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# Redoing the Statutory Scheme by Rule-Making

Charles W. Murdock

*Loyola University Chicago, School of Law, [cmurdoc@luc.edu](mailto:cmurdoc@luc.edu)*

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## **Redoing the Statutory Scheme by Rule-Making**

By Professor Charles **Murdock**[\*]

With a presidential election around the corner, regulation and deregulation are now major issues. According to Speaker John Boehner, regulation is a job killer.[1] On the other hand, the private sector has added over 2.5 million jobs since June, 2009.[2] It is the state and local governments, constrained by borrowing limitations and following the austerity path of Europe, which have been the big job killer. Public sector jobs have decreased by over 500,000 in the same period.[3]

Not all regulation is a job killer or anti-business. It is now a dim memory but, in the early 1970s, 20 million shares was an extraordinary trading day for the New York Stock Exchange and 10-12 million shares was more normal.[4] Today, it is not unusual for 2-4 billion shares to be traded,[5] a geometric increase. The market has demonstrated a capability to absorb huge quantities of shares and the increased volume has sparked increased following by analysts, hedge funds, institutions and other money managers, although, as the investigation by Attorney General Spitzer of New York demonstrated, analyst advice is not necessarily wise.[6]

After considering the changed environment, the SEC, in 2005, adopted far-reaching regulatory changes to the operation of Section 5 of the Securities Act of 1933 (the 1933 Act)[7] regulating the distribution of securities to the public. In view of the current topical nature of regulation, this would be an appropriate time to review the Securities Offering Reform, a 468 page release (the "Reform Release"),[8] from the perspective of the historical Section 5 requirements and the changes effected by the new rules. The Release began by stating "[t]he Securities and Exchange Commission is adopting rules that will modify and advance significantly the registration, communications, and offering processes under the Securities Act of 1933. Today's rules will eliminate unnecessary and outmoded restrictions on offerings." [9]

The deregulation accomplished by the Reform Release has been expanded in April of this year when Congress passed and the president signed the "Jumpstart Our Business Startups Act," [10] known by the acronym "JOBS." A better acronym might be the "FOG" Act, or "Fraud on Grandma" Act, since it reduces disclosure, thereby fogging the perspective of investors, and will undoubtedly result in more fraud in securities transactions.[11] Much of the JOBS Act impacts disclosure under the Securities Exchange Act of 1934; [12] however, there are also significant changes to the 1933 Act, [13] including to Section 5. [14]

Section 5 divides eternity into three periods: pre-filing, interim, and post effective by focusing upon two points at a time, the filing of a registration statement and the subsequent effectiveness of the registration statement. [15] Since Section 5 is composed of three sub-paragraphs, one might have supposed (erroneously) that each paragraph dealt with one of these periods, i.e. sub-paragraph (a) with the pre-filing period, sub-paragraph (b) with the interim period, and sub-paragraph (c) with the post-effective period. But, as we know, legislation is seldom that logical. The chart enclosed as Appendix A affords a perspective on the operation of the three sub-

paragraphs prior to the reform.

The most orderly way to review the operation of Section 5, both before and after the reform regulations, is to look at the activities permitted or prohibited in each of the three periods, the task of the balance of this article.

### **The Pre-Filing period.**

Section 5(c), on its face, appears absolutist:

“(c) *Necessity of Filing Registration Statement.* It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal or stop order (prior to the effective date of the registration statement) any public proceeding or examination under Section 8.”[16]

On its face, this section would preclude preliminary negotiations with the underwriter. On the other hand, in our system of firm commitment underwriting, no issuer would want to go to the expense of preparing and filing a registration statement unless it was comfortable that an underwriting group could be formed to market the securities. Consequently, the definition of offer contains an exclusion for such preliminary negotiations.[17]

Other issues were triggered by a broad prohibition against pre-filing offers. Early on, the SEC took a dim view of “gun jumping,” that is, corporate publicity aimed at arousing public interest in a forthcoming offering.[18] In a well-known administrative case,[19] Davis, who owned extensive real estate in the “Gold Coast” of Florida, formed Arvida Corporation to develop the real estate. Loeb, Rhodes, a registered broker-dealer and prospective underwriter, issued a press release describing the proposed development and its financing.[20] The SEC concluded that the purpose of the press release was “the stimulation of investor and dealer interest as the first step in a selling effort,” and thus violated Section 5(c).[21] While the SEC determined that it was not necessary in the public interest to expel respondents from the NASD or revoke their registration as broker-dealers, the case nonetheless sent a strong message against pre-filing market conditioning.

Before examining the new rules, it is important to understand that all issuers are not equal under the new schema. Under the new rules and the JOBS Act, there are basically five types of companies: 1) pre-IPO companies, reporting companies, which are further divided into 2) companies that have a float of less than \$75 million, 3) companies that have a float \$75 million or more, and thus could be eligible to use form S-3, and, 4) after the Reform Release, companies with a float of \$700 million or more, and, 5) after the JOBS Act, “emerging growth companies.”[22]

Basically, reporting companies are those that have previously had a public offering or those that have at least 2000 shareholders and \$10 million of assets.[23] Those eligible to use form S-3 are sometimes referred to as “seasoned issuers,”[24] whereas other reporting companies are sometimes referred to as “unseasoned issuers,”[25] or as a “smaller reporting company.”[26] Companies that have either \$700 million or more in market value of common equity securities or have issued at least \$1 billion in principal amount of non-convertible securities for cash[27] are known as well-known seasoned issuers, or sometimes referred to as a “WKSI” company.

There are also two groups of companies that may be excluded from the benefit of the new rules: “risky” companies (blank check companies, shell companies, and penny stock companies) and “investment” companies (mutual funds and business development companies).[28]

The new rules, Rules 163,[29] 163A,[30] 168,[31] and 169,[32] now provide safe harbors for certain conduct such that it will not be considered an illegal offer under Section 5(c).[33] Arguably, much of the conduct described in rule 169 would have been permissible prior to the adoption of the rule.[34] The safe harbors are significant because any violation of Section 5 could trigger liability under Section 12(a)(1)[35] or cause the effectiveness of the registration statement to be delayed.[36]

Rule 163 applies to well-known seasoned issuers only and provides that an offer by such an issuer is exempt from the prohibitions of Section 5(c), as long as the requirements of the rule are followed. A written communication under the rule is deemed to be a free writing prospectus which must contain a specified legend and must be filed with the SEC. The communication must come from the issuer, not the underwriter. If these requirements are met, the body of law with respect to gun jumping is now irrelevant for these companies and Section 5(c) is in effect repealed for them.

On the other hand, Rule 163A provides a safe harbor for both reporting and non-reporting companies (but not “risky” or “investment” companies) for communications that do not reference the forthcoming offering and which occur more than 30 days prior to the filing of the registration statement. Such communications are deemed not to be an offer. Again, the rule protects communications from the issuer, not from the underwriter. The rule, in effect, determines that any undue conditioning of the market will be dissipated by the passage of time, now 30 days.

Rules 168 and 169 focus on the type of information and the manner and purpose of the transmission. Rule 168 provides a safe harbor for a reporting company (other than an “investment” company) when it issues factual business information **or forward-looking information** consistent with past practices. Such protected information is deemed not to be an offer under Sections 2(a)(10)[37] or 5(c). Again, the rule protects communications by the issuer, not by an underwriter, and the communications cannot contain information about the offering. Basically, the communication is protected if the issuer has previously disseminated information of the same type in the ordinary course of business, and the timing, manner, and form in which the information is released is consistent with past practice.

On the other hand, Rule 169 provides a safe harbor for all companies (both reporting and non-reporting) but only applies to **factual** information intended for customers and suppliers, but not for investors, in accord with past practices. Such protected information is deemed not to be an offer under Sections 2(a)(10) or 5(c). Once again, the offering protects an issuer, but not an underwriter, and the communication cannot include information about the offering. Like Rule 168, the issuer must have previously disseminated information of the same type in the ordinary course of business, and the timing, manner, and form of the dissemination must be compatible with past practices. Investment companies or business development companies are not covered by this rule.

What the foregoing rules have in common (except for Rule 163) is that the communication cannot mention the proposed offering (this would be permitted in a communication satisfying Rule 135[38]) or underwriters. A significant difference between Rule 163A and Rules 168 and 169 is timing. For Rule 163A to be applicable, the communication must be 30 days prior to filing the registration statement, whereas a communication covered by either Rule 168 or Rule 169 can occur at any time prior to filing. On the other hand, a communication that fails

to meet the strictures of Rules 168 or Rule 169 would be protected by Rule 163A if it occurs 30 days prior to filing.

The JOBS Act has added another wrinkle to permissible activity in either the pre-filing or interim period. In the case of an emerging growth company, either the company or a person authorized to act on its behalf, which would most likely include an underwriter, can contact, either orally or in writing, a qualified institutional buyer or an institution that is an accredited investor to determine if it is interested in purchasing securities in the proposed offering.<sup>[39]</sup> This is another “test the waters” type provision. There is a caveat that such solicitation is subject to Section 5(b)(2), which would mean that no security could be delivered in connection with the solicitation.

### The Waiting Period

Just as Section 5(c) is the important statutory provision with regard to the pre-filing period, Section 5(b)(1)<sup>[40]</sup> is the critical statutory provision with regard to the waiting period. This section prohibits transmission of a prospectus after filing, unless the prospectus meets the requirements of Section 10.<sup>[41]</sup> Section 2(a)(10) defines a prospectus essentially as any written communication or communication by radio or television that offers or confirms the sale of a security. Since this section of the 1933 Act was last amended prior to the advent of the Internet, Rule 405,<sup>[42]</sup> as currently amended, defines a written communication to include a graphic communication, and defines a graphic communication as including all forms of electronic media.

Section 5(b)(1) only controls the use of prospectuses, and prospectuses are written communications (an offer communicated through radio or television is also a prospectus). Accordingly, oral offers (other than by radio or television) are not proscribed during the waiting period. However, both oral and written communications can give rise to a Rule 10b-5<sup>[43]</sup> violation or any enforcement action under Sections 8A or 17.<sup>[44]</sup> In addition, a prospectus that does not comply with the requirements of Section 10 will violate Section 5 and give rise to a cause of action under Section 12(a)(1).<sup>[45]</sup> A prospectus that is misleading will give rise to a cause of action under Section 12(a)(2)<sup>[46]</sup> or Rule 10b-5, or an enforcement proceeding under Sections 8A or 17.

Since oral offers are permissible during the waiting period, most of the issues that arise in the waiting period involve whether a communication is a prospectus, and if so, whether the prospectus meets the requirements of Section 10.

In the “old days,” that is, until December 2005, the problem was fairly simple: Rule 430<sup>[47]</sup> authorized the use of a “preliminary” or “red herring” prospectus. This is a prospectus that would meet the requirements of Section 10(a)<sup>[48]</sup> or, in other words, be a final prospectus, except that it did not include pricing information. Thus it was a Section 10(b) prospectus. Section 2(a)(10)(b)<sup>[49]</sup> and Rule 134<sup>[50]</sup> authorized “identifying statements” and “tombstone ads.” Rule 134(d) also authorized a letter or card which asked the recipient to indicate whether he or she might be interested in purchasing the security. This sub paragraph required a legend stating that the response was not binding and also required that the communication be preceded by a preliminary prospectus. A summary prospectus was also authorized under Rule 431, but was rarely used.

Prior to 2005, any “free writing” during the waiting period would result in a violation of Section 5(b)(1). It was a simpler world. Now, the SEC has introduced the concept of a permissible free writing prospectus in Rule 433.<sup>[51]</sup> Rule 405 basically defines a free writing prospectus as one that is not a traditional Section 10 prospectus. Thus, it covers what was formerly prohibited free writing in the waiting period. Rule 164<sup>[52]</sup> provides that a free writing prospectus (as defined in Rule 405), meeting the conditions set forth in rule 433, will be a Section

10(b) prospectus for purposes of Section 5(b)(1). Rule 433 itself states that a free writing prospectus is a Section 10 (b) prospectus.

The first step in determining whether or not a valid free writing prospectus exists is to determine the nature of the issuer: is the issuer a seasoned issuer or a well-known seasoned issuer, or is the issuer a non-reporting company or an unseasoned issuer. On the one hand, if the issuer is a non-reporting issuer (a typical IPO situation) or an unseasoned reporting company (one that is not eligible to use Form S-3),<sup>[53]</sup> then, if the free writing prospectus is used or referenced by the issuer or an offering participant or if consideration will be given by the issuer or an offering participant for the dissemination of the free writing prospectus, the registration statement must include a section 10 prospectus, such as a rule 430<sup>[54]</sup> or preliminary prospectus, and the preliminary prospectus must precede or accompany the free writing prospectus.<sup>[55]</sup> On the other hand, if the issuer is a well-known seasoned issuer, or a seasoned issuer and the offering is on Form S-3 (or certain other forms), there is no need to accompany the free writing prospectus with a preliminary prospectus.<sup>[56]</sup>

The second step deals with the information in the free writing prospectus.<sup>[57]</sup> First of all, the free writing prospectus can contain information not contained in the registration statement. However, the information cannot be inconsistent with public information and publicly filed documents (the registration statement or the issuer's periodic and current reports). In addition, the free writing prospectus must include a legend stating that a registration statement has been filed and that the recipient of the communication should consult the documents on file with the SEC before making an investment decision. It may also provide information as to where and how the documents may be obtained

The third step deals with filing. Generally, the free writing prospectus and something known as "issuer information" must be filed by the issuer with the SEC.<sup>[58]</sup> However, if the free writing prospectus does not contain substantive changes from a previously filed free writing prospectus, the later free writing prospectus need not be filed. Similarly, if the issuer information has previously been filed with the SEC, there need not be an additional filing.<sup>[59]</sup>

The filing provisions also stipulate that the free writing prospectus is not deemed to be a part of the registration statement.<sup>[60]</sup> This means that any misrepresentations in the free writing prospectus will not give rise to Section 11<sup>[61]</sup> liability but only to Section 12(a)(2)<sup>[62]</sup> or Rule 10b-5<sup>[63]</sup> liability or enforcement actions under Section 8A or 17.<sup>[64]</sup>

The filing requirements become more complicated when the communication involves road shows or media communications. A "road show" is defined as an offer, other than a traditional prospectus, that contains a presentation regarding an offering, by one or more members of management, and that includes discussion of the issuer, management, or the securities being offered.<sup>[65]</sup> In the past, road shows were made available to institutional investors and analysts, but not to the general public. A road show is now considered a free writing prospectus and, if the issuer is not a reporting company, the road show must be filed, unless the issuer makes available, no later than other versions are available, at least one version of an electronic road show, without restriction, to any person, including potential investors.<sup>[66]</sup> Road shows to institutional investors often contain forward-looking information; however, it is likely that the version to be made available without restriction to the public will not contain such information.

If any issuer, underwriter or dealer, or someone acting on their behalf, provided, authorized or approved information that is disseminated by the media and which could be considered an offer, such information would

also be considered a free writing prospectus.<sup>[67]</sup> However, if no payment or consideration is made by the issuer or other offering participant, then no preliminary prospectus need be delivered, and the legend and filing requirements are satisfied if the communication is filed with the SEC within four business days of the issuer or other participant becoming aware of the publication, radio or television broadcast, or other dissemination of the communication, and the filing includes the required legend.<sup>[68]</sup> The filing may also correct any misinformation in the communication.<sup>[69]</sup>

Two typical media outlets would be newspapers and television. If the issuer's management gave an interview to a newspaper, it would be almost impossible to ensure that each reader was given a copy of the preliminary prospectus. Similarly, if a member of management was interviewed on television, it would be impossible to give each viewer a preliminary prospectus. But this burden is removed if no consideration is given in connection with the communication.

The new regulations also deal with the problem of hyperlinking material on an issuer's website. Materials on an issuer's website or materials which are hyperlinked from the issuer's website to a third party's website may be deemed to be a written offer by the issuer that must be filed with the SEC.<sup>[70]</sup> However, "historical issuer information that is identified as such and located in a separate section of the issuer's Web site containing historical issuer information, that has not been incorporated by reference into or otherwise included in a prospectus of the issuer for the offering and that has not otherwise been used or referred to in connection with the offering," will not be considered an offer and thus will not be a free writing prospectus.<sup>[71]</sup> This appears to be a version of the so-called "envelope theory" pursuant to which information on a website, which was not in proximity to a prospectus on the website and was not sales oriented, was not considered free writing since it was outside the envelope containing the offering materials.

### **The Post-Effective Period**

Let's take a look at how the system was originally designed in 1933. In other words, let's go back to the really old days—the 1990s.

At one time [U.C.C. § 8-319](#)<sup>[72]</sup> set forth the mechanism for complying with the statute of frauds. Basically, if a buyer received a confirmation and did not act within 10 days, the statute of frauds was satisfied. It also was satisfied if the buyer accepted delivery of the security.

In connection with an IPO, there would not be publicly available information about the issuer. The 1933 Act wanted to ensure that the buyer was fully informed before being committed. Accordingly, to prevent an uninformed buyer from being bound by accepting delivery of a security, Section 5(b)(2) provided that it was unlawful to carry a stock certificate in interstate commerce for purposes of sale unless accompanied or preceded by a Section 10(a) prospectus. In addition, Section 5(a)(2) prohibited delivery of the security using interstate commerce until after effectiveness. Thus, no stock certificate could be delivered until after effectiveness nor prior to the buyer's receipt of a final prospectus.

The issue of a confirmation was a bit more complicated. The content of a confirmation is governed by Rule 10b-10.<sup>[73]</sup> Focus on subparagraphs (a)(1) and (2), which require information setting forth the date of the transaction, the identity, price and number of shares or units of the security, whether the representative was acting as an agent or principal, and the compensation to the representative. This is clearly information that the customer would want to know before being committed to a purchase. However, Section 5(b)(1) provides that it is unlawful to carry a prospectus in interstate commerce unless the prospectus meets the requirements of Section 10; clearly

a confirmation does not contain all the information required by Section 10.

Under Section 2(a)(10), the confirmation is itself a prospectus. However, clause (a) of this section provides that, after the effective date, the writing is not deemed a prospectus if it is preceded or accompanied by a Section 10(a) prospectus. Therefore, if the statute of frauds were to be satisfied by sending a confirmation, the sender would also need to send a final prospectus and, in theory, the buyer would be fully informed before being bound.

To complete the “old” picture, after the SEC had preliminarily approved the registration statement, there would be negotiations leading to the price at which the underwriters would buy, then an overnight trip to the SEC to file the pricing amendment, after which the SEC would accelerate effectiveness of the registration statement, the registration statement would be declared effective, and thereafter a final prospectus with the pricing information (a Section 10(a) prospectus) would be sent, along with the confirmation of sale, to the buyer, resulting in a binding obligation. The confirmation would itself be a non-Section 10 prospectus which would violate section 5(b)(1) but for the fact that, by preceding the confirmation by a final or Section 10(a) prospectus, the confirmation was deemed not to be a prospectus pursuant to Section 2(a)(10)(a).[74] Thus, the final prospectus had a curative effect.

Accordingly, the 1933 Act and the former statute of frauds provision in the Uniform Commercial Code worked nicely together. However, [Section 8-319](#) has now been excised from the UCC and [Section 8-113](#)[75] now provides that a writing is no longer necessary in order that there be a binding agreement.

In the 1990s, the game was slightly changed in that the SEC was then able to declare a prospectus effective even though the pricing information was lacking, eliminating the frenetic overnight activity above referred to. This is the drift of rule 430A.[76] However, the omitted pricing information had to be included in a form of prospectus filed with the SEC pursuant to Rule 424(b)[77] within 15 days of the effectiveness of the registration statement, or else, the registration statement had to be amended to reflect the pricing information. This would create a new effective date, and the issue of whether the registration statement was incomplete or misleading would be determined at this later date, rather than at the time of the initial SEC declaration of effectiveness.

Today, Rule 172(a)[78] provides that a written confirmation is exempt from the provisions of Section 5(b)(1) of the act if subparagraph (c) is met. This means that the registration statement must be effective and not subject to a stop order under Section 8,[79] that there is no pending cease-and-desist proceeding against the issuer, underwriters or participating dealers under Section 8A,[80] and that a Section 10(a) prospectus has been filed with the SEC. With respect to this latter requirement, subparagraph (c) has some weasel language that exculpates the issuer if it makes a “good faith and reasonable effort to file” the section 10(a) prospectus “as soon as practicable.” If paragraph (c) is fulfilled, Rule 172(b)[81] also provides that there is no obligation to send a Section 10(a) prospectus along with the stock certificate, which otherwise would be necessary under section 5(b)(2).

Under Section 4(3),[82] a dealer appears to be obligated to deliver a final prospectus (a Section 10(a) prospectus) in connection with the sale by the dealer. The basic rule under the 1933 Act as enacted was that this obligation extended for 40 days after the effective date of the registration statement. If there were an IPO, the last paragraph of this section extended the period to 90 days. However, by the 1990s, the 40-day period had disappeared if the issuer were a reporting company. Rule 174[83] shortened the period to zero days (in other words, there was no obligation to deliver a final prospectus).

Subparagraphs (a) and (b) of Rule 172 also apply to the dealers' obligations with respect to confirmations

and delivery of the security. However, the situation of a dealer is even better than that of the issuer because subparagraph (c)(4) provides that, with respect to section 4(3) of the Act, the (c)(3) condition of Rule 172 that the issuer file a final prospectus does not apply to the dealer's exemption. In other words, even if the issuer does not file a final prospectus, the dealer would not violate the 1933 Act by sending a confirmation or delivering a security.

Rule 173<sup>[84]</sup> requires that each underwriter or dealer should provide the purchaser, within two business days, a copy of the final prospectus or a notice that the sale was made pursuant to a registration statement. It can be expected that underwriters and dealers, rather than providing a final prospectus, will simply give the purchaser the aforesaid notice. This is a modest obligation and you would expect that the Rule 173 notice would accompany the confirmation sent under the protective arm of Rule 172. However, Rule 173(c) provides that Rule 173 compliance is not a condition to reliance upon Rule 172. Thus, Rule 173 is pretty toothless since a dealer need not verify that the issuer has filed a final prospectus, nor need it deliver one itself or even send a notification that the sale was made pursuant to a registration statement.

Rule 172 only deals with confirmations (and delivery of the security) in the post effective period. What about other free writing that is transmitted in the post effective period? In a firm commitment underwriting, it is unlikely that the issuer will be involved with any selling efforts after effectiveness that could generate free writing. But an underwriter or dealer could be.<sup>[85]</sup>

In effect, one could rationalize Rule 172 with the old practice on the theory that access equals delivery. In other words, since a final prospectus has been filed with the SEC, it is “deemed” to have been delivered so as to avoid violations of Section 5(b) of the act by the transmittal of the communication deemed to be free writing. However, this is not how the rule actually operates. Rather, Rule 172 is phrased as an exemption from Section 5(b)(1), rather than treating the filing of the Section 10(a) prospectus as having curative powers under Section 2(a)(10)(a) of the 1933 Act.

Let's return to Section 2(a)(10)(a) of the Act. This curative provision (namely that a communication after the effective date that is preceded or accompanied by a Section 10(a) prospectus that was “sent or given” to the recipient of the communication, will no longer be deemed to be a prospectus) is not limited to confirmations but includes other communications in general. Thus, it could be asserted that a Section 10 (a) prospectus will “cure” free writing in the post-effective period, such that the free writing would no longer be considered a prospectus, provided that the Section 10 (a) prospectus was sent or given to the recipient of the free writing. However, a prospectus that is only filed with the SEC as provided in Rule 172 is not “sent or given” in accordance with Section 2(a)(10)(a).

The free writing, however, will be a free writing prospectus and, if compliance is had with respect to Rule 433, the free writing will be a Section 10(b) prospectus and thus can be transmitted in interstate commerce without violating Section 5(b)(1) of the Act. While, under Rule 433, there is no prospectus delivery requirement for a seasoned issuer or a well-known seasoned issuer, with respect to an IPO or an offering by an unseasoned issuer, Rule 433 requires that the free writing be accompanied by a Section 10(a) prospectus in the post effective period,<sup>[86]</sup> that the appropriate legend be included, and that the free writing prospectus be filed with the SEC.<sup>[87]</sup>

At first glance, it would appear that, if the communication is accompanied by a section 10 (a) prospectus, then section 2 (a) (10) (a) would make the communication “not a prospectus;” however, section 2 (a) (10) (a)

provides that this curative provision is not applicable to a section 10 (b) prospectus, which rule 433 now considers free writing to be. To make this more complicated, the definition of a free writing prospectus<sup>[88]</sup> excludes communications that fall within the curative provision of section 2 (a) (10) (a). The ultimate effect of all this wordsmithing would appear to be that the communication would first be deemed to be a free writing prospectus that must be accompanied by a final prospectus, thereby making the communication a section 10 (b) prospectus which is not affected by the curative provision in section 2 (a) (10) (a), and thus remains a prospectus. Consequently, the communication must be accompanied by the rule 433 legend and filed with the SEC.

What the foregoing clearly demonstrates is the complexity of Rule 433 in conjunction with the existing statutory provisions.

If the above analysis is correct, free writing in the post-effective period is a Rule 433 section 10(b) prospectus and thus does not violate Section 5(b)(1); however, if the free writing is misleading, a private action could be brought under Section 12(a) (2) [since the free writing is a prospectus] or Rule 10 b-5, or an enforcement action under Section 17.<sup>[89]</sup>

### Conclusion

If “Back to the Future” were possible so that we could transport the typical lawyer practicing securities law in the early 2000s to the present, the system would hardly be recognizable. Today, the lawyer certainly would be less likely to have an ulcer worrying about whether some activity constituted gun jumping, or whether a broker's letter could be a prospectus violating Section 5(b)(1). He or she would also be amazed at the simplicity of consummating a transaction in the post-effective period and at reduced responsibilities of dealers post-effective.

While free writing is now permissible during the interim period, the lawyer might wonder whether the attendant mechanics are worth the effort, at least in connection with an unseasoned company, or if it is better just to tell the client to avoid free writing. He or she would certainly wonder, after the “dot-com” bubble and the corporate corruption scandals that had just started coming to light, why the JOBS Act is encouraging “little” investors to buy and why we are trying to reduce disclosure obligations by shrinking the number of reporting companies.

But, in any event, the lawyer would be impressed with the extent to which the statutory provisions over which he or she labored have now, in effect, been modified by rule. Not all regulation is burdensome!

<sup>[FN\*]</sup> Professor of Law, Loyola University Chicago

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<sup>[FN1]</sup> See Rep. John Boehner Press Release, Congressman Boehner Statement on New Job-Killing Energy Regulations, Mar. 27, 2012, available at <http://johnboehner.house.gov/News/DocumentSingle.aspx?DocumentID=287459>.

<sup>[FN2]</sup> This data can be retrieved from the Bureau of Labor Statistics Website—Data Bases & Tools, Table B-1 [Total Private], available at <http://www.bls.gov/webapps/legacy/cesbtab1.htm>.

<sup>[FN3]</sup> This data can be retrieved from the Bureau of Labor Statistics Website — Data Bases & Tools, Table B-1 [Government], available at <http://www.bls.gov/webapps/legacy/cesbtab1.htm>.

[FN4] The following is a link to the 1970's trading volume: <http://www.nyse.com/marketinfo/stats/vol70-79.dat>.

[FN5] The general link to NYSE daily trading volume is <http://www.nyse.com/financials/1022221393023.html>; while the ten largest trading volumes can be found at [http://www.nyxdata.com/nysedata/asp/factbook/viewer\\_edition.asp?mode=table&key=3007&category=3](http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=3007&category=3).

[FN6] See Merrill Ordered to Reform Ratings: New York AG Wins Court Order Finding Brokerage Firm Issued 'Misleading Stock Ratings,' CNNMONEY, Apr. 8, 2002, <http://money.cnn.com/2002/04/08/news/companies/merrill/index.htm>.; The Merrill Lynch Settlement: Good for Merrill, Not for Investors, June 5, 2002, <http://www.upenn.edu/pennnews/researchatpenn/article.php?44&bus.>; Gretchen Morgenson & Patrick McGeehan, Wall Street and the Nursery School: A New York Story, N.Y. TIMES, Nov. 14, 2002, available at <http://query.nytimes.com/gst/fullpage.html?res=9C03E3D71630F937A25752C1A9649C8B63&fta=y>. For the content of some e-mails, see Lawyershop.com, Merrill Lynch, <http://www.lawyershop.com/practice-areas/criminal-law/white-collar-crimes/securities-fraud/lawsuits/merrill-lynch/> (last visited May 7, 2012). Examples include: "Internet Capital Group (ICGE): E-mail: October 5, 2000—"Going to 5?" (strong sell)," "October 6, 2000—"No helpful news to relate, I'm afraid. This Has been a disaster- there really is no floor to the stock,"" "Investor advice: October 5, 2000—2-1 rating (buy to strong buy)," "excite@home (ATHM): E-mail: June 3, 2000—"ATHM is such a piece of crap!"" "Investor advice: June 3, 2000—2-1 rating (buy to strong buy)," "Lifeminders (LFMN) E-mail: December 4, 2000—"I can't believe what a POS that thing is,"" and "Investor advice: December 4, 2000—2-1 rating (buy to strong buy)." Id.

[FN7] 15 U.S.C.A. § 77e.

[FN8] Effective December 1, 2005, the SEC adopted the [Securities Offering Reform Release No. 33-8591](#). Available at [www.sec.gov/rules/final/33-8591.pdf](http://www.sec.gov/rules/final/33-8591.pdf).

[FN9] Id. at 1.

[FN10] Pub. L. No. 112-106, 126 Stat. 306 (2012).

[FN11] See *infra* notes 12 & 13.

[FN12] Title I of the JOBS act amends the definitional sections of the 1933 and 1934 Acts to define a new entity, an "emerging growth company," which is a company that has annual revenues of less than \$1 billion. Paradoxically, such a company is larger than almost all IPO companies have been and larger than many listed companies. Such companies are exempted from some of the 34 act disclosure requirements and from the necessity to have their internal controls audited for a period of five years. More importantly, Title V circumscribes the definition of a Section 12 (g) company. See *infra* note 23 & accompanying text.

[FN13] Title II of the JOBS Act permits general advertising in a Rule 506 offering so long as all purchasers are accredited investors and permits general advertising and offers under Rule 144A to non-

qualified institutional investors, so long as sales are made only to persons reasonably believed to be qualified institutional investors. It also permits a person to maintain a “platform” to facilitate Rule 506 offerings without being registered. These provisions enable broadening the base of potential investors so long as sales are made only to accredited investors or qualified institutional investors, and are subject to SEC rulemaking.

Title III implements “Crowdfunding” by adding a new exemption, Section 4(6) to the 1933 Act and a new Section 4A to the Act. Section 4(6) permits, with respect to offerings of \$1.0 million or less, sales to an investor, with annual income or net worth of \$100,000 or less, of securities equal to \$2,000 or 5% of annual income or net worth, or sales to an investor, if the annual income or net worth exceeds \$100,000, of securities equal to 10% of annual income or net worth [if this is confusing, don't worry; the math does not work]. It would seem the purpose of the legislation is to permit anyone to lose a small amount of money. To minimize this risk, Section 4A, places certain responsibilities on the issuer and any intermediary between the issuer and the investor, and contemplates the creation of “portals” to facilitate crowdfunding. It will be interesting to see how many issuers take advantage of these new provisions since Section 4A(c) defines “issuer” to include officers and directors for liability purposes.

Title IV is a new exemption authority added to section 3 (b) of 1933 Act with a \$50 million limit. In effect, it is an expanded Regulation A type provision. It authorizes the SEC to make rules regarding, offering statements, “test the waters” solicitations, and subsequent periodic disclosures. Securities so sold are not deemed “restricted securities.”

[FN14] Title I, dealing with emerging growth companies, also has provisions affecting the 1933 Act. Such companies need not provide more than two years of audited statements and can file a confidential draft registration statement with the SEC prior to public filing. In addition, there are provisions affecting Sections 2 and 5 of the 1933 Act. See *infra* note 17 and text at note 39.

[FN15] See 15 U.S.C.A. § 77e(a) re: effectiveness of the registration statement, and 15 U.S.C.A. § 77e(c) regarding filing of the registration statement.

[FN16] 15 U.S.C.A. § 77e(c).

[FN17] See 15 U.S.C.A. § 77b(a)(3): “The terms defined in this paragraph and the term “offer to buy” as used in subsection (c) of section 5 shall not include preliminary negotiations or agreements between any issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer) and any underwriter or among underwriters who are to be in privity of contract with an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer”). Section 105 of the JOBS act overturns Rules 137-139, 17 C.F.R. § 230.137, .138, & .139, by permitting distribution of a research report on an emerging growth company by a broker or dealer in the pre-filing, interim, or post-effective periods, irrespective of whether the broker or dealer is participating in the offering.

[FN18] In *Sec. Act Rel. No. 3844 (1957)*, the SEC stated:

It follows from the express language and the legislative history of the Securities Act that an issuer, underwriter or dealer may not legally begin a public offering or initiate a public sales campaign prior to the filing of a registration statement. It apparently is not generally understood, however, that the public-

ation of information and statements, and publicity efforts, generally, made in advance of a proposed offering, although not couched in terms of an express offer, may in fact contribute to conditioning the public mind or arousing public interest in the issuer in a manner which raises a serious question whether the publicity is not in fact part of the selling effort.

[FN19] [Carl M. Loeb, Rhoades & Co.](#), 38 S.E.C. 843 (1959).

[FN20] According to the SEC, the press release contained the following information:

The release, which was issued on the letterhead of letterhead of Loeb Rhoades, stated that Arvida, to which Davis was transferring his real estate, would be provided with \$25 million to \$30 million of additional capital through an offering of stock to the public, and that Arvida would have assets of over \$100,000,000 “reflecting Mr. Davis' investment” and the public investment. It referred to a public offering scheduled within 60 days through a nationwide investment banking group headed by registrant's and to the transfer from Davis to Arvida of over 100,000 acres ‘in an area of the Gold Coast’ in 3 named Florida counties and contained a brief description of these properties including reference to undeveloped lands and to “operating properties.”

The release identified the principal officers of Arvida and stated that Arvida proposed to undertake a “comprehensive program of orderly development,” under which some of the lands would be developed “immediately into residential communities” and others would be held for investment and future development as the area expands. It closed with a reference to the attraction of new industry and the place Arvida would assume in the “further growth of Southeastern Florida.” 38 S.E.C. 843 at \*2-\*3.

[FN21] *Id.* at \*7.

[FN22] See *supra* note 12.

[FN23] See Section 13 (a) of the 1934 Act, 15 U.S.C.A. § 78m (a), provides that issuers of a security registered pursuant to section 12 are required to file reports. Securities so registered include those listed on a national securities exchange (section 12(a) of the 1934 Act, 15 U.S.C.A. § 78 l (a)) and, formerly, those held of record by more than 500 shareholders when the issuer has more than \$10 million in assets (section 12(g) of the 1934 Act, 15 U.S.C.A. § 78 l (g) and Rule 12g-1). See also section 15(d) of the 1934 Act, 15 U.S.C.A. § 78o(d). The JOBS Act has now limited the scope of Section 12(g) to companies with a class of securities held of record by 2000 shareholders or 500 persons who are not accredited investors. See § 501 of the JOBS Act. Section 303 of the JOBS Act directs the SEC to exclude “crowdfunding” shareholders from the computation of the number of record holders.

[FN24] See Rule 433 (b) (1), 17 C.F.R. § 230.433 (b) (1).

[FN25] See Rule 433 (b) (2), 17 C.F.R. § 230.433 (b) (2).

[FN26] See Rule 405, 17 C.F.R. § 230.405.

[FN27] See Rule 405, 17 C.F.R. § 230.405.

[FN28] See Rule 163(b)(3), 17 C.F.R. § 230.163(b)(3), Rule 163A(b)(3), (4), 17 C.F.R. § 230.163A(b)(3), (4), Rule 168(c)(3), 17 C.F.R. § 230.168(c)(3), and Rule 169(d)(4), 17 C.F.R. §

230.169(d)(4).

[FN29] 17 C.F.R. § 230.163.

[FN30] 17 C.F.R. § 230.163A.

[FN31] 17 C.F.R. § 230.168.

[FN32] 17 C.F.R. § 230.169.

[FN33] 15 U.S.C.A. § 77e(c).

[FN34] See [Publication of Information Prior to or After the Filing And Effective Date of the Registration Statement Under the Securities Act of 1933](#), Securities Act Release, No. 5009 (Oct. 7, 1969), 1969 WL 96374, and [Guidelines for the Release of Information by Issuers Whose Securities Are in Registration](#), Securities Act Release No. 5180 (August 16, 1971), 1971 WL 126068.

[FN35] 15 U.S.C.A. § 77l(a)(1).

[FN36] 15 U.S.C.A. §§ 77h and 77h-1.

[FN37] 15 U.S.C.A. § 77b(a)(10).

[FN38] 17 C.F.R. § 230.135.

[FN39] See Section 105(c) of the JOBS Act, adding Section 5(d) to the 1933 Act.

[FN40] 15 U.S.C.A. § 77e(b)(1).

[FN41] 15 U.S.C.A. § 77j.

[FN42] 17 C.F.R. § 230.405

[FN43] 17 C.F.R. § 240.10b-5.

[FN44] 15 U.S.C.A. §§ 77h-1 & 77q.

[FN45] 15 U.S.C.A. § 77l(a)(1).

[FN46] 15 U.S.C.A. § 77l(a)(2).

[FN47] 17 C.F.R. § 230.430

[FN48] 15 U.S.C.A. § 77j(a).

[FN49] 15 U.S.C.A. § 77b(a)(10)(b).

[FN50] 17 C.F.R. § 230.134.

[FN51] 17 C.F.R. § 230.433.

[FN52] 17 C.F.R § 230.164.

[FN53] To use Form S-3, a reporting company must have \$75 million in common equity held by non-affiliates of the issuer. See 17 C.F.R. § 239.13, General instructions/transaction requirements.

[FN54] 17 C.F.R. § 230.430.

[FN55] 17 C.F.R. 230.433 (b) (2) (i).

[FN56] 17 C.F.R. § 230.433 (b) (1).

[FN57] 17 C.F.R. § 230.433 (c).

[FN58] 17 C.F.R. § 230.433 (d).

[FN59] 17 C.F.R. § 230.433 (d)(3)(4).

[FN60] 17 C.F.R. § 230.433 (d)(1).

[FN61] 15 U.S.C.A. § 77k.

[FN62] 15 U.S.C.A. § 77l(a)(2).

[FN63] 17 C.F.R. § 240.10b-5.

[FN64] 15 U.S.C.A. §§ 77h-1 & 77q.

[FN65] Rule 433 (h) (4).

[FN66] Rule 433 (d) (8).

[FN67] Rule 433 (f).

[FN68] Rule 433 (f)(1).

[FN69] Rule 433 (f)(2) (ii).

[FN70] Rule 433 (e).

[FN71] Rule 433 (e) (2).

[FN72] See U.C.C. § 8-113 (1978).

[FN73] For the contents of a confirmation, see 17 C.F.R. § 240.10b-10.

[FN74] 15 U.S.C.A. § 77b(a)(10)(a).

[FN75] See U.C.C. § 8-113 Offic. Cmt. (1994):

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978). With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business.

For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

[FN76] 17 C.F.R. § 230.430A.

[FN77] 17 C.F.R. § 230.424(b).

[FN78] 17 C.F.R. § 230.172(a).

[FN79] 15 U.S.C.A. § 77h.

[FN80] 15 U.S.C.A. § 77h-1.

[FN81] 17 C.F.R. § 230.172(b).

[FN82] 15 U.S.C.A. § 77j(d)(3).

[FN83] 17 C.F.R. § 230.174.

[FN84] 17 C.F.R. § 230.173.

[FN85] So also could a broker if the broker solicits the purchase. See 15 U.S.C.A. § 77d (4).

[FN86] Rule 433 (a)(2)(i).

[FN87] Rule 433(d).

[FN88] See Rule 405.

[FN89] An enforcement action could also be brought under Rule 10b-5, but under this rule, the SEC would need to establish scienter, whereas, under Section 17 scienter is not necessary. See [Aaron v. Securities and Exchange Commission](#), 446 U.S. 680, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980).

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40 NO 3 SECRLJ ART 2

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