VEDDER PRICE

Corporate Securities

A bulletin designed to keep corporate executive and investment banking professionals informed on major developments in the securities industry

If you have questions regarding material in this issue of *Corporate Securities* or suggestions for a specific topic you would like addressed in a future issue, please contact Steven J. Gray (312/609-7528), Jennifer R. Evans (312/609-7686) or any other Vedder Price attorney with whom you have worked.

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SEC LAUNCHES "AIRCRAFT CARRIER" PROPOSALS

In early November, the SEC introduced sweeping proposals to modernize the process for public offerings under the Federal securities laws. The proposals have been labeled the "Aircraft Carrier" in recognition of the massive scope of the reforms.

The changes proposed by the SEC are in response to recent capital market trends that have rendered aspects of the current securities registration system cumbersome and inefficient. The more important market trends prompting the changes are:

- significant growth of the institutional "private placement" or Rule 144A market
- expansion of the role of the research analyst in the offering process
- rise of the Internet and electronic communication
- relative attractiveness to issuers of the public vs. private markets

If adopted, the proposals will work fundamental changes to the way securities are offered and sold in public offerings under the Securities Act of 1933.

The SEC proposals address five major areas of the offering process:

- the registration system
- offering communications and publicity
- prospectus delivery
- integration of public and private offerings
- periodic reporting under the Securities Exchange Act of 1934

The Registration System

The Aircraft Carrier proposals introduce a multi-tiered securities registration system. Form A registration statements would be used by smaller issuers or unseasoned companies. Form B registration statements would be employed by larger seasoned companies. Form B could also be used by any issuer to register certain specified types of offerings. Form C registration statements would be used for business combinations and exchange offers.

The most significant changes to the registration process fall under Form B. Form B users would be given greater control over the timing of public offerings and more freedom to communicate with investors and the market. Unique features of Form B offerings will include the following:

- a registration statement can be filed any time before the *first sale* of securities in an offering
- companies can decide when an offering goes effective
- filings will not be subject to staff review procedures
- companies will be free to communicate with investors or the market at any time without fear of gun-jumping or making illegal offers

Form B eligible companies would include issuers with a public float of $250 million or issuers with a public float of $75 million *and* an average daily trading volume (ADTV) of $1 million. Form B would also be used by seasoned companies of any size for sales to qualified institutional buyers. Companies not meeting the public float or ADTV issuer requirements could use Form B for rights offerings, dividend reinvestment plans, direct stock purchase plans, exercises of transferrable options or warrants, securities issued upon conversion of convertible securities, and nonconvertible investment grade securities.

An abbreviated Form B registration statement would include offering information, terms of the securities, and the incorporation of Exchange Act reports.

Form A registration statements would be available for small or unseasoned companies. The process for Form A offerings would resemble the system currently in place for initial public offerings or secondary offerings of smaller issuers. Smaller reporting companies, however, would be allowed to incorporate Exchange Act reports under Form A. Certain reporting companies may also be given flexibility as to when a Form A registration statement could go effective.

Form C registration statements would cover registered exchange offers, mergers and other business combinations. Form C would generally require much of the same information presently required about the transaction, the acquiror, and the company to be acquired.

The current Regulation S-B system for small business issuers would effectively remain in place. The SEC is proposing that any company with revenues of less than $50 million (up from the present $25 million standard) would qualify to use Regulation S-B.

Communications and Publicity

Under the Aircraft Carrier reforms, the SEC is proposing to loosen the strict controls on communications to investors and the market at the time of an offering. Under the proposals, all restrictions on offering communications would be lifted for Form B issuers. The free communication rule would not be available for issuers that are not registered under the Exchange Act or those that had not been timely in filing Exchange Act reports.

For companies that do not qualify for the free communication rule, the SEC is proposing a bright line safe harbor test. Communications made 30 days prior to the filing of a registration statement would not constitute illegal offers or gun-jumping. The SEC is also proposing that factual business communications made by any company or forward-looking statements made by reporting companies be unrestricted during the offering process.

Free writing during the marketing phase of an offering will also be permitted under the proposed reforms. Any free writing materials would be required to be filed with the SEC.

Acknowledging of the importance of the research analyst's role in public offerings, the SEC is proposing to broaden the use of analysts' research reports during an offering. For Form B offerings, analysts could publish research reports without interruption due to a registered offering. Safe harbors would be expanded for research reports for Form A offerings.

Prospectus Delivery

The Aircraft Carrier reforms would change the current rules on prospectus delivery. Delivery of preliminary prospectus information would be determined by the nature of the issuer and the offering. For Form B offerings, a securities term sheet or abbreviated prospectus would be required to be delivered before investors made their investment decision. For Form A offerings, a preliminary prospectus would need to be delivered to investors 7 calendar days before pricing, in the case of an initial public offering, or 3 calendar days for companies that had completed a public offering at least one year earlier.

Instead of requiring a final prospectus to be delivered after sale, the SEC proposals would simply require companies and broker dealers to tell investors, before they receive confirmation of sale, where they can obtain the final prospectus free of charge.

Integration of Public and Private Offerings

To address interpretive issues surrounding the integration of public and private offerings, the SEC is proposing amendments to rules governing integration. These amendments would address the following situations:

- a private offering completed before a registration statement is filed would not be integrated with a registered offering

- privately offered securities could be registered for resale so long as the private offering is completed before a resale registration statement is filed

- lock-up agreements would not prevent the registration of securities to be issued in merger or acquisition transactions if the lock-ups are signed only by insiders and votes are to be solicited from other stockholders

Under the new registration system, Form B issuers would have maximum flexibility to convert private offerings to public offerings because a registration statement need not be filed before offers can be made. For Form A issuers, private offerings can be converted to public offerings after notice to all offerees in the private offering. A public offering can be converted to a private offering after a 30 day cooling-off period, or sooner if the issuer and the underwriter agree to accept liability standards under the Securities Act.

Exchange Act Disclosure

As part of the SEC registration reforms, the SEC is proposing a number of changes to Exchange Act reports. This is in recognition of the importance of Exchange Act reports in the offering process.

The SEC is proposing risk factor disclosures in Exchange Act reports. This would apply to all reporting companies. Annual reports would include comprehensive risk factor disclosure, while quarterly reports would require only disclosure of material changes.

It is also proposed that public companies be required to file selected financial data on Form 8-K 30 days after the end of each quarter, and 60 days after the end of each year. This would coincide with customary press releases of quarterly and annual financial performance ahead of Form 10-Q and Form 10-K filings. As an alternative, the SEC is considering whether to accelerate Form 10-Q and Form 10-K filings to 30 and 60 days, respectively.

The SEC is also proposing that the items that must be

reported on Form 8-K be expanded to include disclosure on material modifications to the rights of security holders, the departure of a CEO or CFO, material defaults on senior securities, notices concerning prior audits and name changes.

Other Reforms

There are a variety of other proposals that in the Aircraft Carrier release would effect the registration process. One of the most important (and controversial) will require that persons signing a report certify that they have read the report, and that the report contains no material misstatements or omissions.

The SEC is also proposing to provide guidance to underwriters on due diligence investigations to cope with an expedited offering process. The proposals would also provide guidance with respect to staff review of registration statements and periodic reports. For example, all IPO transactions would continue to receive staff review. For Exchange Act filings, the staff will allow companies to request a review of their Exchange Act reports in anticipation of an offering.

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The Aircraft Carrier proposals are significant and pervasive. The SEC has set a four-month comment period, and comment letters are expected to be heavy. It is likely that the comment and review process will take 12 to 18 months before any of the proposals, as they may be modified or amended, will take effect.

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SEC PROPOSES UPDATES TO TAKEOVER REGULATIONS

In conjunction with the Aircraft Carrier release, the SEC is proposing to update and simplify the regulation of takeover transactions. Mergers, acquisitions, tender offers and similar corporate transactions will be affected by the proposed rules.

The SEC has identified three predominant trends that are

driving the need for reforms in today's M&A market. These include:

- the use of securities by acquirors in takeover transactions
- an increase in hostile transactions involving proxy contests
- technological advances in communications permitting quicker and direct contact with security holders

In the SEC's view, these trends have created complex issues under the current regulatory system, resulting in unnecessary burdens to companies. The proposed reforms are intended to simplify and update the M&A process.

The key reforms under the M&A proposals include:

- lifting present restrictions on shareholder communications in M&A transactions involving registered securities
- creating a level playing field for exchange offers (i.e., tender offers where the bidder is offering securities) and cash tender offers
- streamlining the regulatory process for transactions that involve a combination of tender offer, proxy solicitation and Securities Act registration issues

Free Communications

Recognizing the immediate needs of the market for current and forward-looking information upon the announcement of a merger, acquisition or tender offer, the SEC is proposing to eliminate all restrictions on communications about an upcoming M&A transaction. This would be achieved by the adoption of safe harbors for oral or written communications before a registration statement, proxy statement or tender offer statement is filed.

The SEC is proposing to make the free communication safe harbors available to all companies – not just large or seasoned issuers. All written communications used in connection with a transaction would be required to be filed with the SEC upon first use.

About Vedder Price

Vedder, Price, Kaufman & Kammholz is a national, full-service law firm with approximately 180 attorneys in Chicago, New York City and Livingston, New Jersey.

The Corporate Securities Group

The firm's corporate finance and securities attorneys regularly represent underwriters and issuers, both foreign and domestic, in a wide variety of matters, including:

- debt and equity offerings, including initial public offerings, structured debt financings, aircraft securitizations, dual-class equity structures and sophisticated preferred stock instruments;
- capital formation, for initial capitalization,

financing ongoing operations and acquisitions;

- corporate disclosure, periodic reporting, proxy solicitations, and insider trading and beneficial ownership compliance matters;
- private placement of securities including Rule 144A and Regulation S transactions;
- tender offers, mergers and acquisitions and recapitalizations and restructurings;
- international offerings of securities and compliance by foreign issuers with the U.S. securities laws; and
- litigation, administrative and arbitration proceedings involving various securities fraud claims, disclosure issues and regulatory enforcement matters.

Vedder, Price, Kaufman & Kammholz
A Partnership including Vedder, Price, Kaufman & Kammholz, P.C.

Chicago
222 North LaSalle Street
Chicago, Illinois 60601
312/609-7500
Facsimile: 312/609-5005

New York
805 Third Avenue
New York, New York 10022
212/407-7700
Facsimile: 212/407-7799

New Jersey
354 Eisenhower Parkway
Plaza II
Livingston, New Jersey 07039
973/597-1100
Facsimile: 973/597-9607

Timing of Exchange Offers

The SEC proposals are designed to place third-party exchange offers on an equal footing with cash tender offers. In addition to the free communication safe harbors, which would apply equally to third-party exchange offers and cash tender offers, the new proposals would provide that third-party exchange offers can commence upon filing a registration statement or on a date selected by the bidder. There would be no requirement that a registration statement in a third-party exchange offer be reviewed first by the SEC.

Going private transactions and roll-ups involving exchange offers would continue to be subject to SEC review before commencement of the offering.

Streamlining the Regulatory Process

The M&A reforms would create an integrated set of uniform disclosure regulations for issuer tender offers, third-party tender offers, and going private transactions. The reforms would also allow for single filings to satisfy all disclosure obligations regardless of the structure of the transaction.

Financial statement disclosure in M&A transactions will also be effected under the new proposals. Disclosure of financial statements of targets in cash mergers will be eliminated if the acquiror's stockholders are not voting. When the target is a non-reporting company and the acquiror's stockholders are not voting on the transaction (which involves the issuance of acquiror securities), only target financial statements for the latest fiscal year, prepared in accordance with GAAP, will be required (unless GAAP financial statements were also prepared for the previous two years). Financial statement requirements for non-reporting targets in roll-ups would not be affected by the reforms.

The SEC proposals would also update the current tender offer rules in a variety of ways. These reforms would:

- permit securities to be tendered after the tender offer is completed (without withdrawal rights) in third-party tenders for all outstanding shares of the target
- clarify the financial information required of bidders

in cash tender offers

- clarify the obligation of targets to report purchases of its own securities after a third-party tender offer is commenced

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The M&A proposals were published in conjunction with the Aircraft Carrier release. The SEC has indicated, however, that adoption of the M&A proposals will not necessarily be tied to the adoption of the Aircraft Carrier proposals.

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AUDITING "MANAGEMENT'S DISCUSSION AND ANALYSIS"

The Auditing Standards Board of the American Institute of Certified Public Accountants has adopted SSAE No. 8, which sets forth guidance for the examination and review by accounting firms of "Management's Discussion and Analysis" disclosures in annual reports, prospectuses and other documents.

Under SSAE No. 8, MD&A audits can be performed for public companies or nonpublic companies that prepare an MD&A presentation under SEC rules and regulations. Audit reviews of MD&A can be conducted for annual and/or interim reporting periods. MD&A audits cover all of the information in the MD&A section, including historical financial data, market or industry information and forward-looking statements.

The opinions that can be given under SSAE No. 8 include:

- the MD&A presentation includes, in all material respects, the required elements of the rules and regulations of the SEC

- the historical financial amounts have been accurately derived, in all material respects, from the company's financial statements

- the underlying information, determinations,

estimates, and assumptions of the company provide a reasonable basis for the disclosures in the MD&A

An MD&A audit can be an important due diligence device for boards of directors, audit committees and underwriters. Boards and audit committees should discuss the availability of an MD&A audit and assess its desirability. Prospective underwriters may want to negotiate MD&A audits in connection with public offerings. Given the novelty of the MD&A audit, cost and timing considerations should be addressed early on in the process of preparing MD&A disclosure.

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