to terminate the prior offering and whether investors initially contacted can be included in the registered offering. We do not believe that any significant purpose is served by these restrictions.

We support the expansion of Rule 152 to include offerings pursuant to a §3(b) exemption. Similar policy considerations of allowing companies to switch to a registered offering or to commence a registered offering after completing an exempt offering apply in these situations.

3. Private Placements During a Public Offering.

A converse situation is the conduct of a private placement during the pendency of a registered public offering or shortly following its completion. The position of the Commission has been that the mere filing of a non-shelf registration statement constitutes general solicitation which prevents undertaking a private placement while the registration statement is pending. [Footnote: See Letter dated March 23, 1984 from John J. Huber, Director of the Division of Corporation Finance to Michael Bradfield, General Counsel of the Board of Governors of the Federal Reserve System; and Traiger Energy Investments, SEC Litigation Release No. 10241 (1983).] Similarly, the conduct of a registered offering can prevent a subsequent private placement if the traditional integration principles apply; a six-month waiting period to obtain the certainty of a safe harbor may be required in order for the issuer to be assured that there will not be a violation.

These results can have significant adverse consequences for a company in need of financing. Consider the case of a company that commences a registered offering (perhaps an initial public offering) but finds that the window for public

offerings of its type has closed or encounters delays in the registration process; it therefore seeks to do a private placement with qualified investors. The foregoing position of the Commission would likely prevent it from doing the private placement unless it withdraws the registration statement and possibly waits six months. It may have to resort to an offshore financing to be able to obtain the needed financing. Under these circumstances, a company proceeds at its peril in filing a registration statement. Another example is the company that completes the public offering but soon has an opportunity (perhaps an acquisition) that requires additional financing which it seeks to obtain through a private placement. The Commission's integration interpretation would likely prevent proceeding with the private placement.

The Task Force Report recognizes these problems and recommends elimination of the presumption that the mere filing of a registration statement constitutes general solicitation, leaving general principles regarding general solicitation to apply. It also recommends adoption of a safe harbor in the case of "quiet filings." We support the Task Force's recommendations but we do not believe that they go far enough in addressing the problem.

First, as indicated above and in our letter dated October 25, 1995, we believe that the prohibition of general solicitation should be eliminated, at least in the case of sales exclusively to qualified investors. Second, a private placement or limited offering should never be integrated with a registered offering. We refer to the earlier ABA proposal for a safe harbor rule on integration. [Footnote: See ABA Task Force Report on "Integration of Securities Offerings," 41 Business Lawyer 595 (1986).] These steps would provide relief not only in the case of a quiet filing, but where there has been marketing activity. In the first example above, the public offering window could close or the delay could be encountered equally after distribution of the preliminary prospectus as before. The relief should not be limited to the case of quiet filings; to do so would impose an unnecessary penalty on distributing the preliminary prospectus. Additionally, the Commission should address the problem of the company that wished to do a private placement following completion of its registered offering. As discussed above, a company should always be in position to complete a private placement to qualified investors. These investors do not need to be protected from unregistered general solicitation activity or through the application of integration principles. In the case of sales to non-qualified investors, it may be appropriate to have a brief cooling-off period after completion of the registered offering.

4. Warrants and Convertible Securities.

In recent years, the Staff has taken the position that securities issuable upon the exercise or conversion of warrants or convertible securities that were privately placed cannot be registered for issuance to the private purchasers upon such

exercise or conversion. This position is based on the principle that a private offer (the right to acquire the underlying security) cannot be combined with a public sale, presumably based on concern over "gun-jumping." This position unnecessarily applies a theoretical principle to defeat the legitimate expectations of the parties to the transaction and to impose an undesirable burden on the issuer. Rather than receiving registered securities in connection with what, in many cases, amounts to a new investment decision (namely, the decision to exercise the warrant and pay the exercise price or to convert one security into another security with different rights -- often, a senior security into common equity), the investor receives restricted securities and the issuer is required to keep in effect a resale registration statement. In fact, it is even possible that a private offering exemption will not be available to cover issuance of the underlying security on exercise of the warrant if the warrants are held by non-accredited investors due to transfers or a change in circumstances.

There is no compelling investor-protection interest served by this Staff position and it should be abandoned.

5. Summary Proposal.

The following is a proposal for addressing many of the foregoing problems involving the public/private offering distinction that reflects the themes discussed above. It has the benefit of being relatively simple and straightforward and subject to quick implementation in large part by Staff or Commission interpretation.

a. Issuers should be free to make offers in any manner to "qualified investors," which can then be completed to such investors either privately or in a registered public offering. By definition, these investors do not need the protection of registration or to be shielded from "gun jumping."

b. Correspondingly, registered offers should not preclude private sales to qualified investors, either during the pendency of the registered offering (without regard to whether or not marketing activity has taken place) or anytime following completion of the registered offering. Since these investors do not need the protection of registration, they are not harmed by the public offering activity. Put another way, general solicitation should not preclude a private offering to qualified investors.

c. As is now the case, an issuer should be able to make sales privately to non-qualified investors within limits if it restricts its offering activity.

d. Alternatively, an issuer should be able to broadly solicit potential investors (possibly subject to a notice filing) and then complete the offering either as a

registered sale (without regard to the nature of investors) or as a private sale to qualified Investors. This recognizes the desirability of allowing test-the-waters activity but protecting nonqualified investors at the offer stage.

e. Private offers should always be able to be completed as registered sales.

6. Expanded Local Offering Exemption.

We support the recommendation in the Task Force Report that the Commission develop an expanded and workable local offering exemption to simplify capital-raising by smaller issuers. The Task Force recommendation was first made by several members of the Committee in a letter dated August 9, 1991.

The premise of our proposal was that offerings by local issuers in a local area (which could be a metropolitan area that crossed state lines) could properly be regulated by the states and did not require federal regulation. We proposed clarifying the requirements for the statutory intrastate offering exemption under §3(a)(11), while expanding the scope of the exemption by using the exemptive authority under §3(b). With the Commission's new broad exemptive authority under NSMIA, a meaningful local offering exemption could be put in place without being circumscribed by the limitation of §3(a)(11) or the dollar limit of §3(b).

Since the exemption is targeted to assist smaller businesses and is premised on the presence of state regulation, we would exclude listed and NMS issuers of covered securities for which state regulation is preempted.

D. Resales

1. Dealing with the "4(1 1/2)" Gap

The Commission has provided a safe harbor under Regulation D for private offerings by issuers but it has not provided a similar safe harbor for resales by accredited and other investors who purchased in the Regulation D offering. The only resale exemption is under Rule 144A and that is limited to resales to qualified institutional buyers (narrowly defined) and is subject to other limitations (e.g., non-fungibility; offers only to QIBs -- as contrasted with absence of general solicitation under Regulation D). This leaves Regulation D purchasers in a state of uncertainty regarding resales, having to rely on the undefined so-called "4(1 1/2) exemption" for resales to purchasers who are not QIBs. This creates a particular problem for dealers who act as principal in side-by-side Rule 144A and Regulation D offerings.

There is a need for a resale exemption safe harbor for purchasers in Regulation D offerings allowing them to resell at least to "accredited investors" who may not be QIBs. Preliminary Note 4 to Regulation D currently limits the safe harbor to sales by issuers.

This resale exemption should be coordinated with Rule 144A so that permissible activity under one does not prevent use of the other. Alternatively, the definition of QIB under Rule 144A could be expanded to broaden its availability. Additionally, the proscription of offering activity under Rule 144A, like the prohibition of general solicitation under Regulation D, should be eliminated or narrowed so that the focus is on actual purchasers.

2. Definition of Affiliate.

We support the Advisory Committee's proposal to narrow the definition of "affiliate" for purposes of Securities Act resale limitations and strongly recommend that this narrowing and clarification be done now across the board for all issuers. The ambiguous concept of "affiliates" has in practice expanded well beyond its original statutory purpose and now covers a broad group of directors and officers, often coextensive with those subject to §16 of the Exchange Act. This imposes unnecessary limitations on resales and burdens the process. These persons have to comply with the mechanics of Rule 144, routine transactions with brokers become complex and special arrangements have to be made with transfer agents. The resale system would be significantly streamlined if the narrower definition of "affiliate" proposed by the Advisory Committee were adopted.

We do not, however, favor changing at this time the definition of underwriter as proposed by the Advisory Committee. This change should be dealt with in the context of the more fundamental change in the regulatory system we believe should occur. Some of the present problems caused by the breadth and uncertainty of the term "underwriter" can be alleviated through a shortening of the Rule 144 holding period.

3. Rule 144 Holding Period.

We support shortening the holding periods under Rule 144 as proposed by the Commission in Release No. 33-7187 (File No. S7-17-95). We refer to our letter dated September 6, 1995.

IV. Elements of a Long-Term Solution

While it is undoubtedly possible to minimize or in some cases even eliminate certain of the problems described above by amending rules, defining or

redefining terms and using the SEC's new exemptive authority, and these things should certainly be done in the short term as discussed in Part III of this letter, we believe that a patchwork approach will not adequately address, much less solve, the problems of adapting the registration requirements of the Securities Act to today's world. We believe that the SEC must completely rethink how the capital-raising and securities distribution processes should be regulated, develop a model of how regulation should work, attempt to achieve as many elements of that model as it has authority to do and consider approaching Congress to obtain any greater authority or guidance it thinks it needs.

We believe that certain principles should guide the search for a more realistic and efficient regulatory regime.

1. It should eliminate or alleviate as many of the problems identified in Part II of this letter as possible.
2. It should be simpler than our current system. Where possible, objective criteria, such as numbers of holders and classes of purchasers, should be substituted for vague concepts such as public offering, general solicitation, directed selling efforts, etc. Rescission rights under § 12(a)(1) should not turn on such vague concepts, which are subject to a wide range of interpretations in the hands of judges and juries.
3. It must work in the light of today's realities (e.g., T+3 settlement) and expectations as to tomorrow's realities (e.g., T+1 settlement). It must take into account instantaneous worldwide communications, the role and accessibility of research, etc.
4. While the SEC should continue to have authority to stop or prevent fraudulent offers, offerees who do not purchase securities should not have civil remedies. Purchasers' remedies should not be affected by either the number or the qualifications (or lack thereof) of offerees who do not purchase. Concerns about "conditioning the market", although understandable in an earlier and simpler world, must be abandoned. The focus should be on protecting purchasers that have been damaged, identifying the information on which they are legitimately entitled to rely in making investment decisions, determining who should be responsible for deficiencies in that information and establishing the standards by which their culpability should be judged.
5. Clearance and settlement have to be de-linked from disclosure. It must be recognized that purchasers of securities don't make up their minds whether to purchase securities on the basis of a reading of the final prospectus received after they have committed to purchase. If there are significant developments that will appear for the first time in a final prospectus, well-advised underwriters

recirculate an updated preliminary prospectus, circulate a preliminary prospectus supplement or get the word out orally.

6. Underwriters' and other gatekeepers' strict liability subject to a reasonable investigation ("due diligence") defense should be confined to those situations in which it is realistic and reasonable to expect them to be able to conduct a reasonable investigation and influence the disclosure.

V. A Possible Model

A. Overview

The SEC should adopt a new regulatory model applicable to the capital-raising and securities distribution process. The model can be constructed using the architecture of the SEC's integrated disclosure system, but with the Exchange Act rather than the Securities Act serving as the model's foundation. We present below our thoughts as to how one possible model might work.

Overall, the model would:

- eliminate all restrictions on offering communications
- subject issuers to a mandated continuous disclosure process based on the nature and number of their securityholders
- treat sales of securities by an issuer and its affiliates and their underwriters as occasions for updating the issuer's mandated disclosure package
- dispense with prospectus delivery obligations except for unseasoned issuers, companies with a limited securityholders or trading volume, problematic distributions and certain transactions that substantially change the nature of an investor's existing investment
- remove all administrative clearances and review procedures that could interfere with a public company's continuing access to the securities markets
- rationalize disclosure liabilities of distribution participants and others

B. Offers -- Oral and Written

Offers, whether oral or written and whether before, during or after a distribution, would not be subject to any regulatory restriction or to any filing requirement.

Written, electronic, CD and video communications, including press releases, research and selling materials, would all be permitted.

Under this new regulatory model, research and dissemination of corporate news could proceed on a timely, uninterrupted basis without fear of liability for making an unregistered offer or engaging in a general solicitation or a directed selling effort that would preclude reliance on § 4(2) or Regulation S. Companies could test the waters for interest in an offering; private placements could be offered over the Internet. Permitting free writing throughout an offer would allow "profile" disclosures, term sheets, written responses to investor inquiries and open access to the press and financial analysts.

The SEC would continue to be able to bring administrative and civil proceedings to restrain and penalize fraudulent or misleading and manipulative conduct. Private remedies would be limited to purchasers for damages resulting from materially false or misleading statements as described in greater detail below.

C. Entry into Disclosure Regime

Assuming that engaging in a "public offering" is no longer determinative in triggering the disclosure regulatory process, it becomes necessary to decide what extrinsic facts should subject an issuer to the disclosure regulatory regime. We would envision that entry into the mandatory disclosure regime should be a phased transition. We think it could look something like this.

1. The issuer would be entitled to sell securities of any type to (a) family members, employees, customers and suppliers and (b) "accredited investors" as currently contemplated under Regulation D. The informational requirements would be as at present under Regulation D. Whether broker-dealers participate as agent or intermediaries would be irrelevant. Liability could be as under § 12(a)(2) or Rule 10b-5 using a recklessness standard. Resales of the securities would be restricted to similar persons, subject to the consequences described in paragraph 3 below.
2. The issuer could sell securities of any type to "eligible purchasers," defined as any person (legal or natural) that owns "investment securities" with a specified minimum value at the time of purchase. There would be no prescribed informational requirements -- eligible purchasers will dictate what they want to receive. Liability for materially false or misleading statements could be as under § 12(a)(2) or Rule 10b-5 using a recklessness standard. Eligible purchasers could freely resell such securities to other eligible purchasers, subject to the consequences described in paragraph 3 below.

3. Within 120 days after the end of an issuer's latest specified fiscal period (e.g., fiscal year or quarter) in which:

(a) the number of holders of its equity securities who are not accredited investors or eligible purchasers exceeds a minimum number (e.g., 500),

(b) the number of holders of its equity securities, whether or not eligible purchasers, exceeds a higher number (e.g., 2,000), or

(c) the number of holders of all its securities (equity, debt etc) who are not eligible purchasers exceeds a still higher number (e.g., 2,500),

the issuer would be required to register with the SEC, file with the SEC a comprehensive disclosure document (subject to SEC review) and become subject to the SEC's continuous reporting requirements. If an issuer or an affiliate proposes to make sales of the issuer's securities that would cause the number of holders of its securities to exceed the above thresholds, it would first have to similarly register with the SEC. Issuers would also be able to register voluntarily.

4. The disclosure requirements could be tailored to the size, number of holders and reporting experience of the particular issuer.

5. During a specified period (e.g., one year), and as long thereafter as the issuer has fewer than a specified number of security holders (e.g., 2,500) and in other cases prescribed by the SEC (e.g., major business combinations, partnership rollups, penny stocks, etc.), the issuer in connection with proposed sales of securities would be required to prepare and file a prospectus that would be subject to potential SEC review before sales of the securities could be made.

6. Absent the circumstances described in paragraph 5, sales of the issuer's securities by the issuer, an affiliate and underwriters would be permitted at any time without prior staff review or clearance, prospectus delivery would not be required and reliance would be placed on the mandated disclosure in the public record.

Liability would be determined on the basis of the state of the issuer's public record at the time confirmations of sale are sent to purchasers. To avoid liability the public record would have to be current in all material respects except for Rule 430A-type information, which could be included in the public record within two business days after the first mailing of confirmations.

7. Foreign issuers would be permitted to sell an unlimited amount of debt or equity securities to an unlimited number of "eligible purchasers". Such securities could be traded in an exchange or electronic trading system, provided that the

securities are sold inside the United States only to eligible purchasers. If a foreign issuer proposes to sell debt or equity securities to other than eligible purchasers and the thresholds described in paragraph 3 (measured on the basis of U.S. holders) would be exceeded, the foreign issuer would have to enter the disclosure system in the same manner as a U.S. issuer. As at present, the initial and continuing disclosure requirements would be tailored to the circumstances of foreign issuers.

D. Mandated Disclosures -- Public Record

Once subject to the mandated disclosure requirement and having filed its comprehensive disclosure document, the issuer would update its public record on an ongoing basis as it does today, through the filing of annual reports, quarterly reports and current reports to disclose specified material developments affecting the issuer.

E. Prospectus Delivery

Subject to limited exceptions identified below, under the proposed model there would be no requirement to prepare a prospectus or to deliver any other prescribed disclosure to a purchaser in connection with a sale of securities by the issuer, its affiliates and underwriters. Investors' access to the issuer's public record, which would contain all mandated disclosures and be readily and immediately available through Edgar, would suffice. The model places substantial reliance on ready electronic access to the public record on file with the SEC. This will require the SEC to restructure Edgar to assure investors free and immediate electronic access to Edgar filings over the Internet when made, not on the current delayed basis.

Preparation and delivery of a prospectus (subject to potential prior SEC review) would be required for securities sales during an issuer's first year as a public company. This would both provide investors with a comprehensive updated disclosure package for companies as to which a market following may just be developing and assure that all those involved in the distribution will have the opportunity to do the due diligence necessary to assure the quality of the disclosure provided in connection with the transaction. For similar reasons, in addition to these unseasoned companies, prospectus delivery also may be warranted for distributions by companies with a limited number of securityholders or whose securities have a minimal level of trading volume, or issuers of the type that have been the source of problematic practices in the past, such as blank check or penny stock companies.

In addition, where a transaction (other than a distribution of securities for cash) would substantially change the nature of securityholders' existing investment,

such as a major business combination or restructuring, mandated delivery of disclosure would be appropriate. In these cases, the mandated information could be tiered to take into account a number of factors, including, for example, the size of the companies involved and extent of their securityholder base as well as the nature and level of materiality of the transaction.

All mandated prospectuses would be required to be filed as part of the public record and delivered to purchasers. However, the delivery requirement could be satisfied by the delivery of a prospectus containing all material information other than Rule 430A-type information at least 24 or 48 hours prior to confirmation of sales. (This would be analogous to the procedure currently contemplated by Exchange Act Rule 15c2-8.) Any mandate to deliver a prospectus or other disclosure document should include an exception for transactions with eligible purchasers and sales outside the United States.

F. Staff Review

Underlying this proposal to bring all securities offerings by public companies within the mandated disclosure process is the basic premise that generally after being a public company for one year, the issuer, its affiliates and underwriters will be free to proceed with the sale of securities without prior staff review or other administrative clearance and without the threat of stop-order. Staff review would be made of the mandated comprehensive disclosure document required to be filed at the time a company first enters the mandated disclosure process and of any mandated prospectuses. Otherwise, staff oversight of the disclosures made by public companies, including those in connection with a distribution, would be conducted after publication as in the case of Exchange Act reports today. When the SEC believes a company's disclosures are misleading or insufficient, the SEC would have to take formal enforcement action under § 17 of the Securities Act or under the Exchange Act to stop the distribution.

G. Liability

All sales by a public company, its affiliates or their underwriters would be subject to potential liabilities to purchasers for misleading disclosures. While sales offshore would not be subject to these heightened liabilities, they would apply with respect to securities sold abroad initially and resold into the United States within a specified time period. The proposed liability regime would continue the existing distinction between liabilities in connection with sales made by issuers, their affiliates and underwriters, and other securities transactions. Tracing, therefore, would still be required as it would be inequitable to impose on issuers, affiliates and underwriters heightened liabilities beyond the distribution made.

While we believe it continues to be appropriate to impose heightened liabilities for misleading disclosures when the issuer, affiliates and their underwriters are selling the issuer's securities, the current liability regime needs recalibration to reflect current market and regulatory realities. The new regulatory model should impose liability for failure to meet obligations realistically and fairly imposed.

1. Mandated Public Record. With respect to information contained in the mandated public record:

a) Issuer, signing officers, directors and experts. All would have the same liability as at present under § 11 with respect to all distributions.

b) Underwriters. When a distribution is subject to mandatory prospectus delivery, underwriters would continue to have § 11-type liability with respect to the issuer's public record, including the mandated prospectus. This is reasonable because the underwriters can be expected to have sufficient opportunity to conduct a due diligence investigation and to affect the disclosure document provided to investors.

In all other cases, the underwriters' liability should be subject to a lesser standard. This should not be that of § 12(a)(2) because § 12(a)(2) is not sufficiently different from § 11 in that it charges an underwriter with knowledge of information that reasonable care would have uncovered, when the premise of the lesser liability standard is the inability to conduct an investigation. It could, however, be similar to the liability standard currently applicable to "expertised" portions of the registration statement, i.e., that the underwriters are not liable if, at the time of sale, they had no reasonable ground to believe, and did not believe, that the public record contained any misstatement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. The effect of this change would be to relieve the underwriters of the requirement, in establishing a defense, that they prove that they made a reasonable investigation. As an alternative, the standard of liability could be that of Rule 10b-5 using a recklessness standard. One attraction of this approach is that the SEC could accomplish this result by utilizing its new power to exempt underwriters from §§11 and 12(a)(2) with respect to the public record in specified classes of cases and stating that the underwriters will continue to be subject to Rule 10b-5.

2. Offering Material Outside the Mandated Public Record. Each person making oral statements or using written offering material outside the mandated public record should be subject to liability for materially false or misleading statements that go beyond the mandated public record and are in fact used to sell the securities being distributed. The standard could be that of present § 12(a)(2) or Rule 10b-5 with a recklessness standard. Presumably these statements or

documents would have to stand on their own two feet, i.e., they could not rely on cautionary statements and risk factors incorporated by reference to the mandated public record to counterbalance bullish statements in the document used to sell the securities.

H. Special Sales.

It is recognized that at times an issuer may be unable or for good business reasons unwilling to include in the public record information that would be required to be disclosed, or necessary to update the public record, and yet still need to raise capital by selling securities to eligible purchasers that either don't need the required information or to which the necessary information can be entrusted on a confidential basis. So long as adequate precautions are taken to address insider trading concerns, such sales should be permitted. Disclosure concerning the absence of required information or the material development would be made to the purchasers prior to the sale, and the purchasers would be restricted by the issuer from freely reselling the securities until the issuer makes such information part of its public record. In view of this possibility, the SEC would need to make clear that any mandated disclosure of the sale of securities by an issuer, affiliate or underwriter would not be viewed as an implicit representation by the issuer to the market that all material developments through the date of the reported securities sale have been made part of the public record.

VI. Conclusion

There is currently a unique opportunity to address the problems of the present system regulating capital formation while reformulating that system to put in place a regulatory scheme that recognizes the dramatic changes in information technology, the globalization of the securities markets, the dominant role played by institutional investors and the other new realities described in this letter. The Advisory Committee Report, the Task Force Report and other commentaries on the need to reform the system have created an environment in which real progress can be made. We urge the Commission and its Staff to seize this opportunity to put in place a securities regulatory system that will serve investors, the financial markets and issuers well into the next century. The members of the Committee look forward to assisting the Commission and its Staff in meeting this challenge. We are available to work with you on this important effort upon your request.

Respectfully submitted,

John M. Liftin, Chair
Committee on Federal Regulation of Securities

John J. Huber, Chair
Subcommittee on 1933 Act -- General

Stanley Keller, Co-Chair
Task Force on Small Business Issuers

William J. Williams, Jr., Chair
Task Force on Review of the Federal Securities Laws

cc: The Hon. Arthur Levitt, Chairman
The Hon. Steven M.H. Wallman, Commissioner
The Hon. Isaac C. Hunt, Jr., Commissioner
The Hon. Norman S. Johnson, Commissioner

Brian J. Lane, Director
Division of Corporation Finance

Drafting Committee

Parts II, IV and V:

Joseph McLaughlin
Linda C. Quinn
William J. Williams, Jr.

Part III:

Alan J. Berkeley
John J. Huber
Stanley Keller

Participants:

Daniel S. Evans
Dan L. Goldwasser
Jean E. Harris
Keith Higgins
R. Todd Lang
Richard M. Leisner
Bruce Alan Mann
Ellen L. Marks
John F. Olson

Quinton F. Seamons
Gregory Yadley