in the opinion of the Commission, produces copies suitable for a permanent record. Irrespective of the process used, all copies of any such material shall be clear, easily readable and suitable for repeated photocopying. Debits in credit categories and credits in debit categories shall be designated so as to be clearly distinguishable as such on photocopies.

(c) The body of all printed statements and reports and all notes to financial statements and other tabular data included therein shall be in roman type at least as large and as legible as 10-point modern type. However, to the extent necessary for convenient presentation, financial statements and other tabular data, including tabular data in notes, may be in roman type at least as large and as legible as 8-point modern type. All such type shall be leaded at least 2 points.

(d) Statements and reports shall be in the English language. If any exhibit or other paper or document filed with a statement or report is in a foreign language, it shall be accompanied by a summary, version or translation in the English language.

General Requirements as to Contents

§ 240.12b-23 Incorporation by reference.

(a) Except for exhibits covered by Rule 12b-32 (17 CFR 240.12b-32), information may be incorporated by reference in answer, or partial answer, to any item of a registration statement or report subject to the following provisions:

(1) Financial statements incorporated by reference shall satisfy the requirements of the form or report in which they are incorporated. Financial statements or other financial data required to be given in comparative form for two or more fiscal years or periods shall not be incorporated by reference unless the material incorporated by reference includes the entire period for which the comparative data is given;

(2) Information in any part of the registration statement or report may be incorporated by reference in answer, or partial answer, to any other item of the registration statement or report; and

(3) Copies of any information or financial statement incorporated into a registration statement or report by reference, or copies of the pertinent pages of the document containing such information or statement, shall be filed as an exhibit to the statement or report, except that a proxy or information statement incorporated by reference in response to Part III of Form 10-K (17 CFR 249.310) need not be filed as an exhibit.

(b) Any incorporation by reference of matter pursuant to this section shall be subject to the provisions of Rule 24 of the Commission's Rules of Practice (17 CFR 201.24) restricting incorporation by reference of documents which incorporate by reference other information. Material incorporated by reference shall be clearly identified in the reference by page, paragraph, caption or otherwise. Where only certain pages of a document are incorporated by reference and filed as an exhibit, the document from which the material is taken shall be clearly identified in the reference. An express statement that the specified matter is incorporated by reference shall be made at the particular place in the statement or report where the information is required. Matter shall not be incorporated by reference in any case where such incorporation would render the statement or report incomplete, unclear or confusing.

§ 240.12b-24 Summaries or outlines of documents. [Removed]

(Secs. 6, 7, 10, 19(a), 48 Stat. 78, 81, 85; secs. 205, 209, 48 Stat. 906, 908; sec. 8, 68 Stat. 685; sec. 1, 79 Stat. 1051; Sec. 308(a)(2), 90 Stat. 57; secs. 3(b), 12, 13, 15(d) and 23(a), 48 Stat. 882, 892, 894, 895 and 901; sec. 203(a), 49 Stat. 704; sec. 8, 49 Stat. 1379; secs. 3, 4, 5 and 6(d), 78 Stat. 565-574; sec. 28(c), 84 Stat. 1435; secs. 3 and 18, 89 Stat. 1149, 15 U.S.C. 77f, 77g, 77j, 77s(a), 78c(b), 78*l*, 78o(d), 78w(a))

Statutory Authority

These amendments are being proposed pursuant to Sections 6, 7, 10 and 19(a) of the Securities Act of 1933 and Sections 3(b), 12, 13(a), 15(d) and 23(a) of the Securities Exchange Act of 1934.

By the Commission.

George A. Fitzsimmons,

Secretary.

August 6, 1981.

Regulatory Flexibility Act Certification

I, John S.R. Shad, Chairman of the Securities and Exchange Commission, hereby certify, pursuant to 5 U.S.C. 605(b), that the proposed amendments published in Securities Act Release No. 6333 (August 6, 1981) will not, if promulgated, have a significant economic impact on a substantial number of small entities. The reasons for such certification are that (i) the proposed amendments to Regulation C (17 CFR 230.400 through 230.494) and Regulation 12B (17 CFR 240.12b-1 through 240.12b-36) will up-date or eliminate out-moded, unnecessary or inconsistent regulation; (ii) the proposed amendments will implement the stream-lined reporting requirements established by the integrated disclosure program; and (iii) the Commission is not aware of any costs which will be imposed on any persons (including small entities) in connection with the proposed amendments. Thus, the proposed amendments will not have a significant economic impact on a substantial number of small entities.

Dated: August 6, 1981.

John S.R. Shad,

Chairman.

[FR Doc. 81-23440 Filed 8-13-81; 12:56 pm]

BILLING CODE 8010-01-M

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17 CFR Parts 229 and 230

[Release Nos. 33-6334; 34-18010; IC-11890; File No. S7-896]

Delayed or Continuous Offering and Sale of Securities

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking.

SUMMARY: The Commission has revised in response to public comment a proposed rule to permit the registration of securities to be offered and sold on a delayed or continuous basis (so-called "shelf registration") and is republishing the revised proposal for further comment. As revised, the proposed rule would permit the shelf registration of securities if certain conditions are met. These conditions are designed to assure a bona fide intent to offer and sell the securities, accurate and current information about the registrant and the plan of distribution, and liability protection for investors under the Securities Act of 1933. The proposal also places certain additional limitations upon the availability of shelf registration for primary, at the market offerings of equity securities. The proposed Rule is designed to facilitate the development of innovative capital raising techniques which reduce burdens and costs to registrants while maintaining full investor protection under the federal securities laws and is one of a series of revisions and proposals published today that are designed to eliminate out-moded and duplicative requirements and to enhance the integration of disclosure systems.

DATE: Comments should be received on or before October 30, 1981.

ADDRESSES: Comments should be addressed in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. Comment letters should refer to File No. S7-896. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 1100 L Street, N.W., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Beverly Rubman, (202) 272-2604, or

Catherine Collins McCoy, (202) 272–2589, Office of Disclosure Policy, Division of Corporation Finance, and, with respect to market-related matters, Carlos Morales, (202) 272–2876, Division of Market Regulation, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission has revised in response to public comment proposed Rule 462A [17 CFR 230.462a] under the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77a et seq.] which, if adopted, would permit the registration of securities that are to be offered and sold on a delayed or continuous basis in the future ("shelf registration") and today is republishing the revised Rule for further comment. Proposed Rule 462A, as revised, differs in certain significant respects from the original proposal. However, the proposed Rule would still permit shelf registration of securities, provided that certain conditions, designed to assure a bona fide intent to offer and sell the securities registered, the availability of accurate and current information and liability protection under the Securities Act, are met. The proposal has been revised to place certain limitations upon the availability of shelf registration for at the market offerings of equity securities made by or on behalf of the registrant. If proposed Rule 462A is adopted, the Commission intends to eliminate Guide 4 of the Guides for the Preparation and Filing of Registration Statements and Periodic Reports (the "Guides") [1] that currently contains staff policy concerning shelf registration.[2]

The Commission recognizes that proposed Rule 462A, particularly insofar as it would permit, for the first time, primary offerings of equity securities on a continuous basis, may result in the development of innovative capital-raising methods of public companies that can serve the interests of issuers and the investing public. At the same time, because the proposal is a significant departure from past practice, the Commission intends to monitor the operation of the Rule, if adopted, in order to insure that its purposes are met and that abuses do not develop.

The Commission today has proposed or reproposed for comment in separate releases several other rulemaking proposals. These proposals include: (1) a three tier system for the registration of securities, Forms S–1, S–2 and S–3 (originally denominated for comment purposes as Forms A, B and C);[3] (2) expansion of Regulation S–K [17 CFR 229.001 et seq.] to include additional disclosure items and the rescission of the Guides, other than Guides relating to specific industries, thereby completing the Commission's "sunset" review of the Guides;[4] (3) amendments to Regulation C under the Securities Act [17 CFR 230.400 through 230.494] and Regulation 12B [17 CFR 240.12b–1 through 12b–36] under the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78a et seq.] to simplify and clarify procedural requirements, thereby commencing the Commission's "sunset" review of those regulations;[5] (4) a rule relating to the responsibility of persons subject to Section 1 of the Securities Act [15 U.S.C. 77k] in an integrated disclosure system;[6] (5) a statement of the Commission's policy with respect to the disclosure of security ratings;[7] and (6) amendments to other Securities Act registration forms [8] and certain Exchange Act forms and schedules [9] to incorporate the new Regulation S–K provisions and make other changes. These proposals represent the next major step in the Commission's efforts to achieve a simplified and integrated disclosure system under the Securities Act and the Exchange Act, as well as the continuation of the Commission's "sunset" review of all existing rules and regulations.

Pursuant to Section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), the Chairman of the Commission has certified that the rulemaking proposed herein will not, if promulgated, have a significant economic impact on a substantial number of small entities. This certification, including the reasons therefor, is attached to this release.

I. Background

On December 23, 1980, the Commission issued a release [10] (hereinafter referred to as the "Guides Release") in which it proposed for comment the reorgnization of Regulation S–K, the elimination or codification in Regulation S–K or Regulation C of all of the Guides,[11] except those pertaining to specific industries, and certain revisions to the General Rules and Regulations under the Securities Act [17 CFR 230.100 et seq.] and the Exchange Act [17 CFR 240.0–1 et seq.]. The Commission's proposal concerning shelf registration derived from its analysis and discussion of Guide 4. Guide 4 interprets the last sentence of Section 6(a) of the Securities Act [15 U.S.C. 77f(a)]—that "[a] registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered"—as prohibiting the registration of securities for a delayed or postponed offering. However, the Guide also cites various instances in which such shelf registration is permitted, for example, when the registrant proposes to engage in a continuing acquisition program or in the case of securities underlying exercisable options, warrants or rights.

In the Guides Release, the Commission discussed the policies underlying Section 6(a) of the Securities Act and practice under Guide 4.[12] It concluded that "a restrictive policy on shelf registration is not appropriate or necessary for the protection of investors." [13] The Commission, therefore, proposed that Guide 4 be eliminated and that its stated prohibition of shelf registration be replaced with proposed Rule 462A which would permit shelf registration provided that certain conditions are met.

The Commission received twenty-two letters in response to its invitation for public comment.[14] The commentators generally favored the Commission's efforts to clarify and expand the permissible uses of shelf registration. In particular, these commentators observed that the proposal would provide issuers with the flexibility to take advantage of favorable conditions in a changing market and that it would facilitate the development of innovative techniques

[1] *See* Securities Act Release No. 4936 [December 9, 1968] [33 FR 18617], as amended.

[2] *See* discussion of the proposed disposition of all of the Guides in Securities Act Release No. 6332 [August 6, 1981].

[3] Securities Act Release No. 6331 [August 6, 1981], as originally proposed in Securities Act Release No. 6235 [September 2, 1980] [45 FR 63693] [the "ABC Release"].

[4] Securities Act Release No. 6332 [August 6, 1981] [the "Regulation S–K Release"], as originally proposed in Securities Act Release No. 6276 [December 23, 1980] [45 FR 78] [the "Guides Release"].

[5] Securities Act Release No. 6333 [August 6, 1981] [the "Regulation C Release"].

[6] Securities Act Release No. 6335 [August 6, 1981].

[7] Securities Act Release No. 6336 [August 6, 1981].

[8] Securities Act Release No. 6337 [August 6, 1981].

[9] Securities Act Release No. 6338 [August 6, 1981].

[10] Securities Act Release No. 6276 [December 23, 1980] [46 FR 78].

[11] For a description of the background and development of the Guides generally, *see* 46 FR at 82–83.

[12] *See* the discussion in 46 FR at 87–88.

[13] 46 FR at 88.

[14] Letters were received from the following categories of commentators: corporations [10]; law firms and associations [7]; the securities industry [4]; and other associations [1]. Copies of these letters are available for public inspection and copying in the Commission's Public Reference Room [File No. S7–869]. For the convenience of the public, a copy of the summary of comments prepared by the staff of the Commission has been placed in File No. S7–869 and also is available for public inspection and copying. In addition, File No. S7–869 contains all comment letters received by the Commission concerning the other proposals in the Guides Release and a copy of the comment summary prepared by the Commission's staff.

for raising capital, thus reducing burdens and costs to registrants. At the same time, a substantial number of specific comments were directed to various aspects of the Rule as proposed, particularly with regard to expanding the types of offerings for which shelf registration would be available and revising the undertakings to file post-effective amendments to the registration statement. Commentators also responded to specific questions raised in the Release concerning the market impact of certain forms of primary offerings that would, for the first time, be permitted by the proposed Rule. The Rule proposed herein reflects many of those comments and suggestions. The specific comments and responses are discussed where appropriate in the following portions of this release.

Several commentators were concerned that proposed Rule 462A did not attract widespread attention and comment from issuers and investment bankers because the proposal appeared in the middle of a lengthy release detailing the re-organization of Regulation S–K and the generally nonsubstantive incorporation of provisions from the Guides into Regulation S–K and Regulation C. These commentators recommended that the proposal be republished for comment in a separate release in order that it receive the careful consideration that it deserves.

In light of these comments, the revisions made to the Rule as proposed and the Commission's efforts to develop a system of integrated disclosure as reflected in the other releases promulgated today, the Commission considers it appropriate to repropose Rule 462A for public comment in a separate release. In so doing, the Commission expects that all issuers, market professionals and other interested persons will receive adequate notice of its proposals so that thoughtful comment can be made.

II. The original Rule Proposal

As previously discussed, the Commission concluded that shelf registration of securities could be permitted if three basic conditions were met: the seller has a bona fide intention to offer and sell the securities registered; accurate and current information about the issuer and the offering is available throughout the life of the shelf registration statement; and investors receive full liability protection under the Securities Act.

To meet the first condition, Rule 462A, as proposed, permitted the registration of an amount of securities that reasonably could be expected to be offered and sold within two years from the effective date of the initial registration statement. However, the proposed Rule also permitted shelf registration in certain specific instances in which it was clear that, at the time of registration, the seller possessed a bona fide intent to offer and sell the securities registered. Therefore, securities could be registered for a continuous or delayed offering if they were: (1) reasonably expected to be offered or sold pursuant to dividend or interest reinvestment plans or employee benefit plans of the registrant; (2) the subject of options, warrants or rights which were, or within two years from the effective date of the initial registration statement would be, exercisable; (3) issuable upon the conversion of other securities, if such other securities also were registered on the effective date; or (4) pledged as collateral. Although the proposal set no outer limits upon the duration of an offering of the securities so registered, the registrant was required to undertake to deregister any of the registered securities which remained unsold at the termination of the offering or as to which there was no longer a reasonable expectation of sale.

In order to insure that accurate and current information was available whenever shelf-registered securities actually were sold, the proposal required that the registrant include several specific undertakings in the registration statement. Under the Rule, as proposed, the registrant would undertake: (1) "[t]o file post-effective amendments (or, with the permission of the Commission, prospectuses under Rule 424(c) [17 CFR 230.424(c)]) whenever required to set forth any information necessary in order that the registration statement not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein not misleading"; and (2) to file any prospectus required by Section 10(a)(3) of the Securities Act[15] as a post-effective amendment. The proposal also contained an instruction which exempted registrants who registered their securities on proposed Form A[16] and incorporated by reference their periodic reports under the Exchange Act into such registration statements from filing post-effective amendments if the information those amendments would have contained was included in those periodic reports—unless the prospectus contained a material misstatement of fact or failed to state a material fact necessary to make the information in the prospectus not misleading as of any time during the offering.

In order to insure that liability protection under the Securities Act remained in force throughout the life of the shelf registration statement, the proposal mandated one additional undertaking. Pursuant to that undertaking, the registration statement would specify that each post-effective amendment would be deemed to be a new registration statement relating to the securities offered therein and the offering of such securities at that time would be deemed to be the initial bona fide offering thereof.

Finally, the Rule, as proposed, declared that its provisions did not apply to registration statements filed by investment companies registered under the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.].

III. Synopsis of the Revised Rule Proposal

At the outset, the Commission wishes to emphasize that proposed Rule 462A is a procedural rule that applies to securities which are registered on any registration form and are intended to be offered in a certain fashion—that is, on a continuous or delayed basis. It does not affect the eligibility of registrants (domestic or foreign private issuers) to use any of those forms,[17] nor does it alter the disclosure requirements contained in those forms, except insofar as the Rule may add certain items of disclosure or undertakings, nor does it change any other provisions in the forms, such as those detailing the incorporation by reference of Exchange Act reports or setting forth specific prospectus or report delivery requirements.[18]

The revised proposals generally reflect the following changes to Rule 462A as it was originally proposed: (1)

[15] Section 10(a)(3) of the Securities Act provides that "when a prospectus is used more than nine months after the effective date of the registration statement, the information contained therein shall be as of a date not more than sixteen months prior to such use so far as such information is known to the user of such prospectus or can be furnished by such user without unreasonable effort or expense." 15 U.S.C. 77j(a)(3).

[16] *See* the ABC Release.

[17] Registrants should be aware that, under proposed Rule 401(b) of Regulation C [17 CFR 230.401(b)], they must meet the eligibility criteria for the use of the form upon which the securities have been registered at the time that they file any post-effective amendment for the purposes of meeting Section 10(a)(3) of the Securities Act. *See* the Regulation C Release.

[18] In particular, registrants should be aware that a Form S–8 [17 CFR 239.61b] registration statement for securities issued pursuant to an employee benefit plan is almost always a shelf registration under proposed Rule 462A. The provisions of the proposed Rule are intended to harmonize with the requirements of Form S–8.

the proposal expands somewhat the provisions concerning the amount of securities that can be registered on a shelf registration statement so that securities to be issued upon the exercise or conversion of outstanding options, warrants, rights or convertible securities are treated equally and are not subject to a two year limitation for reasonable expectations of sales; (2) similarly, securities offered and sold by persons other than the issuer, a subsidiary of the issuer or a person of which the issuer is a subsidiary ("secondary offerings") and securities registered on Form S–12 [17 CFR 239.19] and Form C–3 [17 CFR 239.5]—American depositary receipts for foreign securities—can be registered without regard to the two-year standard; (3) in the case of a registration statement for a primary at the market offering of equity securities, the offering and sale must be made through an underwriter or underwriters, who must be named in the prospectus;[19] and (4) the proposal now exempts from its coverage only certain investment companies registered under the Investment Company Act of 1940, and registration statements filed by any foreign government.

In addition, the undertakings set forth in the original proposal and the instruction to the Rule regarding permissible incorporation by reference have been modified and moved to a new section of Regulation S–K entitled "Undertakings." [17 CFR 229.512(a)].[20] As now proposed, post-effective amendments to the registration statement would be required in the following situations: (1) to include a prospectus required by Section 10(a)(3) of the Securities Act; (2) to reflect any facts or events arising after the effective date of the registration statement which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement; and (3) to include any material information with respect to the plan of distribution, including (but not limited to) any addition or deletion of a managing underwriter, other than as a co-manager.[21] Furthermore, the proposal now would permit incorporation by reference of periodic reports filed under the Exchange Act in lieu of a post-effective amendment for registration statements upon Form S–8 as well as upon proposed Form S–3.

A. Bona Fide Intention to Offer and Sell

Commentators generally favored the proposals contained in subparagraph (a)(1) of the Rule, as proposed. However, a number of suggestions were made to expand or clarify the permissible categories of securities that would be eligible for shelf registration under the proposed Rule. The specific recommendations and revisions made to the proposal in response to the comment letters are described in detail below.

1. *The Two Year Standard.* Rule 462A, as proposed, provided that any security could be registered on a shelf registration statement in an amount which is reasonably expected to be offered and sold within two years of the registration statement's effective date. The majority of the commentators that addressed this provision approved of the two year test because it would provide a flexible yet measurable standard by which to evaluate the amount of securities to be registered under the Rule.[22] However, one commentator suggested that the Rule itself, not just the release, should make clear that the two year standard applies only to the reasonable expectations of the seller at the time of registration and does not set a limit upon the duration of the actual sales efforts. In accordance with that suggestion, subparagraph (a)(1)(i) has been revised to indicate that the reasonable expectation of sales is to be measured at the time that the registration statement is declared effective.

Several commentators objected to the two year standard, noting that Section 6(a) of the Securities Act itself contains no such limitation upon sales or intentions to sell and that no limitation is currently imposed by the Commission upon permissible shelf registrations on Form S–16 [17 CFR 239.27] for secondary offerings or offerings of securities underlying options, warrants, rights or convertible securities. These commentators asserted that other provisions of the Rule, as proposed, notably the undertakings to deregister, to provide current information and to file post-effective amendments and prospectuses under Rule 424(c)[23]—are sufficient to deal with the unique problems raised by shelf offerings. At the same time, one of these commentators did recognize that "there is some feeling of concern about a completely open-ended registration for a primary offering of securities."

In regard to registration statements for secondary offerings, one commentator observed that Commission concerns about an open-ended shelf registration would not exist because the amount of securities to be offered would be fixed by the amount owned by the selling security holder. In addition, this commentator asserted that a selling security holder might lose his or her right to compel the issuer to register the securities owned[24] if all such securities were not registered for later resales. In light of the comments received, the Commission has modified the proposal so that secondary offerings of securities—that is, securities offered and sold solely by or on behalf of a person or persons other than the registrant, a subsidiary of the registrant or a person of which the registrant is subsidiary—may be registered without regard to the two year standard.[25] This change accords with current practices. The Commission's considerable experience with shelf registration for secondary offerings has not demonstrated a need to impose any limitations upon the amount of securities registered for such offerings.

The Commission continues to believe, however, that subparagraph (a)(1)(i), with the two year benchmark, is an appropriate condition to its allowing the general use of shelf registration statements for primary offerings. The entire structure of the Securities Act is transactional—that is, its requirements are triggered by the occasion of an offer and sale of securities. For this reason, since its earliest experiences under the Securities Act, the Commission consistently has interpreted ths last

[19] The provision of the proposed Rule relating to primary at the market equity offerings is discussed in a separate section at the end of the release. That section also discusses certain issues raised by the commentators concerning the interrelationship of proposed Rule 462A and the antimanipulative rules under the Exchange Act, particularly Rule 10b–6 [17 CFR 240.10b–6].

[20] This release discusses each undertaking that is applicable to a shelf registration statement and includes the full text of the proposed undertakings.

[21] In addition, where appropriate, registrants can continue to reflect other material changes in or additions to the information contained in the registration statement by means of a prospectus under Rule 424(c) without Commission permission.

[22] In the Guides Release, the Commission explained that the two year benchmark was derived from general staff practice in evaluating the reasonableness of the amount of the securities that were proposed to be registered in light of the purposes of the proposed offering.

[23] These requirements appeared as subparagraphs (a)(2)(i), (ii) and (iv) of Rule 462A as originally proposed.

[24] Under section 6(a) of the Securities Act, only the issuer can register securities for sale. In order to protect themselves, persons receiving unregistered securities frequently enter into arrangements with the issuer at the time of receipt of these securities that allow such persons, under specified circumstances, to compel the issuer to register the securities so received for resale by those persons.

[25] This revision is reflected in subparagraph (a)(1)(ii) of the proposed Rule, as modified. A comparable change has been made in the instructions to Form S–8 concerning resales by affiliates of securities received pursuant to registered employee benefit plans. *See* Securities Act Release No. 6337, *supra*.

sentence of Section 6(a) as permitting only the registration of securities that the registrant proposes to offer in the proximate future.[26] In the Commission's view, the registration of an unlimited amount of securities to be offered and sold over the course of many years into the future is inconsistent with the basic framework of the Securities Act, as well as the specific provision in Section 6(a). At the same time, the Commission believes that permitting shelf registration for certain offerings of securities that the registrant reasonably expects to offer and sell within the next two years would provide such a registrant with a desirable degree of flexibility to meet often-changing market conditions without harming the structure and purposes of the Securities Act. Furthermore, an issuer can reasonably be expected to make financial plans at least two years in the future so that the registration of securities pursuant to subparagraph (a)(1)(i) of the proposed Rule accords with the statutory language that a registration statement pertain to securities "as proposed to be offered." Accordingly, the two year test of subparagraph (a)(1)(i) has been retained insofar as it applies to offerings by or on behalf of the registrant, its parents and its subsidiaries.[27]

2. *Employee Benefit Plans and Dividend and Interest Reinvestment Plans.* The commentators generally approved of this provision but made several suggestions for additions or clarifications as to the scope of the proposal. For example, several commentators noted that the term "employee benefit plan" might be too restrictive because it could be interpreted as applying to plans available only to large numbers of employees, as distinct from plans available only to salaried or management employees or because it might not be viewed as encompassing all plans devised by registrants pursuant to which securities are issued to employees. Also, several commentators noted that the provision does not entirely parallel that contained in the Instructions to the use of Form S–16 that permits the registration for continuous offerings of securities issued pursuant to dividend or interest reinvestment plans.[28]

The Commission agrees with the commentators that the scope of the subparagraph is not sufficiently clear in the absence of definitions for the terms used. Accordingly, the Commission is proposing that the phrases "employee benefit plan" and "dividend or interest reinvestment plan" be defined and that such definitions appear, not in revised Rule 462A, but in the definitional section of Regulation C[29] so that they will apply to all registration statements filed under the Securities Act.[30] The proposed definitions reflect the suggestions made by the commentators and are intended to encompass all plans mentioned by those commentators. However, any other issuer plans that do not meet the proposed definitions could still be registered in accordance with the two year standard in subparagraph (a)(1)(i) of the proposed Rule.[31]

Finally, the provision in proposed Rule 462A has been modified so that it applies to "securities which are to be offered and sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan of the registrant."[32]

3. *Securities Underlying Options, Warrants or Rights or Convertible Securities.* Commentators questioned the differences in treatment accorded securities underlying options, warrants and rights, on the one hand, and convertible securities, on the other hand, by the proposed Rule. In particular, those commentators who objected to the two year standard in subparagraph (a)(1)(i) of the proposed Rule also opposed the inclusion of a two year test for exercisable options, warrants or rights. Another commentator recommended that a two year limitation also be imposed upon convertible securities to make the two provisions congruent.

Several commentators also objected to the fact that the proposal permitted the registration of all securities underlying options, warrants and rights irrespective of the registration status of those options, warrants or rights while securities underlying convertible securities could not be registered unless the convertible securities themselves were registered on the effective date of the shelf registration statement. These commentators observed that the treatment of convertible securities is inconsistent with current practice under Form S–16 and that there is no need for such a provision.

The Commission agrees in both instances with the observations of the commentators and has revised proposed Rule 462A to accord equal treatment to both classes of securities. Under the proposed Rule, as revised, shelf registration will be available for securities "to be issued upon the exercise of outstanding options, warrants or rights,"[33] without regard to the time period of possible exercise. At the time the options, warrants or rights are registered, the registrant clearly is proposing to offer the underlying securities, irrespective of when the actual exercise occurs. Therefore, a two year limitation is unnecessary just as it is in the case of securities to be issued upon the conversion of other securities.

Similarly, the Commission has determined that there is no need to require that the convertible securities themselves be registered in order to allow the shelf registration of the underlying securities. This requirement has been eliminated from the proposed Rule. The Commission now proposes to permit shelf registration for "securities which are to be issued upon conversion of other outstanding securities."[34] It should be noted that the proposed provision is not limited to situations in which securities are convertible only into other securities of the same issuer; rather, it applies equally to securities

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[26] *See, e.g., In re United Combustion Corporation*, 3 S.E.C. 1062 (1938); *In re Shawnee Chiles Syndicate*, 10 S.E.C. 109 (1941).

[27] It should be noted that subparagraph (a)(1) of the proposed Rule would codify the permissible forms of shelf registration under Guide 4 except that securities which might be issued in a continuing acquisition program over a period longer than two years would become subject to the two year limitation. Also, assuming Guide 10 is eliminated, as proposed in the Guides Release [46 FR at 92], transferable options, warrants or rights and securities issuable upon their exercise that are issued to underwriters in connection with a public offering of securities would no longer be required to be registered although proposed Rule 462A would permit such registration. *See* the Regulation S–K Release.

[28] See Item 4 of General Instruction A to Form S–16 [17 CFR 239.27]. This same provision was incorporated into proposed Form A. *See* the ABC Release, *supra*, 45 FR at 63710. That provision has been revised and republished in Securities Act Release No. 6331, *supra*.

[29] *See* proposed Rules 405(i) and 405(k) as discussed in the Regulation C Release. In particular, one commentator suggested that it was unclear whether options issued under a registrant's employee plan would be covered by subparagraph (a)(1)(ii) or by subparagraph (a)(1)(iii)(A) of the proposed Rule because the latter provision generally deals with securities underlying options, warrants and rights. Another commentator suggested that monthly investment plans be included specifically in subparagraph (a)(1)(ii). For a description of these latter plans and their status under the Securities Act *see* Securities Act Release No. 4790 [July 13, 1965] [30 FR 9059]. All of these plans clearly would be "employee benefit plans" under the definition proposed today in Regulation C.

[30] Securities offered pursuant to employee benefit plans generally are registered on Form S–8 but neither the proposed definition nor proposed Rule 462A is limited to securities which may be registered on Form S–8.

[31] For example, the staff has processed registration statements for shelf offerings of common stock to customers of several large public utilities. *See, e.g.*, File No. 2–67577.

[32] It also has been redesignated as proposed subparagraph (a)(1)(iii).

[33] Subparagraph (a)(1)(iv) of the proposed Rule, as revised

[34] The provision has been redesignated subparagraph (a)(1)(v) of the proposed Rule, as revised.

convertible into securities of an affiliate or of an unrelated issuer.[35]

4. *Pledged Securities.* No commentators addressed this provision. The Commission continues to believe that it is appropriate to single out pledged securities for registration under Rule 462A without regard to the two year standard. Those securities are the subject of a bona fide intent to offer and sell because the prospective seller has transferred a legal right to sell the securities in question to the pledgee. Therefore, the provision appearing in the original Rule proposal has been retained and redesignated as proposed subparagraph (a)(1)(vi).

5. *Securities Registered on Form S–12 and Form C–3* The proposed Rule has been revised to include an additional category of securities that may be registered on a shelf registration statement without regard to the two year standard. The revised proposal now would include American depositary receipts ("ADRs")[36] registered on Forms S–12 [17 CFR 239.19] and C–3 [17 CFR 239.5]. An ADR is a substitute trading certificate. It is usually issued by a U.S. bank, denominated in shares, and certifies that a stated number of securities of a foreign private issuer have been deposited and will be held as long as the ADR remains outstanding. Once a depositary arrangement has been created, usually at the instigation of a U.S. broker or arbitrageur, any person can deposit securities of the foreign issuer and receive registered ADRs at any time. This system has functioned without incident, and the Commission sees no need to alter current practice. Accordingly, subparagraph (a)(1)(vii) of proposed Rule 462A would permit the shelf registration of ADRs without regard to the two year limitation.

6. *Outer Limits.* In the Guides Release, the Commission requested specific comment on whether some outer limit ought to be placed upon the duration of a shelf offering.[37] The commentators uniformly opposed such a requirement. Most commentators argued that an outer limit was unnecessary because the proposed Rule required the registrant to undertake to deregister securities under certain circumstances and to provide current information throughout the life of the shelf registration statement. At this time, the Commission agrees with the commentators that no outer limit ought to be placed on the length of a shelf offering provided that the other conditions in proposed Rule 462A are met. Nonetheless, the absence of such outer limits confirms the importance of careful scrutiny of the amounts of securities that are proposed to be registered. One commentator urged that the staff defer to the good faith judgment of the registrant or selling security holder in determining the proper amount of securities to be registered. The Commission does not intend that its staff would second-guess the sellers' good faith determinations. However, registrants should be prepared, when requested, to furnish as supplemental information the justification for the registration of the particular amount of securities.

7. *Undertaking to Deregister.* As noted by several commentators, the two year standard contained in subparagraph (a)(1)(i) of the proposed Rule and the absence of an outer limit upon the duration of a shelf offering were balanced by a requirement in subparagraph (a)(2)(iv) of the proposed Rule that the registration statement contain an undertaking by the registrant to deregister by post-effective amendment any of the registered securities which remain unsold at the termination of the offering or as to which there is no longer a reasonable expectation of sale.

Of the four commentators that addressed this provision, three objected to the undertaking to deregister securities when there is "no longer a reasonable expectation of sale." These commentators observed that the phrase is so subjective and imprecise as to make compliance difficult. In addition, they noted that this undertaking is an unnecessary change from current practice.[38] Two commentators explained that, in most instances, the registrant or selling security holder would elect to deregister securities as to which there was no longer a reasonable expectation of sales in the foreseeable future because, in the words of one commentator, of "the disclosure and other restrictions" imposed upon them and their underwriters by the Securities Act. However, these commentators believed that the decision to deregister should be left to the registrant or selling security holder.

The fourth commentator to address this provision argued that the first half of the undertaking—to deregister securities upon the termination of the offering—lacked clarity because of the difficulty in defining the term "offering" when there may be several definable offerings made within the longer life of a shelf registration statement. This commentator recommended that the undertaking encompass only deregistration when there is no longer a reasonable expectation of sale.

The Commission shares the concern of most commentators on this provision that a standard based upon termination of reasonable expectations of sales may be too subjective and imprecise to be meaningful. For example, market conditions or other economic forces may make sales unlikely during a certain period but the seller still may want to sell the securities as soon as conditions improve. In that instance, the seller would be required to analyze at what point it no longer could reasonably expect to sell the securities in question. Under today's current volatile market conditions, sales might be impossible for several months or the situation might change quickly so that sales might resume after a hiatus of several days. The Commission would not, therefore, ordinarily conclude that the securities should be deregistered in those circumstances.

Accordingly, the Commission has determined that an undertaking to deregister securities should only apply to securities that remain unsold at the termination of the offering. As previously noted, this requirement currently appears in several registration forms and does not seem to have generated any confusion as to its meaning. The phase "termination of the offering" has been and should continue to be interpreted as referring to the overall offering of all securities registered which may be composed of smaller distributions as described in the plan of distribution. In the Commission's view, the deregistration requirement helps in verifying that all the requirements of the Securities Act—particularly the requirements of updating the prospectus under Section 10(a)(3) and delivering the prospectus under Section 5(b)—are met. Such a requirement in the form of an undertaking also serves to remind registrants that their obligations under the Securities Act do not cease when the registration statement becomes effective.

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[35] In fact, under Section 3(a)(9) of the Securities Act [15 U.S.C. 77(c)(a)(9)], many conversions of securities into securities of the same issuer would be exempt from registration under the Securities Act. That provision exempts "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange."

[36] These securities are occasionally referred to as "American shares," "American shares certificates," or "New York shares."

[37] 46 FR at 89.

[38] *See, e.g.* clause (d) of Undertaking A to Forms S–16, and S–7 [17 CFR 239.26] and clause (4) of Undertaking B to Form S–8.

B. Accurate and Current Information

As discussed in the Guides Release, early Commission reaction against the use of shelf registration arose, in large part, from the fact that the registration of securities that were not to be offered, in whole or in part, for immediate sale, gives "the appearance of a registered status" [39] without providing its true substance—accurate and current information.[40] Rule 462A proposed to meet that basic concern of the Securities Act by requiring the registrant to include in the registration statement several undertakings which would insure that investors receive accurate and current information no matter when the shelf-registered securities are sold.

1. *Undertakings to File Post-Effective Amendments.* Although many commentators agreed that the undertakings required in subparagraph (a)(2) of the proposed Rule would provide adequate and appropriate protection for investors, others questioned the appropriateness of the requirement that material changes to the prospectus must be made generally by post-effective amendment, rather than by prospectus under Rule 424(c).[41]

Commentator opposition to the proposed use of post-effective amendments to reflect material changes generally rested upon two arguments. First, commentators believed that updating by post-effective amendment resulted in unnecessary expense and delay.[42] Commentators further observed that the registration statement normally will be updated annually pursuant to Section 10(a)(3) of the Securities Act and subparagraph (a)(2)(ii) of the proposed Rule, so that a prospectus used in a shelf offering would not remain unchanged for an inappropriately long period of time. The prospectus also would remain subject to the liability standards of Section 12(2) of the Securities Act [15 U.S.C. 771(2)].[43] Several commentators also pointed out that, under current practice, stickers are often used to disclose material developments.

The second line of comments centered upon the fact that currently no guidelines or instructions delineate when updating may be accomplished by post-effective amendment or by sticker. These commentators recommended that the Commission take some rulemaking action, in Rule 462A or elsewhere, to clarify the situation. Also, several commentators objected to subparagraph (a)(2)(i) as proposed because it seemed to require specific Commission permission before a sticker could be used. They explained that such a requirement is contrary to present practice and would seem to impose new delays upon the updating process.

The updating requirements of proposed Rule 462A have been revised and consolidated in response to the comments received and further Commission analysis. The Commission is now proposing that registrants undertake to file post-effective amendments under the following circumstances: (1) to include any prospectus required by Section 10(a)(3) of the Securities Act;[44] (2) to reflect any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement;[45] and (3) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement, including (but not limited to) any addition or deletion of a managing underwriter other than as a co-manager.[46]

The first undertaking regarding prospectuses required by Section 10(a)(3) of the Securities Act reflects current staff practice and received no adverse comment when proposed in the original version of Rule 462A.

The second undertaking, to present fundamental changes to information in the registration statement as a post-effective amendment, is a refinement of the initial proposal made in proposed Rule 462A. The Commission continues to believe that the filing of a post-effective amendment is appropriate in certain instances in order to insure full statutory liability for the information disclosed and to afford the Commission's staff an opportunity to review that disclosure in appropriate cases. However, the Commission also is aware that staff practice concerning the filing of post-effective amendments and stickers, for all registration statements, has been somewhat flexible depending on the nature of the information to be disclosed or modified and the ability to reflect that information in a short sticker to the prospectus. The Commission wishes to preserve that flexibility within the context of a shelf registration statement and also believes that a detailed listing of the situations in which post-effective amendments or stickers must be used is neither feasible nor desirable. Therefore, the proposal has been revised to eliminate any requirement that Commission permission is needed before a sticker can be used and to raise the threshold for requiring the filing of a post-effective amendment to those facts and events that represent fundamental changes to the information in the registration statement.

The use of the term "fundamental" is intended to reflect more accurately current staff practice under which post-effective amendments are filed when major and substantial changes are made to information contained in the registration statement.[47] Material changes that can be accurately and succinctly stated in a short sticker would continue to be permitted. While many variations in matters such as operating results, properties, business, product develoment, backlog, management and litigation ordinarily would not be fundamental, major changes in the issuer's operations, such as significant acquisitions or dispositions, would require the filing of a post-effective amendment.[48] Also, any change in the business or operations of the registrant that would necessitate a restatement of the financial statements always would be reflected in a post-effective amendment.[49] At the same

[39] *In re United Combustion Corporation*, 3 S.E.C. 1062, 1063 (1938).

[40] *See In re Shawnee Chiles Syndicate*, 10 S.E.C. 109, 113–14 (1941); Hodes, "Shelf Registration: The Dilemma of the Securities and Exchange Commission," 49 Va. L. Rev. 1106 (1963); 46 FR at 87.

[41] Amendments reflected in such prospectuses also are called "stickers" or "prospectus supplements."

[42] The use of post-effective amendments was used to involve delays because such amendments must be filed with the Commission and declared effective under Section 8(c) of the Securities Act [15 U.S.C. 77h(c)]. Also, each such amendment is deemed to be a new registration statement and liability attaches to the entire prospectus as of the date of the post-effective amendment. *See* proposed Item 512(a)(2) of Regulation S–K, as discussed *infra*.

[43] Section 12(2) of the Securities Act imposes liability upon any person who offers or sells a security by means of a prospectus (which would include a sticker) or oral communication which contains or omits to state a material fact unless such person can prove that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

[44] This is proposed as Item 512(a)(1)(i) of Regulation S–K.

[45] This is proposed as Item 512(a)(1)(ii) of Regulation S–K.

[46] This is proposed as Item 512(a)(1)(iii) of Regulation S–K.

[47] The proposal also reflects the fact that numerous small changes to information in the registration statement can cumulatively become fundamental. *Cf. In re Franchard Corporation*, 42 S.E.C. 163, 184–85 (1964).

[48] Similarly, a change in the registrant's capital structure caused by sales of securities under the shelf registration statement could, if sufficiently large, be such a fundamental change.

[49] *See also* the undertakings required by the staff in connection with a shelf registration for a continuing acquisition program. Letter re Beatrice Foods Co., [1973] Fed. Sec. L. Rep. (CCH) ¶ 79,351

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time, pursuant to the undertaking, a registrant using a shelf registration statement for a series of debt offerings would be able to sticker the prospectus to reflect changes in interest rates, redemption prices and maturities. Although such information clearly is material to any investor in the securities, it does not represent a fundamental change in the information set forth in the registration statement when all other details remain the same.

The third undertaking—concerning additions to or changes in the proposed plan of distribution—has been included as a separate provision to reflect the unique characteristic of a shelf registration statement. By definition, a shelf offering does not include one in which all the securities are offered immediately upon effectiveness of the registration statement but, rather, is intended to occur, in whole or in part, at some time in the future. In that case, the registrant may be unable to provide a full description of the proposed plan of distribution in the initial registration statement, or that plan may change over time. Accordingly, the registrant must undertake to file a post-effective amendment to reflect any new material information about the plan of distribution or any material change in the plan already described in the registration statement.

Under the proposed provision, a change from an underwriting on a "best efforts" basis to any variety of "firm commitment" underwriting, for example, always would necessitate the filing of a post-effective amendment. Also, a registration statement containing no set plan of distribution or stating generally that securities would be sold in a variety of fashions could be declared effective; however, no sales could be made until the material aspects of the plan were filed as a post-effective amendment. [50]

At the same time, as noted in the Guides Release,[51] the plan of distribution for many types of shelf offerings ordinarily does not change over time and, therefore, can be disclosed adequately in advance of the actual transaction.[52] In those situations, a post-effective amendment would not be necessary.

In order to provide additional guidance to registrants, the undertaking makes clear that a post-effective amendment always is required to reflect the addition or deletion of a managing underwriter other than as a co-manager.[53] In using the term "managing underwriter," the Commission is referring to that underwriter (or underwriters) who, by contract or otherwise, deals with the issuer, organizes the selling effort and represents any other underwriters in such matters as maintaining the records of the distribution, arranging the allotments of securities offered and arranging for appropriate stabilization activities, if any.[54] If only one underwriter is involved in an offering, that entity also would be deemed to be the "managing underwriter" for purposes of this undertaking; also, if there were a small number of underwriters performing substantially the functions previously described, and if no one underwriter were acting for the other, each would be a "managing underwriter."

The Commission specifically requests comment on whether the term "managing underwriter" is sufficiently clear based upon the above discussion or whether a definition should be included in Rule 462A or in Regulation C generally. If a definition is recommended, the Commission requests that the commentator submit a specific suggestion.

Given the important role played by this category of underwriter, the Commission believes that a change in managing underwriter, other than the addition or deletion of a co-manager, would represent a material alteration to the proposed plan or distribution, even if the actual method of distribution remained the same.[55] This information would be especially critical when the registrant changed from an underwritten offering to one made without the involvement of an underwriter, or vice versa.[56] The undertaking to file a post-effective amendment (rather than a sticker to the prospectus) provides a formal mechanism to facilitate underwriter involvement with the registration statement when such a material change in the plan of distribution occurs.

2. *Exceptions to the Undertakings to File Post-Effective Amendments.* It should be noted that the undertakings to file post-effective amendments are not in force under two sets of circumstances. The first exception applies to all issuers and the second is peculiar to registration statement filed on certain forms.

First, the undertaking to file a post-effective amendment of any kind is operative only when offers or sales of securities are being made. Accordingly, there is no requirement that the registrant maintain a so-called "evergreen" prospectus irrespective of the existence of offers and sales of securities. For example, if securities to be issued upon the exercise of an option or warrant have been registered pursuant to proposed Rule 462A, and the market price of those securities is substantially below the exercise price so that exercise would not occur, the registrant need not update the registration statement. However, the Commission would expect any

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(available January 17, 1973). These undertakings would be subsumed within the undertaking to file post-effective amendments to reflect fundamental changes.

[50] Nonetheless, if the registration statement contained a full description of several alternative methods of distribution, including the names of any underwriters required to be named, the method of compensating those underwriters and the method by which the offering price would be determined, so that the only missing information consisted of numerical details such as price and underwriting spread, a post-effective amendment would not be required pursuant to the undertaking. In such an instance, the registrant could sticker the prospectus to reflect the final terms of the transaction. This situation might occur, for example, when a registrant generally intended to sell securities through an agent directly into the marketplace but wished to reserve the option to sell using other techniques, such as those envisioned by Rules 391 and 392 of the New York Stock Exchange, Inc. In those situations, for example, it would be appropriate to indicate the purchase price from the issuer (the equivalent of the underwriting spread) and the offering price in the prospectus sticker. It must be emphasized, however, that a post-effective amendment ordinarily would be required where the registrant was unable to provide all other information about each offering plan, apart from price and spread.

On the other hand, if, as is currently the case in many registration statements for secondary offerings, the sellers' plan of distribution provides for sales of securities in ordinary brokerage transactions, no post-effective amendment would be required to name the broker-dealers used, even though such persons might be deemed to be statutory underwriters under the Securities Act. *See* discussion of treatment of statutory underwriters, *infra*.

[51] *See* 46 FR at 90 n. 86.

[52] For example, shares are purchased through a dividend or interest plan at a price set in accordance with a predetermined formula. Also, a continuous offering of securities into an existing trading market at the current market price would require no further description if the agencies for sale and proposed method of sale were described fully in the initial registration statement.

[53] Thus, if one of two managing underwriters were deleted, or if a second manager were added to one already present, a post-effective amendment would not be required. Generally, the Commisson would expect that the addition or deletion of a co-manager or any other participating underwriter would be reflected in a sticker to the prospectus.

[54] *See* L. Loss, *Securities Regulation* at 167–70 [2d ed. 1961].

[55] The critical role played by underwriters in an offering of shelf-registered securities is further reflected in the addition to proposed Rule 462A of a requirement that at the market offerings of equity securities must be made through an underwriter or underwriters acting as principal(s) or agent(s) of the issuer and named in the prospectus. *See* discussion of at the market offerings, *infra*.

[56] Several commentators also raised issues regarding underwriters' ability to verify information contained in a shelf registration statement to satisfy their due diligence obligation. Such concerns are discussed in securities Act Release No. 6335, *supra*.

registration to be cautious in determining that the duty to update had been suspended.

The second exception to the duty to update occurs in the case of a registration statement filed upon proposed Form S–3 or existing Form S–8 where the information required to be included in a post-effective amendment by the undertakings in proposed Item 512(a)(1)(i) and (a)(1)(ii) of Regulation S–K—prospectuses required by Section 10(a)(3) of the Securities Act and fundamental changes in the information set forth in the registration statement—is instead contained in periodic reports filed under the Exchange Act and incorporated by reference in the registration statement.[57] The exception does not extend to the requirement to file a post-effective amendment to reflect material changes in the proposed plan of distribution.[58] Such information always must be reflected in the prospectus itself.

This exception had been included in the original version of proposed Rule 462A only insofar as it applied to proposed Form S–3 (then denominated Form A). The commentators generally approved of the provision but suggested that it be expanded to two other forms that utilize incorporation by reference of Exchange Act reports—Form S–8 and proposed Form S–2 (then called Form B). The Commission agrees that inclusion of Form S–8 in the exception is appropriate because Form S–8, like proposed Form S–3, incorporates by reference not only past Exchange Act reports but all such reports that are filed subsequent to the effective date of the registration statement.[59] In contrast, proposed Form S–2 does not incorporate by reference those subsequent reports. Therefore, the duty to update cannot be satisfied by those documents that are incorporated by reference in proposed Form S–2; instead, post-effective amendments must be filed pursuant to the undertaking.

One further change has been made concerning updating through incorporation by reference of Exchange Act reports. The original version of the provision as proposed stated that no post-effective amendment to a proposed Form S–3 (then Form A) registration statement need be filed if the information was contained in Exchange Act periodic reports incorporated by reference in the registration statement unless the information actually included in the prospectus contained a material misstatement of fact or omitted to state a material fact. In that case, the prospectus itself would have to be updated by post-effective amendment or sticker. This provision has been removed because it did no more than restate the issuer's obligation not to use a prospectus that has been rendered materially false or misleading by events subsequent to the effective date of the registration statement.[60] Furthermore, the issue is not unique to shelf registration but, rather, arises from the use of registration forms, such as Form S–8 and proposed Form S–3, which permit incorporation by reference of subsequently filed Exchange Act reports.[61]

C. *Liability Protection Under the Securities Act.* No commentators addressed the proposal that registrants must undertake that each post-effective amendment "shall be deemed to be a new registration statement relating to the securities offered therein and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof." This undertaking reflects the Commission's view of the law in this area and also the longstanding staff practice of requiring the inclusion of such an undertaking in many shelf registration statements. As noted in the Guides Release, it has been included as the third condition to the expanded use of shelf registration for reasons of clarification and certainty.[62] This undertaking has been retained but has been moved to proposed Item 512(a)(2) of Regulation S–K.

D. *Exemptions From the Rule.* Rule 462A, as proposed, did not apply to registration statements filed by investment companies registered under the Investment Company Act of 1940 ("1940 Act") [15 U.S.C. 80a–1 et seq.]. As indicated in the Guides Release, registered investment companies were exempted from the proposal in recognition of the specific provisions for continuous registration contained in the 1940 Act. One commentator rightly observed that those provisions apply only to securities issued by a face-amount company or redeemable securities issued by an open-end management company or unit investment trust.[63] Accordingly, proposed Rule 462A has been changed to exempt only registration statements filed by those entities. This amendment would continue to permit the use of a shelf registration statement for offerings of the securities of closed-end investment companies,[64] as well as for offerings by business development companies.[65]

The Guides Release also requested comment upon whether or not the proposal should apply to foreign governments and political subdivisions thereof.[66] Although the commentators that addressed this issue saw no need to treat these issuers differently from domestic issuers, most were aware that the Commission had recently published as a release a staff interpretative letter setting forth procedures to be followed by foreign governmental issuers in using a shelf registration that differed somewhat from Rule 462A as proposed

[57] In the case of a financial statement appearing in a periodic report that is incorporated by reference into the registration statement, Rule 439 under the Securities Act [17 CFR 230.439] and the proposed amendments thereto assure that the requisite written consent of the independent accountant is furnished to the Commission. *See* the Regulation C Release.

[58] Proposed Item 512(a)(1)(iii) of Regulation S–K.

[59] The Commission is aware that the staff has taken a flexible position concerning the updating of information contained in Form S–8, and nothing in proposed Rule 462A is intended to alter those practices. *See* generally Securities Act Release Nos. 6202 (April 2, 1980) [45 FR 23653] and 6281 (January 5, 1981) [46 FR 8446]; Letter re Crocker National Corporation (September 25, 1980); Letter re Allis-Chalmers (March 20, 1981).

[60] *See* Section 12(2) of the Securities Act.

[61] *See* Securities Act Release No. 6331, *supra.*

[62] In addition, the Commission is now proposing to require that each registration statement upon proposed Form S–3 or Form S–8 contain an undertaking that each filing of the registrant's annual report pursuant to Section 13 or Section 15(d) of the Exchange Act also shall be deemed to be a new registration statement and that the offering of such securities at that time shall be deemed the initial bona fide offering thereof. *See* proposed Item 512(b) of Regulation S–K in the Regulation S–K Release.

[63] Section 24(e) of the Investment Company Act of 1940 [15 U.S.C. 80a–24(e)].

[64] Primary and secondary offerings by closed-end investment companies are registered on Form N–2 [17 CFR 239.14, 17 CFR 274.11a]. Although Form S–16 also can be used to register secondary offerings of such companies, closed-end investment companies would not be permitted to file on proposed S–3. *See* Securities Act Release No. 6331, *supra.*

[65] The Small Business Investment Incentive Act of 1980 [Pub. L. No. 96–477], *inter alia*, amended the 1940 Act by establishing a new system of regulation for certain investment companies called "business development companies" ("BDCs"). A BDC is defined as a domestic, closed-end company that is operated for the purpose of making investments in small and developing businesses and financially troubled businesses; that offers significant managerial assistance to its portfolio companies; and that has notified the Commission of its election to be subject to the system of regulation established by Section 55 through 65 of the 1940 Act. Such companies are required to comply with the periodic reporting requirements under the Exchange Act and are not registered as investment companies. There currently is no specific Securities Act registration form for BDCs; however, the staff has requested that these companies register on Form N–2. Investment Company Act Release No. 11703 (March 26, 1981) [46 FR 19459].

[66] *See* 46 FR at 90. These issuers register securities pursuant to Section 10(a)(2) of the Securities Act by filing a registration statement containing the information specified in Schedule B of the Securities Act, as well as additional statistical information required by the staff regarding the issuer, its country, economy and government.

and also as modified today.[67] In that release, the staff indicated that it viewed the procedures described therein as an experiment and that, after further experience, it might recommend that the Commission codify the interpretation in a rule. The Commission believes that the staff has not yet had sufficient experience with the use of shelf registration by foreign governments and political subdivisions thereof and that, at this time, proposed Rule 462A should not include these issuers.[68] Instead, foreign governmental issuers may continue to use the procedures set forth in the staff interpretive letter.

IV. At The Market Offerings

In the Guides Release, the Commission recognized that the adoption of proposed Rule 462A would expand for the first time the availability of shelf registration to certain kinds of primary offerings, particularly at the market offerings of equity securities, and that such offerings raise novel market and disclosure concerns. The Commission requested comment upon the advisability of limiting the availability of the Rule for such offerings and asked specifically whether at the market equity offerings should be limited to certain issuers which exceed the eligibility requirements for use of proposed Form A or should be limited to offerings that are sold by or through a broken-dealer or a limited, named group, as agent(s) or principal(s).[69] The Commission also asked a series of questions concerning the market implications of these forms of shelf offerings, particularly under the anti-manipulative provisions of the Exchange Act and the rules thereunder, Rules 10b-2, 10b-6 and 10b-7 [17CFR 240.10b-2, 10b-6 and 10b-7].[70]

A. Requirement of Named Underwriters

All commentators unanimously opposed any limitation on at the market offerings based upon outstanding float or value in the market or any limitation upon timing or amounts of sales, as had been suggested in the Guides Release. Commentators argued that such limitations were unnecessary, particularly in view of the issuer's incentive to preserve an orderly trading market in its securities. Most noted that such limitations would impair issuer flexibility in effecting sales of its securities pursuant to a shelf registration and that such flexibility is the issuer's primary reason for utilizing this offering technique.[71] In addition, commentators argued that disclosure, including disclosure of the plan of distribution and any resultant market overhang,[72] generally would constitute sufficient protection with respect to most manipulative concerns that might arise.

Nonetheless, several commentators did recommend the imposition of certain conditions upon the availability of shelf registration for an at the market offering. Those conditions included requiring the presence of an underwriter or underwriters, as well as limiting the use of shelf registration to issuers eligible to use proposed Form S-3 or an even more select group, or to issuers who have complied with the reporting requirements of the Exchange Act for some minimum period of time.

At this time, the Commission believes that the expansion of the availability of shelf registration for novel, at the market offerings of equity securities by the issuer must be made with due deliberation and concern for the effect of such offerings upon the public and the market place. The Commission agrees with the commentators that the involvement of an underwriter can provide a desirable discipline upon such offerings of equity securities into an existing trading market.[73] The presence of an underwriter also helps to ensure that complete accurate and current disclosure is made to investors in the prospectus and that the prospectus delivery requirements of the Securities Act are met. The Commission also believes that the other limitations upon the availability of the proposed Rule, suggested in the Guides Release and by the commentators, are not necessary or appropriate at this time provided that an underwriter is directly involved in the offering.

Accordingly, the Commission is proposing, in new subparagraph (a)(3) of proposed Rule 462A, that, in the case of a registration statement pertaining to a primary at the market offering of equity securities, those securities must be sold through an underwriter or underwriters, acting as principal(s) or agent(s) for the issuer, and such underwriter(s) must be named in the prospectus which is part of the registration statement.[74] The proposed subparagraph also defines an "at the market offering" as an offering of securities into an existing trading market for outstanding shares of the same class of securities at other than a fixed price on or through the facilities of a national securities exchange or to a market maker otherwise than on an exchange.

Under proposed subparagraph (a)(3), a registration statement providing for an at the market offering of equity securities registered therein could be declared effective without a named underwriter or underwriters if such at the market offering would not begin immediately following the effective date of the registration statement. Offerings of securities under the registration statement could then by made without underwriter involvement, provided that such offerings were not made at the market. However, before any at the market offering of equity securities actually occurred, the registrant would have to enter into formal arrangements with at least one underwriter and would

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[67] *See* Securities Act Release No. 6240 (September 17, 1980) [45 FR 61609]. In particular, the staff imposed certain additional prospectus-delivery requirements upon the registrant and limited the availability of the shelf registration to securities which the registrant proposed to sell in one year.

[68] However, the above discussion does not affect the ability of foreign private issuers to utilize shelf registration procedures under proposed Rule 462A wherever appropriate.

[69] 46 FR at 90.

[70] The Commission specifically solicited comment on

(1) whether and to what extent there is a potential for manipulation in connection with issuer sales in an at the market offering;

(2) whether and to what extent any such manipulative potential would differ from that with respect to market transactions not involving the issuer;

(3) whether any potential concerns could be adequately dealt with by disclosure of the plan of distribution and any resulting market overhang;

(4) whether and what limitations, if any, should be imposed on at the market offerings on the basis of outstanding value or float in the market for the securities; and

(5) whether and what conditions, if any, should be imposed upon the timing and amounts of sales in an at the market offering.

45 FR at 90.

[71] Commentators consistently pointed out that shelf registration provides issuers with the opportunity to take immediate advantage of increases in market price be selling securities without the delays that often accompany the conventional registration process.

[72] These disclosure provisions are proposed in Items 508 and 201(a)(3) of Regulation S-K respectively. *See* the Regulation S-K Release.

[73] *Cf. In re Hazel Bishop Inc.*, 40 S.E.C. 718, 729-32 (1961).

[74] Registrants should be aware that, where the naming of one or more underwriters in the prospectus is required by proposed subparagraph (a)(3), at least one of those underwriters will be deemed to be a "managing underwriter" for purposes of the undertaking in proposed Item 512(a)(1)(iii) of Regulation S-K to file a post-effective amendment to reflect the addition or deletion of a managing underwriter other than as a co-manager.

In addition, proposed Section 508 of Regulation S-K sets forth required disclosure provisions concerning "principal underwriters" of the issue. Rule 405(p) [17 CFR 230.405(p)] defines "principal underwriter" as any underwriter of the security that is in privity of contract with the issuer of that security. Any underwriting arrangement entered into to satisfy proposed subparagraph (a)(3) generally would cause the underwriter to be a "principal underwriter" subject to the disclosure requirements of proposed Section 508.

be required to file a post-effective amendment naming that underwriter.[75]

Proposed subparagraph (a)(3) is limited to offerings of equity securities in recognition of the fact that debt securities are priced to a substantial extent according to interest rates and other factors.

B. Treatment as Statutory Underwriter

The question of what entities, whether or not named in the registration statement or in privity of contract with the registrant or selling security holder, meet the statutory definition of an "underwriter" is not unique to offerings of shelf-registered securities.[76] However, several commentators observed that proposed Rule 462A, by permitting for the first time a direct distribution of securities by an issuer into an existing trading market over an extended period of time, raises the issue of underwriter status in a novel, unexplored situation.[77] These commentators particularly were concerned about the status of market professionals trading on the floor of a stock exchange, such as exchange specialists or exchange members, who might deal in securities that are registered for an at the market offering.

In light of these comments, the Commission has examined the issues raised and tentatively has arrived at the following conclusions concerning the status of a market professional as an underwriter in an at the market offering of equity securities by an issuer under proposed Rule 462A. The Commission is publishing those views for the purpose of soliciting public comment on these important issues.

The Commission believes that any market professional—a market maker, specialist, or ordinary broker-dealer—who purchases a registered security as principal from the registrant [78] or who sells that security for the registrant as agent ordinarily would be deemed a statutory underwriter under Section 2(11) of the Securities Act even in the absence of a specific written agreement between the issuer and that market professional. Thus, the underwriter(s) required, under proposed subparagraph (a)(3) of the Rule, to be named in the prospectus for a primary at the market equity offering, and any other underwriter required to be named by proposed Item 508 of Regulation S-K,[79] would clearly be statutory underwriter(s). However, in a primary at the market offering of equity securities under the proposed Rule, any market professional that is not identified in the prospectus, that does not deal with the registrant, that purchases from or acts as agent only for persons other than the registrant in the purchase of the securities in the ordinary course of its business, and that doe not enter into any special arrangements with or receive any special compensation [80] for effecting the transaction from the issuer or any underwriter of the offering ordinarily would not be viewed as an underwriter of those securities.

Accordingly, an exchange member or specialist effecting a transaction in the shelf-registered security with an underwriter who is in privity with the registrant generally would not be deemed to be an underwriter if the member or specialist performed its usual functions and had not entered into any special selling arrangements with the registrant or the underwriter. The same would be true in the case of an over-the-counter market maker who did not buy from the registrant. In a similar vein, a broker-dealer could solicit buy orders from its customers for a security subject to such a shelf registration statement without being deemed an underwriter of that security upon executing the trade, as long as such broker-dealer limited itself to its ordinary business activities and had no special arrangements with the underwriters or issuer.

C. Application of the Anti-Manipulative Rules

The commentators generally agreed that continuous at the market offerings might raise manipulative concerns. In their view, however, these concerns are no different than those that may arise in connection with similar secondary offerings. The commentators stated that generally it would be in the best interests of the issuer, and of any broker-dealer acting with, or on behalf of, the issuer, not to disrupt orderly market processes in connection with these types of primary offerings.

The Commission does not at this time perceive a need for special rules to prevent manipulation in connection with at the market shelf offerings. The current framework of substantive anti-manipulative rules, together with the existing disclosure requirements, appears to provide sufficient protection against market abuses.[81] However, as indicated earlier, in view of the novel issues which are posed by primary at the market shelf offerings, the Commission will monitor offerings pursuant to proposed Rule 462A, if it is adopted, and will consider further measures if they prove necessary.

In addition to responding to general manipulative concerns under the Exchange Act and addressing potential limitations on primary at the market offerings, many commentators raised specific questions concerning the applicability of Rule 10b-6 to these offerings.[82]

Some commentators were concerned that Rule 10b-6, and present staff interpretations of certain of its provisions, would interfere unduly with at the market offerings permitted by

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[75] *See* proposed Item 512(a)(1)(iii) of Regulation S-K.

[76] Section 2(11) of the Securities Act defines an underwriter as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such underwriting, or participates or has a participation in the direct or indirect underwriting of any such undertaking."

[77] Although the factors utilized to determine whether a person is an underwriter for purposes of the Securities Act are not the same as those used to determine whether one is an underwriter or otherwise a participant in a distribution for purposes of Rule 10b-6 under the Exchange Act [17 CFR 20.10b-6], the commentators raised an analogous issue with respect to Rule 10b-6. It should be noted, however, that these issues are not novel. They have existed under both the Securities Act and the Exchange Act for some time in connection with secondary at the market offerings of securities.

[78] The Commission notes that Rule 113 of the New York Stock Exchange, Inc. prohibits purchases or sales of securities by the specialist directly from or to the issuer of that security.

[79] *See* the Regulation S-K Release.

[80] Section 2(11) of the Securities Act provides that the term "underwriter" does not include "a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission."

[81] The existing regulatory framework includes rules adopted both by the Commission and the self-regulatory organizations. The Commission is especially interested in receiving comment from the national securities exchanges and other self-regulatory organizations concerning the impact that shelf-registered primary at the market offerings might have on existing exchange and over-the-counter markets. In particular, the Commission requests comment on whether the adoption of proposed Rule 462A would necessitate revisions to existing rules and practices imposed on members and member firms or to disclosure and other requirements currently imposed on issuers, *e.g.*, through listing standards of stock exchanges and for the National Association of Securities Dealers Automated Quotation System.

[82] Rule 10b-6 provides in relevant part:

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in Section 10(b) of the Act for any person,

(1) who is an underwriter or prospective underwriter in a particular distribution of securities, or

(2) who is the issuer or other person on whose behalf such a distribution is being made, or

(3) who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution,

directly, or indirectly, * * * either alone or with one or more persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right until after he has completed his participation in such distribution.

proposed Rule 462A. In particular, they argued that the application of Rule 10b–6 would inhibit the participation of various market professionals in the offerings and, therefore, that Rule 10b–6 should be amended to clarify the obligations of underwriters and other participants in a shelf-registered primary offering. Other commentators, however, noted that existing interpretations of Rule 10b–6 could be applied to at the market offerings without undue burden but suggested that the Commission clarify the Rule's applicability to various situations that might arise that would be peculiar to a primary shelf offering.

If proposed Rule 462A is adopted, the Commission believes that the application of existing interpretations of Rule 10b–6 will not interfere unduly with at the market offerings by issuers. To the extent that these offerings may raise novel questions under Rule 10b–6 concerning the permissible scope of market activity by participants during such an offering, the Commission believes that it will be possible, either on a case-by-case basis, by interpretative release, or by amendment to the Rule, to facilitate such offerings in conformity with the anti-manipulative purposes of Rule 10b–6.

Several commentators suggested that the Commission define the term "distribution" for purposes of Rule 10b–6, particularly in the context of a shelf-registered offering. The Commission believes that the criteria traditionally utilized in determining whether a distribution exists appear to be equally relevant to primary shelf offerings on an at the market basis.[83] Under those criteria the issuer generally would be engaged in a distribution for purposes of Rule 10b–6 from the time it made the initial decision to go forward with the offering. Thus, commencing at or before the filing of a shelf registration statement, the issuer and its affiliates ordinarily would be prohibited from bidding for or purchasing the security that is the subject of the distribution, any security of the same class and series, or any right to purchase any such security, unless the bid or purchase was specifically excepted or exempted from the Rule.[84] However, the Commission recognizes that, in the context of a shelf registration for an offering or offerings to be made in the future, including a registration statement that permits a variety of selling alternatives and efforts in the issuer's discretion, it may be argued, depending on the facts, that no decision to offer occurs until a time after the filing of the registration statement. The Commission specifically solicits comment on when a distribution should be deemed to commence for purposes of Rule 10b–6 in connection with a shelf registration statement pursuant to proposed Rule 462A.

The Commission also is aware that there may be periods of time during the life of a shelf registration when the issuer has determined neither to engage in any selling efforts nor to make any sales of the securities registered.[85] During those periods of time, it may be appropriate to permit issuers and their affiliates to make purchases of the issuer's securities by exemptions from Rule 10b–6. The Commission solicits comment on what kinds of conditions should be imposed on such purchases.[86]

In addition, whenever the issuer makes any arrangements with any broker-dealer to participate in the offering of the securities registered on the shelf (*e.g.*, as selling agent), that broker-dealer would become a participant in the distribution from the time it agreed to participate,[87] and it would be subject to the prohibitions of the Rule.[88] That broker-dealer would have completed its participation in the distribution when its agreement with the issuer terminated or when it had sold all securities it had agreed to offer or sell, whichever occurred later. Nevertheless, it may be appropriate for a broker-dealer that has a continuing agreement with the issuer to participate in the shelf-registered offering of securities to bid for or purchase securities during periods in which all sales and selling efforts had been suspended.[89]

A major subject addressed by the commentators was the potential liability under Rule 10b–6 of market makers, block positioners or specialists who, without any prior arrangements with the issuer, bought shelf-registered securities either directly from the issuer or from a broker-dealer, or a group of broker-dealers, acting for the issuer either as agent or principal. Some commentators

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[83] In *Collins Securities Corporation*, Securities Excurities Exchange Act Release No. 11766 (October 23, 1975), 8 SEC Docket 250, the Commission stated:

Rule 10b–6 * * * is designed to prevent manipulation in the markets. To that end, it precludes a person from buying stock in the market when he is at the same time participating in an offering of securities which is of such a nature as to give rise to a temptation on the part of that person to purchase for manipulative purposes. The term distribution in Rule 10b–6 should therefore be interpreted to identify situations where that temptation may be present. Our opinion in *Bruns Nordeman* attempted to define distribution so as to identify such circumstances.

8 SEC Docket at 256. The Commission said in *Bruns Nordeman & Company*, 40 S.E.C 652 (1961), that a distribution for purposes of Rule 10b–6 is to be distinguished from ordinary trading transactions and other normal conduct of a securities business on the basis of the magnitude of the offering and particularly on the basis of the selling efforts and selling methods utilized. 40 S.E.C. at 660

[84] *See* Rule 10b–6(a)(3) and (g).

[85] The Commission solicits comment on how and under what circumstances an issuer would determine to suspend all selling efforts of shelf-registered securities and whether a press release or other public announcement of such a suspension should be required as a condition of exempting purchases from Rule 10b–6 while the offering is suspended.

[86] The exemption could be conditioned on compliance with the limitations of proposed Rule 13e–2 (as proposed in Securities Act Release No. 6248 (October 17, 1980) [45 FR 70890]), if adopted, or with the similar requirements set forth in Appendix C (2 Fed. Sec. L. Rep. (CCH) ¶22,726). In addition, the exemption might require a "cooling off" period (*e.g.*, ten business days) after cessation of purchases and prior to the recommencement of sales of shelf-registered securities. The Commission solicits comment on (i) whether a ten business day or other period is appropriate in all or any circumstances, (ii) whether the conditions of proposed Rule 13e–2 or Appendix C would be appropriate or too stringent in this context, and (iii) whether purchases by affiliates of the issuer should be treated differently from purchases by the issuer.

[87] Of course, under existing interpretations of Rule 10b–6, if a broker-dealer agreed to participate in an offering of securities prior to its commencement, the broker-dealer would not be required to cease bidding for or purchasing the security being offered until the later of ten days before the proposed commencement date of the offering or the time it agreed to participate. *See* Rule 10b–6(a)(3)(xi).

[88] A broker-dealer that has an agreement or understanding with the issuer to participate in an offering of this kind may have the incentive to make purchases in order to facilitate the distribution. Of course, such broker-dealers could effect transactions that were excepted from Rule 10b–6. *See* Rule 10b–6(a)(3).

One commentator suggested that a broker-dealer that is named in a registration statement should not be deemed in all cases to be a participant in the issuer's distribution. The fact that such broker-dealer has already been chosen by the issuer, however, implies at the very least some agreement to sell the issuer's securities even though such sales, or the broker-dealer's participation, may be at a future date.

A broker dealer with no continuing agreement with the issuer but which the issuer invites, at any one time, to participate in selling as agent or principal securities that are shelf-registered would be subject to the prohibitions of Rule 10b–6 at the time it agreed to participate in the distribution. The Commission notes that this position does not differ in any way from that taken in more conventional underwritten offerings in determining when an underwriter, selling dealer or other participant has become involved in a distribution for purposes of Rule 10b–6.

[89] As in the case of issuer purchases during this period, purchases by the broker-dealer ordinarily could be effected only pursuant to an exemption from Rule 10b–6. Such an exemption again might be conditioned on a "cooling off" period of, possibly, ten business days after cessation of purchases and prior to the recommencement of any sales of shelf-registered securities. The Commission solicits specific comment on what period is appropriate and whether any exemptive relief for transactions to be effected by such a broker-dealer should be conditioned on any other limitations, such as limitations analogous to those contained in Appendix C or proposed Rule 13e–2. *See* n. 86, *supra*.

correctly understood the staff's present interpretive position under Rule 10b–6 to be that such market makers, block positioners or specialists are not automatically deemed to be participants in the issuer's distribution and, therefore, are not subject to Rule 10b–6 solely because they purchase securities from the issuer or broker-dealers acting for the issuer. Nevertheless, they noted that certain staff interpretive letters do not accord with this position and have never been formally rescinded.[90] These commentators suggested that a clear statement on the applicability of Rule 10b–6 to market professionals who purchase securities in connection with a primary shelf offering is necessary.[91]

The staff takes the position that, for purposes of Rule 10b–6, a market professional who does not have any prior agreement or understanding with the issuer should not be deemed to be a participant in the issuer's distribution pursuant to a shelf registration statement solely because it purchases, in the ordinary course of its business, securities that are registered on the shelf and are offered by the issuer or a broker-dealer acting for the issuer. Nevertheless, the Commission cautions such market professionals to examine carefully the manner in which they intend to dispose of those sercurities once they have purchased them against the traditional indicia of a Rule 10b–6 distribution in order to determine whether their resales might consitute a separate distribution for purposes of Rule 10b–6.

It is anticipated that, if proposed Rule 462A is adopted, issuers may choose to raise capital through a combination of conventional fixed price offerings and shelf-registered offerings. One commentator raised certain concerns with respect to the coordination of shelf-registered at the market offerings with separately registered conventional fixed price offerings. As a practical matter, it is doubtful that sales at the market pursuant to a shelf registration statement would be made at the same time that the issuer or its underwriters were engaged in a fixed price underwriting. Such sales might have a depressing effect on the market price of the security and, consequently, might adversely affect the pricing of the fixed price offering. Nevertheless, during times when the shelf registration statement is effective, but sales pursuant to it have been formally suspended, issuers may determine to go forward with conventional offerings. Under those circumstances, careful coordination would be necessary to avoid possible problems that may arise under Rules 10b–6 and 10b–7.[92] In order to eliminate those problems, it may be appropriate for the Commission to prohibit all sales or selling efforts in connection with an at the market shelf offering during the pendency of a fixed price offering until the end of a ten business day (or other) period after all stabilizing purchases in connection with the fixed price offering have ended or purchases to cover a syndicate short position have been completed. The Commission solicits specific comment on how an issuer and broker-dealers acting on behalf of an issuer could coordinate any fixed price offerings with a shelf-registered offering that contemplates sales at the market.

Another commentator raised the point that, because Rule 10b–6 prohibits inducements to purchase the security being distributed, broker-dealers who are deemed to be participants in a shelf-registered distribution of securities of a particular issuer would not be able to distribute any research concerning that issuer for as long as they continued to be participants in the distribution. This commentator argued that such an interpretation would interfere unduly with the duty of a broker-dealer to provide updated research to customers concerning issuers the broker-dealer previously had recommended. The Commission believes that present staff interpretations under Rule 10b–6 concerning research reports by participants in a distribution of securities would be equally applicable in the context of shelf-registered offerings. Generally, the staff has taken the position that research reports complying with Rule 139 under the Securities Act [17 CFR 230.139] [93] do not constitute prohibited inducements to purchase under Rule 10b–6. Thus, broker-dealers with a continuing agreement to participate in a shelf-registered offering generally would be able to distribute research which did not contain specific recommendations with respect to that issuer. If a broker-dealer did not have a continuing agreement with the issuer, but participated in the offering in a limited capacity, such as in connection with a single block transaction off the shelf, it would have to refrain from further dissemination of any specific recommendation that it had issued prior to being invited to participate in the distribution or from issuing further recommendations, until its participation in the distribution ended.

Finally, one commentator suggested that the staff consider expanding its interpretive position under Rule 10b–6 with respect to bids for or purchases of debt securities by participants in a distribution of a security of the same class and series, particularly in the context of a shelf registration of debt securities to be offered over a period of time at different interest rates and maturity dates.[94] The Commission solicits specific comment on whether the staff interpretive position should be expanded, how it could be expanded, and what type of further limitations, if any, would be appropriate.

V. Request for Comment

Any interested persons wishing to submit written comments upon proposed Rule 462A and the related undertakings proposed in Item 512(a) of Regulation S–K, as well as on other matters discussed in the Release or which might have an impact on the proposals contained herein, are requested to do so. The Commission also requests comment concerning possible revisions or amendments to any other rules under the Securities Act, such as those relating to the delivery of a statutory prospectus,[95] that may be necessary or appropriate to further the objectives of proposed Rule 462A.

The Commission also solicits comment as to whether the proposals would have an adverse effect on competition or would impose a burden on competition that is not necessary or appropriate in furtherance of the

[90] *See, e.g.*, Letter re *Victory Markets* (September 21, 1972) and Letter re *Continental Coffee* (March 3, 1972).

[91] Commentators recognized, however, that the market maker or block positioner, even if not a participant in the issuer's distribution, might be involved in a separate distribution for purposes of Rule 10b–6 depending on how it disposed of the securities it had acquired.

[92] For example, although Rule 10b–6 does not prohibit concurrent distributions, sales at the market under certain circumstances might constitute inducements to purchase securities being distributed in a conventional offering, in violation of Rule 10b–6. Similarly, stabilization of a fixed price offering pursuant to Rule 10b–7 might be deemed to constitute impermissible stabilization of an at the market offering in certain cases. *See* Rule 10b–7(g).

[93] Under Rule 139, the distribution or publication by a dealer of certain types of information, opinions or recommendations concerning an issuer are deemed not to constitute an offer for sale or offer to sell securities of that issuer, for purposes of Sections 2(10) and 5(c) of the Securities Act, even if the dealer is participating in an underwritten offering of the issuer's securities.

[94] *See* Letter re American Telephone and Telegraph Company (February 26, 1975), in which the Division of Market Regulation stated that it would not recommend that the Commission take enforcement action under Rule 10b–6 if dealers participating in a distribution of debt securities of an issuer bid for or purchased other outstanding debt securities of the same issuer so long as certain conditions were met.

[95] *See, e.g.*, Rules 153 and 174 under the Securities Act [17 CFR 230.153 and 230.174].

purposes of the Securities Act and the Exchange Act.

VI. Text of Proposals

In accordance with the foregoing, it is proposed to amend Title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. By adding § 230.462a to read as follows:

§ 230.462a Delayed or continuous offering and sale of securities.

(a) Sécurities may be registered for an offering to be made on a continuous or delayed basis in the future, *Provided That*

(1) The registration statement pertains to:

(i) Securities in an amount which, at the time the registration statement becomes effective, is reasonably expected to be offered and sold within two years from the initial effective date of the registration statement by or on behalf of the registrant, a subsidiary of the registrant of a person of which the registrant is a subsidiary; or

(ii) Securities which are to be offered or sold solely by or on behalf of a person or persons other than the registrant, a subsidiary of the registrant or a person of which the registrant is a subsidiary; or

(iii) Securities which are to be offered and sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan of the registrant; or

(iv) Securities which are to be issued upon the exercise of outstanding options, warrants or rights; or

(v) Securities which are to be issued upon conversion of other outstanding securities; or

(vi) Securities which are pledged as collateral; or

(vii) Securities which are registered on Form S–12 [17 CFR 239.19] or Form C–3 [17 CFR 239.5].

(2) The registrant furnishes the undertakings required by Item 512(a) of Regulation S–K [17 CFR 229.512(a)].

(3) In the case of a registration statement pertaining to an at the market offering of equity securities by or on behalf of the registrant, the securities so registered must be sold through an underwriter or underwriters, acting as principal(s) or as agent(s) for the issuer, and the underwriter or underwriters must be named in the prospectus which is part of the registration statement. As used in this paragraph, the term "at the market offering" means an offering of securities into an existing trading market for outstanding shares of the same class at other than a fixed price on or through the facilities of a national securities exchange or to a market maker otherwise than on an exchange.

(b) This section shall not apply to any registration statement pertaining to securities issued by a face-amount certificate company or redeemable securities issued by an open-end management company or unit investment trust under the Investment Company Act of 1940 or any registration statement filed by any foreign government.

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934—REGULATION S–K

2. By adding paragraph (a) to Item 512 of § 229.500 to read as follows:

§ 229.500 Registration statement and prospectus provisions.

* * * * *

Item 512. Undertakings.

Include each of the following undertakings that is applicable to the offering being registered.

(a) *Rule 462A Offerings.* Include the following if the securities are registered pursuant to Rule 462A under the Securities Act [17 CFR 230.462a]:

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement;

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement, including (but not limited to) any addition or deletion of a managing underwriter other than as a comanager;

Provided, however, That paragraphs (a)(1)(i) and (a)(1)(ii) do not apply if the registration statement is on Form S–3 [17 CFR 239.13] or Form S–8 [17 CFR 239.16b], and the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

VII. Statutory Authority

This rulemaking is being promulgated pursuant to Section 7, 10 and 19(a) of the Securities Act [15 U.S.C. 77g, 77j and 77s(a)].

By the Commission.

George A. Fitzsimmons,

Secretary.

August 6, 1981.

Regulatory Flexibility Act Certification

I, John S.R. Shad, Chairman of the Securities and Exchange Commission, hereby certify, pursuant to 5 U.S.C. 605(b), that the proposed rulemaking published in Securities Act Release No. 6334 (August 6, 1981), "Delayed or Continuous Offering or Sale of Securities," will not, if promulgated, have a significant economic impact on a substantial number of small entities for the following reasons. Although the proposed Rule would, by its terms, permit all registrants (including small entities) to use its procedures to conduct certain offerings which heretofore had been prohibited under the Securities Act, the types of offerings permitted by the proposed Rule ordinarily would not be utilized by small entities. Unlike larger issuers which have a constant need to raise additional capital, small entities generally make public offerings at a specific time and for a specific purpose and do not regularly enter the public markets on a continuous basis. Therefore, it is anticipated that the proposed Rule will not have a significant effect upon small entities because, generally, it will not be used by such entities.

Dated: August 6, 1981.

John S.R. Shad,

Chairman.

[FR Doc. 81–23441 Filed 8–13–81; 12:56 pm]

BILLING CODE 8010–01–M

17 CFR Part 230

[Release No. 33-6335, 34-18011, IC-11889, File No. S7-897]

Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act

Treatment of Information Incorporated by Reference Into Registration Statements

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Commission is publishing for comment a proposed rule identifying certain circumstances bearing upon the reasonableness of the investigation conducted to discharge one's obligation under Section 11(b) of the Securities Act of 1933 and upon what constitutes reasonable grounds for belief under that Section. The Commission also is soliciting further comment on a proposed rule relating to the effective date of information incorporated by reference into a registration statement, as well as a proposed rule regarding the effect of any statement in a registration statement modifying or superseding a statement in a document incorporated by reference.

These three rules are being proposed as part of the Commission's comprehensive program to integrate the disclosure requirements of the Securities Act and the Securities Exchange Act of 1934. The proposals relate to the concerns expressed by some members of the financial community regarding the ability of underwriters and others to undertake a reasonable investigation with respect to the adequacy of the information incorporated by reference from periodic reports filed under the Exchange Act into the short form registration statements utilized in an integrated disclosure system.

DATE: Comments must be received on or before October 30, 1981.

ADDRESSES: Comments should be submitted in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Washington, D.C. 20549. Comment letters should refer to File No. S7-897. All comments received will be available for public inspection and copying at the Commission's Public Reference Room, 1100 L Street, N.W., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Gregory H. Mathews, Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549 at (202) 272-2589.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is proposing for comment Rule 176 (17 CFR 230.176) under the Securities Act of 1933 ("Securities Act") (15 U.S.C. 77a et seq.). The proposed rule, which would codify Section 1704(g) of the American Law Institute's proposed Federal Securities Code (the "Code"), is intended to make explicit what circumstances may bear upon the determination of what constitutes a reasonable investigation and reasonable ground for belief as these terms are used in Section 11(b) of the Securities Act.

In addition, the Commission is republishing as part of Regulation C under the Securities Act (17 CFR 230.400 through 230.494) prior proposals [1] regarding the effective date of documents incorporated by reference and the legal effect of modifying or superseding statements in a registration statement. Specifically, proposed Rule 412 (17 CFR 230.412) [Effective Date of Certain Documents Incorporated by Reference] would provide that the effective date of a document incorporated by reference in a registration statement for purposes of Section 11(a) of the Securities Act is the date of the initial filing of such document with the Commission. Proposed Rule 418 (17 CFR 230.418) [Modified or superseded documents] would: (1) deem a statement contained in a document incorporated by reference to be modified or superseded to the extent that it has been modified or replaced by a statement contained in the prospectus or in any other subsequently filed document incorporated by reference; (2) provide that the making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement constituted a violation of the federal securities laws, and (3) provide that any statement so modified or superseded shall not be deemed in its prior form to constitute a part of the registration statement or prospectus for purposes of the Act.

These three rules are being proposed as part of the Commission's comprehensive program to integrate the disclosure requirements of the Securities Act and the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78a et seq.). The proposals relate to the concerns expressed by some members of the financial community regarding the ability of underwriters and others to undertake a reasonable investigation with respect to the adequacy of the information incorporated by reference from periodic reports filed under the Exchange Act into the short form registration statements utilized in an integrated disclosure system.

The Commission today also has published for comment in separate releases several other rulemaking proposals. These proposals include: (1) a three tier system for the registration of securities, Forms S-1, S-2 and S-3 (originally denominated for comment purposes as Forms A, B and C);[2] (2) expansion of Regulation S-K (17 CFR 229.001 et seq.) to include additional disclosure items and the rescission of the Guides for the Preparation and Filing of Registration Statements and Reports ("Guides"), other than Guides relating to specific industries, thereby completing the Commission's "sunset" review of the Guides;[3] (3) amendments to simplify and clarify procedural requirements, thereby commencing the Commission's "sunset" review of Regulation C;[4] (4) a new rule governing registration of securities to be sold in a continuous or delayed offering;[5] (5) a statement of the Commission's policy with respect to the disclosure of security ratings;[6] and (6) amendments to other Securities Act registration forms [7] and certain Exchange Act forms and schedules [8] to incorporate the new Regulation S-K provisions and make other changes. These proposals represent the next major step in the Commission's efforts to achieve a simplified and integrated disclosure system under the Securities Act and the Exchange Act, as well as the continuation of the Commission's "sunset" review of all existing rules and regulations relating to disclosure.

I. Background

The Securities Act and the Exchange Act, as originally enacted, served different functions. The Securities Act

[1] *See* Securities Act Release No. 6235 (September 2, 1980) [45 FR 63693] and Securities Act Release No. 5998 (November 17, 1978) [43 FR 56053].

[2] Securities Act Release No. 6331 (August 6, 1981), as originally proposed in Securities Act Release No. 6235 (September 2, 1980) [45 FR 63693] (the "ABC Release").

[3] Securities Act Release No. 6332 (August 6, 1981) (the "Regulation S-K Release") as originally proposed in Securities Act Release No. 6276 (December 23, 1980) [46 FR 78] (the "Guides Release").

[4] Securities Act Release No. 6333 (August 6, 1981) (the "Regulation C Release").

[5] Securities Act Release No. 6334 (August 6, 1981). Originally proposed as part of Securities Act Release No. 6276 (December 23, 1980) [46 FR 78].

[6] Securities Act Release No. 6336 (August 6, 1981).

[7] Securities Act Release No. 6337 (August 6, 1981).

[8] Securities Exchange Act Release No. 18014 (August 6, 1981).

was adopted to prevent fraud and to assure "full and fair disclosure of the character of securities" sold to the public.[9] The Exchange Act was devised to regulate the brokers and dealers who sell securities and the markets in which investors continually trade the securities previously issued to the public. The disclosure provisions of the Securities Act were triggered only by a public offering and related to the offering and the condition of the issuer at that time. The disclosure provisions of the Exchange Act required, *inter alia*, that issuers periodically make available up-to-date information about each class of securities listed for trading on a stock exchange, whether or not securities actually were being sold to the public.[10] Subsequent amendments tb the Exchange Act [11] expanded the application of these continuous requirements to all listed and unlisted issuers with over $1 million in assets and a class of securities held of record by at least 500 persons.

Prior to 1964, the transaction-based disclosure system of the Securities Act and the continuous disclosure system of the Exchange Act operated independently of each other. Issuers, underwriters, accountants and others spent much time and effort preparing the lengthy registration statement, including the prospectus, required by the Securities Act. Information had to be set forth in that registration statement even if it had been disclosed previously in a periodic report filed by the issuer pursuant to the Exchange Act. Commentators noted the needless duplication and overlap resulting from this situation,[12] and in 1967 the Commission responded by adopting a new short form of registration, Form S–7 (17 CFR 239.26),[13] which permitted certain seasoned registrants to rely upon information reported under the Exchange Act to satisfy partially the information requirements of the registration statement.[14]

Another major step toward better coordination of the two disclosure systems occurred in 1970 when the Commission, acting upon recommendations of its Wheat Report,[15] adopted Form S–16 (17 CFR 239.27).[16] Issuers qualified to use Form S–7 could utilize Form S–16 to register securities to be sold in certain secondary distributions by the issuer's shareholders. Through the device of incorporating by reference information in Exchange Act reports, Form S–16 minimized the amount of previously disclosed information required to be reiterated in the prospectus delivered to investors. In 1978, Form S–16 was amended to make it available for certain primary offerings that are underwritten on a firm commitment basis.[17] Because Form S–16 relies upon incorporation by reference, it can be prepared by the issuer in far less time than it takes to prepare the previously utilized long form registration statements.

In 1976, then Chairman Roderick M. Hills appointed the Advisory Committee on Corporate Disclosure (the "Advisory Committee") to evaluate the corporate disclosure system that had developed under the federal securities laws as implemented by the Commission. In its final report, published in November 1977, the Advisory Committee recommended, among other things, the complete integration of the Federal Securities Acts, primarily by incorporating by reference Exchange Act reports into Securities Act registration statements.[18] New Form S–15 (17 CFR 239.29) [19] and the revision of the system of registration of securities, which is being published today, are substantially based on this recommendation of the Advisory Committee.

Proposed Form S–3,[20] which would be available for certain primary and secondary offerings by seasoned issuers, requires the incorporation by reference of the issuer's latest Form 10–K (17 CFR 249.310) and all other Exchange Act reports filed by the issuer since the end of the fiscal year covered by the Form 10–K. In addition, Item 11 of proposed Form S–3 requires that this information be updated by describing in the prospectus all material changes in the issuer's affairs which have not been described previously in periodic reports.

Proposed Form S–2 [21] basically would be available to an even larger group of relatively seasoned issuers. This proposed form gives issuers the option of meeting certain of the informational requirements of the form by incorporating the relevant information contained in the issuer's annual report provided security holders pursuant to Rule 14a–3 (17 CFR 240.14a–3) or Rule 14c–3 (17 CFR 240.14c–3). Also, the issuer's latest Form 10–Q can be used to meet such requirements. Unlike Form S–3, however, the incorporated documents would have to be delivered to investors.

Finally, the Commission has proposed Rule 462A (17 CFR 230.462A) [Delayed or Continuous Offering and Sale of Securities], which would permit registration of securities for offering in the future ("shelf registration") in amounts that can reasonably be expected to be offered and sold within two years.[22] A principal condition of the proposal is that the information in the registration statement be kept current during the offering. If a shelf offering is registered on proposed Form S–3, the obligation to keep information current would ordinarily be met by incorporation by reference of Exchange Act reports filed throughout the period of the offering.

If the current proposed changes are adopted, the cumulative effect clearly will be to increase greatly the extent to which previously filed periodic reports are relied upon to satisfy some of the disclosure requirements of the Securities Act. The result will be that every company reporting for at least three years under the Exchange Act, and in a timely manner during the third year, can utilize its Exchange Act reports in connection with a public offering. This reliance should reduce substantially both the printing cost of registration statements and the time and expense necessary to prepare them. As a result the Commission will have eliminated artificial delays to rapid access to today's capital markets.

Although the purpose of integration is to streamline and simplify disclosure for the benefit of issuers and investors, the

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[9] H.R. No. 152, 73d Cong., 1st Sess. 24 (1933).

[10] These provisions sought to overcome the obstacles encountered by the exchanges in "securing proper information for the investor." H.R. No. 1383, 73d Cong., 2d Session 13 (1934).

[11] Primarily the addition of Section 15(d) in 1936 and Section 12(g) in 1964.

[12] *See, e.g.*, Cohen, " 'Truth in Securities' Revisited," 79 Harv. L. Rev. 1340, 1341 (1966).

[13] Securities Act Release No. 4886 (November 26, 1967) [32 FR 17933].

[14] Form S–7 was amended in 1976 to substantially broaden the number of eligible issuers in and the types to transactions for which it could be used. Securities Act Reaease No. 5791 (December 20, 1976) [41 FR 56304]

[15] Securities and Exchange Commission, *Disclosure To Investors: A Reappraisal of Administrative Policies Under the 1933 and 1934 Acts* (1969).

[16] Securities Act Release No. 5117 (December 23, 1970) [36 FR 777].

7 Securities Act Release No. 5923 (April 10, 1078) [43 FR 18672].

[18] *Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission*, 95th Cong., 1st Sess. 451 (Comm. Print 1977). (Hereinafter *Advisory Committee Report*).

[19] Securities Act Release No. 6232 (September 2, 1980) [45 FR 63647].

[20] The Form was initially proposed as Form A in the ABC Release. It has been revised and redesignated as proposed Form S–3. *See* Securities Act Release No. 6331, *supra* note 2.

[21] The form was initially proposed as Form B in the ABC Release. The draft form has been redesignated and reproposed, with certain revisions, for further public comment. *Id.*

[22] Proposed Rule 462A, Securities Act Release No. 6276 (December 23, 1980) [46 FR 78]. The proposal has been revised and is being republished today for further comment, Securities Act Release No. 6334, *supra* note 5.

Commission recognizes that the changes may be perceived as affecting the manner in which persons fulfill their responsibilities under the Securities Act. Accordingly, the Commission believes it is appropriate at this time to address certain issues relating to information in an Exchange Act document which is incorporated by reference in a Securities Act registration statement.

II. Concerns Regarding Responsibilities Under the Integrated Disclosure System

The Securities Act was conceived in order to "bring back public confidence" which had been eviscerated by the widespread securities frauds of the 1920's.[23] According to James Landis, one of the drafters of the Securities Act, the lengthy Senate hearings on corporate financing which preceded adoption of the Act, "indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money."[24] The resulting Securities Act imposed high standards of care on all persons involved in public offerings of securities. The legislative history indicates that the Congressional intent in adopting the Securities Act was to impose standards of "[h]onesty, care and competence" upon those who participate in preparation of the registration statement or the distribution to public investors of the securities registered thereunder.[25]

The statute generally requires that new public issues of securites be registered with the Commission. The signers of the registration statement, the issuer's directors or partners, the underwriters, the accountants and certain other persons are made civilly liable by section 11(a) of the Securities Act for any untrue statement of a materal fact which is contained in an effective registration statement or for any omission to state a material fact required to be stated therein or necessary to avoid making the statements therein misleading.[26] Section 11(b) of the Securities Act provides that each person, other than the issue, will not be held liable, however, if he can sustain the burden of proof that his conduct, under the circumstances, was reasonable.[27] Specifically, sub-section 11(b)(3) permits the defendant to prove that he made a reasonable investigation of and had reasonable grounds to believe in the accuracy of the non-expertised portions of the registration statement or, with respect to any part presented upon the authority of an expert other than the defendant, that he had no reasonable ground to believe and did not believe there was a material omission or misstatement.[28]

Underwriters and others have expressed concern regarding their ability to discharge fully their responsibilities under Section 11 with respect to registration statements incorporating substantial information from periodic reports. Historically, preparation of the traditional Form S-1 (17 CFR 239.11) registration statement began many weeks in advance of the proposed offering due to the time required to assemble and verify the information required to be set forth in the registration statement and prospectus. During this time, underwriters, directors and others conducted the necessary due diligence inquiries which, as a matter of prudence, were substantially completed before the initial filing of the registration statement. In contrast, integrated short form registration statements rely, to the maximum extent possible, on information contained in previously filed Exchange Act reports or in the annual report to security holders. Information actually set forth in the short form registration statement pertains primarily to the proposed transaction, the use of proceeds and the updating of information in incorporated documents. Preparation time is reduced sharply, as is the period of time between the issuer's decision to undertake a securities offering and the filing of the registration statement with the Commission.[29] Some commentators are fearful that this reduction in preparation time, together with competitive pressures, will restrict the ability of responsible underwriters to conduct what would be deemed to be a reasonable investigation, pursuant to Section 11, of the contents of the registration statement. They believe that issuers may be reluctant to wait for responsible underwriters to finish their inquiry, and may be receptive to offers from underwriters willing to do less.

Some underwriters also object to utilizing information in periodic reports for registration purposes, because it has been composed by persons without consultation with the underwriters who may, in turn, be held, in the context of a registration statement, to a higher standard of civil liability than that to which the original preparers may have been subject.[30] Moreover, there is a perception that issures may be reluctant to modify previously filed documents in instances where the underwriters question the quality of the disclosure and that this reluctance, again coupled with competitive pressures, will hinder due diligence activities.

Moreover, because Section 11 imposes liability for omissions or misstatements of material fact in any part of the registration statement when that part became effective, there has been concern that liability could be asserted based on information in a previously filed document which was accurate when filed but which had become outdated and subsequently was incorporated by reference into a registration statement.

Proposed Rule 462A, allowing shelf registration, also has caused apprehension. Commentators on the rule as initially proposed believed that insufficient consideration had been given to the responsibilities of the persons involved in a shelf registration of a primary at the market equity offering under the new proposed Rule.[31] For example, a shelf offering on proposed Form S-3 could involve automatic incorporation by reference into the registration statement of Exchange Act reports for a substantial period of time because the offering may be made on a delayed or continuous basis. In addition, if an underwriter is brought into a shelf offering after the initial effective date of the registration statement, the late-arriving underwriter would be responsible for the accuracy of the contents of the registration statement as of the time of his entry into the transaction.[32] Although incorporation by reference of subsequently filed documents and changes in underwriters can occur in any offering, they may be more likely to

[23] President Franklin D. Roosevelt, quoted in H.R. No. 85, 73d Cong., 1st Sess. 2 (1933).

[24] Landis, "The Legislative History of the Securities Act of 1933," 28 Geo. Wash. L. Rev. 29, 30 (1959).

[25] H.R. No. 85 at 5.

[26] 15 U.S.C. § 77k(a).

[27] The standard of reasonableness is "that required of a prudent man in the management of his own property." 15 U.S.C. § 77k(c).

[28] § 11(b)(3), 15 U.S.C. § 77k(b)(3).

[29] For estimates of the amount by which preparation time may be reduced *see* Hayes, "The Transformation of Investment Banking," 57 *Harv. Bus. Rev.* 153, 168 (January-February 1979) and "The Mixed Blessing of the S-16," *Institutional Investor* 40 (November 1980).

[30] Newly elected directors of an issuer, who were not in office when an Exchange Act report was filed, would be in a similar position.

[31] See Securities Act Release No. 6276 (December 23, 1980) [46 FR 78].

[32] Section 11(d) of the Securities Act provides that:

> If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

occur in shelf offerings, which may continue over a substantial period and contemplate a variety of offering techniques for the registered securities.[33]

III. Proposals to Address Concerns in an Integrated Disclosure System

In the past, several specific suggestions addressing the concerns of members of the financial community have been advanced.

A. Recommendation of the Advisory Committee on Corporate Disclosure

In 1977, the Advisory Committee, in urging the comprehensive integration of disclosure requirements, expressed its belief that "this expanded utilization of incorporation by reference of 1934 Act filings necessitates a corresponding limiting interpretation of the liability provisions . . ." of the Securities Acts.[34] Toward this end, the Advisory Committee recommended that the Commission adopt a rule identifying seven factors a court should take into account when determining what constitutes reasonable investigation or reasonable care and reasonable ground for belief under the Securities Act with respect to information incorporated by reference into a registration statement.[35]

[33] Proposed Rule 462A, as revised, may facilitate the activities of underwriters and others in fulfilling their statutory responsibilities in shelf offerings. Under the new proposal, fundamental changes in the registration statement (if not set forth in incorporated documents) and the most significant changes in underwriters—addition or deletion of a managing underwriter (other than as a co-manager)—must be reflected in a post-effective amendment. The filing of an amendment clearly identifies the information for which an existing or new underwriter or other person is responsible and allows underwriters and others an opportunity to evaluate that information.

[34] *Advisory Committee Report*, at 451.

[35] The Advisory Committee proposed the following rule:

In determining what constitutes reasonable investigation or care and reasonable ground for belief under the Securities Act of 1933, of information incorporated by reference into a registration statement or prospectus, the standard of reasonableness is that required by a prudent man under the circumstances, including but not limited to (1) the type of registrant, (2) the type of particular person, (3) the office held when the person is an officer, (4) the presence or abence of another relationship to the registrant when the person is a director or proposed director, (5) reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the registrant and the filing), (6) the type of underwriting arrangement, the role of the particular person as an underwriter, and the accessibility to information with respect to the registrant when the person is an underwriter, (7) the type of security, and (8) whether or not with respect to information or a document incorporated by reference, the particular person had any responsibility for the information or document at the time of the filing from which it was incorporated.

Advisory Committee Report at 454–55.

B. Securities Industry Association Proposals

In 1978, following the Commission's amendment of Form S–16 to permit use of the Form for certain primary offerings of securities,[36] the Corporate Finance Committee of the Securities Industry Association (SIA) formally petitioned the Commission to (1) adopt a rule concerning underwriters' liability with respect to registration statements on Form S–16 and (2) either to suspend the availability of Form S–16 for primary offerings until the adoption of such a rule or to adopt an emergency temporary rule on this subject.[37]

The emergency temporary rule proposed by the SIA was patterned after Section 1704(g) of the American Law Institute's proposed Federal Securities Code[38] but applicable only when an offering was made on Form S–16. It provided that:

In determining whether an underwriter has made a reasonable investigation, exercised care or had a reasonable ground for belief under the [Securities] Act with respect to a registration statement on Form S–16, relevant circumstances include (1) the type of registrant, (2) the type of security, (3) the type of underwriting arrangement, the role of the underwriter and the accessibility to information with respect to the registrant and (4) with respect to information or a document incorporated by reference, the fact (if such is the case) that the underwriter had no responsibility with respect to the information or document at the time of the filing from which it was incorporated.

Subsequently, the SIA submitted a proposed permanent rule which would have provided underwriters a safe harbor from liability under Section 11 and Section 12(2) of the Securities Act under certain circumstances.[39]

[36] Securities Act Release No. 5923 (April 11, 1978) [43 FR 16672].

[37] Letter of Paul R. Judy, Chairman, Corporate Finance Committee, Securities Industry Association to the Securities and Exchange Commission dated May 1, 1978.

[38] The relevant provisions of the Federal Securities Code are discussed in the text accompanying notes 48–50, *infra*.

[39] The proposed rule provided that:

an underwriter shall be deemed to have conducted a reasonable investigation and to have reasonable ground for belief for purposes of Section 11, and to have exercised reasonable care for purposes of Section 12(2), of the Securities Act of 1933 if the underwriter, (1) has read the registration statement including all exhibits and documents incorporated therein by reference, (2) has discussed the registration statement with responsible representatives of the registrant, and of any persons named therein as an expert, and (3) after such reading and discussion, does not know of any untrue statement of a material fact in such registration statement or any omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

More recently, the Corporate Finance Committee of the SIA, in commenting upon the ABC Release, reaffirmed its support of the approach taken in Section 1704(g) of the Code by proposing that the Commission adopt the following rule:

In determining whether an underwriter has made a reasonable investigation, exercised reasonable care or had a reasonable ground for belief under the [Securities] Act with respect to a registration statement, relevant circumstances include, but are not necessarily limited to, (1) the type of registrant, (2) the type of security, (3) the type of underwriting arrangement (e.g., whether negotiated or competitive), the role of the underwriter and the accessibility of information with respect to the registrant and (4) with respect to information or a document incorporated by reference, the fact (if such is the case) that the underwriter had no responsibility with respect to the information or document at the time of the filing from which it was incorporated.[40]

The Federal Regulation Committee of the SIA, in its comment letter on the ABC Release, also urged adoption of a rule comparable to Section 1704(g) of the draft Federal Securities Code.[41]

C. Prior Commission Actions

While the Commission declined to adopt either of the proposed rules submitted by the SIA in 1978, it did express its belief that,

a court would consider all circumstances surrounding an underwriter's position with respect to information contained in documents incorporated by reference into a Form S-16 registration statement including the presence or absence of responsibility for material contained therein at the time of filing as well as any other circumstances inherent in the type of offering that would legitimately affect an underwriter's ability to discharge its "due diligence" obligation under the Securities Act.[42]

At the same time, the Commission proposed a rule intended to assuage some of the concerns of underwriters about their potential liability for inaccuracies in previously filed documents incorporated by reference in Form S-16 registration statements.[43] As proposed, new paragraph (e) of item 7 of Form S–16 provided that, for purposes of

Letter of Paul R. Judy, Chairman, Corporate Finance Committee, Securities Industry Association to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, dated June 26, 1978.

[40] Letter from R. John Stanton, Chairman, Corporate Finance Committee to George A. Fitzsimmons dated February 25, 1981 (File No. S7–849).

[41] Letter of Joseph McLaughlin, Chairman, Federal Regulation Committee to George A. Fitzsimmons dated February 18, 1981 (File No. S7–849).

[42] Securities Act Release No. 5998 (November 17, 1978) [43 FR 56054, 56056].

[43] *Id.*

Section 11(a) of the Securities Act, the effective date of a document incorporated by reference pursuant to item 7 would be the date of the document's initial filing with the Commission, rather than the effective date of the registration statement into which it was incorporated. A new paragraph (f) of item 7 proposed that a statement in an incorporated document would be deemed not to be part of the registration statement if the statement had been modified or superseded by another statement set forth in the registration statement or incorporated therein by reference. New paragraph (f) also provided that the making of a modifying or superseding statement would not be deemed an admission that the modified or superseded statement constituted a violation of the Federal Securities Acts.[44]

The Commission's proposals were intended to respond to the concern expressed by underwriters regarding their liability for information in incorporated documents which was accurate when filed but may have become outdated and to the possibility that issuers would be hesitant to revise or replace statements in previously filed incorporated documents if such changes could be used against them in a suit alleging violations of the Securities Acts. Only a small number of public comments were submitted to the Commission, and the majority of the commentators stated that the proposals were insufficient.[45] In view of the mixed reaction to the proposals, the Commission took no action on the matter at the conclusion of the public comment period.

In September 1980, the Commission proposed to include similar provisions in Forms A and B [46] in order to address the treatment of statements incorporated by reference. Although a number of the commentators supported the approach proposed by the Commission, others concluded that the proposals were inadequate standing alone. Even if the proposed items led issuers to accept more readily the underwriter's recommendations, it was argued that substantial new liability risks would remain. In particular, it was asserted that the most difficult disclosure issues are detected and resolved in the course of drafting the text of the prospectus to be utilized in the planned securities offering. According to the commentators, the incorporation of information from Exchange Act documents into a short form registration statement would sacrifice this important crucible of the adequacy of disclosure since the underwriter generally would not have participated in preparation of the Exchange Act reports. Nevertheless, the underwriters would be held to the same standard of liability with respect to such information.

Several commentators recommended that the Commission adopt the rule proposed by the Securities Industry Association to provide underwriters who meet certain conditions with a safe harbor from liability for statements made in incorporated Exchange Act reports. Other commentators believed the problem should be dealt with through adoption of a rule similar to Section 1704(g) of the American Law Institute's proposed Federal Securities Code (the "Code").[47]

D. The Federal Securities Code

Section 1704(g) of the Code includes incorporation by reference as a factor to be considered in determining the reasonableness of the underwriter's conduct for purposes of Section 11. Specifically Section 1704(g) of the Code, which would substitute for Section 11(c) of the Securities Act, provides that:

> In determining what constitutes reasonable investigation and reasonable ground for belief under section 1704(f)(3), the standard of reasonableness is that required of a prudent man under the circumstances in the conduct of his own affairs. Relevant circumstances include, with respect to a defendant other than the registrant, (1) the type of registrant, (2) the type of defendant, (3) the office held when the defendant is an officer, (4) the presence or absence of another relationship to the registrant when the defendant is a director or proposed director, (5) reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular defendant with respect to the registrant and the filing), (6) when the defendant is an underwriter, the type of underwriting arrangement, the role of the particular defendant as an underwriter, and the accessibility to information with respect to the registrant, and (7) whether, with respect to a fact or document incorporated by reference, the particular defendant had any responsibility for the fact or document at the time of the filing from which it was incorporated.[48]

This standard would be appliable to evaluating the conduct of each type of defendant presently subject to Section 11 liability.[49]

After extensive analysis and discusssion, the Commission, in September 1980, announced its decision to support enactment of the Federal Securities Code as modified to incorporate changes agreed to by the Commission and Professor Louis Loss, the American Law Institute's reporter, and his advisors.[50] With regard to Section 1704(g), it was agreed that the phrase "and the accessibility to information with respect to the registrant" in clause (6) should be deleted on the ground that the preceding phrase "the role of the particular defendant as an underwriter" in the same clause adequately recognized the more limited role of non-managing underwriters without inviting undue dilution of their responsibilities.

IV. Due Diligence in an Integrated Disclosure System

As discussed earlier, the Securities Act imposes a high standard of conduct on specific persons, including underwriters and directors, associated with a registered public offering of securities. Under Section 11, they must

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[44] *Id.*

[45] *See generally* File No. S7-763.

[46] Item 8 of proposed Form A and item 9 of proposed Form B, provided, in pertinent part, that:

(b) Effective Date of Documents Incorporated by Reference.

(1) Only for purposes of determining pursuant to Section 11(a) of the Securities Act when a document incorporated by reference pursuant to this Item 8 "became effective," the effective date shall be the date of the document's initial filing with the Commission.

(2) For all other purposes under the Act, including Section 13, the effective date shall be the effective date of the registration statement.

(c) *Modified or Superseded Documents.*

(1) Any statement contained in a document incorporated or deemed to be incorporated by reference shall be deemed to be modified or superseded for purposes of the prospectus the extent that a statement contained in the prospectus or in any other subsequent filed document which also is or is deemed to be incorporated by reference modifies or replaces such statement.

(2) The modifying or superseding statement may, but need not, state that it has modified or superseded a prior statement or include any other information set forth in the document which is not modified or superseded. The making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement, when made, constituted an untrue statement of a material fact, an omission to state a material fact necessary to make a statement not misleading, or the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, couse of business or artifice to defraud, as those terms are used in the Act, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, or the rules and regulations thereunder.

Any statement so modified shall not be deemed in its unmodified form to constitute part of the registration statement or prospectus for purposes of the Act. Any statement so superseded shall not be deemed to constitute a part of the registration statement or the prospectus for purposes of the Act.

[47] ALI, *Federal Securities Code* (1980).

[48] *Id.* § 1704(g).

[49] Compare Section 11(a) of the Securities Act and Section 1704(f) of the proposed Federal Securities Code.

[50] Securities Act Release No. 6242 (September 18, 1980).

make a reasonable investigation and have reasonable grounds to believe the disclosures in the registration statement are accurate. As the Court stated in *Escott* v. *BarChris Construction Corporation:*

> In order to make the underwriter's participation in this enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them. They may not rely solely on the company's officers or on the company's counsel. A prudent man in the management of his own property would not rely on them.[51]

The principal goal of integration is to simplify disclosure and reduce unnecessary repetition and redelivery of information which has already been provided, not to alter the roles of participants in the securities distribution process as originally contemplated by the Securities Act. The integrated disclosure system, past and proposed, is thus not designed to modify the responsiblity of underwriters and others to make a reasonable investigation. Information presented in the registration statement, whether or not incorporated by reference, must be true and complete in all material respects and verified where appropriate. Likewise, nothing in the Commission's integrated disclosure system precludes conducting adequate due diligence. This point can be demonstrated by addressing the two principal concerns which have been raised.

First, as discussed above, commentators have expressed concern about the short time involved in document preparation. There also may be a substantial reduction in the time taken for pre-effective review at the Commission. As to the latter point, however, commentators on the ABC Release themselves noted that due diligence generally is performed prior to filing with the Commission, rendering the time is registration largely irrelevant. As to the former point, there is nothing which compels an underwriter to proceed prematurely with an offering. Although, as discussed below, he may wish to arrange his due diligence procedures over time for the purpose of avoiding last minute delays in an offering environment characterized by rapid market changes, in the final analysis the underwriter is never compelled to proceed with an offering until he has accomplished his due diligence.

The second major concern relates to the fact that documents, prepared by others, often at a much earlier date, are incorporated by reference into the registration statement.[52] Again, it must be emphasized that due diligence requires a reasonable investigation of all the information presented therein and any information incorporated by reference. If such material contains a material misstatement, or omits a material fact, then, in order to avoid liability, a subsequent document must be filed to correct the earlier one, or the information must be restated correctly in the registration statement. Nothing in the integrated disclosure system precludes such action.

The Commission specifically rejects the suggestion that the underwriter needs only to read the incorporated materials and discuss them with representatives of the registrant and named experts. Because the registrant would be the sole source of virtually all information, this approach would not, in and of itself, include the element of verification required by the case law[53] and contemplated by the statute.

Thus, verification in appropriate circumstances[54] is still required, and if a material misstatement or omission has been made, correction by amendment or restatement must be made. For example, a major supply contract on which the registrant is substantially dependent should be reviewed to avoid the possibility of inaccurate references to it in the prospectus. On the other hand, if the alleged misstatement in issue turns on an ambiguity or nuance in the drafted language of an incorporated document making it a close question as to whether a violation even has been committed, then the fact that a particular defendant did not participate in preparing the incorporated document, when combined with judgmental difficulties and practical concerns in making changes in prepared documents, would seem to be an appropriate factor in deciding whether "reasonable belief" in the accuracy of statements existed and thus in deciding whether to attach liability to a particular defendant's conduct.

In sum, the Commission strongly affirms the need for due diligence and its attendant vigilance and verification.[55] The Commission's efforts towards integration of the Securities Act and the Exchange Act relate solely to elimination of unnecessary repetition of disclosure, not to the requirements of due diligence which must accompany any offering. Yet, in view of the fact that court decisions to date have construed due diligence under factual circumstances not involving an integrated system, and in order to encourage a focus on a flexible approach to due diligence rather than a rigid adherence to past practice, the commission believes that it would be helpful to codify its prior statements so that courts and others may fully understand the new system.

V. Techiques of Due Diligence in an Integrated Disclosure System

Although the basic requirements of due diligence do not change in an integrated system, the manner in which due diligence may be accomplished can properly be expected to vary from traditional practice in some cases. To this end, underwriters and others can utilize various techniques. Historical models of due diligence have focused on efforts during the period of activity associated with preparing a registration statement, but the integrated disclosure system requires a broader focus. Issuers, underwriters and their counsel will necessarily be reevaluating all existing practices connected with effectuating the distribution of securities to develop procedures compatible with the integrated approach to registration.

In view of the compressed preparation time and the volatile nature of the capital markets, underwriters may elect to apply somewhat different, but equally thorough, investigatory practices and procedures to integrated registration statements. Unless the underwriter intends to reserve a specified period of time for investigation after the registration statement has been prepared but before filing, it will be necessary to develop in advance a reservoir of knowledge about the companies that may select the underwriter to distribute their securities registered on short form registration statements. To a considerable extent, broker-dealers already take this approach when they provide financial planning and investment advisory services to the investing public, as well as financial advice to companies themselves.

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[51] 283 F. Supp. 643, 647 (S.D.N.Y. 1968).

[52] It should be noted that Item 11 of proposed Form S-2 gives preparers the choice of either incorporating by reference specified information about the registrant from the annual report to security holders and its latest Form 10-Q or of setting forth such information directly in the registration statement.

[53] "If they may escape that responsibility by taking at face value representations made to them by the company's management, then the inclusion of underwriters among those liable under Section 11 affords investors no additional protection." 283 F. Supp. at 697.

[54] "To require an audit would obviously be unreasonable. On the other hand to require a check of matters easily verifiable is not unreasonable." *Id.* at 690.

[55] *See* Section 17(a) of the Securities Act; *Feit* v. *Leasco Data Processing Equipment Corporation*, 332 F. Supp. 544, 584 (E.D.N.Y. 1971).

Extensive data about seasoned companies can be obtained with little effort. The periodic reports filed pursunt to the Exchange Act contain a wealth of information relating to subject issuer's financial performance, competitive position and future prospects. Other material developments are promptly reported on Form 8–K (17 CFR 249.308). Careful review of these filings on an on-going basis not only facilitates a general familiarity with each issuer but should permit the underwriter to identify factors critical to the continiug success of the company. In many cases, the underwriters, also have available analysts' reports to evaluate the issuer and its industry.[56] With greater knowledge, the underwriter will be better prepared to question incomplete explanations, descriptions or reasoning and generally will be more sensitive to detecting and assessing material developments. The process of verification should be expedited as a result.

The issuer's investor relations program provides another opportunity for enhancing the underwriter's familiarity with the company. In particular, analysts and brokers meetings allow underwriters or potential underwriters to question members of management and to evaluate their skills and abilities. Discussion at such sessions can address recent transactions, events and economic results in relation to other companies in the same industry. When combined with the practice of furnishing detailed written analyses of material corporate events, these sessions can duplicate certain steps traditionally undertaken by the underwriter and issuer only during the preparation of the registration statement.

For directors, their continuing involvement in their company's activites must be considered. They receive reports, request information from management, meet periodically, and analyze, plan and participate in the company's business. These activities provide a strong basis for their evaluation of disclosure in a registration statement, and for considering what further due diligence is necessary on their part. In particular, their roles in reviewing the company's Form 10–K annual report and other Exchange Act filings are relevant to their due diligence for a registration statement incorporating those filings.

[56] The Commission has revised the eligibility criteria for use of proposed Form S–3 to insure that only widely followed companies are entitled to use the form for equity offerings.

By developing a detailed familiarity with the company and the periodic reports it files with the Commission, the underwriter and others can minimize the number of additional tasks that must be performed in the context of a subsequent registered offering in order to meet the statutory standard of due diligence. When the short form registration statement is being prepared, the underwriter's investigation then can proceed expeditiously and can be concluded at the earliest appropriate point in time. By way of comparison, a first time offering by a new or relatively unseasoned issuer requires the underwriter and other subject persons to engage in extensive data collection, analysis and independent inquiry during the preparation period for the long form registration statement.[57]

In sum, under the Exchange Act a great deal of information about registered companies is both regularly furnished to the marketplace and also carefully analyzed by investment bankers, directors and others. Although perhaps not traditionally seen in this light, a close following of this information by investment bankers can be an important part of due diligence in the case of an underwritten offering and should expedite the remaining due diligence inquiries and verification.[58]

Issuers eligible for short-form registration also can undertake specific steps designed to minimize the need for elaborate original investigations by underwriters immediately prior to the public distribution of newly registered securities. These actions could include (1) involvement of directors and underwriters in the preparation of the Form 10–K, (2) similar involvement by counsel for the underwriting group, (3) early discussions with underwriters about major new developments and (4) early coordination, well in advance, with respect to offerings contemplated during a given year.

The Commission believes it is crucial that issuers carefully consider what is required for underwriters and others to accomplish their investigation and cooperate with them in their efforts to satisfy their statutory obligations. The financing plans of issuers must take these practical requirements into account.

[57] Incorporation by reference is not applicable to first time registrants. The Commission has discussed at length the obligation of underwriters and others to be particularly thorough in investigating information in such registration statements. *See* Securities Act Release No. 5275 (July 26, 1972) [37 FR 16011].

[58] Some underwriters currently maintain records of the due diligence activities undertaken for each offering in which they are involved. Since due diligence within an integrated disclosure system may take place over an extended period of time, documentation of each step in the investigation for future reference may be especially helpful.

VI. The Proposed Rules

A. Proposal Identifying Circumstances Affecting the Reasonableness of Conduct Under Section 11

The Commission continues to believe that a court would of its own accord take into account every circumstance, including the fact of incorporation by reference, that may legitimately affect the ability of an underwriter or other subject person to conduct a reasonable investigation into the information contained in a registration statement or to develop reasonable grounds for belief. The Commission also believes that only a court can make the determination of whether a defendant's conduct was reasonable under all the circumstances of a particular offering. Nevertheless, many persons believe that it would be helpful for the Commission's position to be reflected in a rule. In light of these views, as well as the further integration of the disclosure requirements of the Securities Acts, the recommendations of the Advisory Committee, and the Commission's endorsement of the proposed Federal Securities Code, the Commission has concluded that it would be appropriate at this time to propose a rule which identifies and interprets certain relevant circumstances which may bear on the determination of whether a defendant has discharged his due diligence obligation under Section 11.

The proposed rule, in effect, would codify Section 1704(g) of the proposed Code, and would be applicable not only to underwriters, but also to all the other types of persons enumerated in Section 11(a) who are liable for misstatements and omissions in effective registration statements. It should be reemphasized, however, that there is variation in the nature of the duty owed to the investing public by the different persons named in Section 11(a). Therefore, not every circumstance set forth in the proposed rule will apply to every defendant to whom it applies.

The explanation of the specific circumstances in the proposed rule is not intended to be exhaustive, but rather to illustrate the manner in which each circumstance can affect the conduct of subject persons.

1. *The type of issuer.* The type of issuer is important because it bears upon the categories of information which should receive special attention and the extent of the investigation generally. Analysis of the type of

business in which the issuer is engaged and the characteristics of the issuer's industry are central to identifying potentially important disclosure issues.[59] A limited partnership raises considerations different from corporations, including the nature of the legal relationship between the general partner, the partnership and the limited partners, the rights and responsibilities of each respective type of partner and the valuation of proposed partnership properties, among other things.

2. *The type of security.* This circumstance is included because of its relevance to evaluation of the financial condition and prospects of the issuer. For example, if the security to be offered is short-term debt, then the adequacy of the issuer's current and short-term economic results will be of paramount importance. On the other hand, in a common equity offering a more broadly based evaluation of the company's long-term as well as short-term prospects would be appropriate.

3. *The type of person.* This circumstance takes account of the fact that Congress intended that there would be variation in the throughness of the investigation performed by the different persons subject to Section 11 liability based on ". . . the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect." [60]

4. *The office held when a person is an officer.* The nature of investigation will vary to some extent depending upon the person's position and responsibilities within the organization.

5. *The presence or absence of another relationship to the issuer when the person is a director or proposed director.* This provision would acknowledge that there should be variation in the standard of reasonableness, which is, according to the Conference Report, "[c]ommensurate with the confidence, both as to integrity and competence, that is placed in [the person]." [61] The case law makes clear that a director who has another relationship with the issuer involving expertise, knowledge or responsibility with respect to any matter giving rise to the omission or misstatement will be held to a higher standard of investigation and belief than an outside director with no special knowledge or additional responsibility.[62]

6. *Reasonable reliance on others.* This provision arises from the Congressional intent to permit reliance in the following manner:

> Delegation to others of the performance of acts which it is unreasonable to require that the fiduciary shall personally perform is permissible. Especially is this true where the character of the acts involves professional skill or facilities not possessed by the fiduciary himself. In such cases reliance by the fiduciary, if his reliance is reasonable in the light of all the circumstances, is a full discharge of his responsibilities.[63]

From the legislative history, it appears that this language was included to avoid placing excessive burdens on the issuer's directors.[64]

7. *The type of underwriting arrangement and the role of the particular person as an underwriter.* The reference to the role of the particular person as an underwriter is intended to distinguish between a traditional underwriter and a technical "statutory" underwriter, such as a selling shareholder, who, although meeting the legal definition of underwriter,[65] may not be able to perform the kind of investigation which can reasonably be expected when an investment banking firm acts as an underwriter. Such a person also would play little or no role in the actual distrubution of the securities. The role of a participating underwriter with respect to the distribution is less than that of the managing underwriter, but the Securities Act holds each underwriter to the same standard of liability.[66]

8. *The circumstances of incorporation by reference.* This provision would be relevant where it is alleged that there was an omission or misstatement in the Exchange Act report *ab initio*. Where materially is a close question, where the phrasing, emphasis, balance or completeness of the disclosure is in issue or in other appropriated situations, a court may take into account which persons had responsibility for preparing the previously filed document.[67] Where material information in a previously filed report becomes false and misleading due to a subsequent development, there appears to be no reason for making any distinction among the persons named in Section 11(a).

B. Rules Regarding Effective Date of Documents Incorporated by Reference and the Use of Modified or Superseded Statements

These provisions originally were proposed in Securities Act Release No. 5998 and were reproposed in September 1980 as Item 8 of Form A and Item 9 of Form B. They are being reproposed as new Rules 412 and 418 of Regulation C to indicate that the rules would apply to every registration form which incorporates by reference information in previously filed documents. The intended effect is to convey explicitly the Commission's belief that updated or subsequently improved disclosure promotes the purposes of the Federal securities laws and therefore the fact of change should have no probative value.

The Commission, however, is reconsidering proposed Rule 412 which would provide that the effective date of an incorporated document for purposes of Section 11(a) is the date of its initial filing with the Commission.[68] This rule is clearly appropriate for documents filed and incorporated after the effective date

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[59] The case of *Escott* v. *BarChris, supra* note 51, illustrates this point. Adequate cash flow is a critical concern for most construction companies, and this was certainly true for BarChris. BarChris depended upon its factor to provide the funds it needed on an ongoing basis to construct and equip bowling alleys. The underwriters and others failed to examine agreements between BarChris and its factor which obligated BarChris to repurchase all the notes of defaulting customers in certain circumstances. There was no review of the factor's correspondence with BarChris discussing the problem of customer delinquencies nor was there any meeting with representatives of the factor. Such inquiries would have revealed material omissions or misstatements in BarChris's registration statement. There also was inadequate investigation of other matters including BarChris's status with its construction creditors.

[60] H.R. No. 85 at 9. The Court stated in *Feit* v. *Leasco* that "what constitutes 'reasonable investigation' and a 'reasonable ground to believe' will vary with the degree of involvement of the individual, his expertise and his access to the pertinent information and data." 332 F. Supp. 544, 577. *See also* the statement of James Landis that, "reasonability . . . will differ widely according to the person involved." "Liability Sections of the Securities Act Authoritatively Discussed," 18 *AM. Accountant* 330, 332 (1933).

[61] H.R. No. 152, 73d Cong., 1st Sess. 26 (1933).

[62] *See, e.g., Escott* v. *BarChris*, 283 F. Supp. at 684–690. *See generally*, Folk, "Civil Liability Under the Federal Securities Acts: The *BarChris* Case, Part I," 55 Va. Rev. 1, 21–48 (1969).

[63] H.R. No. 152 at 26.

[64] *See, e.g., Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 206–10 (1933); *See also* Landis, "The Legislative History of the Securities Act of 1933," 28 Geo. Wash L. Rev. 29, 48 (1859).

[65] Section 2(11).

[66] Section 11(a). The Commission has stated that each participating underwriter "must satisfy himself that the managing underwriter makes the kind of investigation the participant would have performed if he were the manager." 37 FR at 18014. *See also*, the Court's discussion of this issue *In Re Gap Stores Securities Litigation*, 79 F.R.D. 283, 300-02 (N.D. Cal. 1978).

[67] *See also*, discussion of this issue in Section IV of this release.

[68] The proposed rule specifically indicates that filing of an Exchange Act report does not create an effective date for purposes of commencement of the statute of limitations. It should be noted that Form S-8 and proposed Form S-3 provide that filing of a subsequent annual report under the Exchange Act which is incorporated by reference is treated as a new registration statement for purposes of the statute of limitations.

of the registration statement.[69] Information in such documents cannot be evaluated, for purposes of Section 11(a), as of a time earlier than their initial filing. Yet, this conclusion is so obvious that perhaps it need not be stated by rule. As to incorporated documents filed before the registration statement becomes effective, the application of the rule is less certain. In any event, the persons subject to Section 11(a) must evaluate the entire contents of the registration statement—including any information incorporated by reference—as of the effective date, in order to fulfill their due diligence obligations. The declaration that the effective date of a prior filing is its initial filing date does not mean that it must be evaluated for purposes of Section 11(a) as of that date or that if there is an error in that filing a liability will attach under the Securities Act based solely on the contents of the document at the time of its initial filing. Rather, inaccurate or out-dated information in a prior filing should not be deemed to make the prospectus false or misleading if up-dating or correcting information is included in a later filing or in the registration statement. Yet this latter principle is better expressed in the provisions of proposed Forms S–2 and S–3 regarding information about material unreported developments[70] and in Rule 418 regarding modified and superseded documents. Accordingly, the Commission specifically requests comments on whether some or all of Rule 412 might not be necessary or appropriate to clarify responsibilities for incorporated documents.

VII. Conclusion

Prior to enactment of the Securities Act in 1933, there was little information available about the new issues of securities offered for sale to the public.[71] Today, however, a wealth of accounting and other company-specific information is rapidly disseminated throughout increasingly efficient securities markets. Because the securities markets absorb previously filed information about seasoned issuers, the Commission has determined to permit such issuers to satisfy certain disclosure requirements of the Securities Act by incorporating by reference into the registration statement pertinent information, updated where necessary, from previously filed Exchange Act reports. Although an efficient market conveys information expeditiously, it has no capacity to authenticate information.[72] Therefore, the Commission rejects any notion that investors no longer rely upon the underwriter and others to perform an investigatory function.[73]

Proposed Rule 176 is intended to clarify when there may be legitimate variation in the nature of investigation performed and in the basis for reasonable belief. Proposed Rules 412 and 418 are designed to assist underwriters and others in assuring there is adequate disclosure of all material information in short form registration statements. The Commission believes that these three rules respond to the concerns which have been expressed by underwriters in the past regarding their liability risks with respect to information incorporated by reference into a registration statement.

Finally, as part of its analysis of the operation of the provisions of Regulation C, the Commission is giving consideration to the question of whether Rule 461[74] should be amended to require that the managing underwriter state, in connection with a request for acceleration, whether there has been time to reasonably review and comment upon documents incorporated by reference into the registration statement. Such a proposal would ensure that underwriters can take as much time as necessary to complete the investigation prior to filing the registration statement or the submission of an acceleration request. Accordingly, the Commission invites commentators to address the question of whether there is need for such a rule.

Text of Proposed Amendments

17 CFR Part 230 is proposed to be amended as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. By adding § 230.176 to read as follows:

§ 230.176 Circumstances affecting the determination of what constitutes reasonable investigation and reasonable grounds for belief under section 11 of the Securities Act.

In determining whether or not the conduct of a person constitutes a reasonable investigation or a reasonable ground for belief meeting the standard set forth in section 11(c), relevant circumstances include, with respect to a person other than the issuer,

(a) The type of issuer;

(b) The type of security;

(c) The type of person;

(d) The office held when the person is an officer;

(e) The presence or absence of another relationship to the issuer when the person is a director or proposed director;

(f) Reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the issuer and the filing);

(g) When the person is an underwriter, the type of underwriting arrangement and the role of the particular person as an underwriter; and

(h) Whether, with respect to a fact or document incorporated by reference, the particular person had any responsibility for the fact or document at the time of the filing from which it was incorporated.

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[69] Item 12(b) of proposed Form S–3 requires that during the offering all documents subsequently filed by the registrant pursuant to Sections 13, 14 or 15(d) of the Exchange Act shall be deemed incorporated by reference. There is a similar requirement for proposed Form S–2.

[70] Item 11(a) of proposed Forms S–2 and S–3.

[71] On source has observed that:

A typical offering circular for that period contained little or no financial information, very little information as to the use of proceeds, a rather brief description of the securities themselves and few, if any, material facts relating to the business of the issuer. Furthermore, the disclosures required today with respect to such matters as underwriting spreads, compensation of management and the possible interests of insiders in the financing or in recent transactions with the issuer were virtually unknown.

Halleran and Calderwood, "Effect of Federal Regulation on Distribution and Trading in Securities," 28 Geo. Wash. L. Rev. 86, 94 (1959).

[72] As the Advisory Committee reported:

The market price of a security reflects true information and false information with equal efficiency, as long as the quality of the information is not itself a part of the information in the marketplace. Thus, a fraudulent income statement not known to be false will be reflected in the market price of the security to the same extent as a true one.

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[73] The Commission agrees that:

No greater reliance in our self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter. He is most heavily relied upon to verify published materials because of his expertise in appraising the securities issue and issuer, and because of his incentive to do so. He is familiar with the process of investigating the business conditions of a company and possesses extensive resources for doing so. Since he often has a financial stake in the issue, he has a special motive thoroughly to investigate the issuer's strengths and weaknesses. Prospective investors look to the underwriter—a fact well known to all concerned and especially to the underwriter—to pass on the soundness of the security and the correctness of the registration statement and prospectus.

Chris-Craft Industries Inc. v. *Piper Aircraft Corp.*, 480 F. 2d 341, 370 (2d Cir. 1973), *cert. denied*, 414 U.S. 910 (1973).

[74] 17 CFR 230.461 (1980).

2. By removing present § 230.412 and adding new § 230.412 to read as follows:

§ 230.412 Effective date of certain documents incorporated by reference.

For purposes of determining pursuant to section 11(a) of the Act only when a document incorporated by reference "became effective," the effective date shall be date of the document's initial filing with Commission. For all other purposes under the Act, including section 13, the effective date shall be the effective date of the registration statement.

3. By adding § 230.418 to read as follows:

§ 230.418 Modified or superseded documents.

(a) Any statement contained in a document incorporated or deemed to be incorporated by reference shall be deemed to be modified or superseded for purposes of the registration statement or the prospectus to the extent that a statement contained in the prospectus or in any other subsequently filed document which also is deemed to be incorporated by reference modifies or replaces such statement.

(b) The modifying or superseding statement may, but need not, state that it has modified or superseded a prior statement or include any other information set forth in the document which is not so modified or superseded. The making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement, when made, constituted an untrue statement of a material fact, an omission to state a material fact necessary to make a statement not misleading, or the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business or artifice to defraud, as those terms are used in the Act, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, or the rules and regulations thereunder.

(c) Any statement so modified shall not be deemed in its unmodified form to constitute part of the registration statement or prospectus for purposes of the Act. Any statement so superseded shall not be deemed to constitute a part of the registration statement or the prospectus for purposes of the Act.

Authority

These rules are being proposed pursuant to Sections 6, 7, 10 and 19(a) of the Securities Act of 1933.

By the Commission.

George A. Fitzsimmons,

Secretary.

August 6, 1981.

Regulatory Flexibility Act Certification

I, John S. R. Shad, Chairman of the Securities and Exchange Commission, hereby certify, pursuant to 5 U.S.C. 605(b), that proposed Rule 176 and proposed Rules 412 and 418 as set forth in Release No. 33-6335 (August 6, 1981), if promulgated, will not have a significant economic impact on entities subject to the amendments, and therefore will not have a significant economic impact on a substantial number of small entities. The reasons for this certification are that (1) proposed Rule 176 only provides additional guidance to persons subject to section 11(b) of the Securities Act of 1933 and does not modify the statutory responsibilities imposed upon such persons by that section and (2) proposed Rules 412 and 418 are technical in nature and do not alter the requirement that information set forth in a registration statement be true and complete in all material respects.

Dated: August 6, 1981.

John S. R. Shad,

Chairman.

[FR Doc. 81-23442 Filed 8-13-81: 12:50 pm]

BILLING CODE 8010-01-M

17 CFR Part 230

[Release Nos. 33-6336; 34-18012; IC-11892; File No. S7-898]

Disclosure of Security Ratings in Registration Statements

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking.

SUMMARY: The Commission is issuing a statement of its policy and two proposals to permit the voluntary disclosure of security ratings assigned by nationally recognized statistical rating organizations to classes of debt securities, convertible debt securities and preferred stock in registration statements filed under the Securities Act of 1933. The first proposed rule would permit the disclosure of security ratings in certain communications not deemed a prospectus under the Securities Act of 1933. The second proposed rule would exclude any nationally recognized statistical rating organization whose security rating is disclosed in a registration statement from civil liability under Section 11 of the Securities Act of 1933.

DATE: Comments must be received on or before October 30, 1981.

ADDRESSES: Comments should be submitted in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. Comment letters should refer to File No. S7-898. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 1100 L Street, N.W., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Mary Ann Binno or Beverly K. Rubman, Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, (202) 272-2604.

SUPPLEMENTARY INFORMATION: The Commission today is publishing its policy to permit the voluntary disclosure of security ratings assigned by nationally recognized statistical rating organizations ("rating organizations") to classes of debt securities, convertible debt securities and preferred stock in registration statements under the Securities Act of 1933 ("Securities Act") (15 U.S.C. 77a et seq.) and is publishing for public comment two proposals to facilitate such disclosure. The Commission is announcing that, contrary to prior general staff positions on this matter, it now will permit the disclosure of security ratings assigned by rating organizations in registration statements. In order to give guidance to registrants, the Commission also is setting forth its views concerning the appropriate disclosure in addition to the actual security rating or ratings assigned to the particular class of securities that registrants should include in the registration statement to provide meaningful information to investors.

To facilitate this change of policy, the Commission is publishing two proposals. The first would amend Rule 134 under the Securities Act (17 CFR 230.134) to permit the disclosure of security ratings of debt securities, convertible debt securities or preferred stock assigned by a rating organization in certain communications deemed not to be a prospectus ("tombstone advertisements"). The second proposal would add a new subparagraph (g) to Rule 436 under the Securities Act (17 CFR 230.436(g)) to provide that a security rating is not a part of a registration statement prepared or certified by a person or a report or valuation prepared or certified by a person within the meaning of Sections 7 and 11 of the Securities Act (15 U.S.C. 77 (g) and (k)). If adopted, this proposal would eliminate the required filing by the registrant of the rating organization's consent under Section 7 of the Securities Act if the rating is included in the registration statement and would