

SEC Proposes to Further Liberalize Communications by WKSIs and Underwriters Acting on Their Behalf Before the Filing of a Registration Statement

Summary

The SEC recently proposed amendments to Rule 163(c) under the Securities Act of 1933 that should facilitate greater access to capital by well-known seasoned issuers (“WKSIs”)¹, particularly in the context of pre-marketed transactions. Subject to a number of conditions described below, the proposed amendments would permit underwriters or dealers, acting on behalf of a WKSI, to offer securities prior to the filing of a registration statement without violating the gun-jumping provisions of the Securities Act. Under current Rule 163, WKSIs, but not underwriters or dealers, are permitted to communicate directly with potential investors before a registration statement has been filed.

By permitting authorized underwriters and dealers to communicate with investors on behalf of a WKSI where a registration statement is not already on file, the proposed amendments are designed to provide a WKSI with access to the underwriters’ or dealers’ existing networks of investors to gauge the level of interest in the market for a potential offering of the WKSI’s securities without filing a registration statement that could telegraph an offering and potentially have a damaging effect on the market for an issuer’s stock.

The full text of the proposed amendments can be found in SEC Release 33-9098 (Dec. 21, 2009), available at <http://www.sec.gov/rules/proposed/2009/33-9098.pdf>. The deadline for providing comments to the SEC is January 27, 2010.

Background

Historically, the statutory regulation of communications related to offerings registered under the Securities Act was relatively straightforward: prohibiting all offers before filing a registration statement; prohibiting written offers other than by a statutory prospectus after filing; and prohibiting other writings after effectiveness unless accompanied or preceded by a final prospectus. However, in practice, the distinction between permissible communications and illegal offers violating the registration provisions of the Securities Act (known as “gun-jumping”) was not always clear and often required a “facts and circumstances” analysis.

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¹ A WKSI is an issuer that meets the registrant requirements of Form S-3 or Form F-3; has at least \$700 million in worldwide market value of outstanding voting and non-voting common equity held by non-affiliates (or has issued, for cash, within the last three years at least \$1 billion aggregate principal amount of non-convertible securities through primary offerings registered under the Securities Act); and is not an “ineligible issuer,” as defined in Securities Act Rule 405.

In June 2005, the SEC adopted a series of significant reforms to the registration and offering rules under the Securities Act. To reduce the uncertainty surrounding the so-called gun-jumping provisions and encourage the timely dissemination to investors of more information regarding offerings, the 2005 reforms, among other things, liberalized the communication rules applicable to registered offerings. WKSIs, a newly created class of issuers, were the primary beneficiaries of the 2005 reforms. As part of the effort to ensure that WKSIs enjoyed complete relief from the gun-jumping provisions and were not unnecessarily constrained from raising capital, the SEC adopted Rule 163. So long as the conditions to the rule are satisfied (e.g., filing and legending written offering communications), Rule 163 provides an exemption from Section 5(c) of the Securities Act that permits WKSIs to engage in unrestricted oral and written offers before a registration statement is filed.

The Need for Proposed Rule 163(c)

The current exemption under Rule 163 contains an important limitation, the impact of which was not readily apparent in 2005. The exemption is available only for communications “by and on behalf of an issuer.” In this regard, offering participants who are underwriters or dealers are explicitly precluded from relying on the exemption. As a result, currently, if a WKSI wishes to engage a prospective underwriter to test the waters in connection with a proposed offering, the WKSI would need to have a registration statement on file.² The proposing release, however, notes that many WKSIs either have not filed automatic shelf registration statements, or the automatic shelf registration statements they have filed may not register all the types of securities they may want to offer, perhaps due in part to concerns about market overhang.

Pre-marketed “Wall Crossing” Transactions

The restrictive definition of “by and on behalf of an issuer” in Rule 163 particularly constrains pre-marketed “wall crossing” transactions that employ an abbreviated (often overnight) pre-offering, confidential marketing period to assess market interest.³ In these transactions, due to concerns related primarily to a lack of knowledge about potential investors and/or confidentiality issues, issuers often are unable or unwilling to contact potential investors about their capital-raising plans without the assistance of an underwriter or dealer. However, Rule 163 currently does not permit an offering participant who is an underwriter or dealer to make such pre-filing communications.

Proposed Rule 163(c)

The proposed amendments would revise the “by and on behalf of an issuer” definition in Rule 163(c) so that, under certain circumstances, underwriters or dealers can communicate with investors about a potential offering by a WKSI prior to the filing of a registration statement (or

2 If a WKSI has on file a registration statement covering the securities being offered, then it would not need the exemption from Section 5(c) of the Securities Act, which prohibits offers being made before a registration statement has been filed.

3 In a typical “wall crossing” transaction, large institutional investors are approached and asked if they would be interested in learning more about a potential securities offering. After agreeing to keep the information confidential, a requirement mandated by Regulation FD, and to refrain from trading in the issuer’s securities until the public offering is announced, the investors are brought “over-the-wall” and learn the identity of the issuer and the details of the proposed offering. If the investor appetite is sufficient, the offering is launched and priced. If investors do not demonstrate sufficient interest, the issuer may determine not to proceed with the offering and, except where it has disclosed material non-public information to investors (which could, depending on the circumstances, include the failed attempt to raise capital), the issuer need not disclose anything to the market.

filing of a post-effective amendment to add classes of securities) covering the securities in question. In this regard, an underwriter or dealer could act as an agent or representative of a WKSI if the following conditions are satisfied:

- The underwriter or dealer receives written authorization from the WKSI to act as its agent or representative before making any communication on its behalf;
- The WKSI authorizes or approves any written or oral communication before it is made by an authorized underwriter or dealer; and
- Any authorized underwriter or dealer that has made any authorized communication on behalf of the issuer in reliance on Rule 163 is identified in any prospectus contained in the registration statement that is filed for the offering to which the communication relates.

In the proposing release, the SEC stated that one way an issuer could satisfy the second condition is to approve via oral communications the contents of the information that will be conveyed by the authorized underwriter or dealer to potential investors. The proposing release does not elaborate further on the degree of authorization or approval that would be required to meet this condition.

All other current requirements of Rule 163 would continue to apply, including that:

- All communications made by or on behalf of the issuer and in reliance on Rule 163 would continue to be subject to Regulation FD;⁴
- Every written communication that is an offer made in reliance on the Rule 163 exemption would contain substantially the legend required by the rule; and
- Every written communication that is an offer made in reliance on the Rule 163 exemption would be filed with the Commission as a free writing prospectus when the registration statement, or amendment to the registration statement, is filed.

Conclusion

By permitting WKSIs to engage offering participants who are underwriters or dealers for the purpose of communicating with potential investors prior to the filing of a registration statement (or post-effective amendment, as the case may be), the proposed amendments should provide WKSIs greater access to capital through the use of the underwriters' or dealers' existing network of investors and the increased flexibility to assess whether to proceed with an offering as well as terms of the offering. Depending on the size of the offering and its materiality to the issuer and holders of its securities, WKSIs may be required, under Regulation FD, to disclose their intentions to access the market unless investors enter into appropriate confidentiality agreements.

⁴ The proposed amendments do not change the applicability of Regulation FD to communications made in reliance on Rule 163, which are not considered to be in connection with a registered securities offering for purposes of the exclusion for such communications from Regulation FD. The proposing release notes that, "[i]f an authorized underwriter or dealer acting on behalf of an issuer desires to communicate material non-public information in reliance on proposed amended Rule 163 to persons enumerated in Regulation FD [e.g., securities market professionals and security holders who may trade on the basis of the information], the issuer, or the underwriter or dealer acting on its behalf, would first need to obtain a confidentiality agreement from the enumerated persons or the issuer would need to publicly disclose the information in the manner and within the timeframe set forth in Regulation FD. Moreover, any misuse of the information for trading by any person subject to a confidentiality agreement would be covered under either the "temporary insider" or the misappropriation theory of insider trading." (footnotes omitted) The SEC's proposing release also contains a cautionary note that "public or private sales of additional securities" of an issuer "should be reviewed carefully to determine whether they are material," requiring disclosure under Regulation FD unless investors enter into appropriate confidentiality agreements.