DECEMBER 10, 1999

CURRENT ISSUES AND RULEMAKING PROJECTS

DIVISION OF CORPORATION FINANCE

Securities and Exchange Commission
Washington, D.C. 20549

TABLE OF CONTENTS

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In addition to this outline, several other sources of information about issues involving the Division of Corporation Finance are available in the "Current SEC Rulemaking" section of the Securities and Exchange Commission's web site, *http://www.sec.gov*:

- Releases, Staff Legal Bulletins, Staff Accounting Bulletins
- Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance
- Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations (including updates)

A number of the forms and regulations administered by the Division are available in the "Small Business Information" section of the web site.

I. DIVISION ORGANIZATION AND EMPLOYMENT OPPORTUNITIES

The Division's organizational structure follows:

Division Director - Brian Lane (202) 942-2929

Deputy Director - Michael McAlevey (202) 942-2810

Operations

Associate Director (Disclosure Operations)
- Martin P. Dunn (202) 942-2890

Associate Director (Disclosure Operations)
- Shelley Parratt (202) 942-2830

Associate Director (Small Business)
- (vacant) (202) 942-2880

Disclosure Support

Associate Director (Legal)
-(vacant) (202) 942-2820

Associate Director (Regulatory Policy, Mergers & Acquisitions)
- Mauri Osheroff (202) 942-2840

Associate Director (International)
- (vacant) (202) 942-2870

Associate Director (Chief Accountant)
- Robert Bayless (202) 942-2850

Senior Counsel to the Director
- Anita Klein (202) 942-2980

Assistant Directors

Health Care and Insurance
- Jeffrey P. Riedler (202) 942-1840

Consumer Products
- H. Christopher Owings (202) 942-1900

Computers and Office Equipment
- James Daly (202) 942-1800

Natural Resources
- Roger Schwall (202) 942-1870

Transportation and Leisure
- William L. Tolbert, Jr. (202) 942-1850

Manufacturing and Construction
- Steven Duvall (202) 942-1950

Financial Services
- Todd Schiffman (202) 942-1760

Real Estate and Business Services
- Paula Dubberly (202) 942-1960

Small Business
- Richard Wulff (202) 942-2950

Electronics and Machinery
- Peggy Fisher (202) 942-1880

Telecommunications
- Barry Summer (202) 942-1990

Structured Finance and New Products
- Mark W. Green (202) 942-1940

Other Offices

Office of Chief Counsel
- Catherine Dixon, Chief (202) 942-2900

Office of Mergers and Acquisitions
- Dennis O. Garris, Chief (202) 942-2920

Office of International Corporate Finance

- Paul Dudek, Chief (202) 942-2990

Office of EDGAR and Information Analysis
- Herbert Scholl, Chief (202) 942-2930

Division Employment Opportunities for Accountants and Attorneys

Accountants

The Division has about 100 staff accountants with specialized expertise in the various industry offices. The Division provides a fast-paced, challenging work environment for accounting professionals. Our staff works on hot IPOs and current and emerging accounting issues. We influence accounting standards and practices and interact with the top professionals in the securities industry.

A staff accountant's responsibilities include examining financial statements in public filings and finding solutions to the most difficult and controversial accounting issues. A minimum of three years' experience in a public accounting firm or public company dealing with SEC reporting is required. If you want to experience a unique learning opportunity and explore the depth and breadth of accounting theory, principles, and practices, call (202) 942-2960 for information on employment opportunities in the Division.

Attorneys

From time to time, the Division of Corporation Finance has positions available for law school graduates with solid legal skills and experience. Applicants should demonstrate an ability to accept major responsibilities. We prefer applicants who have had extensive experience in securities transactions involving public companies. It is also helpful, but not necessary, if applicants have accounting and/or business training.

Responsibilities include analyzing and commenting on disclosure documents in public offerings. The positions involve working directly with companies, their executives, underwriters, outside counsel and outside accountants. Working on transactions in today's market requires people that are dynamic and fast-paced. The work involves innovative cutting-edge financing and business structures. Interested persons should send a resume to Division of Corporation Finance, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

II. REGULATION OF SECURITIES OFFERINGS PROPOSING RELEASE (the "AIRCRAFT CARRIER")

A. Background

The Commission for the past several years has been actively reevaluating the current registration system. Recent Commission steps in that process have included:

- the Report of the Task Force on Disclosure Simplification (March 1996);
- the Report of the Advisory Committee on the Capital Formation and Regulatory Process (July 1996); and
- the Securities Act Concept Release (July 1996).

In 1996, Congress for the first time granted the Commission broad general exemptive authority. Thereafter the Commission began to consider more broadly how to improve the present system using this new authority. On November 13, 1998 the Commission published a proposing release (Securities Act Release No. 7606A) that would modernize the regulation of capital formation. These proposals would provide significant benefits to issuers of securities, securities professionals and public investors. The public comment period has been extended to June 30, 1999.

Briefly, the proposals cover five major topics. First, the proposals would create a three-tiered registration system that would extend the some of the advantages of private offerings - timing and disclosure flexibility - to many registered offerings. The registration proposals also would permit more issuers to take advantage of the streamlined small business requirements by increasing the small business issuer threshold. Second, the proposals would lift many of the restrictions on communications around the time of an offering and provide certainty and clarity in the areas of "gun jumping" and the "quiet period." Accordingly, the current limitations on free writing would be loosened and the current safe harbors for research reports would be significantly expanded. Third, the proposals would re-focus prospectus delivery requirements to ensure that investors receive prospectus information when they need it most: before their investment decisions. Today, only delivery of final prospectuses is usually required and they are typically delivered with the confirmation. Fourth, the proposals would provide issuers with integration safe harbors so that they could convert a private offering to a public offering (or vice versa) in response to changing market conditions. This flexibility also would permit "testing the waters" for all issuers, while maintaining investor protection. Finally, to reduce concerns about selective disclosure, the proposals seek better and more timely disclosure in Exchange Act reports.

B. The Registration System

We now have a number of forms for registration of securities offerings under the Securities Act. All of these forms require issuers to file specified disclosure. The proposed system would eliminate Forms S-1, S-2, S-3, S-4, S-11, F-1, F-2, F-3 and F-4. In their place the proposed system would add Forms A, B and C. Forms A, B and C would be available for offerings by both foreign and domestic issuers. Form A would be available for smaller or unseasoned issuers. Form B would be available for offerings by larger, seasoned well followed issuers and for offerings made to informed or sophisticated investors. Form C would be available for business combinations.

C. Communications

The current system imposes certain restrictions on communications before and during the time an issuer is "in registration." In the pre-filing period, no offers may be made and, during the waiting period, written offers may be made only through a mandated-content prospectus. The net effect of these existing restrictions is to inhibit communications by the issuer and underwriter around the time of an offering. The proposals would lift these restrictions for many offerings.

1. Form B Offerings

In Form B offerings, there would be no restrictions on communications. Issuers would be permitted to make offers, orally or in writing, before filing a registration statement. Communications during the offering period would have to be filed, either as offering information or free writing materials. The offering period would be defined as the period beginning 15 days before the first offer was made, by or on behalf of the issuer, and ending at the completion of the offering. Offering information would be filed as part of the registration statement and be subject to Sections 11 and 12(a)(2) as well as the antifraud provisions of the federal securities laws. Free writing materials would be filed under proposed Rule 425 and be subject to Section 12(a)(2) and the antifraud provisions. Offering information and free writing used in the 15 days before filing the registration statement would be filed at the time the registration statement is filed; such materials used after the filing of the registration statement would be filed at the time of first use.

2. Other Offerings

The proposals include a bright line communications exemption that would permit any communication made by or on behalf of the issuer more than 30 days before a Form A registration statement is filed. The Form A issuer must take reasonable steps to prevent distribution of communications made before the 30 day pre-filing period from being distributed during this time.

During the 30 day pre-filing period, free writing would remain restricted. The proposals, however, do permit certain communications during the 30 day pre-filing period: factual business communications and, for reporting companies, regularly released forward looking information.

The proposals would eliminate all restrictions on free writing after the filing of a registration statement if the issuer complies with the prospectus delivery requirements in proposed Rule 172, files the free writing used during the offering period pursuant to proposed Rule 425 and files a final prospectus before the first sale. Free writing materials would be filed at the time of first use and would be subject to Section 12(a)(2) and the antifraud provisions of the federal securities laws.

The proposed communications exemptions do not apply to business combinations. A separate regulatory scheme addressing communications involving business combinations has been adopted in rulemaking on Takeovers and Security Holder Communications (see Section IV.A of this outline).

3. Research Reports

The communications exemptions for research reports currently contained in Rules 137, 138 and 139 would be significantly expanded to provide for greater communications during the offering period.

D. Prospectus Delivery Requirements

Currently, all issuers must send a final prospectus to purchasers. A preliminary prospectus is required to be delivered only in limited situations. The proposed prospectus delivery requirements contemplate that the investor receives information when it needs it most, prior to its investment decision. As with other reforms, what prospectus information is required to be delivered, and when, will depend on the nature of the issuer and the offering.

1. Form B Offerings

In Form B offerings, a prospectus meeting the requirements of Section 10 would not be required to be delivered. A term sheet would be required to be delivered. These reforms also apply to seasoned Schedule B filers registering an offering of more than $250 million that is underwritten on a firm commitment basis and is registered more than a year after the effective date of its IPO.

2. Offerings by Small or Unseasoned Issuers

For other offerings, a prospectus meeting the requirements of Section 10 must be delivered before the investment decision is made. For an IPO or offerings registered within one year of the IPO, the proposals require delivery 7 calendar days before the securities are priced (in a firm commitment offering) or before the investor makes a purchase commitment (in a best efforts offering). For offerings by more seasoned issuers, a prospectus must be delivered 3 calendar days before pricing or commitment. If a material change has occurred that was not described in the delivered prospectus, the issuer must disclose the information about the change at least 24 hours before either pricing or the purchase commitment. Smaller, unseasoned Schedule B filers would be treated like Form A issuers.

3. Final Prospectuses

There is no delivery requirement for final prospectuses in most offerings, although final prospectuses would still be filed with the Commission. Pursuant to proposed Rule 173, most issuers would be exempt from delivering a final prospectus if the following conditions are met: the issuer files a Section 10(a) prospectus (minus Rule 430A price-related information) before confirmations are sent; investors are informed before confirmation where they may obtain a final prospectus, free of charge; and a prospectus is delivered pursuant to proposed Rule 172. Final prospectuses still would be required to be delivered in business combinations on Forms C, SB-3, F-8 and F-80.

4. Aftermarket Prospectus Delivery

Dealers are currently required to deliver prospectuses in certain offerings for a specified period of time after effectiveness of a registration statement. They are subject to this requirement even though they may not have participated in the offering. Proposed revisions to Rule 174 would extend dealers' aftermarket delivery obligation to all offerings. This aftermarket delivery obligation would exist for 25 calendar days after the later of the effectiveness of a registration statement or the first date on which the securities were offered. The proposals, however, would deem the aftermarket delivery obligation to be satisfied if the final prospectus (excluding Rule 430A price-related information) is on file with the Commission and the dealer informs the investor, before or at confirmation, where it may obtain the final prospectus, free of charge. The proposals would also repeal Rule 153, which deems the prospectus delivery requirement to be met by delivery to an exchange.

E. Integration of Public and Private Offerings

The proposals permit issuers flexibility in determining whether to proceed on a registered or unregistered basis, provided that key investor protections are maintained. The revisions eliminate many of the uncertainties while permitting testing the waters. Safe harbors would be provided for converting public offerings to private offerings and vice versa.

Proposed revisions to Rule 152 would provide guidance on when a private placement is considered completed. Proposed Rule 159 would codify the current staff position concerning lock-up agreements before business combinations.

F. Exchange Act Reporting Revisions

In order to provide better and more timely disclosure and prevent selective disclosure, the Exchange Act proposals expedite the reporting of certain information and add requirements to report certain material events.
These proposals would:

- require risk factor disclosure in Exchange Act annual reports and registration statements with quarterly updates in Forms 10-Q and 10-QSB;
- accelerate the due dates for most Forms 8-K from 15 days to 5 days;
- require the filing of Form 8-K for additional events including:

-material defaults on senior securities;
-material modifications to the rights of security holders;
-company name change;
-departure of CEO, CFO, COO or President;
-notification that reliance on prior audit is no longer permissible, or that auditor will not consent to use of its report in a Securities Act filing;

- require the filing of Form 8-K in one business day for certain items;

- require the filing of Form 8-K for selected financial information as specified in Item 301 of Regulation S-K (60 days after the end of the fiscal year and 30 days after the end of the quarter); and

- accelerate the filing of Form 20-F from 6 months to 5 months.

The proposals also solicit comment on:

- accelerating the Form 10-K filing period from 90 days to 60 or 70 days;
- accelerating the Form 10-Q filing period from 45 days to 30 or 35 days; and
- revising Form 6-K to mandate reporting of Form 8-K events if the information is disclosed under applicable foreign requirements.

The Exchange Act proposals also would:

- treat information set forth in Part I of Forms 10-Q and 10-QSB as filed for purposes of Section 18;
- require the principal executive officers and a majority of the board of directors to sign Exchange Act reports;
- require signers of Exchange Act filings to certify that they have read the filing and that, to their knowledge, the filing does not contain an untrue statement of a material fact or an omission of a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading; and
- permit concurrent registration under the Securities Act and the Exchange Act by checking a box on the Securities Act registration statement.

III. PLAIN ENGLISH INITIATIVE

In August 1995, Chairman Arthur Levitt created a staff Task Force on Disclosure Simplification to review rules and forms relating to capital raising transactions, periodic reporting pursuant to the Exchange Act, proxy solicitations, and tender offers and beneficial ownership reporting under the Williams Act. On March 5, 1996, the Commission published the Report of the Task Force on Disclosure Simplification.

One of the Task Force's major concerns was the lack of readability of prospectuses and other disclosure documents. The report noted that issuers, underwriters and their lawyers draft defensively written documents that place a premium on legal jargon and over-inclusive disclosures. The Task Force recommended requiring plain English disclosure to improve the readability of the prospectus.

To implement the Task Force recommendations, the SEC issued proposed rules for public comment (Securities Act Release No. 7380 (January 14, 1997)). On January 22, 1998, the Commission adopted the final plain English rules (Securities Act Release No. 7497). These rules apply to public companies and mutual funds. The Division of Corporation Finance issued Staff Legal Bulletin No. 7 on the new rules, and updated it on June 7, 1999.

1. New Rule 421(d) - The Plain English Rule

This rule requires public companies and mutual funds to prepare the front portion of their prospectuses in plain English. They must use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section. Also, when writing these portions of the prospectus, they must comply substantially with six basic principles:

- Short sentences;
- Definite, concrete, everyday language;
- Active voice;
- Tabular presentation or bullet list for complex material, whenever possible;
- No legal jargon or highly technical business terms; and
- No multiple negatives.

In addition, public companies and mutual funds must design the cover page, summary, and risk factors section to make them easy to read. They must format the text and design the document to highlight important information for investors. The rule also permits them to use pictures, charts, graphics, and other design features throughout the prospectus to make it easier to read.

2. Amended Rule 421(b) - The Clear, Concise, and Understandable Rule

Rule 421(b) currently requires that the *entire* prospectus be clear, concise, and understandable. To provide guidance on this rule, we adopted amendments that set out four general writing techniques that public companies and mutual funds must use throughout their prospectuses:

- Present information in clear, concise sections, paragraphs, and sentences. Whenever possible, use short explanatory sentences and bullet lists;
- Use descriptive headings and subheadings;
- Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and
- Avoid legal and highly technical business terminology.

We also added a new note to Rule 421(b) that lists writing conventions to avoid because they make prospectuses harder to read:

- Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;
- Vague boilerplate explanations that are readily subject to differing interpretations;
- Complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and
- Repetitive disclosure that increases the size of the document but does not enhance the quality of the information.

3. Amendments to Regulation S-K and Regulation S-B

To implement the changes we made to Rule 421, we also adopted amendments to Regulations S-K and S-B.

4. Plain English Handbook

"A Plain English Handbook--How to Create Clear SEC Disclosure Documents," issued by the Office of Investor Education and Assistance, is now available in final form. You can download a copy from our web site at *http://www.sec.gov* or request a paper copy by calling 1-800-SEC-0330.

IV. MERGERS AND ACQUISITIONS

In addition to the matters in this section, see Section XI.G below, "Financial Statements in Hostile Exchange Offers."

A. Regulation of Takeovers and Security Holder Communications

On October 22, 1999, the Commission adopted a new regulatory scheme for business combination transactions and security holder communications (Securities Act Release No. 7760). The new rules and amendments are effective January 24, 2000. The amendments significantly update the existing regulations to meet the realities of today's markets while maintaining important investor protections. Specifically, the amendments reduce restrictions on communications, balance the regulatory treatment of cash and stock tender offers, and update, simplify and harmonize the disclosure requirements.

1. Reduce Restrictions on Communications

Currently, the Securities Act, as well as the proxy and tender offer rules, restrict communications. The new rules and amendments relax these restrictions by permitting the dissemination of more information on a timely basis without triggering the need to file a mandated disclosure document. Under the new scheme, a complete disclosure document still must be provided before a security holder may vote or tender securities, but other communications regarding the transaction are permitted. This should permit more informed voting and tendering decisions. The content of communications is not restricted, but anyone relying on the new rules must file written communications relating to the transaction on the date of first use, so that all security holders have access to the information. In particular, the amendments permit more communications:

- before the filing of a registration statement relating to either a stock merger or a stock tender offer transaction;
- before the filing of a proxy statement (regardless of the subject matter or contested nature of the solicitation); and
- regarding a proposed tender offer without "commencing" the offer and requiring the filing and dissemination of specified information.

The amendments also harmonize the various communications principles applicable to business combination transactions under the Securities Act, tender offer rules and proxy rules. Confidential treatment of merger proxy statements is retained, but only under limited circumstances. Under the new scheme, if parties to a transaction publicly disclose information beyond that specified in Rule 135, the proxy statement must be filed publicly. If a proxy statement is filed confidentially, but later the parties disclose information beyond Rule 135, then the proxy statement must be re-filed publicly.

2. Balance the Regulatory Treatment of Cash and Stock Tender Offers

Currently, registered stock tender offers (exchange offers) are subject to regulatory delays not imposed on cash tender offers. A cash tender offer may commence as soon as a tender offer schedule is filed and the information disseminated to security holders while an exchange offer may not commence before a registration statement is filed and becomes effective. The delay associated with exchange offers may cause some bidders to favor cash over stock as consideration in a business combination transaction. In addition, the different regulatory treatment can give a bidder offering cash a timing advantage over a competing bidder offering stock. The amendments adopted will balance the regulatory treatment of cash and stock tender offers to the extent practicable.

Under the new rules third-party or issuer exchange offers may commence as early as the filing of a registration statement, or on a later date selected by the bidder, before effectiveness of the registration statement. As a result, a bidder offering securities will not need to wait until effectiveness to commence an exchange offer. Early commencement is not mandatory, but rather at the election of the bidder. A bidder may file a registration statement, wait for staff comments, if any, and then decide to commence its offer. Any securities tendered in the offer could not be purchased until after the registration statement becomes effective, the minimum 20 business day tender offer period has expired, and all material changes are disseminated to security holders with adequate time remaining in the offer to review and act upon the information. A bidder need not deliver a final prospectus to security holders. Security holders may withdraw tendered securities at any time before they are purchased by the bidder.

3. Updating, Simplifying and Harmonizing the Disclosure Requirements

Currently, the procedural and disclosure requirements for business combination transactions vary depending upon the form of the transaction. Many of the differences can be minor and unnecessary. The amendments clarify and harmonize many of the requirements. The amendments also make the requirements easier to understand and facilitate compliance with the regulations.

The substantive disclosure requirements for tender offers, going-private transactions and other extraordinary transactions remain substantially the same, but are moved to one central location within the rules, called "Regulation M-A." In some cases, harmonization reduces the disclosure requirements. The amendments also update the rules in several respects. The more significant amendments will:

- combine the existing schedules for issuer and third-party tender offers into one new schedule available for all tender offers, called "Schedule TO";
- require a plain English summary term sheet in all tender offers, mergers and going-private transactions, except when the transaction is already subject to the plain English requirements of the Securities Act rules;
- update and generally reduce the financial statements required for business combinations;

- require pro forma and related financial information in negotiated cash tender offers when the bidder intends to engage in a back-end securities transaction;

- permit an optional subsequent offering period after completion of a tender offer during which security holders can tender their shares without withdrawal rights;

- revise Rule 13e-1, which requires issuers to report intended repurchases of their own securities once a third-party tender offer has commenced, so that the required information need not be disseminated to security holders and to provide an exclusion from the rule for certain periodic, routine purchases;

- conform the current security holder list requirement in the tender offer rules with the comparable provision in the proxy rules so that the list will include non-objecting beneficial owners; and

- clarify the rule that prohibits purchases outside a tender offer (Rule 10b-13), codify prior interpretations of and exemptions from the rule; add several new exceptions to the rule, and redesignate it as new Rule 14e-5.

B. Cross Border Tender Offers, Rights Offers and Business Combinations

The Commission has adopted exemptive provisions to facilitate the inclusion of U.S. investors in tender and exchange offers, business combinations and rights offerings for the securities of foreign companies. (Securities Act Release No. 7759, October 22, 1999).

1. Reasons for the Exemptions

Although it is very common for U.S. persons to hold securities of foreign companies, they often are unable to participate fully in tender offers, rights offerings and business combinations involving those securities. Offerors often exclude U.S. security holders due to conflicts between U.S. regulation and the regulation of the home jurisdiction or the perceived burdens of complying with multiple regulatory regimes.

In tender offers where the bidder is offering its own securities and rights offers where existing shareholders are offered the opportunity to buy more stock, in the absence of an exemption (such as the new exemptions contained in the release), inclusion of U.S. holders would require registration under the Securities Act. Registration requires the issuer to provide to shareholders financial statements prepared in accordance with U.S. accounting standards. Also, the issuer would incur an ongoing reporting obligation in the United States.

2. Harmful Effects of Excluding U.S. Investors

U.S. investors often are unable to receive the full benefits offered to other investors in these types of offshore transactions. When bidders exclude the U.S.

security holders from tender or exchange offers, the U.S. investors are denied the opportunity to receive the full value of the premium offered for their shares. (In some cases, these holders may eventually have their securities acquired in a compulsory acquisition when the offeror completes the acquisition.) Similarly, when issuers exclude their U.S. security holders from participation in rights offerings, the U.S. investors lose the opportunity to retain their relative ownership position or possibly to purchase at a discount. (In some instances, they may be able to receive the cash value of their rights.)

These offshore transactions may affect the interests of the U.S. investors in the foreign securities, regardless of whether they receive information about the transaction or are able to participate directly in the offer. For example, market activity in the stock after announcement of a tender offer may affect the price of the stock. Even though U.S. investors cannot participate in the tender offer, they must react to the event by deciding whether to sell, hold, or buy additional securities. Offerors will often take affirmative steps to prevent their informational materials from being disseminated in the United States as a means to avoid triggering U.S. regulatory requirements. U.S. investors, therefore, must make this decision without the benefit of information required by either U.S. or foreign securities regulation.

3. The Exemptions

The new exemptions balance the need to promote the inclusion of U.S. investors in these types of cross-border transactions against the need to provide U.S. investors with the protections of the U.S. securities laws. The U.S. anti-fraud and anti-manipulation rules and civil liability provisions will continue to apply to these transactions. The rule changes are effective January 24, 2000.

New provisions in the tender offer rules exempt:

- tender offers for the securities of foreign private issuers from most provisions of the Exchange Act and rules governing tender offers when U.S. security holders hold 10 percent or less of the foreign company's securities that are subject to the offer (the "Tier I exemption").

- tender offers from certain limited provisions of the Securities Exchange Act of 1934 and rules governing tender offers when U.S. security holders hold 40 percent or less of a foreign private issuer's securities that are subject to the offer (the "Tier II exemption"). The Tier II exemption represents a codification of current exemptive and interpretive positions that eliminate frequent areas of conflict between U.S. and foreign regulatory requirements.

- tender offers for the securities of foreign private issuers from Rule 10b-13 of the Exchange Act (redesignated Rule 14e-5 in the Regulation M-A rulemaking), which will permit purchases outside the tender offer during the offer when U.S. security holders hold 10 percent or less of the subject securities.

In addition, two new exemptions from the Securities Act registration and Trust Indenture Act provisions exempt:

- under new Rule 801, rights offerings of equity securities by foreign private issuers from the registration requirements of the Securities Act when U.S. security holders hold 10 percent or less of the securities.

- under new Rule 802, securities issued in an exchange offer, merger or similar transaction for a foreign private issuer from the registration requirements of the Securities Act and the qualification requirements of the Trust Indenture Act when U.S. security holders hold 10 percent or less of the subject class of securities.

Some of the more significant changes from the November 1998 proposals include:

- The U.S. ownership thresholds for the Rule 801 and Rule 802 registration exemptions have been increased from five to 10 percent.

- Under a "cash-only alternative" for Tier I tender offers, bidders will be permitted to offer cash in the United States while offering securities offshore without violating the equal treatment requirements of the tender offer rules. The bidder must have a reasonable basis to believe that the cash being offered to U.S. security holders is substantially equivalent to the value of the consideration being offered to non-U.S. holders.

- holders in both rights offerings and exchange offers would receive restricted stock under Rule 144 only to the extent their existing holdings were restricted. We had proposed treating all securities issued in rights offerings as restricted.

- In determining U.S. ownership, an offeror would be required to "look through" the record ownership of certain brokers, dealers, banks or nominees holding securities for the accounts of their customers. Ten percent holders, foreign or domestic, are excluded from the calculation, rather than just foreign 10 percent holders as had been proposed. Securities held by the bidder also are excluded from the calculation.

C. <u>Amendments To Beneficial Ownership Reporting Under Exchange Act Section 13(d)</u>

On January 12, 1998, the Commission adopted amendments to its beneficial ownership disclosure rules under Section 13(d) of the Exchange Act of 1934 to reduce the reporting obligations of certain investors. See Exchange Act Release No. 39538 (January 12, 1998). The rules had been published for comment in Exchange Act Release No. 37403 (July 3, 1996). The new provisions include the following:

- Unless they were qualified institutional investors, most investors previously were required to file a long-form Schedule 13D disclosing detailed information about the "investor and the purpose and background of the acquisitions. The revised rules now allow passive investors (those that do not have the purpose or effect of changing or influencing control of the issuer) to report their greater than 5% ownership on the short-form Schedule 13G if they do not own 20% or more of the outstanding securities.

- ○ The initial schedule must be filed within 10 days.

- ○ The schedule must be amended annually to reflect any changes in the information.

- ○ The schedule must be amended promptly if ownership increases by more than 10% and thereafter promptly upon increasing or decreasing by more than 5%.

- ○ If the reporting person no longer has a passive investment purpose or increases his or her ownership to 20% or more, a Schedule 13D must be filed within ten days. Upon those events, the person may not vote the securities or acquire additional equity securities of the issuer until 10 days after the Schedule 13D is filed.

- ○ A reporting person may re-establish its Schedule 13G-eligibility and switch from Schedule 13D to Schedule 13G once it becomes a passive investor and its ownership decreases below 20%.

- The list of qualified institutional investors who are eligible to file on Schedule 13G, regardless of their percentage ownership, is expanded to include the following:

  - ○ employee benefit plans maintained primarily for the benefit of state or local government employees;

  - ○ savings associations;

  - ○ church employee benefit plans;

  - ○ control persons of qualified institutional investors who have a passive investment purpose and do not own directly, or

    indirectly through an ineligible entity, more than 1% of the issuer's stock;

  - ○ investment advisers prohibited from registering under the Investment Advisers Act of 1940 pursuant to Section 203A of that Act.

- Copies of Schedule 13G are no longer required to be sent to the exchanges on which the securities trade.

- Under interpretive guidance provided by the Commission in adopting the amendments, the Commission clarified that beneficial ownership by a subsidiary or other business unit may not have to be attributed to the subsidiary's parent entity if the voting and investment powers over the subsidiary's shares are exercised independently from the parent. This determination is based on the facts and circumstances.
    - One circumstance in which beneficial ownership may not be required to be attributed to the parent is when these entities have in place certain informational barriers that ensure that the voting and investment powers are exercised independently.
    - If informational barriers are relied upon, written policies and procedures should be used, annual independent assessments of the informational barriers should be made, and the entities should not share common officers, directors or employees that are involved in the exercise of the voting and investment powers.
- The Commission also provided guidance regarding the impact of soliciting activities by a shareholder with respect to shareholder proposals on the use of Schedule 13G by that shareholder. Soliciting activity that does not have the purpose or effect of changing or influencing control does not prevent the use of Schedule 13G. That determination is based on the facts and circumstances. The release highlights five relevant factors to consider in assessing the purpose and effect of the proposal and related soliciting activity.

D. **Current Issues**

1. **Disclosure Issues Arising in Tender Offers for Limited Partnership Units**

Several tender offers for limited partnership interests have commenced where the price offered is significantly below the amount originally paid for the units, prices paid for the interests in the secondary markets, and/or recent appraisals of the assets owned by the partnership. Some of these tender offers have been conducted by the general partner of the limited partnership, while others have been conducted by unaffiliated parties.

Since most of these transactions have been structured as cash offers for less than all of the outstanding limited partnership units, these transactions generally have not been subject to the roll-up or going private rules, both of which require enhanced disclosure regarding the fairness of the transaction and any conflicts of interests presented by the party making the transaction. However, many of the same concerns that led to the development of a specialized regulatory scheme for roll-ups of limited partnerships are raised by these transactions -- notably the conflict of interest presented by the participation of affiliated entities in purchasing the limited partnership interests and the inability of these investors to realize fair market value for their interests through a trading market, as opposed to accepting what is perceived as an "inadequate offer."

In preparing disclosure documents for these transactions, bidders are advised to remember that the 1991 release adopting the roll-up provisions specifically addresses transactions which, although by definition not roll-ups, raise similar concerns. The release states that the disclosure required by the roll-up rules must be considered from an antifraud perspective (Securities Act Release No. 6922 (October 30, 1991)). Bidders are also advised to provide balanced disclosure as required by Securities Act Release No. 6900 (June 17, 1991), including describing risks of the transaction in bullet form on the cover page, providing a detailed table of contents and writing the document in "plain English."

The staff is closely reviewing the disclosure in these transactions and expects that bidders, whether or not affiliated with the general partner, will provide investors with sufficient disclosure to consider adequately the conflicts presented by any affiliation between the bidder and the general partner and disparities between the value of their interests and the consideration offered, including whether any reports or appraisals that are materially related to the transaction have been prepared by a third party. Financial information relating to the partnership also should be provided, such as selected financial data required by Item 301 of Regulation S-K. If the target partnership is a real estate limited partnership, disclosure comparable to that required by Items 14 (description of real estate) and 15 (operating data) of Form S-11 should be provided. An unaffiliated bidder is required to disclose only information that is otherwise publicly available unless it has received non-public information from the target, in which case the non-public information also would need to be disclosed. Soliciting dealer fees or any other payments to brokers, dealers or agents for soliciting tenders should be prominently disclosed in the offering documents.

2. Investment Banking Firm Disclaimers

Boards of directors of companies soliciting shareholder voting and/or investment decisions in connection with mergers and other extraordinary transactions often retain investment banking firms as financial advisors, in many cases to render an opinion on the financial fairness of the transaction. In connection with its review of proxy statements, Securities Act registration statements and other Commission filings made in this context, the staff increasingly has observed the appearance of disclaimers by or on behalf of the financial advisor regarding shareholders' right to rely on a fairness opinion that the advisor has furnished to the registrant's board, a special committee of the board, and/or the registrant. Examples of such disclaimers include the following:

- "No one other than the Board of Directors [or the Special Committee and/or the Company] has the right to rely on this opinion;"
- "This opinion is provided solely/only to the Board of Directors [or the Special Committee and/or the Company];"
- "This opinion is solely/only for the benefit of the Board of Directors [or the Special Committee and/or Company];"
- "No one may rely on this opinion without the prior consent of the Financial Advisor;" and
- "This opinion is addressed [solely/only] to the Board of Directors [Special Committee and/or the Company] and is not intended to be relied upon by any shareholder."

During the review and comment process, the staff has objected to such statements as inconsistent with the balance of the registrant's disclosure addressing the fairness to shareholders of the proposed transaction from a financial perspective. Specifically, the staff has requested that any such direct or indirect disclaimer of responsibility to shareholders, whether made by or on behalf of the financial advisor, be deleted from any portion of the disclosure document in which it appears (including exhibits). Alternatively, the registrant may add an explanation that clarifies:

(a) the basis for the advisor's belief that shareholders cannot rely on its opinion, including (but not limited to) whether the advisor intends to assert the substance of the disclaimer as a defense to shareholder claims that might be brought against it under applicable state law;

(b) whether the governing state law has addressed the availability of such a defense to the advisor in connection with any such shareholder claim; if not, a statement must be added that the issue necessarily would have to be resolved by a court of competent jurisdiction; and

(c) that the availability or non-availability of such a defense will have no effect on the rights and responsibilities of the board of directors under governing state law, or the rights and responsibilities of the board or the advisor under the federal securities laws.

3. <u>Securities Act Registration Issues Arising in Connection With Mergers and Other Extraordinary Transactions</u>

[Note: These procedures will change after effectiveness of the new regulatory scheme for business combinations discussed in Section IV. A.]

Third parties often urge shareholders to vote against a pending merger on the basis that the third party is proposing its own competing acquisition proposal. When the competing acquisition proposal involves the use of the third party's securities as consideration (through an exchange offer or merger), communications by the third party to shareholders regarding its competing bid may, depending on the facts and circumstances, be an "offer to sell" or “solicitation of an offer to buy” the third party's securities. As a result, the opposition solicitation triggers the registration requirements of Section 5 of the Securities Act, as well as the proxy disclosure and dissemination requirements.

Generally speaking, a third party's written communications in connection with its solicitation in opposition to a pending merger or business combination would not raise Section 5 concerns if the communications fall within the safe harbor provisions of Securities Act Rules 145(b) and 135. Parties should consider the following matters in order to avoid Section 5 concerns.

Under Rule 145(b)(1) of the Securities Act, a written communication would not be deemed an offer to sell if it contains no more than: (i) the name of the third party or other person or entity that might be issuing securities in the potential competing transaction, as well as the names of any other parties to such transaction, (ii) a brief description of the potential competing transaction and the basis upon which such transaction will be made, and (iii) any legend or similar statement required by State or federal law or administrative authority. See also Rule 135 of the Securities Act.

Under Rule 145(b)(2) of the Securities Act, any written communication that is subject to and meets the requirements of Exchange Act Rule 14a-12, and is filed in accordance with paragraph (b) of that rule, would not be deemed an “offer to sell” under Section 5. Rule 14a-12 provides that a solicitation (other than one subject to Rule 14a-11, which pertains to election contests) may be made before furnishing security holders a written proxy statement meeting the requirements of Rule 14a-3(a) if:

(1) the solicitation is made in opposition to a prior solicitation or an invitation for tenders or other publicized activity, which if

successful, could reasonably have the effect of defeating the action proposed to be taken at the meeting;

(2) no form of proxy is furnished to security holders before the written proxy statement required by Rule 14a-3(a) is furnished to security holders;

(3) the identity of the "participants" in the solicitation and a description of their interests, direct or indirect, by security holdings or otherwise, are set forth in each communication published, sent or given to security holders in connection with the solicitation, and

(4) a written proxy statement meeting the requirements of Regulation 14A is sent or given to solicited security holders at the earliest practicable date.

However, the safe harbor provisions of Securities Act Rules 145(b) and 135 only protect written communications made before a registration statement is filed. Accordingly, oral communications made before a registration statement is filed may still raise Section 5 concerns. If a person is relying on Rule 14a-12 and Rule 145(b)(2) to disseminate information to shareholders before filing a registration statement, the information must be in written form and filed with the Commission when first disseminated. These issues arise often in meetings and conference calls with analysts or shareholders before filing a registration statement.

The staff also notes that Rule 14a-12 only applies to solicitations that are made before furnishing security holders a written proxy statement meeting the requirements of Rule 14a-3(a). The proxy statement is required to be sent or given to solicited security holders "at the earliest practicable date." The safe harbor cannot be relied upon if the soliciting person challenging a proposed merger does not intend to file and deliver a Rule 14a-3 proxy statement within a reasonable period of time.

Where the third party's proxy solicitations trigger the need for compliance with the registration and prospectus delivery provisions of the Securities Act, the third party should file promptly a registration statement to cover the securities offering to target shareholders.

In view of the number of communications the third party may disseminate in opposition to the "friendly" transaction during the "waiting period," the staff will not object if the "core" proxy statement/prospectus is not redelivered with each additional communication, so long as:

- Before dissemination of additional communications, the preliminary proxy statement/prospectus (without a proxy card containing a proposal directed to the third party's competing package) is sent or given to all target company shareholders eligible to vote at the shareholders' annual or special meeting at which shareholders will consider and vote on the "friendly" proposal.

- Each additional communication is filed as a pre-effective amendment to the registration statement. In lieu of filing a pre-effective amendment, a registrant eligible to use Form S-3 or F-3 may file the additional communications under cover of a Form 8-K that is incorporated by reference into the proxy statement/prospectus, which is part of the registration statement.

- Each additional communication used after delivery of the preliminary prospectus includes a statement to the effect that the third party has filed a registration statement, that the preliminary prospectus has been sent or given to all shareholders eligible to vote at the meeting at which the "friendly" transaction will be considered, and that the proxy statement/prospectus is incorporated by reference into the communication.

The staff's procedures outlined above are limited solely to the dissemination of additional communications and are not applicable to the dissemination of revisions to the "core" document.

Securities Act registration issues also may arise in connection with the announcement of a negotiated, stock-for-stock merger by one or both of the parties to the prospective transaction. Such announcements, which typically are accompanied or followed by various other market communications regarding the planned transaction, frequently are made by the parties' senior management, their respective investment bankers and/or other representatives before the filing of the required Securities Act registration statement. While issuers in these circumstances may have obligations under federal securities antifraud and stock exchange rules to make timely disclosure of the impending transaction, they should remember that such pre-filing communications may go beyond what arguably is necessary and appropriate for compliance with applicable antifraud and SRO provisions and, as such, could be deemed to constitute market conditioning that violates Section 5. Whatever its content, moreover, the information conveyed in these pre-filing communications must be reflected in the offering documents subsequently filed with the Commission and delivered to shareholders.

4. Identifying the Bidder in a Tender Offer

Rule 14d-1(c)(1) of Regulation 14D defines "bidder" in a tender offer as "any person who makes a tender offer or on whose behalf a tender offer is made." The term bidder, for Regulation 14D purposes, does not include an issuer that makes a tender offer for its own securities. Each bidder in a tender offer subject to Regulation 14D must file a Schedule 14D-1 (Schedule TO after the Regulation M-A rules become effective) and disseminate the information required by that schedule.

The determination of who is the bidder does not necessarily stop at the entity used to make the offer and purchase the securities. Rule 14d-1(c)(1) also requires persons "on whose behalf" the tender offer is being made to be included as bidders. For instance, where a parent company forms an acquisition entity for the purpose of making the tender offer, both the acquisition entity and the parent company are bidders even though the acquisition entity will purchase all securities tendered. The staff views the acquisition entity as the nominal bidder and the parent company as the real bidder. They both should be named bidders in the Schedule 14D-1. Each offer must have at least one real bidder, and there can be co-bidders as well.

The fact that the parent company or other persons control the purchaser through share ownership does not mean that the entity is automatically viewed as a bidder. Instead, we look at the parent's or control person's role in the tender offer. Bidder status is a question that is determined by the particular facts and circumstances of each transaction. A similar analysis of bidder status is made in a tender offer subject only to Regulation 14E. When we analyze who is the bidder, some relevant factors include:

- Did the person play a significant role in initiating, structuring, and negotiating the tender offer?
- Is the person acting together with the named bidder?
- To what extent did or does the person control the terms of the offer?
- Is the person providing financing for the tender offer, or playing a primary role in obtaining financing?
- Does the person control the named bidder, directly or indirectly?
- Did the person form the nominal bidder, or cause it to be formed?, and
- Would the person beneficially own the securities purchased by the named bidder in the tender offer or the assets of the target company?

One or two of these factors may control the determination, depending on the circumstances. These factors are not exclusive.

We also consider whether adding the person as a named bidder means shareholders will receive material information that is not otherwise required under the control person instruction, Instruction C to Schedule 14D-1. However, this issue is not dispositive of bidder status. A person who qualifies as a bidder under Rule 14d-1(c)(1) must be included as a bidder on the Schedule 14D-1 even if the disclosure in the Schedule 14D-1 will not change as a result. Instruction C elicits information about the control persons of the bidder. Merely disclosing the Instruction C information does not eliminate the requirement that the real bidder sign the Schedule 14D-1 and take direct responsibility for the disclosure. Where the real bidder does not sign the Schedule 14D-1 and does not provide the required disclosure, the parties run the risk of having to extend the offer to provide a full 20 business day period for shareholders to consider the new information.

If a named bidder is an established entity with substantive operations and assets apart from those related to the offer, the staff ordinarily will not go further up the chain of ownership to analyze whether that entity's control persons are bidders. However, it still would be possible for other parties involved with the offer to be co-bidders. The factors listed above would be used in the analysis. In addition, we would consider the degree to which the other party acted with the named bidder, and the extent to which the other party benefits from the transaction.

5. <u>Schedule 13E-3 Filing Obligations of Issuers or Affiliates Engaged in a Going-Private Transaction</u>

Generally, Exchange Act Rule 13e-3 requires that each issuer and affiliate engaged, directly or indirectly, in a going-private transaction file a Schedule 13E-3 with the Commission and furnish the required disclosures (e.g., the statement of "reasonable belief" as to the fairness or unfairness of the proposed transaction) directly to the holders of the class of equity securities that is the subject of the transaction. A joint filing may be permissible in this situation, provided each filing person individually makes the required disclosures and signs the Schedule 13E-3.

Two separate but related issues may be raised with respect to the determination of "filing-person" status in situations where a third party proposes a transaction with an issuer that has at least one of the requisite "going-private" effects: first, what entities or persons are "affiliates" of the issuer within the scope of Rule 13e-3(a)(1) and, second, when should those affiliates be deemed to be engaged, either directly or indirectly, in the going-private transaction. Resolution of both issues necessarily turns on all relevant facts and circumstances of a particular transaction. The following considerations should be noted:

(a) The staff consistently has taken the position that members of senior management of the issuer that is going private are affiliates of that issuer. Depending on the particular facts and circumstances of the transaction, such management also might be deemed to be engaged in the transaction. As a result, such management-affiliates may incur a Schedule 13E-3 filing obligation separate from that of the issuer. For example, the staff has taken the position that members of senior management of an issuer that will be going private are required to file a Schedule 13E-3 where the transaction will be effected through merger of the issuer into the purchaser or that purchaser's acquisition subsidiary, even though:

(i) such management's involvement in the issuer's negotiations with the purchaser is limited to the terms of each manager's future employment with and/or equity participation in the surviving company; and

(ii) the issuer's board of directors appointed a special committee of outside directors to negotiate all other terms of the transaction except management's role in the surviving entity.

An important aspect of the staff's analysis was the fact that the issuer's management ultimately would hold a material amount of the surviving company's outstanding equity securities, occupy seats on the board of this company in addition to senior management positions, and otherwise be in a position to "control" the surviving company within the meaning of Exchange Act Rule 12b-2 (<u>i.e.</u>, "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.").

(b) Questions have arisen regarding the nature and scope of the Schedule 13E-3 filing obligation of an acquiring person, or "purchaser," in a merger or other going-private transaction. In the situation described in (a) above, where management of the issuer-seller that will be going private is essentially "on both sides" of the transaction, the purchaser also may be deemed to be an affiliate of the issuer engaged in the transaction and, as a consequence, required to file on Schedule 13E-3. See Exchange Act Release No. 16075 (August 2, 1979) (noting that "affiliates of the seller often become affiliates of the purchaser through means other than equity ownership, and thereby are in control of the seller's business both before and after the transaction. In such cases the sale, in substance and effect, is being made to an affiliate of the issuer ...."). Accordingly, the issuer-seller, its senior management and the purchaser may be deemed Schedule 13E-3 filing persons in connection with the going-private transaction. Where the purchaser has created a merger subsidiary or other acquisition vehicle to effect the transaction, moreover, the staff will "look through" the acquisition vehicle and treat as a separate, affiliated purchaser the intermediate or ultimate parent of that acquisition vehicle. Accordingly, <u>both</u> the acquisition vehicle and the entity or person who formed it to acquire the issuer would have separate filing obligations (although, as noted, a joint filing may be permitted by the staff).

V. <u>ELECTRONIC FILING AND TECHNOLOGY</u>

A. <u>EDGAR</u>

The Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system has been operational since 1992, with mandated electronic filing by those subject to the Division's review beginning in April 1993. Electronic filings are publicly available on a 24-hour delayed basis in the “EDGAR Database” area of the Commission’s website, *http://www.sec.gov*. This area also contains other information about EDGAR, including an outline entitled “Electronic Filing and the EDGAR System: A Regulatory Overview.” The following events are of current interest:

1. <u>EDGAR Modernization and Related Rule Amendments</u>

On June 22, 1998, the Commission awarded to TRW, Inc. a three year contract for the modernization of the EDGAR System, with options for contract extensions for up to five years. The EDGAR architecture will be converted to an Internet-based system using Hyper Text Markup language ("HTML") as the filing format, and also will support the attachment of graphical files. The new system is expected to reduce costs and efforts of preparing and submitting electronic filings, as well as permit more attractive and readable documents.

On May 17, 1999, the Commission issued Securities Act Release No. 7684 adopting new rules and amendments to existing rules and forms in connection with the first stage of EDGAR modernization. The rules become effective June 28, 1999.

On June 28, the Commission began accepting live filings submitted in HTML, as well as documents submitted in the currently required American Standard Code for Information Interchange ("ASCII") format. Filers have the option of accompanying their required filings with unofficial copies in Portable Document Format ("PDF"). Filers also are encouraged to submit test filings that include documents in HTML and PDF format.

2. <u>Paper Filings No Longer Accepted</u>

The Commission has adopted a new electronic filing rule (Rule 14 of Regulation S-T) to make it clear that it will no longer accept filings made in paper that should have been filed electronically. See Release No. 33-7472 (October 24, 1997). The rule became effective January 1, 1998. If a filer submits a paper document required to be filed electronically, and does not follow the appropriate procedures for a temporary or continuing hardship exemption outlined in Rules 201 and 202 of Regulation S-T, the filing will not be accepted or processed. If the filing desk receives a document by courier it will be given back to the courier, and if received through the mail or other delivery service, it will be returned by mail.

B. <u>Electronic Delivery of Information</u>

The Commission has issued interpretive releases and rules addressing the use of electronic media to deliver or transmit information under the federal securities laws. These initiatives reflect the Commission's continuing recognition of the benefits that electronic technology provides to the financial markets. These releases are premised on the belief that the use of electronic media should be at least an equal alternative to the use of paper delivery.

The first interpretive release (Securities Act Release No. 7233 (October 6, 1995)) provides guidance to issuers who use electronic media in complying with the applicable delivery requirements of the federal securities laws. Information distributed through electronic means may be viewed as satisfying the delivery requirements of the federal securities laws if it results in the delivery to the intended recipients of substantially equivalent information as they would have had if the information were delivered in paper form. The interpretive release advises issuers to consider the following:

- Has timely and adequate notice been provided to the investor that the information is available?

- Does the investor have access to the information? Specifically:

  - is it practically accessible?

  - is it available on-line for as long as a delivery requirement applies?

  - does the investor have the opportunity to retain the information or have ongoing access equivalent to personal retention?

  - is it available in paper upon request?

- Does the selected distribution method provide reasonable assurance that it will result in delivery? Examples for consideration by persons with delivery obligations include:

  - an investor has given an informed consent to receive the information through a particular electronic medium and been provided appropriate notice and access;

  - there is evidence that the investor actually received the information (e.g., electronic mail return receipt or confirmation of downloading);

  - the information is provided by facsimile to an investor who has provided a fax machine number;

  - the investor has accessed an electronic document with hypertext linking to a document required to be delivered; or

  - an investor returns an order form available only through an electronically delivered document.

The release also contains numerous examples applying these concepts to specific fact situations.

On May 9, 1996, the Commission issued a second interpretive release primarily addressing issues associated with the electronic delivery of information by broker-dealers, transfer agents, and investment advisers under certain Exchange Act and Advisers Act rules (Securities Act Release No. 7288). This release also contains a section following up the 1995 release with additional examples. A third interpretive release issued in 1998 is discussed below.

On May 9, 1996, the Commission also adopted a number of technical amendments to its rules and forms intended to codify some interpretations set out in the interpretive release (Securities Act Release No. 7289). Most changes relate to rules that require distribution of information by mail, or rules that require presentation of information in a specified type size or font, or in red ink or boldface type. For example, if a rule requires presentation of a legend using a specified type size and font, the rule now provides that if an electronic medium is used, the legend must be presented using any means reasonably calculated to draw attention to it.

Guidance in this area also is provided by interpretive letters addressing particular issues regarding electronic dissemination. See Section XII. In addition, the staff has issued two letters addressing the identification of an issuer's web site in a prospectus: ITT Corporation (December 6, 1996) and Baltimore Gas and Electric Company (January 6, 1997).

C. Interpretive Release Relating to Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore

The Commission issued an interpretive release on March 23, 1998, that provides guidance on the application of the registration requirements of the U.S. securities laws to offers of securities or investment services made on Internet Web sites by foreign issuers, investment companies, investment advisers, broker-dealers and exchanges. In the release (Securities Act Release No. 7516), the Commission expresses its views on when the posting of offering or solicitation materials on Internet Web sites would not be considered to be an offering "in the United States."

The release states that, for purposes of the registration requirements only, offshore Internet offers and solicitation activities would not be considered to be made "in the United States" if Internet offerors implement measures that are reasonably designed to ensure that their offshore Internet offers are not targeted to the United States or to U.S. persons. In the Commission's view, offshore Internet offers that are not targeted to the United States would not trigger the registration requirements of the U.S. securities laws, even if U.S. persons are able to access the Web site offers.

The interpretation suggests measures that Web site offerors could implement to guard against targeting their offers to the United States. The measures outlined in the release are not exclusive. Other procedures may suffice to guard against sales to U.S. persons. Under the interpretation's general approach, a foreign offeror could post an offer on its Web site without registering the offer, if: i) the offeror puts a meaningful disclaimer on the Web site that would specify intended offerees by identifying the jurisdictions in which the offer is or is not being made; and ii) the offeror implements measures reasonably designed to prevent sales to U.S. persons.

The release explains that the measures suggested under the general approach may not be adequate for U.S. offerors making offshore Internet offers. Because domestic offerors are very likely to have significant contacts with the United States, and because investors may reasonably assume SEC regulation of the Internet offers of domestic entities, the Commission believes that U.S. offerors making offshore Internet offers should, in addition to following the general approach, password protect their Web sites to ensure that only non-U.S. persons may access their unregistered Web site offers.

Offerors may wish to post their offerings on third-party Internet sites or communicate with offerees through forms of Internet communication that are more directed than through an Internet Web site posting. Depending on the activities and status of the offerors, implementation of the measures described under the general approach may not be adequate to guard against targeting the United States. For example:

- If an offeror seeks to have its offshore offer posted on the Web sites of third parties that are acting on its behalf, such as Web site service providers or underwriters, the offeror should only use third parties that employ at least the same level of precautions against targeting the United States as would be adequate for the offeror to employ.

- If, to generate interest in their offshore Internet offers, offerors use the services of investment-oriented Web site sponsors that have a significant number of U.S. clients or subscribers, then those offerors should employ measures to ensure that only non-U.S. persons may access the offering materials on their Web sites.

- Offerors that address or direct communications, such as e-mail, about their offers to particular U.S. persons or groups must assume the responsibility of determining when their offering communications are being sent to persons in the United States, and must fully comply with U.S. securities laws.

The release discusses issues that arise under the Securities Act of 1933 when foreign issuers make offshore Internet offers at the same time they make other offers in the United States. Offerors of concurrent offerings should consider whether, in addition to following the general approach, they should implement more restrictive measures to avoid targeting the United States. The release indicates that:

- Offerors of concurrent offshore Internet and U.S. private offers may not use their Web site offers as a means to solicit investors for their U.S. private offerings. The release suggests two non-exclusive ways to reach that result. These offerors could either: i) allow unrestricted access to their offshore Internet offers, but implement procedures to identify respondents to their Web site offers and restrict them from participating in their U.S. private offers; or ii) limit access to their offshore Internet offers to only those respondents who first provide the offerors with information indicating that they are not U.S. persons.

- Offerors of concurrent offshore Internet and U.S. registered offers should keep in mind U.S. securities laws limitations on pre-filing and waiting period communications.

In addition to addressing issues under the Securities Act of 1933, the release provides guidance on the application of the general approach to the registration obligations under the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the broker-dealer and exchange registration provisions under the Securities Exchange Act of 1934.

D. <u>Year 2000 Interpretive Release and Frequently Asked Questions</u>

The "Year 2000 problem" arose because many existing computer programs use only the last two digits to refer to a year. Therefore, these computer programs do not properly recognize a year that begins with "20" instead of the familiar "19." If not corrected, many computer applications could fail or create erroneous results. The extent of the potential impact of the Year 2000 problem is not yet known, and if not timely corrected, it could affect the global economy.

On July 29, 1998, the Commission issued an interpretive release on Year 2000 disclosure, Securities Act Release No. 7558 (effective August 4). This release is meant to elicit more meaningful Year 2000 disclosure from public companies, investment advisers, investment companies and municipal securities issuers.

For public companies that make filings with the Division of Corporation Finance, the Commission's authority basically is directed toward eliciting disclosure. The disclosure framework requires companies to disclose material information that enables investors to make informed investment decisions. The interpretive release provides specific guidance for public companies making disclosure called for by Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), financial statement requirements and other rules and regulations.

MD&A (Item 303 of Regulation S-B and S-K) is the regulation that requires companies to disclose known events, trends, and uncertainties -- forward-looking information. Most discussions of Year 2000 issues contain forward-looking elements. Under the release's interpretation of MD&A, a company would provide Year 2000 disclosure if:

(1) its assessment of its Year 2000 issues is not complete, or
(2) management determines that the consequences of its Year 2000 issues would have a material effect on the company's business, results of operations, or financial condition, without taking into account the company's efforts to avoid those consequences.

The Commission believes that the vast majority of companies have material Year 2000 issues, and therefore expects them to address this topic in their MD&A. In almost all cases, this disclosure should be updated in each quarterly and annual periodic report.

When a company has a Year 2000 disclosure obligation, the release states that full and fair disclosure includes:

(1) the company's state of readiness;
(2) the costs to address the company's Year 2000 issues;

(3) the risks of the company’s Year 2000 issues; and
(4) the company’s contingency plans.

Each company must consider if its own Year 2000 circumstances require disclosure of other matters to meet their disclosure obligations. The release provides suggestions for some of these other matters.

To encourage companies to provide meaningful disclosure, the release provides interpretive guidance on the application of the statutory safe harbors for forward-looking information provided by the Private Securities Litigation Reform Act of 1995. These safe harbors provide protection for forward-looking information accompanied by meaningful cautionary statements. The safe harbors provide protection from class action lawsuits in federal court.

The release also addresses investment advisers and investment companies. The Commission, which has direct regulatory authority over these entities, has concluded that the best approach to monitor the year 2000 readiness of investment advisers and investment companies is to require the investment advisers to provide publicly available reports to the Commission. In June 1998, the Commission proposed to require these reports. The release also discusses the importance of disclosure by investment companies and investment advisers if the Year 2000 issue is material to their operating results or financial conditions, and provides guidance for such disclosure.

The Commission’s regulatory authority over disclosure by issuers of municipal securities is not as broad as its authority over disclosure by public and investment companies. Generally, municipal securities offerings are, by statute, exempt from registration and municipal securities issuers are exempt from the reporting provisions of the federal securities law, including line-item disclosure rules. Under an anti-fraud standard, the release provides guidance to municipal securities issuers on how to disclose their Year 2000 issues.

On November 9, 1998, the Commission gave additional guidance on the interpretive release by publishing Frequently Asked Questions to clarify some recurring issues (Securities Act Release No. 7609).

VI. SMALL BUSINESS ISSUES

A. Recent Small Business Initiatives

The Commission has undertaken several initiatives to help small businesses, including the following:

- A special Corporation Finance headquarters unit specializes in small company filings and the needs of small businesses, including crafting rules to lessen the burden of Commission's regulation on these issuers. The telephone number for the unit is (202) 942-2950.

- The Commission’s Internet site (*http://www.sec.gov*) has been enhanced to provide information specifically designed for small business and access to such Commission publications as "Q & A: Small Business and the SEC."

- The Division has added a new section to the Small Business Information page on the Commission's Internet site. The new section, Small Business Forms and Associated Regulations, will provide guidance to small businesses as they prepare their SEC filings under the Securities Act of 1933 and Securities Exchange Act of 1934. The new section contains the text of a number of forms and regulations of interest to small businesses. Hypertext links between the forms and the regulations are provided, and updates will be made to reflect the adoption of new rules or changes to existing rules. More forms and rules will be added in the future.

- Since 1996, a number of town hall meetings between the Commission and small businesses have been conducted throughout the United States. These town hall meetings convey basic information to small businesses about fundamental requirements that must be addressed when they wish to raise capital through the public sale of securities. In addition, the Commission hopes to learn more about the concerns and problems facing small businesses in raising capital so that programs can be designed to meet their needs, consistent with the protection of investors. The most recent town hall meeting was held in Albuquerque, New Mexico on October 21, 1999.

- The 18th annual Government-Business Forum on Small Business Capital Formation was held in Washington, D.C. on September 13-14, 1999. This platform for small business is the only governmentally-sponsored national gathering for small business, which offers annually the opportunity for small businesses to let government officials know how the laws, rules and regulations are affecting their ability to raise capital. Next year's Government-Business Forum will be in Texas in September.

B. Small Business Rulemaking

1. Rule 504 of Regulation D

On February 25, 1999, the Commission issued a release (Securities Act Release No. 7644) adopting amendments to Rule 504, the limited offering exemption under Regulation D. Rule 504 permits non-reporting issuers to offer and sell securities to an unlimited number of persons without regard to their sophistication or experience and without delivery of any specified information. The aggregate offering price of this exemption is limited to $1 million in any 12-month period, and certain other offerings must be aggregated with the Rule 504 offering in determining the available sales amount. Before these amendments were adopted, general solicitation and advertising was permitted and the securities sold under this exemption could be resold freely by non-affiliates of the issuer.

Unfortunately, there have been some recent disturbing developments in the secondary markets for some securities initially issued under Rule 504, and to a lesser degree, in the initial Rule 504 issuances themselves. These offerings generally involve the securities of “microcap” companies. Recent market innovations and technological changes, most notably, the Internet, have created the possibility of nation-wide Rule 504 offerings for securities of non-reporting companies that were once thought to be sold locally.

As part of the Commission’s comprehensive agenda to deter registration and trading abuses, particularly by microcap issuers, in May 1998, the Commission proposed amendments to Rule 504 to eliminate the freely tradable nature of the securities issued under the exemption (Securities Act Release No. 7541). Under the proposals, these securities could only have been resold only after the one-year holding period of Rule 144, through registration, or through another exemption (such as Regulation A) if available. The Commission also solicited comment on an alternative to revise Rule 504 so it would be substantially similar to its pre-1992 format, permitting public offerings only where the issuer complies with state registration processes that require the preparation and delivery of a disclosure document to investors before sale of the securities. Comment also was solicited on the appropriate treatment for offerings made under certain state exemptions, such as the one recently developed for sales to accredited investors (e.g., the Model Accredited Investor Exemption).

Almost all commenters objected to the proposal to make all securities issued in a Rule 504 transaction restricted, since it would require issuers to offer a substantial liquidity discount in all Rule 504 issuances, even fully state registered ones, causing a significant reduction of capital. Commenters believed that the alternative approach, which was to reinstitute the rule largely as it had been in effect for a number of years before 1992, would be equally, if not more, effective. If an issuer goes through state registration and must deliver a disclosure document to investors, sufficient information ought to be available in the markets to permit investors to make more informed investment decisions and thus deter manipulation of Rule 504 securities.

After consideration of the comments, the Commission decided to return to the pre-1992 approach, which should deter microcap fraud without unduly penalizing small businesses. As amended, Rule 504 establishes the general principle that securities issued under the exemption, just like the other Regulation D exemptions, will be restricted, and prohibits general solicitation and general advertising, unless the specified conditions permitting a public offering are met. These conditions are:

- the transactions are registered under a state law requiring public filing and delivery of a substantive disclosure document to investors before sale. For sales to occur in a state without this sort of provision, the transactions must be registered in another state with such a provision and the disclosure document filed in the state must be delivered to all purchasers before sale in both states; or

- the securities are issued under a state law exemption that permits general solicitation and advertising, so long as sales are made only to accredited investors as that term is defined in Regulation D.

Most Rule 504 offerings are private. Private Rule 504 offerings are still permitted for up to $1 million in a 12-month period, under the same terms and conditions, except for the specific disclosure requirements, as offerings under Rules 505 and 506. Securities in these offerings would be restricted, and these offerings would no longer involve general solicitation and advertising.

The amendments became effective on April 7, 1999. Rule 504 offerings that begin on or after this date will have to comply with the new rule. With respect to Rule 504 offerings that are ongoing on the effective date, issuers will have to discontinue offers and register under a state law requiring the preparation and delivery of a disclosure document to investors before sale in order to issue freely tradable securities.

In response to questions the staff has received about the Rule 504 amendments, we would like to point that for public offerings registered under the provisions of a complying state registration system (New York and the District of Columbia do not have such a system), such offerings must be made exclusively to the citizens of the state(s) of registration. Registration in one state and attempted sale to the citizens of another state (except for New York and the District of Columbia) would not meet the public offering requirements and also may violate the law of the state where registration was not effected. Registration under a state law with sales to citizens of a foreign jurisdiction would not meet the standards for a public offering under revised Rule 504.

2. Rule 701

On February 25, 1999, the Commission issued a release (Securities Act Release No. 7645) adopting amendments to Rule 701 under the Securities Act of 1933, which allows private companies to sell securities to their employees without the need to file a registration statement, as public companies do. Rule 701 provides an exemption from the registration requirements of the Securities Act for offers and sales of securities under certain compensatory benefit plans or written agreements relating to compensation. The exemptive scope covers securities offered or sold under a plan or agreement between a non-reporting company (or its parents or majority-owned subsidiaries) and the company's employees, officers, directors, partners, trustees, consultants and advisors Before these amendments were adopted, the total amount of securities that could be offered in the preceding 12 months could not exceed the greater of $500,000 or an amount determined under one of two formulas (i.e., 15% of the issuer's total assets or 15% of the outstanding securities of the class being offered), but in no event more than $5 million.

In February 1998, the Commission proposed a number of revisions to increase the flexibility and usefulness of Rule 701, as well as to simplify and clarify the rule (Securities Act Release No. 7511). On February 25, 1999, the Commission issued an adopting release that:

- removes the $5 million aggregate offering price ceiling and, instead, sets the maximum amount of securities that may be sold in a year at the greatest of :

--$1 million (rather than the current $500,000);
--15% of the issuer's total assets; or
--15% of the outstanding securities of the class;

- requires issuers to provide specific disclosure if more than $5 million worth of securities are to be sold (i.e., a copy of the compensatory benefit plan or contract; a copy of the summary plan description required by the Employee Retirement Income Security Act of 1974 ("ERISA"), or if the plan is not subject to ERISA, a summary of the plan's material terms; risk factors associated with investment in the securities under the plan or agreement; and the financial statements required in an offering statement on Form 1-A under Regulation A);

- does not count offers for purposes of calculating the available exempted amounts;

- harmonizes the definition of consultants and advisors permitted to use the exemption to the narrower definition of Form S-8, thereby narrowing the scope of eligible consultants and advisors;

- amends Rule 701 to codify current and more flexible interpretations; and

- simplifies the rule by recasting it in plain English.

Non-reporting foreign private issuers will be required to provide the same disclosure as non-reporting domestic issuers if sales under Rule 701 exceed $5 million in a 12-month period. When, and if, the Commission accepts international accounting standards or guidelines for filing and reporting purposes, Rule 701 will be amended to allow theses standards to satisfy Rule 701's financial statement disclosure obligations for foreign private issuers. For issuers making smaller offerings, the foreign companies may continue to follow the rule as they have in the past, which means that "home country" reports may be used, as necessary, to satisfy the antifraud standards. However, both domestic and foreign private issuers that cross the $5 million barrier will have to provide the disclosure required under Regulation A, which includes unaudited financial statements. Where financial statements prepared in accordance with U.S. GAAP are not provided by the foreign private issuer, a reconciliation to such principles must be attached.

These amendments to Rule 701 became effective on April 7, 1999. The changes to the rule are not retroactive. Offers and sales made in reliance before the effective date will continue to be valid if they meet the conditions of the rule before its revision.

Because of errors in the Federal Register version of the adopting release, a different way of calculating the amount of the exempt offering appears in the Code of Federal Regulations than that approved by the Commission. On November 5, 1999, the Secretary of the Commission issued a release (Securities Act Release No. 7645A) to correct the errors. The correction deletes a reference to the necessity of only making calculations based upon an annual balance sheet. The original intention was to permit calculations to be made on the basis of interim balance sheets as long as they were no older than the issuer's most recent fiscal year end.

VII. INTERNATIONALIZATION OF THE SECURITIES MARKETS

A. Foreign Issuers in the U.S. Market

Foreign companies raising funds from the public or having their securities traded on a national exchange or the Nasdaq Stock Market are generally subject to the registration requirements of the Securities Act and the registration and reporting requirements of the Exchange Act. The Commission has provided a separate integrated disclosure system for foreign private issuers that provides a number of accommodations to foreign practices and policies. These accommodations include:

- interim reporting on the basis of home country and stock exchange practice rather than quarterly reports;
- exemption from the proxy rules and the insider reporting and short swing profit recovery provisions of Section 16;
- aggregate executive compensation disclosure rather than individual disclosure, if so permitted in an issuer's home country;
- acceptance of three International Accounting Standards relating to cash flow statements (IAS # 7), business combinations (IAS # 22) and operations in hyperinflationary economies (IAS # 21);
- offering document financial statements updated principally on a semi-annual, rather than a quarterly basis; and
- an exemption from Exchange Act registration under Section 12(g) for foreign private issuers that have not engaged in a U.S. public offering or whose securities are not traded on a national exchange or the Nasdaq Stock Market.

Additionally, the Commission staff has implemented procedures to review foreign issuers' disclosure documents on an expedited basis and in draft form, if requested by the issuer. This helps to facilitate cross-border offerings and listings in light of potentially conflicting home-country schedules and disclosure requirements.

Over the last five years, the number of foreign companies accessing the U.S. public markets has increased dramatically. As of June 30, 1999 there were over 1200 foreign companies from 57 countries filing periodic reports with the Commission.

In addition to the topics discussed below in this "Internationalization" section, the Commission has issued an interpretive release on offshore Internet offerings; see Section V.C.

B. Abusive Practices under Regulation S and Amendments to the Rule

The Commission adopted Regulation S in 1990 to clarify the applicability of the Securities Act registration requirements to offshore transactions. Since the adoption of Regulation S, a number of abusive practices have developed involving unregistered sales of equity securities by U.S. companies purportedly in reliance upon Regulation S. These transactions have resulted in indirect distributions of those securities into the United States without the investor protection provided by registration.

Regulation S has been used as a means of perpetrating fraudulent and manipulative schemes. In these schemes, the securities are being placed offshore temporarily to evade U.S. registration requirements, but the ownership of the securities never leaves the U.S. market, or a substantial portion of the economic risk is left in or is returned to the U.S. market during the restricted period, or there is no reasonable expectation that the securities could be viewed as coming to rest abroad.

In June 1995, the Commission issued an interpretive release that described certain abusive practices under Regulation S and requested comment on whether the regulation should be revised to limit its vulnerability to abuse, Securities Act Release No. 7190 (June 27, 1995). To address continued abuses of this rule, the Commission published for comment a proposal to amend Regulation S, Securities Act Release No. 7392 (February 20, 1997). In February 1998, the Commission adopted most of these proposed amendments, Securities Act Release No. 7505 (Feb. 17, 1998).

The amendments are designed to eliminate abusive practices under Regulation S, while preserving the benefits of the rule for capital formation. As a result of these amendments, securities sold by domestic issuers pursuant to the Regulation S exemption will be treated in a manner similar to securities sold under the Regulation D exemption from registration.

The amendments to Regulation S affect offshore offerings of equity securities, including convertible securities, by U.S. companies. The amendments are as follows:

- Equity securities of domestic issuers placed offshore pursuant to Regulation S are classified as "restricted securities" within the meaning of Rule 144, so that resales without registration or an exemption from registration will be restricted;

- To avoid confusion between the holding period for "restricted securities" under Rule 144 and the "restricted period" under Regulation S, the term "restricted period" is renamed the "distribution compliance period;"

- The distribution compliance period for these securities is lengthened from 40 days to one year;

- Certification, legending and other requirements, which were applicable only to sales of equity securities by non-reporting issuers, are imposed on these equity securities;

- Purchasers of these equity securities are required to agree that their hedging transactions with respect to these securities will be conducted in compliance with the Securities Act, such as Rule 144 thereunder; and

- Domestic issuers are able to report sales of equity securities pursuant to Regulation S on a quarterly basis, rather than on Form 8-K. This change in reporting requirement was not effective until January 1, 1999, to allow Commission staff to monitor developments under the new amendments.

In addition, the amendments codify an existing Commission interpretive position that resales of these equity securities offshore do not "wash off" the restrictions applicable to these securities.

C. International Accounting Standards

The Commission has been working with the International Accounting Standards Committee (IASC) through the International Organization of Securities Commissions (IOSCO) since 1987 in an effort to develop a set of accounting standards for cross-border offerings and listings. The IASC is an independent, private sector body that was formed in 1973 by the professional accounting bodies in the U.S. and eight other industrialized countries to improve and harmonize accounting standards.

In July 1995, IOSCO and the IASC joined in an announcement that the IASC had developed a work program focusing on a core set of standards previously identified by IOSCO as being the necessary components of a reasonably complete set of accounting standards. The announcement noted that completion of comprehensive core standards that are acceptable to the IOSCO Technical Committee would allow the Technical Committee to recommend endorsement of the standards for cross-border capital raising and listing purposes in all global markets.

In April 1996, the IASC announced that it had accelerated its work program, and the Commission responded with a press release expressing support for the IASC's objective. The Commission's statement noted that the standards should include a core set of accounting pronouncements that constitute a comprehensive, generally accepted basis of accounting; that the standards be of high quality, i.e., they must result in comparability and transparency, and they must provide for full disclosure; and that the standards must be rigorously interpreted and applied. In October 1997, the Commission published a report to

Congress that discussed the progress of the IASC. The report is available on the Commission's web site.

The IASC has completed substantially all the components of its core standards project, and both IOSCO and the Commission currently are engaged in a detailed assessment of the completed standards.

D. International Disclosure Standards - - Amendments to Form 20-F

On September 28, 1999, the Commission adopted changes to its non-financial statement disclosure requirements for foreign private issuers, to conform those requirements more closely to the International Disclosure Standards endorsed by IOSCO in September 1998 (Securities Act Release No. 7745). The changes are intended to harmonize disclosure requirements on fundamental topics among the securities regulations of various jurisdictions.

1. Background

The Commission has long supported the concept of a harmonized international disclosure system, and for a number of years has been working with other members of IOSCO to develop a set of international standards for non-financial statement disclosures that could be used in cross border offerings and listings. The International Disclosure Standards developed by IOSCO reflect a consensus among securities regulators in the major capital markets as to the types of disclosures that should be required for cross border offerings and listings. The Standards cover fundamental disclosure topics such as the description of the issuer's business, results of operations and management and the securities it plans to offer or list.

2. Changes to Foreign Integrated Disclosure System

The Commission amended Form 20-F, the basic Exchange Act registration statement and annual report form used by foreign issuers, to incorporate the International Disclosure Standards. The Commission also revised the Securities Act registration forms designated for use by foreign private issuers, and related rules and forms, to reflect the changes in Form 20-F. The amendments do not change the financial statement reconciliation requirements for foreign issuers, and the Commission will continue to require disclosure on topics not covered by the International Disclosure Standards, such as disclosures relating to market risk and specialized industries such as banks. Unlike the IOSCO International Disclosure Standards, which were intended to apply only to offerings and listings of common equity securities and only to listings and transactions for cash, the amendments to Form 20-F apply to all types of offerings and listings and to annual reports. The Commission also revised the definition of "foreign private issuer," which determines an issuer's eligibility to use certain Commission forms and benefit from certain accommodations under Commission rules, to clarify how issuers should calculate their U.S. ownership for purposes of the definition.

The changes to Form 20-F, the Securities Act registration forms and the "foreign private issuer" definition become effective beginning in September 2000, but foreign registrants are encouraged to use the new forms before that date.

VIII. OTHER PENDING RULEMAKING AND RECENT RULE ADOPTIONS

A. Proposed Amendment to Options Disclosure Document Rule

On June 25, 1998, the Commission issued a release soliciting comments on a proposal to revise Rule 135b (Securities Act Release No. 7550). The proposal provides that an options disclosure document prepared in accordance with Rule 9b-1 under the Securities Exchange Act of 1934 is not a prospectus, and accordingly is not subject to civil liability under Section 12(a)(2) of the Securities Act. The proposal is intended to codify a long-standing interpretive position that was issued immediately after the Commission adopted the current registration and disclosure system applicable to standardized options. The proposed revision is intended to eliminate any legal uncertainty in this area.

B. Amendments Regarding Segment Disclosure

On January 5, 1999, the Commission adopted technical amendments to conform its rules with the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 131 (Securities Act Release No. 7620). The amendments harmonize the narrative disclosure rules with recently revised GAAP financial reporting standards by requiring disclosure of a business enterprise's "operating segments," rather than its "industry segments," as previously required.

C. Final and Proposed Amendments to Form S-8

Form S-8 is the short-form Securities Act registration statement that is available for offers and sales of securities to employees. Unlike other Securities Act registration forms, Form S-8 does not contain a separate prospectus. Instead, Form S-8 relies on employee benefit plan disclosure documents otherwise provided by the employer to satisfy the disclosure obligations of the Securities Act. This abbreviated disclosure is available for offers and sales of securities to employees because of the compensatory nature of these offerings and employees' familiarity with the company's business due to the employment relationship. In 1990, the Commission revised the Form S-8 definition of "employee" to permit the form to be used for offers and sales of securities to consultants or advisors who provide legitimate services to the issuer that do not involve the offer or sale of securities in a capital-raising transaction.

Since adoption of the 1990 revisions, some companies have used Form S-8 improperly to compensate consultants whose primary service to the company is promotion of the company's securities. This practice has been used in fraudulent promotions of microcap and other securities. In other cases, Form S-8 has been used to distribute securities to public investors through so-called "consultants" whose service to the issuer is selling the securities into the market. This practice, which deprives public investors of the disclosure and liability protections of the Securities Act, has been the subject of Commission enforcement action. On February 25, 1999, the Commission issued Securities Act Release No. 7646 ("Adopting Release"), adopting amendments to Form S-8 and related rules designed to deter these abuses. The Adopting Release:

- amends Form S-8 and the definition of "employee benefit plan" in Securities Act Rule 405 so that the form is not available for sales to consultants and advisors who directly or indirectly promote or maintain a market for the company's securities; and

- amends Securities Act Rule 401(g) so that registration statements, such as Form S-8, that become effective automatically upon filing will not be presumed to be filed on the proper form.

The Adopting Release also includes interpretive guidance regarding the types of consulting activities that may - or may not - be compensated with securities registered on Form S-8.

Form S-8, of course, is used primarily for legitimate employee benefit plans. The Adopting Release also amends Form S-8 to simplify the registration of securities underlying stock options issued under employee benefit plans. Because stock options have become an increasingly important component of employee compensation, employees are more likely to face circumstances - such as estate planning and property settlements in connection with divorce - that may require the transfer of options to their family members.

These amendments permit employees' family members, as well as the employees themselves, to use Form S-8 to exercise options issued under employee benefit plans. "Family members" are defined to include persons with specified relationships to the employee, and specified entities that either benefit or are controlled by these persons. A corresponding amendment to General Instruction I.B.4 to Form S-3 makes Form S-3 equally available for the offer and sale of securities underlying both warrants and options, without regard to whether either class of derivative security is transferable.

The Adopting Release also amends the executive compensation disclosure requirements of Item 402 of Regulations S-K and S-B to clarify that an option issued as executive compensation remains reportable, even if the executive subsequently transfers it.

In Securities Act Release 7647 ("Proposing Release"), also issued February 25, 1999, the Commission proposed additional amendments to Form S-8 designed to further deter abuse of this form without imposing undue burdens on companies more likely to be operating legitimate employee benefit plans. The new proposal would require, before filing a registration statement on Form S-8, that:

- any company be timely in its Exchange Act reports during the 12 calendar months and any portion of a month before the Form S-8 is filed; and

- a company formed by merger of a nonpublic company into an Exchange Act reporting company with only nominal assets at the time of the merger (a "shell" company) wait until it has filed an annual report on Form 10-K or Form 10-KSB containing audited financial statements reflecting the merger.

The Proposing Release requests comment on other potential amendments, such as requiring Exchange Act reports to disclose aggregate issuances of securities registered on Form S-8 during the preceding 12 months in excess of a specified percentage of the number of securities of the same class outstanding.

Finally, the Proposing Release also extends the comment period on some of the proposed amendments to Form S-8 and requests for comment that were issued in Securities Act Release 7506 (February 17, 1998). These are:

- the proposed disclosure in Part II of Form S-8 of the names of any consultants or advisors to whom the company will issue securities under the registration statement, as well as the amount of securities to be offered to each and the nature of the consulting or advisory services; and

- the requests for comment:

  - whether companies should be required to disclose Form S-8 sales of securities to consultants or advisors in their Exchange Act reports -- either in Form 10-K and Form 10-Q, or on Form 8-K;

  - whether the aggregate percentage of securities that may be sold to consultants and advisors on Form S-8 during the company's fiscal year should be limited to a specified percentage of the number of securities of the same class outstanding;

  - whether the existing requirement that the company certify "that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-8" should be expanded also to require the company to certify that any consultant or advisor who receives securities registered on the form does not, and will not, engage in capital-raising or promotional activities; and

  - whether the Form S-8 cover page should include a box that the company would be required to check if any securities registered on the form are offered and sold to consultants and advisors.

The Commission will consider these ideas along with those proposed or discussed in the Proposing Release.

D. Shareholder Proposals

On September 18, 1997, the Commission issued a release (Exchange Act Release No. 39093) proposing amendments to Rule 14a-8, the shareholder proposal rule, and related amendments to Rules 14a-4, 14a-5, 14a-2 and 13d-5. The proposals represented a package of reforms to address a range of concerns raised by both shareholder and corporate participants in the proposal process. The Commission adopted amendments to Rule 14a-8 and related amendments to Rules 14a-4 and 14a-5 on May 21, 1998 (Exchange Act Release No. 40018). The revisions:

- recast Rule 14a-8 into a plain English question and answer format;
- reverse the Cracker Barrel interpretive position so that employment-related shareholder proposals raising social policy issues are not automatically excludable on ordinary business grounds;
- amend Rule 14a-4 to provide shareholders and companies with clearer guidance on companies' exercise of discretionary voting authority. The revisions did not include some of the more controversial amendments suggested in the proposing release, such as:
- increasing the percentage of the vote a proposal must receive before it can be resubmitted;
- implementing an override mechanism to permit the inclusion of certain proposals if sufficient shareholder interest was demonstrated;
- streamlining the exclusion for matters considered irrelevant to corporate business;
- modifying the personal grievance exclusion; and
- requiring a separate box on a company's proxy card permitting shareholders to withhold discretionary authority from management on a non-rule 14a-8 proposal.

E. Financial Statements and Periodic Reports For Related Issuers and Guarantors

On February 26, 1999, the Commission proposed rules concerning the financial statement and Exchange Act reporting requirements for subsidiary guarantors and subsidiary issuers of guaranteed securities (Securities Act Release No. 7649). These proposals include revisions to Rule 3-10 of Regulation S-X and new Rule 12h-5 under the Exchange Act.

The proposed amendments to Rule 3-10 would, with one principal difference, codify the staff's current positions as articulated in Staff Accounting Bulletin No. 53 and the interpretive positions that the staff has taken with respect to SAB 53. The principal difference between the proposed financial statement requirements and existing practice is that the proposal would eliminate the presentation of summarized financial information. Rather, it would require companies to present condensed consolidating financial information in all situations in which they currently may present summarized financial information about their subsidiaries.

Proposed Rule 12h-5 eliminates the need for subsidiaries to request an exemption from Exchange Act reporting and removes uncertainty regarding the availability of an exemption from Exchange Act reporting. As proposed, Rule 12h-5 would exempt from Exchange Act reporting any subsidiary issuer or subsidiary guarantor permitted to omit financial statements by proposed Rule 3-10.

F. Delivery of Disclosure Documents to Households

On November 4, 1999, the Commission issued two releases concerning the delivery of a single disclosure document to two or more investors sharing the same address ("householding"). The first release sets forth final rules regarding the householding of prospectuses, annual reports and, in the case of investment companies, semiannual reports (Securities Act Release 33-7766). New Rule 154 permits issuers and broker-dealers to satisfy the Security Act's prospectus delivery requirements by sending a single prospectus to two or more investors residing at the same address if the investors have consented to householding on a written or implied basis. Consent can be implied if four conditions are met:

- the investors have the same last name or are reasonably believed to be members of the same family;
- investors are given advance notice of householding and an opportunity to opt out;
- the investors do not opt out of householding; and
- the prospectus or shareholder report is delivered to a residential street address or a post-office box.

The second release proposes similar changes to the proxy rules to permit the householding of proxy and information statements (Securities Act Release 33-7767). A separate proxy card still would need to be delivered to each shareholder in the household. This release also proposes some modifications to new Rule 154 and the adopted requirements pertaining to householding of annual reports. Among other things, the proposing release would amend Rule 154 to permit the householding of combined proxy statement -prospectuses.

The adopted and proposed householding amendments are intended to reduce the amount of duplicative information that investors receive, and to lower printing and mailing costs to companies that ultimately are borne by investors.

IX. STAFF LEGAL BULLETINS FOR DIVISION OF CORPORATION FINANCE

The Division of Corporation Finance publishes Staff Legal Bulletins to provide advice to the public on frequently recurring issues. Copies of the bulletins may be obtained from the Commission's web site (*http://www.sec.gov*) or by writing to, or making a request in person at, the Public Reference Room, Securities and Exchange Commission, 450 5th Street, N.W., Room 1024, Washington, DC, 20549 ((202) 942-8090). These are the Staff Legal Bulletins the Division has issued to date:

- Staff Legal Bulletin No. 1 (CF) - Confidential Treatment Requests

- Staff Legal Bulletin No. 2 (CF) - Modified Exchange Act Reporting for Companies in Bankruptcy

- Staff Legal Bulletin No. 3 (CF) - Reliance on the Section 3(a)(10) exemption from the Securities Act of 1933 registration requirements (Updated October 20, 1999)

- Staff Legal Bulletin No. 4 (CF) - Spin-Offs

- Staff Legal Bulletin No. 5 (CF/IM) - Year 2000 Disclosure Issues.

  [This Staff Legal Bulletin is superseded by the Year 2000 interpretive release, Securities Act Release No. 7558. See Section V.D of this outline.]

- Staff Legal Bulletin No. 6 (CF/MR/IM) - Euro Conversion Issues

- Staff Legal Bulletin No. 7 (CF) - Plain English (Updated June 7, 1999)

X. CURRENT DISCLOSURE, LEGAL AND PROCESSING ISSUES

A. Disclosure Issues

1. Third-Party Derivative Securities

In Morgan Stanley & Co., Inc. (June 24, 1996), the Division addressed disclosure issues relating to Securities Act Section 5 registered offerings of securities that are exchangeable, on either an optional or a mandatory basis ("Exchangeable Securities"), for the equity securities (or the cash value thereof) of another issuer ("Underlying Securities").

The Division took the view that complete disclosure regarding the issuer of the Underlying Securities is material to investors at the time of both the initial sale of the Exchangeable Securities and on a continuous basis thereafter until the Underlying Securities (or the cash value thereof) have been exchanged for the Exchangeable Securities and other payment obligations on the Exchangeable Securities, if any, have been satisfied. The Division also took the view that this complete disclosure is not required to be set forth in the filings of the issuer of the Exchangeable Securities where there is sufficient market interest and publicly available information regarding the issuer of the Underlying Securities.

The Division stated that sufficient market interest and publicly available information exists where the issuer of the Underlying Securities (i) has a class of equity securities registered under Exchange Act Section 12; and (ii) is either (a) eligible to use Securities Act Form S-3 or F-3 for a primary offering of non-investment grade securities pursuant to General Instruction B.1 of such forms; or (b) meets the listing criteria that an issuer of the Underlying Securities would have to meet if the class of Exchangeable Securities was to be listed on a national securities exchange as equity linked securities, such as American Stock Exchange Rule 107.B.

The Division also stated that where there is sufficient market interest and publicly available information, as described above, the issuer of the Exchangeable Securities may include abbreviated disclosure about the issuer of and terms of the Underlying Securities in its Securities Act registration statement and Exchange Act periodic reports. Abbreviated disclosure in a report is adequate only where there is sufficient market interest and publicly available information at the time the report is filed.

Finally, the Division stated that the abbreviated disclosure would include at least: (i) a brief discussion of the business of the issuer of the Underlying Securities; (ii) disclosure about the availability of information with respect to the issuer of the Underlying Securities similar to that required by Regulation S-K Item 502(a); and (iii) information concerning the market price of the Underlying Securities similar to that called for Regulation S-K Item 201(a).

EITF Issues Nos. 86-28 and 96-12 address certain aspects of the accounting for third-party derivative securities.

2. Management's Disclosure Obligation Regarding Non-Management Nominees for Election of Directors

In connection with the preparation of proxy material for an annual meeting, an issues has arisen that concerns the obligation of a company to disclose information about non-management nominees of a shareholder who has provided adequate notice pursuant to a company by-law regarding his or her intention to nominate certain persons as candidates for the election of directors. An interpretive issue arises as to whether Item 7 of Schedule 14A and Items 401 and 404 of Regulation S-K, whose requirements are incorporated into the schedule through Item 7, obligate the company to furnish line-item disclosure about those shareholder nominees. Similarly, an issue arises as to whether the company is required to place the shareholder nominees on its form of proxy.

Under these circumstances, the staff has taken the position that Note B to Schedule 14A obligates the company to provide line-item disclosure only with respect to proposals made by or on behalf of the company, including the election of the company's nominees for directors. In addition, a soliciting party is required under Exchange Act Rule 14a-4 to include on its proxy card only the names of nominees for which the soliciting party is seeking proxy authority. In rendering this advice, the staff did not address the issue of the disclosure otherwise necessary in the proxy statement, pursuant to the proxy antifraud provisions of Exchange Act Rule 14a-9, with respect to the existence of opposition candidates for election to the board.

B. Legal and Processing Issues

1. Coordination with Other Government Agencies

On occasion, the staff communicates with other government agencies when disclosure indicates that the rules and regulations enforced by that government entity may materially effect the issuer's operations. For example, the staff continues to have an informal understanding with the staff of the Environmental Protection Agency ("EPA") whereby the Commission staff receives from the EPA lists of companies identified as potentially responsible parties on hazardous waste sites; companies subject to cleanup requirements under Resource Conservation and Recovery Act; and companies named in criminal and civil proceedings under environmental laws. The staff uses this information in its review process.

2. Monitor of Form 12b-25 Notices

The staff has implemented procedures to strengthen its monitoring efforts of all Forms 12b-25 notices of late filing. Notices are being monitored, with appropriate action taken depending upon the issuer's reason for delay and whether the subject filing is subsequently filed during the extension period. Possible staff action includes referral to the Division of Enforcement and prioritization of the subject report for staff review.

3. Related Public and Private Offerings

Some companies with pending registration statements have advised the staff that they intend to withdraw the registration statement and shortly thereafter complete the offering without registration in reliance upon the Section 4(2) private offering exemption. This appears to be proposed for both timing and disclosure reasons. In the staff's view, this procedure ordinarily would not be consistent with Section 5 of the Securities Act. The filing of a registration statement for a specific securities offering (as contrasted with a generic shelf registration) constitutes a general solicitation for that securities offering rendering Section 4(2) unavailable for the same offering. In addition, the procedure raises significant integration issues under the traditional five factor test and the staff's integration policy positions since the subsequent private offering does not appear to be a separate offering.

A related issue arises when a company files a registration statement to register issuances of securities to purchasers who committed to purchase securities from the issuer prior to the filing of the registration statement on the condition that the securities be registered prior to issuance. It appears that the purpose of this procedure is to provide the purchasers with registered (rather than restricted) securities. The staff does not believe that this procedure is consistent with the registration provisions of the Securities Act, which cover offers and sales of securities, not issuances. In this situation, it appears that the offers were made and the commitments obtained prior to filing in reliance upon the Section 4(2) private placement exemption. If so, the registration statement should cover resales by the purchasers, not issuances to the purchasers.

The use of "lock-up agreements" in business combination transactions is common. What is not common or consistent is the extent to which these agreements are now used to lock up target shareholders beyond key executives and "blocking" shareholders of the target. While the signing of a lock-up agreement may constitute the making of an investment decision, the staff, noting the realities of these transactions, traditionally has not raised issues with respect to these agreements in connection with acquisitions of public companies. However, the staff has raised issues concerning recently filed acquisition registration statements where 100% of the target shares are locked up or the "lock-up" group is expanded to include non-traditional "members" such as middle management.

4. <u>Equity Swap Arrangements</u>

Equity swap arrangements (including the related equity security) and similar devices typically shift some or all of the economic interests and risks of an equity security. These arrangements raise a number of legal and regulatory issues under the federal securities laws. Application of Exchange Act Section 16 to these arrangements is addressed in Exchange Act Releases No. 34514 and 37260. Those releases stated that equity swaps and similar transactions are subject to Section 16, and discussed the manner in which they should be reported. The staff continues to consider the issues raised by equity swaps and other risk-shifting transactions in other areas, including disclosure of security holdings and executive compensation, Schedule 13D reporting and transactions subject to Rule 144, Rule 144A and Regulation S. The treatment of these transactions under Rule 144 is addressed in Securities Act Release No. 7391. The treatment of these transactions under Regulation S is addressed in Securities Act Release Nos. 7392 and 7505; see Section VII.B.

5. <u>Non-Qualified Deferred Compensation Plans</u>

A typical non-qualified deferred compensation plan permits an employee to defer compensation over a set dollar amount. Those monies are retained by the employer. The employee will then either receive a fixed rate of return on the deferred monies or the employer may permit the employee to index the return on those monies off of a number of investment return alternatives.

In a number of no-action positions, the Division has indicated that it would not recommend enforcement action if transactions in non-qualified deferred compensation plans were not registered. The requests in those instances set forth two bases for the determination that registration under the Securities Act was not required. First, those requests set forth the argument that the offer and sale of interests in the deferred compensation plan did not involve the offer or sale of a security because the decision to participate in those plans was based primarily on tax management, not investment, purposes. Second, the requests contained the argument that the employees participating in the plan were top-level executives who did not need the protections provided by registration under the Securities Act.

In providing the no-action position requested, the Division's responses state that, while not agreeing with the analysis in the request, it would not recommend enforcement action if transactions under the plans were not registered. The Division has not taken such a no-action position since 1991.

Due to a number of market and regulatory factors, non-qualified deferred compensation plans have greatly proliferated, both with respect to the number of employers offering such plans and the number of employees participating. At this time, the Division is not prepared to disregard the argument that the debt owing to plan participants is analogous to investment notes, which typically are viewed as debt securities. Further, the staff is not persuaded that there is a meaningful distinction between those plans that offer returns tied to different investment alternatives and those that offer only a fixed rate. The Division, therefore, will not grant requests for no-action with respect to any non-qualified deferred compensation plan, including those that have an interest only return. The Division has not stated affirmatively, however, that all interest only deferred compensation plans involve securities. Instead, the Division currently is leaving that question for counsel's analysis of the facts and circumstances. To the extent that interests in a non-qualified deferred compensation plan are securities, registration would be required unless the offerings under the plan would qualify for an exemption, e.g., Section 4(2).

Form S-8 would be available when an employer registers the offer and sale of interests in the deferred compensation plan under the Securities Act. The filing fee should be based on the amount of compensation being deferred, not on the ultimate investment return. As the "deferred compensation obligations" to be registered are obligations of the issuer/employer, not interests in the plan, the registration of the "deferred compensation obligations" would not result in a requirement that a deferred compensation plan file a Form 11-K with respect to those securities. Further, based on the unique terms of the "deferred compensation obligations" (both with respect to interest and maturity), compliance with the Trust Indenture Act of 1939 has not been required.

6. Trust Indenture Act Issues Arising in Certain Transactions Exempt from Securities Act Registration

Offerings exempt from registration under Sections 3(a)(9) and 3(a)(10) of the Securities Act and Section 1145(a) of the Bankruptcy Code are not exempt from qualification under the Trust Indenture Act. Like Section 5 of the Securities Act, Section 306 of the Trust Indenture Act works transactionally. Unless the indenture for a debt security is qualified under Section 305 of the Trust Indenture Act, which covers registered offerings, or exempt from qualification under Section 304, the sale of the debt security violates Section 306 of the statute. Section 306(c) forbids any offer of the debt security until an application for qualification of the related indenture has been filed with the Commission.

The Division has recently noted a number of offerings of debt securities for issuers in Chapter 11 proceedings where the applications for qualification on Form T-3 were not filed until after approval of the plans of reorganization by both creditors and other claimants and the bankruptcy courts. The Division's view is that the offering event in bankruptcy is the solicitation of plan approval from creditors and other claimants. Accordingly, the application for qualification in these cases should be filed before such approval is sought.

7. Legality Opinion Issues

It is customary practice for counsel drafting legality opinions regarding securities whose issuer is incorporated in Delaware to limit their opinion to "the Delaware General Corporation Law." In these situations, we ask that counsel revise its opinion to make clear that the law covered by the opinion includes not only the Delaware General Corporation Law, but also the applicable provisions of the Delaware Constitution and reported judicial decisions interpreting these laws.

Recently, we discussed this limitation with the Ad Hoc Committee on Legal Opinions in SEC Filings of the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association. In those discussion, the Ad Hoc Committee emphasized that the reference to the "Delaware General Corporations Law" was an opinion drafting convention and that the practicing bar understood this phrase to mean the Delaware General Corporation Law, the applicable provisions of the Delaware Constitution, and reported judicial decisions interpreting these laws.

Based on these discussions, we have revised our procedures for reviewing a legality opinion filed as an exhibit to a registration that includes a statement that it is "limited to the Delaware General Corporation Law." Our new procedures are as follows:

- We will issue a comment asking counsel to confirm to us in writing that it concurs with our understanding that the reference and limitation to "Delaware General Corporate Law" includes the statutory provisions and also all applicable provisions of the Delaware Constitution and reported judicial decisions interpreting these laws. As part of this standard comment, we will ask that counsel file this written confirmation as correspondence on the EDGAR system. As such, it will be part of the Commission's official file regarding the related registration statement.

- Once we receive this written confirmation from counsel, we will not comment further on the inclusion of this language in the opinion for that registration statement.

C. Industry-Specific Issues

1. Real Estate

a. Review of Filings

The Division has issued three releases regarding real estate disclosure in the last few years. On June 17, 1991, the Commission issued an interpretive release relating to partnership offerings and reorganizations (Securities Act Release No. 6900); on October 30, 1991, final rules concerning disclosure of roll-up transactions were issued (Securities Act Release No. 6922). On December 1, 1994, the Commission adopted amendments to its roll-up rules (Securities Act Release No. 7113). The staff considers the disclosure guidelines of each of these releases in connection with its reviews of registration statements and proxy statements filed by limited partnerships and real estate investment trusts.

Current real estate filings relate primarily to real estate investment trusts (REITs) and, to a lesser extent, limited partnerships and limited liability companies. Frequently, REIT filings contain an UPREIT structure which includes an Umbrella Operating Partnership formed by the sponsor and affiliated partnerships to contribute properties or partnership interests to the REIT. In connection with REIT initial public offerings, the staff considers the availability of any claimed exemption from Securities Act registration for the pre-formation roll-up transactions undertaken to form the operating partnership.

Primary offerings by Operating Partnerships must comply with appropriate form requirements. Operating Partnerships may use Form S-3 if the applicable requirements are met, specifically, Instruction I.C., but since the Operating Partnership is unlikely to be able to meet the requirements of Staff Accounting Bulletin 53, separate financial statements and related disclosure must be provided either in the registration statement or through incorporation by reference of a voluntary Form 10. Following the offering, applicable reports must be filed by the Operating Partnership.

Reviews of limited partnership offerings and proxy solicitation materials continue to focus on prior performance and on claims made by sponsors concerning investment obligations and future performance. These reviews also focus on changes to partnership objectives and structure. Finally, the staff continues to examine the practices and disclosure associated with the solicitation of proxies and registration statements related to roll-ups, pursuant to the revised rules. See also Section IV.D.1 for a discussion of the disclosure required in tender offers for limited partnership units.

b. <u>Sales Literature Used in Connection with the Offering of Limited Partnerships</u>

Item 19 of Industry Guide 5 requires that sales literature used in the offering of limited partnership units, including material marked for "Broker Dealer Use Only," be submitted for staff review. These materials should provide a balanced presentation of the risks and rewards involved in the offering. All information must be consistent with the information and representations contained in the prospectus and the sales literature should not be presented in a manner which obscures the prospectus cover page. Registrants should contact the staff before using submitted sales materials.

c. <u>Low Income Housing, Rehabilitation, and Historic Tax Credit Real Estate Limited Partnerships</u>

Certain real estate limited partnership offerings indicate the sponsor's intention to invest in low income housing or other programs eligible for federal or state income tax credits. Most of these offerings highlight the percentage returns to the investor of the tax credits on a simple annualized basis. Since the tax credits are available for only 10 years and the enabling statutes require a 15-year holding period for the property, the rate of return disclosure should include the effects of the time value of money. Further, since it is possible that the property may have no or little residual value at the end of the 15-year holding period, the disclosure of the rate of return should assume a zero resale value of the property.

Further, prior performance disclosure of the results of earlier tax credit offerings by the sponsor should be included. Disclosure of the total amount of tax credits generated for each year should be included as should the amount of tax credits per $1000 invested.

2. Exemption from Registration for Bank and Thrift Holding Company Formations

Section 3(a)(12) of the Securities Act provides an exemption from registration for securities issued in connection with the formation of a bank or savings association holding company where shareholders maintain the same proportional interest in the holding company as they had in the bank or savings association; the rights and interests of the shareholders are substantially the same after the transaction as before it; and the holding company has substantially the same assets and liabilities, on a consolidated basis, as the bank or savings association had before the transaction. The staff has informally taken the position that the exemption would not be available if the new holding company's corporate charter contained antitakeover provisions that were not in the governing documents of the predecessor bank or thrift.

3. Structured Financings

In fall 1992, the Commission extended the benefits of Rule 415 "shelf" registration through the expansion of the availability of Form S-3 to investment grade asset-backed securities offerings (Securities Act Release No. 6964 (October 22, 1992)(the "Shelf Release")). Shortly thereafter, the Commission adopted Rule 3a-7 under the Investment Company Act of 1940 excluding from the definition of "investment company" structured financings that meet the rule's conditions (Investment Company Act Release No. 19105 (November 19, 1992)). These changes appear to have precipitated, or at least coincided with, a movement in the structured finance market toward securitization of assets in the public markets that previously were offered in the private markets. Significant disclosure and eligibility issues continue to come up as a result of market developments.

a. Asset Concentration

The Shelf Release expressly does not adopt a specific asset concentration test. Instead, asset concentration questions have been addressed through existing disclosure rules. While an asset concentration test was not included, the release indicates that the definition of asset-backed security does not encompass securities issued in structured financings for one obligor or group of related obligors.

(i) Multiple Core Prospectuses

Another issue involving asset concentration arises in the context of pooling several different types of underlying assets. The staff permits issuers to register on a single shelf registration statement asset-backed securities supported by more than one category of underlying assets without specifying the amount of each type to be offered. The registration statement must specifically identify the various asset categories and include a separate core prospectus for each such category. In considering whether a separate core prospectus is required, the staff will consider whether the assets described are
intended to be pooled together or securitized separately. If the latter, separate core prospectuses ordinarily would be required.

(ii) Commercial Mortgages

For securitization of commercial mortgages and leases, where the mortgage loan is a non-recourse obligation of the mortgagor, disclosure related to the operating property(ies) will be required where concentration exists. The staff applies the standards described in Staff Accounting Bulletin 71/71A ("SAB 71/71A"). SAB 71/71A generally employs a 20% asset concentration test to determine whether audited property financial statements are required. At concentration levels between 10-20%, financial and other information regarding the underlying properties is required. In determining whether these concentration thresholds are crossed, loans to the same obligor, group of related obligors, or loans on related properties may be aggregated.

In addition, where a mortgage loan or loans of a single obligor, or group of related obligors, accounts for more than 45% of the pool assets, one or more co-issuers may exist. See FBC Conduit Trust I, First Boston Mortgage Securities Corporation (October 6, 1987).

b. Securitizing Outstanding Securities

(i) Corporate Debt Securities

The pooling and securitization of outstanding corporate debt securities of other issuers may be registered on Form S-3 if the requirements of the Form for asset-backed securities offerings are met, provided that the depositor would be free to publicly resell the securities without registration. Thus, a depositor generally cannot include restricted securities (i.e., privately-placed securities where the Rule 144(k) two-year holding period has not run) nor can it include registered securities if the securitization is part of the original distribution. To provide certainty in deciding what is part of the original distribution in resecuritizations by affiliates of underwriters involved in the original offering, the staff has used a bright line test (i.e., securities purchased in the secondary market and at least three months after the depositor had sold out any unsold allotment are not viewed as part of the original dispatch).

Where 20% or more of the pool consists of the securities of a single issuer, the staff requires audited financial statements of such issuer to be included in the prospectus. However, if the underlying issuer is eligible to use Form S-3 for a primary common stock offering, and the depositor's transaction in the securities is purely secondary (e.g., there is no tie to the issuer or the issuer's distribution), the staff would accept a reference in the prospectus to the issuer's periodic reports on file with the Commission. Of course, the prospectus must include a description of the material terms of the pooled securities.

In connection with Exchange Act reporting, reference to the S-3 eligible underlying issuer's periodic reports on file with the Commission will be accepted in lieu of direct disclosure of this information. In addition, the staff generally requires the depositor to undertake to provide financial and other information relating to such underlying issuer directly in its reports in the event such underlying issuer terminates reporting after the pooling transaction.

(ii) Asset-Backed Securities

Securitization of outstanding asset-backed securities is treated similarly if the underlying trust has outstanding securities held by non-affiliates in excess of $75 million and files periodic reports with the Commission. The securities of government-sponsored enterprises ("GSE") which have a comparable market float and which make information publicly available comparable to that of Exchange Act reporting entities are treated similarly.

(iii) Municipal Securities

The offering of asset-backed securities supported by pools of municipal bonds where asset concentration exists, in general, requires that financial statements and other information relating to the underlying municipal issuer be provided. This information must be included directly in the prospectus, must be current, and must otherwise satisfy fully the disclosure requirements under the federal securities regulations.

While there may be instances where financial statements of the municipal issuer are not material to the investor in the asset-backed security, such instances would appear to be rare and the staff will require appropriate legal opinions and other documentation necessary to support the conclusion that financial and other information relating to the municipal issuer is not material to investors.

c. Structuring the Offering

Often the payment terms of asset-backed securities are tailored to meet the particular investment needs of the investor. Prior to effectiveness of the registration statement, investors often ask the underwriter for various computational materials so as to analyze prepayment and other assumptions affecting yield. These computational materials are not permissible prospectuses under the Securities Act and the Commission's rules and regulations. However, recognizing the realities of the asset-backed market, the staff has issued three no-action letters that recognize the industry's practice of providing written information (other than the statutory prospectus) to prospective purchasers of asset-backed securities when negotiating and structuring the securities to meet purchasers' investment criteria. These letters generally permit the provision of limited information outside the preliminary prospectus to purchasers, provided that the final information is filed as part of the registration statement.

d. Delinquent Assets

The definition of "asset-backed security" in Form S-3 states that the assets must "by their terms convert into cash within a finite time period." The staff issued a no-action letter in which it acknowledged that an offering that includes a concentration of delinquent assets may be eligible to be offered on Form S-3 so long as the concentration is less than 20% of the assets. A concentration of 20% or more would not appear to be eligible to be offered on Form S-3 because foreclosure on an asset is not converting to cash by its terms. See The Bond Market Association (Oct. 16, 1997), described in Section XII.K.

4. Credit Linked Securities of Bank Subsidiaries

Recently, a number of banks proposed the following transaction structure:

- the bank forms a limited purpose finance subsidiary;
- the bank transfers mortgages or asset-backed securities to the subsidiary;
- the bank owns all of the subsidiary's common stock; and
- the subsidiary registers the sale of its preferred stock to the public.

The source of funds for dividend payments on the preferred stock would be limited to the income generated by the finance subsidiary's assets. The banks proposed this structure because the preferred securities of the subsidiary may, under relevant risk based capital guidelines, qualify as capital of the bank.

Under bank regulations, if a financial regulatory event occurs, banks must retrieve, or "claw back," the assets of these subsidiaries. Because the assets of these subsidiaries are subject to this claw back, this structure raises significant registration and disclosure issues.

Under one structure, the preferred securities of the subsidiary automatically convert into securities of the bank. Therefore:

- the bank and the subsidiary must be co-registrants on the registration statement for the initial sale of the preferred stock since the bank is also offering preferred stock;
- the full audited financial statements of the bank must be included in this registration statement; and
- if the bank's financial statements are not in US GAAP, they must be reconciled to US GAAP.

If the bank regulators can require the bank to claw back the subsidiary's assets, the financial condition of the bank is material to the subsidiary preferred stockholder at all times. Therefore:

- the full audited financial statements of the bank must be in the registration statement and in the subsequent periodic reports of the subsidiary; and

- if the bank's financial statements are not in US GAAP, they must be reconciled to US GAAP.

XI. ACCOUNTING ISSUES

A. Initiative to Address Improper Earnings Management

Many in the financial community have expressed concern that market pressures are driving more public companies to use improper earnings management tricks. In remarks made to the NYC Center for Law and Business in September 1998, Chairman Levitt identified several areas where accounting rules have been abused by some companies to manage earnings: "big bath" restructuring charges, "creative" acquisition accounting, miscellaneous "cookie jar" reserves, intentional "immaterial" errors, and manipulative revenue recognition. The Chairman outlined a plan to address the threat to the integrity of financial reporting posed by improper earnings management. The Chairman's speech can be found at *www.sec.gov/news/spchindx.htm*.

The Division of Corporation Finance established an Earnings Management Task Force that focused staff resources on the review of filings where potential improper earnings management issues could be present. A primary objective of the reviews has been to elicit improved disclosure in financial statements and MD&A about charges involving asset impairments, restructuring charges, purchased in-process research and development, and similar items. Disclosure sought by the staff has included explanation of the types and amounts of restructuring liabilities and valuation reserves, the timing and amount of increases and decreases in these accounts, and the nature and amount of any changes in estimates. The Task Force also examined filings for indicia of earnings management and other accounting abuses involving revenue recognition, unreasonable valuations of purchased in-process research and development, and manipulation of loss allowances and estimated liabilities. Also, as part of its proactive disclosure program, the Division of Corporation Finance sent letters alerting companies, before their filing 1998 annual reports, of disclosures that are often needed to give transparency to significant charges. Samples of those letters are available at the SEC web site.

In further response to the Chairman's earnings management initiative, the AIPCA published *Issues in Revenue Recognition*, available at *www.aicpa.org*, to help auditors evaluate assertions about revenue. The Office of the Chief Accountant is working closely with the FASB to establish clearer standards concerning liability recognition. The Public Oversight Board has established a distinguished committee to review the way audits are performed today and assess the impact of recent trends in business and the accounting profession on the effectiveness of the audit. Other actions taken in connection with the Chairman's earnings management initiative include issuance of staff interpretive guidance and rulemaking proposals discussed elsewhere in this outline.

B. Materiality in the Preparation or Audit of Financial Statements

On August 12, 1999, the staff published Staff Accounting Bulletin No. 99. That SAB expressed the staff's view that exclusive reliance on certain quantitative benchmarks to assess materiality in preparing or auditing financial statements is inappropriate. The SAB states that the staff has no objection to the use of a percentage threshold as an initial assessment of materiality, but exclusive use of such thresholds has no basis in law or in the accounting literature. The staff stresses that evaluations of materiality require registrants and auditors to consider *all* of the relevant circumstances, and that there are numerous circumstances in which misstatements below that percentage threshold could be material. Some of the circumstances listed in the SAB that should be considered are:

- whether the misstatement masks a change in earnings or other trends,
- whether the misstatement hides a failure to meet analysts' consensus expectations for the enterprise,
- whether a misstatement changes a loss into income or vice versa,
- whether the misstatement concerns a segment of the registrant's business that plays a significant role in the registrant's present or future operations or profitability,
- whether the misstatement affects compliance with loan covenants or other contractual requirements,
- whether the misstatement has the effect of increasing management's compensation.

The SAB observes that managers should not direct or acquiesce to immaterial misstatements in the financial statements for the purpose of managing earnings. The SAB indicates that investors generally would consider significant an ongoing practice to over- or understate earnings up to an amount just short of some percentage threshold in order to manage earnings.

The SAB also notes that even though a misstatement of an individual amount may not cause the financial statements to be materially misstated, it may, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading. The SAB, therefore, provides guidance on when and how to aggregate and net misstatements to see if they materially misstate the financial statements.

The SAB advises that, even if management and auditors find that a misstatement is immaterial, they must consider whether the misstatement results in a violation of the books and records provisions in Section 13(b) of the Exchange Act. Section 13(b) requires that public companies make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect transactions and the disposition of assets of the registrant, and that they maintain internal accounting controls that are sufficient to provide reasonable assurances that financial statements are prepared in conformity with GAAP. In this context, what constitutes “reasonable assurance” and “reasonable detail” are not based on a “materiality” standard but on the level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs.

The SAB sets forth various factors, in addition to those used to evaluate materiality, that a company may consider in deciding whether a misstatement violates its obligation to keep books and records that are accurate “in reasonable detail.” Some of these factors are:

- the significance of the misstatement,
- how the misstatement arose,
- the cost of correcting the misstatement, and
- the clarity of the authoritative accounting guidance with respect to the misstatement.

Finally, the SAB reminds auditors of their obligations under Section 10A of the Exchange Act and auditing standards to inform management and, in some cases, audit committees of illegal acts, such as violations of the books and records provisions of the Exchange Act, coming to the auditor’s attention during the course of an audit.

C. <u>Proposals Implementing Blue Ribbon Committee's Recommendations Regarding Audit Committee Effectiveness</u>

The Commission has proposed new rules to improve disclosure about the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies (Securities Act Release No. 7754 (October 14, 1999)). The proposed disclosures will help inform investors about the role audit committees play in overseeing the preparation of financial statements and underscore the importance of their participation in the financial reporting process. In addition, by requiring companies to have their auditors review interim financial statements, the proposals should facilitate early identification and resolution of significant accounting issues.

The proposals are part of the Commission's continuing efforts to improve the quality of financial reporting. In his September 1998 speech entitled The Numbers Game, Chairman Arthur Levitt set forth an action plan to address certain abuses in financial reporting, better known as "earnings management." These proposals represent further progress on that plan.

The Commission's proposals are part of a broader effort by the securities exchanges and the accounting profession to improve the oversight of financial reporting by corporate boards. Proposals for action by each of the different groups were set forth in the Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. The Blue Ribbon Committee was a prestigious group of business, accounting, and securities professionals led by John Whitehead and Ira Millstein. These proposals coincide with proposed rule changes by the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers. The proposed rule changes by the securities markets would:

- define "independence" more rigorously for audit committee members;
- require audit committees to include at least three members and be comprised solely of "independent" directors who are financially literate;
- require companies to adopt written charters for their audit committees; and
- require at least one member of the audit committee to have accounting or financial management expertise.

Recently, the AICPA's Auditing Standards Board proposed to require independent auditors to discuss with the audit committee the auditors' judgment about the quality, and not just the acceptability under Generally Accepted Accounting Principles, of the company's accounting principles as applied in its financial reporting.

The Commission's rule proposals would require, among other things, that:

- companies' interim financial statements be reviewed by independent auditors before companies file their Forms 10-Q and 10-QSB with the Commission;
- companies provide in their proxy statements a report from the audit committee that discloses whether the audit committee reviewed and discussed certain matters with management and the auditors, and whether anything came to the attention of audit committee members that caused them to believe that the audited financial statements contain any materially misleading statements or omit any material information;
- companies disclose in their proxy statements whether the audit committee has a written charter, and file a copy of their charter every three years; and
- companies whose securities are listed on the NYSE or AMEX or are quoted on Nasdaq disclose certain information about any audit committee member who is not "independent" within their proposed definition. (All other companies must disclose, if they have an audit committee, whether the members are "independent" based on the definition proposed by the SROs.)

D. Mandatorily Redeemable Securities of Subsidiaries Holding Debt of Registrant

Registrants should consider the adequacy of disclosures about mandatorily redeemable securities issued by a finance subsidiary of a parent company when the financial subsidiary holds only debt instruments issued by the parent, particularly if the outstanding security of the finance subsidiary is guaranteed by the parent and mirrors the cash flows of the debt of the parent held by the finance subsidiary. The staff believes that disclosures in these situations often must be expanded to provide investors with a fair and balanced picture of the registrant's effective capitalization and leverage. Inclusion of the outstanding public security in minority interest with minimal disclosure of its characteristics is not adequate, particularly when Section 12(h) reporting relief is requested by registrants for the finance subsidiary. In those situations, the parent should disclose the subsidiary's outstanding securities as a separate line item in the parent's balance sheet captioned "Company-obligated mandatorily redeemable security of subsidiary holding solely parent debentures," "Guaranteed preferred beneficial interests in Company's debentures," or similar descriptive wording. Notes to the financial statements should describe fully the terms of the securities and explain that those terms parallel the terms of the company's debentures which comprise substantially all of the assets of the consolidated trust or subsidiary.

E. Accountant's Refusals to Re-issue Audit Reports

Some accounting firms have adopted risk management policies that lead them to refuse to re-issue their reports on the audits of financial statements that have been included previously in Commission filings. In some cases, accountants whose reports on acquired businesses were included in a registrant's Form 8-K have declined to permit that report to be included in a registrant's subsequent registration statement. In other cases, accountants have declined to reissue their reports on the registrant's financial statements after the registrant engaged a different auditor for subsequent periods. The Commission's staff is not in a position to evaluate the reasons for an accountant's refusal to re-issue its report and will not intervene in disputes between registrants and their auditors. Moreover, the staff will not waive the requirements for the audit report or the accountant's consent to be named as an expert in filings. If a registrant is unable to re-use the previously issued audit report in a current filing, the registrant must engage another accountant to re-audit those financial statements. A registrant that is unable to obtain either re-issuance of an audit report or a new audit by a different firm may be precluded from raising capital in a public offering.

When registrants engage an accountant to perform audit services, they should consider the need for the accountant to re-issue its audit report in future periods. It may be appropriate to address in the audit services contract the registrant's expectations regarding the use of the audit report in filings that it or its successors may make under either the Exchange Act or the Securities Act and the circumstances under which the accountant may decline to permit its re-use.

F. Market Risk Disclosures

On January 28, 1997, the Commission adopted amendments to Regulation S-K, Regulation S-X, and various forms (Securities Act Release No. 7386) to clarify and expand existing requirements for disclosures about derivatives and market risks inherent in derivatives and other financial instruments. Derivative financial instruments are defined in FASB Statement No. 119 to include futures, forwards, swaps, and options. Derivative commodity instruments are defined in the Release to be commodity contracts that are permitted by contract or business custom to be settled in cash or with another financial instrument (e.g., commodity futures, commodity forwards, commodity swaps, and commodity options). Other financial instruments are defined in FASB Statement No. 107 to include, for example, investments, including structured notes, loan receivables, debt obligations, and deposit liabilities. The requirements for quantitative and qualitative information about market risk apply to all registrants except registered investment companies and small business issuers.

In general, the release:

(i) requires enhanced descriptions of accounting policies for derivatives in the footnotes to the financial statements;

(ii) requires quantitative and qualitative disclosures about market risk inherent in derivatives and other financial instruments outside the financial statements; and

(iii) provides a reminder to registrants to supplement existing disclosures about financial instruments, commodity positions, firm commitments, and other anticipated transactions with related disclosures about derivatives.

On July 31, 1997, the staff released Questions and Answers about the New "Market Risk" Disclosure Rules. The interpretive answers were prepared by the staffs of the Office of the Chief Accountant and the Division of Corporation Finance. This publication is posted at the Commission's Internet site; *http://www.sec.gov*.

Based on the Division’s reviews of filings by some registrants required to provide the disclosures about derivatives and market risks inherent in derivatives and other financial instruments, we have the following suggestions:

Accounting policies for derivatives

Remember to provide all of the disclosures regarding accounting policies for certain derivative financial instruments and derivative commodity instruments, to the extent material, as required by Rule 4-08(n) of Regulation S-X and SFAS 119. Include clear disclosure of the method used to account for each type of derivative financial instrument and derivative commodity instrument.

General

Remember to cite the new Item specifically (e.g. Item 7A for Form 10-K or Item 9A for Form 20-F) in the form. Registrants can include the quantitative and qualitative disclosures under the Item reference, cross-reference from the Item reference to the disclosures elsewhere in the filing, or indicate under the Item reference that the disclosures are not required (See Rule 12b-13).

Registrants may need to discuss a material exposure under the Item even though they do not invest in derivatives. For example, registrants that have investments in debt securities or have issued long-term debt should discuss risk exposure if the impact of reasonably possible changes in interest rates would be material. Likewise, registrants that have invested or borrowed amounts in a currency different from their functional currency should discuss risk exposure if the impact of reasonably possible changes in exchange rates would be material.

The market risk disclosures can refer to the financial statements but disclosures required by the new rules should be furnished outside the financial statements. The "safe harbor" established under the new rules does not extend to information presented in the financial statements.

Quantitative disclosures

Tabular presentation. Include all relevant terms of the related market sensitive instruments. In addition, disclose the method and assumptions used to determine estimated fair value, cash flows and future variable rates. In addition, segregate instruments by common characteristics and by risk classification.

Sensitivity analysis and Value at Risk (VAR). Disclose the types of instruments (e.g., derivative financial instruments, other financial instruments, derivative commodity instruments) included in the sensitivity analysis and VAR analysis and provide an adequate description of the model and the significant assumptions used, such as the magnitude and timing of selected hypothetical changes in market prices, method for determining discount rates, or key prepayment or reinvestment assumptions. Indicate whether other instruments are included voluntarily, such as certain commodity instruments and positions outside the required scope of the rule, cash flows from anticipated transactions, etc.

Qualitative disclosures

Explain clearly how the company manages its primary market risk exposures, including the objectives, general strategies and instruments, if any, used to manage those exposures. Explain clearly the changes in how the company manages its exposures during the year in comparison to the prior year and any known or expected changes in the future.

G. Financial Statements in Hostile Exchange Offers

In registration statements that require financial statements of a company other than the registrant (such as when the registrant acquires or will acquire another entity), the audit report of the target's independent accountants must be included in the registration statement. The consent of the target's auditor to the inclusion of its report in the registration statement is required pursuant to Rule 436 of Regulation C.

A registrant offering its own securities in a hostile exchange offer for the target's stock may seek and not be able to obtain the target's cooperation in providing either its audited financial statements or the target auditor's consent to the use of its report in the required registration statement. In this situation, the registrant should follow the guidance in SAB Topic 1A. If the target is a public company, SAB Topic 1A requires that any publicly filed financial information of the target, including its financial statements, be included in the registrant's filing or incorporated by reference into, and therefore made a part of, that filing.

The acquirer/registrant should use its best efforts to obtain the target's permission and cooperation for the filing or incorporation by reference of the target's financial statements, and the target auditor's consent to including its report on the financial statements. At a minimum, a registrant is expected to write to the target requesting these items and to allow a reasonable amount of time for a response prior to effectiveness of the filing. The target may, however, fail to cooperate with the registrant.

Under Rule 437 of Regulation C, a registrant may request a waiver of the target auditor's consent by filing an affidavit that states the reasons why obtaining a consent is impracticable. The affidavit should document the specific actions taken by the registrant to obtain the cooperation of the target for the filing of its financial statements as well as the efforts made to obtain the target auditor's consent. As stated in SAB Topic 1A, the staff will request copies of correspondence between the registrant and the target evidencing the request for and the refusal to furnish financial statements.

If the registrant uses its best efforts but is still unsuccessful in obtaining the target's permission and cooperation on a timely basis, the staff will generally agree to waive the requirement to include or incorporate by reference the target auditor's audit report, but not the target's financial statements. If target financial statements are incorporated by reference into the acquirer's registration statement from the target's public filings, disclosure should be made that, although an audit report was issued on the target's financial statements and is included in the target's filings, the auditor has not permitted use of its report in the registrant's registration statement. The auditor should not be named. Any legal or practical implication for shareholders of either the registrant or the target of the inability to obtain the cooperation of the target or consent of the target's auditor should be explained. No disclosure in the registration statement should expressly or implicitly purport to disclaim the registrant's liability for the target's financial statements. In the event that circumstances change, for example, if the deal turns friendly, the registration statement should be amended to include the audited financial statements and the auditor's consent required by the form.

H. Restructuring Charges, Impairments, and Related Issues (SAB 100)

On November 24, 1999, the staff published Staff Accounting Bulletin No. 100, which provides guidance on the accounting for and disclosure of certain expenses and liabilities commonly reported in connection with restructuring activities and business combinations, and the recognition and disclosure of asset impairment charges.

The Emerging Issues Task Force addressed Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) in Issue No. 94-3. Generally, that consensus limits costs that may be recognized solely pursuant to management's plan to incur them to those costs which result directly from an exit activity, are not associated with and do not benefit continuing activities, and for which there is appropriate authorization, specification, and commitment to execute. SAB 100 discusses the EITF criteria and related disclosure requirements in particular circumstances encountered by the staff in its review of filings by public companies. The SAB expresses the staff's view that a company's exit plan should be at least comparable in its level of detail and precision of estimation to the company's other operating and capital budgets, and should be accompanied by controls and procedures to detect and explain variances and adjust accounting accruals. The SAB discusses disclosures in financial statements and MD&A that are often necessary to make the effects of restructuring activities on reported results sufficiently transparent to investors.

SAB 100 also addresses issues that arise in the application of FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of. The SAB reminds registrants that the operational requirement to continue to use an asset disallows accounting for the asset as held for sale. If the asset is held for use, its carrying value must be systematically amortized to its salvage value over its remaining economic life. If management contemplates the removal or replacement of assets more quickly than implied by their depreciation rates, the useful lives of the assets and rates of depreciation must be re-evaluated. The SAB also provides the staff's views regarding the assessment and measurement of any impairment of enterprise level goodwill, and it specifies the accounting policy disclosures that should be provided.

The SAB also highlights the staff's concerns when a registrant records liabilities assumed in a business combination at amounts materially greater than historically reported by the acquired company. That circumstance could indicate that costs incurred before or after the merger were not properly recognized in the reported results of one or the other combining company. The SAB reminds registrants that, if the acquired company's historical accounting for a liability is based on reasonable estimates of undiscounted future cash flows, the estimated undiscounted cash flows underlying the liability recorded by the acquiring company would not be expected to differ materially from those estimates unless the acquirer intends to settle the liability in a manner demonstrably different from that contemplated by the acquired company.

I. <u>Interpretive Guidance on Revenue Recognition (SAB 101)</u>

On December 3, 1999, the staff published Staff Accounting Bulletin 101 to provide guidance on the recognition, presentation and disclosure of revenue in financial statements. The SAB draws on the existing accounting rules and explains how the staff applies those rules, by analogy, to other transactions that the rules do not specifically address. The SAB spells out basic criteria that must be met before registrants can record revenue.

Specific fact patterns discussed in the SAB include bill-and-hold transactions, long-term service transactions, refundable membership fees, contingent rental income, and up-front fees when the seller has significant continuing involvement. The SAB also addresses whether revenue should be presented at the full transaction amount or on a fee or commission basis when the seller is acting as a sales agent or in a similar capacity. Finally, the SAB provides guidance on the disclosures registrants should make about their revenue recognition policies and the impact of events and trends on revenue.

Registrants may need to change their accounting policies to comply with the SAB. Provided the registrant's former policy was not an improper application of GAAP, registrants may adopt a change in accounting principle to comply with the SAB no later than the first fiscal quarter of the fiscal year beginning after December 15, 1999.

XII. SIGNIFICANT NO-ACTION AND INTERPRETIVE LETTERS THROUGH OCTOBER 1999

A. Section 2(a)(1) of the Securities Act

American Stock Exchange - NASD -July 10, 1998

The Division expressed the view that the American Stock Exchange (the "Exchange") memberships, or "seats," described in the letter are not securities within the meaning of Section 2(a)(1) under the Securities Act. The Division also expressed the view that the described transaction, in which substantially all of the assets and liabilities of the Exchange would be transferred to a limited liability company (the "LLC") in exchange for i) an interest in the LLC and ii) contractual obligations of the NASD under the agreement governing the transaction, would not involve a distribution of the securities issued by the LLC under Securities Act Rule 145(a)(3).

B. Section 2(a)(3) of the Securities Act

First Mutual Savings Bank - October 8, 1999

The Division stated that it no longer responds to requests for no-action advice under Sections 2(a)(3) and 5 for holding company formations structured to occur without a vote of shareholders.

Vanderkam & Sanders - January 27, 1999;
Simplystocks.com - February 4, 1999

In each of these letters, the Division expressed the view that the issuance of securities in consideration of a person's registration or visit to an issuer's internet site would be an event of sale within the meaning on Section 2(a)(3), and would violate Section 5 of the Securities Act unless it were the subject of a registration statement or a valid exemption from registration.

C. Section 2(a)(10) of the Securities Act

Net Roadshow, Inc. - July 30, 1997

The Division took the position that it would not recommend enforcement action if Net Roadshow transmits roadshows via the Internet:

- for the purposes and according to the procedures described in the request; and
- in reliance on counsel's opinion that the transmissions are not prospectuses within the meaning of Securities Act Section 2(a)(10).

Some of the key procedures described in the request include:

(1) an entire "live" roadshow, including any questions and answers, will be transmitted on the Internet and editing (except in limited circumstances) and staging are not permitted;

(2) transmissions of the roadshow will not be available until a registration statement has been filed with the Commission for the subject offering;

(3) transmissions will not be made widely available; access is password-protected and limited only to those "qualified" investors who customarily are invited to attend a "live" roadshow (e.g., registered broker-dealers and investment advisers);

(4) the roadshow may be viewed for one day only by each person or entity given password access;

(5) viewers must agree not to copy, download or further distribute the transmissions (Net Roadshow has also installed technology to prevent copying, downloading or printing of transmissions other than the filed prospectus);

(6) each transmission will include visual statements or "crawls" emphasizing the prohibition on copying, downloading or further distributing;

(7) a copy of the filed prospectus will be available on-line before and during each roadshow transmission, and will be able to be downloaded by the viewer in its entirety; and

(8) issuers and underwriters will be required to take reasonable steps to ensure that information disclosed in the transmission is not inconsistent with the filed prospectus.

Private Financial Network ("PFN") - March 12, 1997

The Division took the position that it would not recommend enforcement action if PFN transmits by satellite, telephone or cable a video of an issuer's road show presentation to PFN's subscribers for the purposes and pursuant to the procedures described in reliance on counsel's opinion that the transmissions are not prospectuses within the meaning of Securities Act Section 2(a)(10).

The procedures described in the request include: (1) transmissions will be available only to PFN's subscribers who agree not to videotape, copy or further distribute the transmissions; (2) before a transmission, each of PFN's subscribers will receive a filed prospectus from the issuer or the underwriter; (3) issuers and underwriters will be required to take reasonable steps to ensure that information disclosed in the road show is not inconsistent with the filed prospectus; and (4) each transmission will include visual statements or "crawls" emphasizing the prohibition on videotaping, copying or further distributing.

<u>Dissemination of Research Materials Relating to Asset-Backed Securities - February 7, 1997</u>

The Division stated that, under the conditions specified, the publication or distribution by a broker or dealer (collectively, "Broker/Dealer") of information, an opinion or a recommendation as to investment grade asset-backed securities (as defined for Securities Act Form S-3 eligibility purposes) ("ABS") will not be deemed, for purposes of Securities Act Sections 2(a)(10) and 5(c), to be an offer of ABS registered or proposed to be registered under the Securities Act ("Registered Securities") whether or not the Broker/Dealer is or will be a participant in the distribution of the Registered Securities.

The conditions relate to (i) the Broker/Dealer's previous publication or distribution of opinions or recommendations on specified types of ABS collateral; (ii) the sufficiency of public information to provide a basis for the Broker/Dealer's expressed view; (iii) relationships between the Broker/Dealer and a participant in the offering; (iv) whether the Broker/Dealer makes a specific recommendation on a specific ABS of a specific issuer; and (v) whether the Broker/Dealer recommends ABS backed by collateral substantially similar to that backing the Registered Securities.

In addition, the Division stated that more conditions must be met if the Registered Securities have not yet been offered or are part of an unsold allotment or subscription. The Division also stated that, in the case of a multi-tranche offering of ABS, each tranche, as described, is treated as a different Registered Security. Finally, the Division stated that its position may be modified or withdrawn if the Commission or the Division determines that this is necessary or appropriate in the public interest or otherwise in furtherance of the federal securities laws.

D. <u>Section 3(a)(2) of the Securities Act</u>

<u>State Street Bank and Trust Company ("State Street") - August 1, 1996</u>

The Division (as well as the Divisions of Investment Management and Market Regulation) addressed State Street's proposal to offer units ("Units") in specified collective trust funds ("Funds") it maintains to plans ("457 Plans") meeting the definition of "eligible deferred compensation plan" in Section 457 of the Internal Revenue Code where specified restrictions are imposed on the ability of employers to withdraw assets from the 457 Plans. The Divisions also addressed past no-action letters as to 457 Plans.

The Division stated that it would not recommend enforcement action if State Street, in reliance on an opinion of counsel that the exemptions under Section 3(a)(2) of the Securities Act and Section 3(a)(12) of the Exchange Act are available, offers Units to 457 Plans without registration under these Acts. The Division of Market Regulation concurred with the Division as to the Exchange Act. The Division of Investment Management stated that it would not recommend enforcement action if State Street offers and sells Units to 457 Plans without registering the Funds as investment companies in reliance on Section 3(c)(11) of the Investment Company Act.

The Divisions noted that they previously had issued a number of no-action letters relating to 457 Plans based largely on the general representation that plan assets would not be used for any purpose other than the exclusive benefit of participants except to the extent that plan assets must remain subject to the claims of general creditors of the employer to preserve the plan's qualification under Section 457. The Divisions also noted, however, that they now believe that this general representation no longer provides an adequate basis for no-action relief without specific additional restrictions on the ability of an employer to withdraw assets similar to those specified by State Street.

An agreement ("Agreement") between State Street and a 457 Plan would, among other things, specifically prohibit an employer from withdrawing 457 Plan assets except for the following purposes: (1) to transfer 457 Plan assets to a trustee in bankruptcy in the event of the employer's insolvency or bankruptcy, or to any other agent independent of the employer authorized to act in such proceedings; (2) to satisfy the claims of the employer's general creditors in the event of the employer's insolvency or bankruptcy; (3) to pay benefits to an employee participating in a 457 Plan; (4) to transfer assets to a 457 Plan's custodian or other person designated by a sponsoring employer in case the Agreement is terminated or a withdrawal is made for the purpose of using another investment manager or investment arrangement; (5) to distribute 457 Plan assets to participating employees in the event a 457 Plan is terminated pursuant to a plan of liquidation; or (6) to reimburse an employer for any 457 Plan benefits that the employer may have paid out of its other assets, or to correct an excess deferral or other mistaken investment in a Fund.

The Divisions concluded that, consequently, the prior no-action letters no longer represent the Divisions' position on enforcement action in the 457 Plan area. The Divisions stated, however, that to facilitate an orderly transition to their current position, they will not recommend enforcement action for a period of 12 months from the date of the response if persons continue to rely on prior letters. Finally, the Divisions took the position that at the end of that period, however, banks and insurance companies wishing to continue including 457 Plans in their collective trust funds or separate accounts should, for new contracts, enter into an agreement similar to the Agreement with the sponsor of each such 457 Plan, and for existing contracts, use reasonable efforts to amend plan documents and/or supporting contracts to conform to the Agreement (or an agreement similar to the

Agreement).

E. Section 3(a)(10) of the Securities Act

Food Lion, Inc. - January 13, 1999

The Division stated that it would not object if , based on counsel's opinion that the exemption from registration provided by Section 3(a)(10) is available, the described exchange of securities traded on the Nasdaq National Market were conducted as proposed.

In reaching its position, the Division noted the recent enactment of the Securities Litigation Uniform Standards Act of 1998 (105 P.L. 353, 112 Stat. 3227), which amended Section 18(b)(4)(C) of the Securities Act to include a reference to Section 3(a)(10). Section 18 of the Securities Act creates an exemption from state securities law registration requirements for "covered securities", and defines "covered security" to include any security listed on the Nasdaq National Market System. As amended, Section 18(b)(4)(C) removes securities that are otherwise covered securities from the definition if they are offered and sold in reliance on certain federal exemptions, including Section 3(a)(10). The Division expressed the view that, as a result of the amendment, state securities law provisions authorizing the approval of certain exchanges of securities may be used to perfect an exemptive claim under Section 3(a)(10) where the security is otherwise a "covered security". The Division stated that, because of this Congressional action, statements to the contrary in Staff Legal Bulletin No. 3, as published on July 25, 1997, are no longer valid.

The Division also addressed other questions raised with respect to the proposed exchange.

Maverick Networks - January 25, 1999

The Division expressed the view that an exemptive claim under Section 3(a)(10) for securities listed on the New York Stock Exchange, the American Stock Exchange, or the Nasdaq Market System in a transaction reviewed under Section 25142 of the California Corporations Code would not be impaired by Section 18(b) of the Securities Act. The Division noted that through the recent amendment to Section 18(b)(4)(C) of the Securities Act, such securities, which otherwise would be "covered securities" exempted by Section 18 from state securities law regulatory requirements, are removed from the definition of covered securities if they are offered and sold in reliance on Section 3(a)(10). As a result, the Division stated, state securities law provisions (such as the California provision at issue) authorizing the approval of certain exchanges of securities may again be used to perfect exemptive claims under Section 3(a)(10) with respect to securities that otherwise would be covered securities.

F. Section 5 of the Securities Act

Wit Capital- July 14, 1999

The Division, without concurring in counsel's analysis, agreed not to recommend enforcement action to the Commission under section 5(a) or 5(b) against Wit Capital for its conduct of initial public offerings using the procedures described in Wit's request.

Under the procedures, Wit circulates an e-mail notice conforming to rule 134 after preliminary prospectus in a segregated area within Wit's web site. The segregated area in Wit's web site, the "cul de sac," separates information concerning the IPO from other information on Wit's web site. A person entering the cul de sac cannot link other sites on the Internet, such as the issuer's web site. The cul de sac includes only a notice conforming to rule 134, the preliminary prospectus, and information on Wit's general account and subscription procedures.

A person visiting the cul de sac who does not hold accounts with Wit must open the account before submitting an offer to buy shares in the IPO. A minimum of $2,000 must be deposited to open the account. The amount deposited is independent of the amount that may be required to purchase shares and remains in the control of the investor. Persons holding accounts who wish to participate in the offering may make offers to buy through the subscription documents included in the cul de sac. Offers to buy may specify the price the investor is willing to pay. Offers to buy that do not specify a price are treated as limit orders at the maximum estimated public offering price disclosed in the prospectus.

Approximately 48 hours before the anticipated effectiveness of the registration statement, Wit sends an e-mail notice requesting reaffirmation of the offers to buy. Persons who do not confirm their earlier offers will not receive allocations. The confirmation will be valid for a maximum of seven business days from this e-mail notice. A further reconfirmation will be required at any time the public offering price deviates from the estimate and at any time the preliminary prospectus is recirculated.

After the registration statement is effective and shortly before the IPO is priced using rule 430A procedures, Wit will send an e-mail notice to each bidder stating that the offering is about to price and that unless the bidder withdraws the offer to buy within a brief period (the minimum is an hour), Wit may accept the offer. Notices of acceptance are sent to persons who have received allocations. The notice will be followed by a confirmation that satisfies Exchange Act rule 10b-10 and the final prospectus required by section 5(b)(2).

American Re Corporation (the "Company") - May 15, 1998

The Division addressed the Company's Charter Partners insurance program (the "Program"). The Program was to involve (i) the sale of insurance policies to members of associations or other organizations (each an "Association") of smaller and middle sized commercial businesses with similar business risks, and (ii) the reinsurance of a portion of the liabilities arising from those policies by a Bermudan "rent-a-captive."

Under the Program, each Association would act as settlor of a trust ("Trust") for the benefit of its members who purchase insurance through the

Program (“Policyholders”). Each Trust would purchase, for a nominal amount, one share of non-voting preferred stock in the holding company (“Holding Company”) that owns the rent-a-captive. The Company or one of its affiliates would hold all of the common stock in the Holding Company. Should an Association have an overall positive result because of its favorable loss experience, the rent-a-captive would pay dividends to the Holding Company with respect to that Association’s policies. The Holding Company would then pay a dividend to the Trust on the preferred stock. Any distribution from the rent-a-captive to the Holding Company, and from the Holding Company to the Trust, would be made pursuant to a predetermined formula set forth in a shareholder agreement between the Holding Company and the Trust. After deduction of certain administrative expenses, all of the dividends paid by the rent-a-captive to the Holding Company would then be distributed to the Policyholders. The distributions to the Policyholders would be based on a separate formula that took into account each Policyholder’s premium volume and loss experience.

The Division took the position that it would not recommend enforcement action to the Commission if, in reliance upon counsel’s opinion that registration was not required, the Program were operated without registration of the Trust interests or the Holding Company preferred stock under the Securities Act. In reaching this position, the Division noted, among other things, that (1) no Policyholder would ever be liable for any dollar amount in excess of the premium paid by the Policyholder for insurance; and (2) any dividends distributed to a Policyholder would be allocated pursuant to a predetermined formula and based primarily upon the Policyholder’s own loss experience.

**<u>Net Roadshow, Inc. (“Net Roadshow”) -
January 30, 1998</u>**

The Division stated that it would not recommend enforcement action if Net Roadshow transmits road shows over its Internet website solely to "qualified institutional buyers" ("QIBS") within the meaning of Securities Act Rule 144A(a)(1) on behalf of a QIB (or person acting on its behalf) that purchases securities from an issuer for resale to other QIBS under Rule 144A ("Seller").

The Division noted counsel's opinion that the activities described would be consistent with Rule 144A(d)(1) and conditioned its position on Net Roadshow's compliance with the following conditions in connection with each road show.

(1) Net Roadshow will deny access to its website for viewing a particular road show (including any notice of the road show posted on Net Roadshow's website) to all but:

   (A) New Roadshow's or the Seller's employees or authorized agents for that road show; and

   (B) the institutions for which the Seller has confirmed its reasonable belief regarding their QIB status.

(2) The confidential password assigned to QIBS for a particular road show will be unique to that road show, and will expire no

later than the date the related offering terminates.

(3) Each Seller's confirmation to Net Roadshow will include the following:

(A) a representation that the Seller is a QIB;

(B) an adequate basis for the Seller's representation of its "reasonable belief" that:

(i) each entity to which the Seller has assigned a confidential password is a QIB; and

(ii) the offering to which the particular road show relates is not subject to Securities Act registration.

(4) Net Roadshow otherwise has no actual knowledge or reason to believe, that:

(A) the Seller is not a QIB;

(B) any of the entities to which the Seller has assigned a confidential password is not a QIB; or

(C) the securities offering to which a particular road show relates is subject to Securities Act registration.

(5) Net Roadshow is not an affiliate of any Seller or issuer of a security that is the subject of a particular road show.

Finally, the Division stated that the Commission or staff may reevaluate this no-action position in the future because regulatory responses to legal issues raised by technological developments may evolve.

Internet Capital Corporation. ("ICC") - December 24, 1997

The Division (as well as the Division of Market Regulation) addressed ICC's electronic posting and delivery of prospectuses and other offering materials for unaffiliated issuers.

ICC will provide this service in connection with Securities Act registered offerings, Securities Act Regulation A offerings and SCOR offerings. ICC will not provide this service in connection with offerings under Securities Act Regulation D Rules 505 and 506. For example, as to registered offerings, ICC will post on its website notices that comply with Securities Act Rule 134 and related preliminary prospectuses that comply with Securities Act Rule 430 and final prospectuses.

The Division stated that it would not recommend enforcement action as a result of the electronic posting and delivery. The Division expressly disclaimed providing a view on whether:

- ICC, in engaging in the activities described, would be an "underwriter" within the meaning of Securities Act Section 2(a)(11); and

- the prospectus delivery procedures described would satisfy the standards set forth in Securities Act Release Nos. 7233 (October 6, 1995) and/or 7288 (May 9, 1996).

The Division of Market Regulation took the position that it would not recommend enforcement action under Exchange Act Section 15(a) if ICC establishes and operates the described Internet web site without registering as a broker-dealer under Exchange Act Section 15(b).

The Divisions noted that their positions were based in part on the oral representation that no ICC affiliate will do business with an issuer or assist an issuer in connection with the issuer's offering of its securities on ICC's web site. Finally, the Divisions noted that their no-action positions may be reevaluated in the future because regulatory responses to ongoing technological developments may evolve.

The Securities Transfer Association, Inc. - October 24, 1997

The Division took the position that it would not recommend enforcement action if, in reliance on an opinion of counsel that registration under the Securities Act is not required, a bank or issuer uses its Internet Web site in connection with an open-market stock purchase plan ("Plan") as described in the request and without compliance with the Securities Act's registration provisions.

The uses described in the request include the following:

- an issuer places on its Web site a notice of Plan availability and a hypertext link to the bank Plan sponsor's Web site; and

- a bank Plan sponsor places on its Web site a list of issuers for which it sponsors Plans and the related Plan materials.

Brown & Wood LLP - February 7, 1997

The Division addressed the resale by specified holders ("Holders") of securities ("Exchange Capital Securities") acquired in a Securities Act registered exchange offer ("Exchange Offer") for substantially similar privately placed financing trust issued securities ("Capital Securities").

The Division concluded that a Holder may resell the Exchange Capital Securities without compliance with Securities Act registration and delivery requirements where the Holder acquires the Exchange Capital Securities in the ordinary course of its business and has no arrangement or understanding with any person to participate in the distribution of the Exchange Capital Securities.

In reaching this position, the Division particularly noted (1) the described characteristics of the Capital Securities; and (2) the described actions to be taken in connection with the Exchange Offer.

Dissemination of Research Materials Relating to Asset-Backed Securities - February 7, 1997

The Division addressed the publication or distribution by a broker or dealer of information, an opinion or a recommendation as to asset-backed securities. See Section XII.C for a discussion of this letter.

IPONET - July 26, 1996

With respect to public offerings, the Division addressed the application of Securities Act Rule 134 to an electronic coupon or card. The Division stated that the reference in Rule 134(d) to "an enclosed or attached coupon or card, or in some other manner" would be equally applicable to the acceptance of indications of interest via electronic coupon or card as well as paper coupon or card. In this regard, the Division noted the representation that Rule 134(d)'s other requirements will be satisfied in connection with the acceptance of such indications of interest.

The Division also addressed, in the electronic context, the definitions of "general solicitation" and "general advertising" under Securities Act Regulation D Rule 502(c). The Division took the position that the initial qualification of accredited or sophisticated investors by means of a generic questionnaire, followed by the subsequent posting of a notice of a private offering in a password-protected page of IPONET accessible only to IPONET members who previously qualified as accredited investors, would not involve any form of "general solicitation" or "general advertising" within the meaning of Rule 502(c).

In reaching this conclusion, the Division noted that (i) both the invitation to complete the questionnaire used to determine whether an investor is accredited or sophisticated and the questionnaire itself will be generic in nature and will not reference any specific transactions posted or to be posted on the password-protected page of IPONET; (ii) the password-protected page of IPONET will be available to a particular investor only after the supervisor of IPONET has made the determination that the particular potential investor is accredited or sophisticated; and (iii) a potential investor could purchase securities only in transactions that are posted on the password-protected page of IPONET after that investor's qualification with IPONET. In this regard, the Division stated that it took no position as to whether the information obtained by the supervisor is sufficient to form a reasonable basis for believing an investor to be accredited or sophisticated.

Real Goods Trading Corporation (the "Company") - June 24, 1996

The Division (as well as the Divisions of Investment Management and Market Regulation) addressed the Company's proposed trading system ("System") that would provide information about prospective buyers and sellers (the

"Participants") of the Company's common stock ("Common Stock"). The Division took the position that the Company's activities in connection with the establishment and maintenance of the System would not require that offers or sales made through the System be registered under the Securities Act. The Division of Investment Management took the position that the Company may engage in the activities specified without registering under the Investment Advisers Act. The Division of Market Regulation took the position that it would not recommend enforcement action under Exchange Act Section 5, 6 or 15 if the Company operates the System in the manner specified without registration as a national securities exchange under Section 6 or as a broker-dealer under Section 15 of the Exchange Act.

In reaching these positions, the Divisions noted that (i) the Company will provide specified notices regarding operation of and participation on the System that will be set forth or contained on the screens and/or hard copy by which System information is provided; (ii) the Company is an Exchange Act Section 12 registrant and will retain that status or, if it should cease to be a Section 12 registrant, otherwise undertake to make publicly available the information required by Exchange Act Section 13(a) in the same manner that Participants will obtain access to the System (e.g., electronic mail, facsimile, mail, the Company's World-Wide Web site, etc.); (iii) the Company will keep records of all quotes entered into the System and make those records available to the Commission and the Pacific Stock Exchange (or any other regulated market on which Company securities are listed) upon reasonable request; (iv) the Company's advertising will comply with specified representations; (v) neither the Company nor any affiliate of the Company will use the System, directly or indirectly, to offer to buy or sell securities, except in compliance with the securities laws, including any applicable registration requirements (absent an available exemption therefrom); and (vi) neither the Company nor any affiliate of the Company will (a) receive any compensation for creating or maintaining the System; (b) receive any compensation for the use of the System; (c) be involved in any purchase or sale negotiations arising from the System; (d) provide information regarding the advisability of buying or selling Common Stock or any other securities; or (e) receive, transfer or hold funds or securities as an incident of operating the System.

G. Rules 144, 145, and 144A

Mandatorily Exchangeable Issuer Securities - October 25, 1999

The Division addressed the eligibility of a security for resale under Rule 144A, where that security, itself eligible to be resold in reliance on Rule 144A(d)(3), is exchangeable at the issuer’s election for securities of unrelated issuers. The securities of the unrelated person could be resold by the issuer of the overlying security in reliance on Section 4(1), either because they were not restricted securities within the meaning or Rule 144(a)(3) or because they could be sold in reliance on Rule 144(k). The Division expressed the view that, under the circumstances described, the overlying security would be eligible for resale under

Rule 144A. The Division expressed no view on the application of the conversion premium test of Rule 144A(d)(3) to securities of this description.

Verio Inc. (“Verio”) - May 25, 1999

The Division expressed the view that, once Verio has fully and unconditionally guaranteed a debt security of its wholly owned subsidiary, holders of warrants to purchase Verio common stock who pay the warrant exercise price by surrendering the guaranteed debt instrument may use their holding periods on the warrants and debt securities to calculate their holding periods for the common stock received on exercise. In reaching its position, the Division particularly noted that the addition of the Verio guarantee would allow Verio and its wholly owned subsidiary to be considered the same issuer for purposes of Rule 144(d)(3)(ii). The Division noted that warrant holders paying the exercise price with any consideration other than the guaranteed debt securities or other Verio securities would use the date of exercise of the warrant and payment of its exercise price as the beginning of the holding period for the Verio common stock received upon exercise. The Division stated that *Amdahl Corp.* (February 27, 1999) and *American Telephone and Telegraph Company* (May 1, 1999) no longer represent the Division’s view on this issue.

CommScan, LLC - February 3, 1999

The Division expressed the view that sellers may rely on the Company's qualified institutional buyers list ("QIB List"), which would be published on an Internet web site accessible only by registered broker/dealers, as a method for establishing a reasonable belief that a prospective purchaser is a "qualified institutional buyer" within the meaning of Rule 144A(a)(1) under the Securities Act. Information underlying inclusion of an entity in the QIB List must be as of a date within 16 months before the date of sale of securities in the case of a United States purchaser, and within 18 months before such date of sale for a foreign purchaser.

Elliott Associates, L.P. and Westgate International, L.P. - January 18, 1999

The Division expressed the view that that the Rule 144(d) holding period for common shares issuable to holders of described outstanding debt of the issuer, in satisfaction of terms in the Trust Deed governing the debt providing for contingent issuance of the common shares, would be identical to the holding period for the debt securities themselves. The Division noted that the obligation to issue the common shares is subject only to conditions outside the control of the parties, and that the issuances will not be made against the payment of any new consideration.

The Petersen Companies, Inc. (“Company”) - July 16, 1998

The Division expressed the view that the Rule 144(d) holding period for shares of Company common stock exchanged for limited liability company interests in Petersen Holdings, L.L.C. (“Petersen”) began on October 1, 1997, the date of the exchange. The Division stated that the holding period could not “tack” to an earlier date because the agreement Petersen interest holders signed when Petersen was formed, granting the Company (in its capacity as Petersen's manager) the right to control all aspects of any initial public offering, did not expressly contemplate conversion from a limited liability company to corporate form in advance of a public offering of securities, with holders of Petersen units retaining no veto or other voting power with respect to the conversion. The Division referred specifically to *Peapod, Inc*. (Nov. 10, 1997).

Peapod, Inc. ("Peapod") - November 10, 1997

The Division took the position that limited partners of a partnership and the shareholders of its corporate general partner could "tack," under Securities Act Rule 144(d), their holding periods for their limited partnership interests and shares, respectively, onto their holding periods for the shares of Peapod received in a conversion (and, in the case of the general partner's shareholders, the general partner's subsequent liquidation).

In the conversion,

- all the equity interests in the partnership were exchanged for Peapod shares;
- the partnership was dissolved; and
- all of the partnership's assets and liabilities were transferred to Peapod.

In reaching this conclusion, the Division noted in particular specified agreements and their contemplation of the partnership's conversion to corporate form in advance of, and to facilitate, the new corporation's public offering.

Rite Aid Corporation - October 20, 1997

The Division expressed the view that, where securities originally issued in a Securities Act Rule 145(a) transaction are transferred as gifts to third parties by a person Rule 145(c) deems an underwriter, the donees in the transfers who are not the issuer's affiliates may make unregistered public resales of the securities in the same manner and to the same extent as the donor.

Nextel Communications, Inc. - August 19, 1997

The Division stated that, where securities originally issued in a Securities Act Rule 145(a) transaction are privately sold by a person deemed an underwriter by Rule 145(c) (other than an affiliate of the issuer), an unaffiliated purchaser of the securities may make unregistered public resales of the securities to the same extent and in the same manner as the private seller.

First Bank System, Inc. - July 30, 1997

The Division stated that when an affiliate pledgor defaults on a loan that is collateralized by securities that are not "restricted" in the hands of the pledgor, and the pledgee bank forecloses on the pledge, the pledgee bank may sell those securities without regard to the holding period requirement of Securities Act Rule 144.

H. Rule 701

Morgan, Lewis & Bockius - November 3, 1999

The Division provided further guidance for issuers when transitioning from former Rule 701 to the new version. The Division expressed these views concerning the treatment of options:

- an issuer could rely on the grant date method for options granted in the 12 months before effectiveness of the revised rule up to the ceiling permitted under the old rule. Excess options - option grants over the ceiling in the old rule - could be considered against the available ceiling under the revised rule either when the excess options become exercisable or when they are actually exercised, whichever is most advantageous;

- the disclosure required by the revised rule where the $5 million ceiling is exceeded must be provided to investors a reasonable time before the exercise of options, even if those options were granted long before the rule revision; and

- the “clean slate” method is appropriate only if the available ceiling under the revised rule is not exceeded when offers and sales under the former rule are combined with sales under the revised rule.

Occidental Petroleum Corporation - August 3, 1999

The Division expressed the view that a private subsidiary of Occidental, a publicly reporting company, may use Rule 701 to offer or sell its securities to its employees.

American Bar Association - August 3, 1999

The Division stated that, subject to preliminary note 5 to Rule 701, a private subsidiary of a publicly reporting company may use Rule 701 to offer or sell its securities, including deferred compensation arrangements whether guaranteed or not guaranteed by the parent, to its employees, officers, directors, partners, trustees, consultants or advisors, or those of its parents or other majority-owned subsidiaries of its parent.

American Bar Association - August 3, 1999

With respect to issues of transition from the former Rule 701 to the new version, the Division expressed the view that the grant date method, the effective date method and the exercisable date method described, each appear to be appropriate ways of handling unexercisable options under the new provision. The Division also concurred with the view that options issued in reliance upon the prior version of Rule 701 regardless of their exercisability would not be subject to the new disclosure requirements at the time of the option grants.

I. Regulation S

Initial Public Offerings of U.S. Companies on EASDAQ - July 27, 1999

The Division took the position that it would not recommend enforcement action if equity securities of non-reporting, U.S. companies are offered and sold in initial public offerings offshore pursuant to Regulation S in connection with a listing on EASDAQ without implementation of the stop-transfer and other provisions set forth under Rule 903(b)(3)(iii)(B) , Rule 903(b)(3)(iv) and Rule 904(b)(1)(ii). In reaching its position, the Division relied on counsel's opinion that the alternative restrictions and arrangements described in the request provide reasonable procedures to prevent public distribution of these equity securities in the United States. The Division also noted that U.S. firms are not permitted to participate in the EASDAQ market, either as brokers or market-makers, and that no EASDAQ trading screens will be placed in the United States.

Sales of Convertible Securities Under Regulation S - August 26, 1998

The Division stated that it would not recommend enforcement action if convertible securities of U.S. reporting companies that are eligible for resale under Rule 144A and that are held in global certificated from (as either registered or bearer securities) by a depository for a book-entry clearance facility are offered and resold pursuant to Regulation S without implementation of the stop-transfer provisions or other procedures set forth under Rule 903(b)(3)(iii)(B)(4) of Regulation S, as long as certain procedures are followed during the applicable distribution compliance period. The Division stated that its view was limited to convertible securities offered or resold under Regulation S, and would not affect the applicability of Rule 903(b)(3)(iii)(B)(4) to any equity securities issued upon the conversion of the convertible securities during the distribution compliance period.

The Division also indicated that debt securities convertible into the equity securities of a person other than the issuer ("exchangeable" securities) would be considered convertible securities for Regulation S purposes.

J. Section 18(b)(4)(A) of the Securities Act

David M. Katz, Esq. - April 24, 1997

The Division addressed one of the definitions of "covered security" provided by Securities Act Section 18(b). Section 18(b)(4)(A) states that a security is a "covered security" as to a transaction that is exempt from Securities Act registration under Securities Act Section 4(1) or 4(3), provided that the issuer "files reports" with the Commission under Exchange Act Section 13 or 15(d). The Division stated that an issuer "files reports" for purposes of Section 18(b)(4)(A) if it has completed a registered initial public offering under the Securities Act, but has not yet been required to file any reports under Section 13 or 15(d).

K. Securities Act Forms

Ropes & Gray - October 30, 1997

The Division stated that post-effective amendments to deregister unsold shares are not required in fee transfers from Securities Act registration forms other than Form S-8 or in fee transfers from Form S-8 solely of fees paid pursuant to Rule 457(h)(3) with respect to additional securities offered for resale.

The Division also stated that the filing of the Securities Act registration statement to which the fee is transferred is deemed to deregister the unsold shares for which the transferred fee originally was paid.

Finally, the Division stated that registrants who wish to transfer Securities Act registration fees also should consult the Rule 429 interpretations in the latest version of the Division of Corporation Finance Manual of Publicly Available Telephone Interpretations, which is available on the Commission's Internet web site (*http://www.sec.gov*), and Securities Act Rel. 7168 (May 11, 1995).

The Bond Market Association - October 16, 1997

The Division provided its views on the availability of Securities Act Form S-3 to asset-backed securities.

The Division stated that an asset-backed security will not fail to meet the definition of "asset-backed security" in Form S-3, General Instruction I.B.5, solely because the security is supported by assets having total delinquencies (as described in the request) of up to 20% at the time of the proposed offering.

The Division also stated that, regardless of whether an asset-backed security meets the definition of "asset-backed security" in General Instruction I.B.5, the security may nevertheless be eligible for registration on Form S-3 as long as the issuer satisfies General Instruction I.A.'s registrant requirements and General Instruction I.B.2.'s transaction requirements.

Merrill Lynch & Co., Inc. (the "Company") - May 16, 1996

The Division stated that it would not object if the Company uses Form S-8 under the Securities Act in connection with exercises of transferable stock options ("Transferable Stock Options") subject to specified transfer restrictions by former employees and by executors, administrators and beneficiaries of estates of employees or former employees, provided that the Transferable Stock Options being exercised have never been transferred by the original grantees and are only exercisable by executors, administrators and beneficiaries of their estates due to such grantees' deaths.

In reaching this position, the Division noted in particular that a

Transferable Stock Option is not transferable by any person other than the original grantee or the estate of the original grantee (which is permitted to transfer such Transferable Stock Option only to the beneficiaries of such estate).

L. Sections 13 and 15(d) of the Exchange Act

Time Warner Inc. (the "Company") - June 10, 1998

The Division stated that it would not object if each of two Company subsidiaries (each a "Subsidiary") did not file reports under Sections 13 and 15(d) of the Exchange Act with respect to its securities guaranteed i) by the Company and ii) by the other Subsidiary (a "Cross Guarantee"). In reaching its conclusion the Division noted, among other factors, that the Company had fully and unconditionally guaranteed the Cross Guarantees. The Division's position was conditioned on the inclusion of certain narrative and financial statement disclosure in the Company's Exchange Act reports.

Pioneer Americas Acquisition Corp. - April 3, 1998

The Division stated that it would not object if an issuer (the "Issuer") of securities guaranteed by its parent (the "Parent Guarantor") and by other wholly-owned subsidiaries of its parent (the "Affiliate Guarantors") did not file reports under Sections 13 and 15(d) of the Exchange Act with respect to the guaranteed securities. The Division also stated that it would not object if the Affiliate Guarantors did not file reports under Sections 13 and 15(d) with respect to the guarantees. In reaching its conclusion the Division noted, among other factors, that the Parent Guarantor and the Affiliate Guarantors had fully and unconditionally guaranteed the Issuer's securities on a joint and several basis. The Division's position was conditioned on the inclusion of certain narrative and financial statement disclosure in the Parent Guarantor's Exchange Act reports.

M. Proxy Rules

Johnson Controls, Inc. ("Johnson") - October 26, 1999

The Division addressed whether a proposal recommending certain disclosure in the financial statements included in Johnson's Commission-prescribed documents could be omitted from Johnson's proxy material under Rule 14a-8(i)(7), as relating to Johnson's ordinary business operations. In expressing its view that the proposal could be omitted, the Division stated that it has determined that proposals requesting additional disclosures in Commission-prescribed documents should not be omitted under the "ordinary business" exclusion solely because they relate to the preparation and content of documents filed with or submitted to the Commission. This interpretive approach reverses the Division's prior approach to such proposals. Beginning with *Johnson Controls*, when evaluating such proposals the Division will consider whether the subject matter of the additional disclosure sough in a particular proposal involves a matter of ordinary business. Where it does, the Division believes the proposal may be excluded under Rule 14a-8(i)(7).

Chevron Corporation -- March 4, 1999

The Division took the position that it would not recommend enforcement action if Chevron omitted a shareholder proposal requesting the board of directors to review and report on Chevron's code of business conduct under Rule 14a-8(i)(12)(ii). The Division noted that the current proposal, when viewed together with the proposals submitted in 1996 and 1997, all appear to focus on Chevron's operations in Nigeria. Furthermore, changing circumstances are not a consideration under Rule 14a-8(i)(12). On this basis, the Division continued to follow the precedent established by a prior staff no-action letter issued to Florida Progress Corporation on January 8, 1997.

General DataComm Industries, Inc. - December 9, 1998

The Division stated that it did not believe that General DataComm could rely on Rule 14a-8(i)(7) as a basis to exclude a shareholder proposal mandating a bylaw amendment on stock option repricing from its proxy materials. The Division noted that in view of the widespread public deate concerning option repricing and the increasing recognition that this issue raises significant policy issues, its view is that proposals relating to option repricing no longer can be considered matters relating to a registrant's ordinary business. This letter reverses a prior staff no-action letter issued to Shiva Corporation on March 10, 1998.

Tenet Healthcare Corporation (the "Company") - July 1, 1998

The Division was unable to concur in the Company's view that Rule 14a-8(c)(7) provides a basis for the Company to omit from its proxy material a proposal requesting that the board of directors prepare a report regarding the status of the Company's computer system preparedness for the Year 2000. The Division expressed the view that the proposal raises significant policy issues that are beyond the ordinary business operations of the Company.

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Company") - October 24, 1997

The Division took the position that it would not recommend enforcement action if the Company prepares and disseminates research reports in accordance with Securities Act Rule 138 or 139 in connection with registered securities transactions, without compliance with the filing, disclosure and dissemination requirements of the proxy rules under Exchange Act Section 14(a).

The Division stated that its position was conditioned on the research report referring, as required by law or applicable rules, to any relationship that may exist between the Company, as issuer of a particular research report, and any participant in a relevant proxy solicitation. The Division also stated that its position did not address the applicability of the federal securities laws' anti-fraud provisions to the activities described in the request.

Finally, the Division stated that it may re-evaluate its no-action position in the future because the request raises issues in an evolving area of the federal securities laws.

N. Section 16 Rules

American Bar Association - October 15, 1999

The staff addressed the application of Rule 16b-3(c) to open market stock purchase plans that, under the standards of Securities Act Release No. 4790, are not required to be registered under Section 5 of the Securities Act. The Division said that the acquisition of issuer stock pursuant to accumulated payroll deductions under such a plan is a transaction with "an employee benefit plan sponsored by the issuer" for purposes of Rule 16b-3(a) where:

- the issuer deducts funds from compensation;
- deducted funds accumulate for a regular, specified interval no shorter than a pay period;
- accumulated funds are invested in issuer stock; and
- the open market plan restricts participation to employees of the issuer and its parents or subsidiaries who would be eligible to purchase securities of the issuer under a registration statement on Form S-8.

Such an acquisition is exempt under Rule 16b-3(c) if the open market plan meets the conditions of Rule 16b-3(b)(5), the definition of a Stock Purchase Plan. Because subsequent sales or transfers of the securities so acquired would be outside the plan, these transactions would not be exempt under Rule 16b-3. Acquisitions pursuant to additional voluntary contributions, although not exempt under Rule 16b-3, would not make the exemption unavailable for acquisitions pursuant to payroll deductions.

Select Sector SPDR Trust (the "Trust") - May 6, 1999

In a joint letter with the Division of Investment Management, the Division addressed the application of Section 16(a) to shares issued by the Trust, a registered open-end management investment company, in its nine separate investment portfolios (the "Funds"). The Divisions stated that, having expressed in this letter and in *PDR Services Corporation* (December 14, 1998) their views as to whether insiders and five percent beneficial owners of exchange-traded products, such as the shares issued by the Funds, must file ownership reports under Sections 16(a) and 13(d), respectively, the Divisions will no longer respond to requests for no-action relief in this area unless the request presents a novel or unusual issue.

American Bar Association - February 10, 1999

The Division addressed the application of Exchange Act Rule 16b-3 to transactions occurring in the following contexts:

- A transaction in issuer securities by the issuer's officer or director with the issuer's majority-owned subsidiary (or an employee benefit plan sponsored by a majority-owned subsidiary) will be considered a transaction with the issuer for purposes of Rule 16b-3(a). However, the approval requirements of Rule 16b-3(d) and 16b-3(e) must be satisfied at the issuer--rather than the subsidiary--level.

The following salary limitations implement "benefit or contribution limitations set forth in the Internal Revenue Code" for purposes of Rule 16b-3(b)(2): (a) the annual compensation limit in Internal Revenue Code Section 401(a)(17); and (b) the Internal Revenue Code Section 415 exclusion from taxable compensation of salary that has been deferred into a non-qualified plan. A supplemental plan that permits employer contributions that otherwise would have been made to the related qualified plan but for either of these limitations will be an Excess Benefit Plan.

- The following plans are not Excess Benefit Plans because the amount of issuer securities acquired will be determined based on the amount of salary the officer or director chooses to defer: (a) a non-qualified deferred contribution plan; and (b) a supplemental plan that provides an employer matching contribution based on the employee's deferral of salary into a non-qualified plan.

- Periodic acquisitions of phantom stock under a non-qualified deferred compensation plan or a supplemental plan that is not an Excess Benefit Plan that are exempted by Rule 16b-3(d) may be reported on an aggregate basis on Form 5.

- Rule 16b-3 is available to exempt an officer's or director's indirect interest in transactions, reportable by the officer or director, between the issuer and the following entities if the approving entity for purposes of Rules 16b-3(d) and 16b-3(e) knows (and the document evidencing approval specifies) the existence and extent of the officer's or director's indirect interest and that the approval is granted for purposes of Rule 16b-3:

    - a partnership or corporation;

    - a member of the officer's or director's immediate family; and

    - a trust.

Skadden, Arps, Slate, Meagher & Flom LLP - January 12, 1999

The Division addressed the application of Exchange Act Rule 16b-3 to transactions occurring in the context of corporate mergers.

Where the conversion or cancellation is simultaneous with or immediately before the related merger, each of the following transactions constitutes a disposition to the issuer of target equity securities eligible for exemption under

Rule 16b-3(e), even if the acquiror pays the merger consideration directly to target equity security holders:

- the conversion of target nonderivative equity securities into acquiror equity securities, debt, cash or a combination of different forms of merger consideration; and

- the conversion of target derivative securities into acquiror derivative securities or acquiror nonderivative equity securities, or the cancellation of target derivative securities for cash.

The approval conditions of Rule 16b-3(e) may be satisfied only by the target.

The acquisition of acquiror equity securities (including acquiror derivative securities) by officers and directors of the acquiror through the conversion of target equity securities in connection with a merger constitutes an acquisition from the acquiror eligible for exemption under Rule 16b-3(d). This position applies equally to employees and directors of the target who become officers and/or directors of the acquiror before, or at the time of, the merger ("New Acquiror Insiders"). The approval conditions of Rule 16b-3(d) may be satisfied only by the acquiror.

In the case of both dispositions and acquisitions, the approval conditions of Rule 16b-3 may be satisfied at the same time as, or following, approval of the merger agreement by the respective issuer's board of directors, as long as they are satisfied before consummation of the merger. Guidance is provided as to the specificity required if approval is granted by the full board or a committee of two or more Non-Employee Directors. Approval of an acquisition may be granted before a New Acquiror Insider becomes an officer or director of the acquiror.

Peter J. Kight - October 16, 1997

The Division addressed the application of Exchange Act Section 16 to transactions involving an irrevocable grantor retained annuity trust ("GRAT").

A grantor ("Grantor"), subject to Section 16 because an officer of a company ("Company") with common stock registered under Exchange Act Section 12, proposes to create a GRAT for estate planning purposes. Grantor proposes to transfer ("Transfer") to the GRAT shares of Company common stock Grantor now owns ("Shares") that constitute less than ten percent of the Company's outstanding common stock.

The GRAT will make a series of fixed annuity payments ("Annuity Payments") to Grantor, payable in either cash or Shares, over a specified time period ("Annuity Period"). During the Annuity Period, Grantor is the GRAT's trustee and beneficiary. After the Annuity Period, Grantor's minor children who share Grantor's household ("Children") are the GRAT's beneficiaries. The dollar amount of the Annuity Payments is established at the time of the Transfer. The present value of the Annuity Payments does not exceed the fair market value of the Shares at the time of the Transfer.

The Division took the position that Rule 16a-13 (exempting changes in form of ownership from Section 16) applies to the Transfer and any Annuity Payments paid in Shares. The Division stated that other transactions in the Shares by the GRAT during the Annuity Period are considered the Grantor's transactions. The Division also stated that the Annuity Period's termination effects a gift of Shares to the Children eligible both for exemption under Rule 16b-5 (exempting bona fide gifts from Section 16(b)) and deferred reporting on Form 5. Finally, the Division stated that after the Annuity Period ends, under Rule 16a-1(a)(2)(ii)(A) Grantor continues to report the Shares the Children hold as beneficially owned by Grantor as long as the Children share Grantor's household.