



SEC Proposes to Relax Restrictions on “Wall-Crossed” WKSI Offerings

On December 21, 2009, the SEC proposed a change to Securities Act Rule 163. Under the proposal, an authorized underwriter or other offering participant could make offers of securities issued by a well-known seasoned issuer (WKSI) before the WKSI files a registration statement.¹ This proposed change would allow WSIs to utilize underwriters for pre-marketed or “wall-crossed” transactions prior to filing an automatic shelf registration with the SEC.

Background of Rule 163

Rule 163 was originally adopted in 2005 as part of the SEC’s Securities Offering Reform rulemaking.² As adopted, Rule 163 provides a non-exclusive exemption that permits WSIs to engage in unrestricted oral and written offers before a registration statement is filed, without violating the gun-jumping provisions of Section 5 of the Securities Act. In adopting this provision, the SEC did not expect it to be used extensively, noting:

In view of the automatic shelf registration process . . . we expect that well-known seasoned issuers usually will have a registration statement on file that it can use for any of its registered offerings. Consequently, it generally will be unusual for these issuers to make offers prior to the filing of a registration statement; however, we have provided this exemption from the prohibition on pre-filing offers to liberalize communications for these issuers to the appropriate extent.

Offers made under the Rule 163 exemption are subject to a number of conditions, including a required legend and the requirement to file any written communications as a free writing prospectus (but only at the time that a registration statement is ultimately filed).

As originally adopted, Rule 163 provided that a communication is made “by or on behalf of” an issuer if the issuer or an agent or representative of the issuer, *other than an offering participant who is an underwriter or dealer*, authorizes or approves the communication before it is made. As a result, the availability of the Rule 163 exemption has been narrowly limited to issuer communications, significantly restricting the ability of a WKSI to conduct any meaningful pre-marketing activities in advance of filing an automatic shelf registration statement.

The Rise of Pre-Marketing

Since the adoption of Rule 163, issuers have faced extraordinary market volatility, which has brought on a number of potential concerns in traditional underwritten offerings. These concerns include the significant execution risk associated with offerings, including the potentially adverse impact on an issuer’s stock price if an offering is

¹ Release No. 33-9098 (December 18, 2009). The proposing release is available at: <http://www.sec.gov/rules/proposed/2009/33-9098.pdf>.

² Release No. 33-8591 (July 19, 2005).

launched but not successfully completed. Further, underwriters have been faced with increased market risk, particularly when facing markets where there may be significant short selling in the company's securities at and around the time when the offering is launched.

In dealing with these market realities, underwriters have found it beneficial to engage in pre-marketing activities prior to public announcement of the transaction. During the pre-marketing phase of the offering, the underwriters contact a select group of institutional investors to gauge the potential interest of those investors in the offering. In making the initial contact, the underwriters generally do not reveal the identity of the issuer. Prospective investors expressing an interest in the offering are then brought "over the wall" by the underwriter, and are told about the issuer, the offering and potentially other material nonpublic information under agreements to keep the information confidential and to not trade on the basis of the information. Following a successful pre-marketing phase, the issuer may choose to publicly announce the transaction and have the underwriters market the securities to a broader group of investors with the expectation of very quickly (usually in a matter of hours) determining the size and price of the offering.

Under current rules, these sorts of pre-marketed or "wall-crossed" transactions can typically only be done without risk of gun-jumping violations when a registration statement is on file and effective with respect to the securities to be offered. Logically, an issuer (as opposed to an underwriter) typically is not in a position to solicit the interest of prospective investors under Rule 163 on a confidential basis without subjecting itself to market risk, principally because any such solicitations would immediately reveal the issuer's identity and the prospects for a transaction to market participants who may not yet be subject to confidentiality and trading restrictions. Moreover, WKSIs may be concerned that the filing of an automatic shelf registration statement immediately before the commencement of the pre-marketing period could signal to the market that an offering is imminent, and thereby create market and execution risk concerns.

Proposed Changes to Rule 163

In proposing to expand the availability of the Rule 163 exemption to offering participants, the SEC acknowledges the use of pre-marketing in public offerings and appears to be changing the rule to further facilitate this practice. Prior to the Rule 163 proposing release, the SEC had not specifically acknowledged or endorsed "wall-crossed" deals.

The SEC notes, in proposing the expansion of Rule 163, that the scope of the original rule was predicated on the expectation that WKSIs would routinely file automatic shelf registration statements covering the securities that they expected to sell in the wake of Securities Offering Reform, thus rendering Rule 163 applicable in only a limited number of cases. What happened, however, is that WKSIs did not universally choose to file automatic shelf registration statements; in fact, the SEC's Office of Economic Analysis found that only 50% of WKSIs had filed automatic shelf registration statements as of the end of fiscal years 2006 and 2007. Issuers continue to be concerned that filing an automatic shelf registration may lead to a perception of significant market overhang that could ultimately depress the price of their securities.

Under proposed amendments to paragraph (c) of Rule 163, an underwriter or dealer would be deemed an agent or representative of a WKSI under the following conditions:

- the underwriter or dealer receives written authorization from the WKSI to act as the WKSI's agent or representative before any communications are made on the WKSI's behalf;
- the WKSI authorizes or approves any written or oral communication before such communication is made by an authorized underwriter or dealer acting as an agent or representative for the WKSI, based on the concept that any Rule 163(c) communication is an issuer communication; and

- any authorized underwriter or dealer that has made any authorized communication on behalf of the issuer under the exemption provided by Rule 163 is identified in the prospectus contained in the registration statement that is filed for the offering to which the communication relates.

The SEC has proposed the condition requiring that an underwriter or dealer receive written authorization from the WKSI to act as its agent or representative prior to the communications as a means to prevent underwriters or dealers from going out without an issuer's authorization to gauge market interest, and then presenting the issuer with an unsolicited proposal for an offering.³ In the SEC's view, permitting underwriters or dealers to solicit investor interest for the purpose of making unsolicited offering proposals to issuers goes beyond the limited purposes of the Rule 163 exemption.

Regulation FD and Insider Trading Considerations

Under Rule 163, any communications made in reliance on the exemption are not deemed to be made in connection with a registered securities offering for the purposes of exclusion provided in Rule 100(b)(2)(iv) of Regulation FD.⁴ Nothing in the proposed amendments would change the relationship between pre-filing communications covered by the Rule 163 exemption and Regulation FD. As a result, if an underwriter or dealer communicates material nonpublic information on a pre-filing basis under the proposed expansion of Rule 163(c) to those persons enumerated in Regulation FD, the underwriter or dealer would need to do so under a confidentiality agreement, or the issuer would need to publicly disclose the information in accordance with Regulation FD. Further, nothing in the proposed expansion of Rule 163(c) would obviate the need to obtain agreements not to trade in the WKSI's securities, and the SEC confirmed in the proposing release that any misuse of information for trading by a person subject to a confidentiality agreement would be subject to the application of either a "temporary insider" or misappropriation theory of insider trading.

Before the pricing of a public offering and the execution of an underwriting agreement, WKSIs and their underwriters do not generally enter into a written agreement relating to the offering. Under the proposed rules, this practice may change to some degree, and the applicable WKSI and underwriter may seek to document certain aspects of the pre-marketing activity. For example:

- The proposed amendments contemplate a written authorization from the WKSI for the underwriter to act as the WKSI's representative. A short agreement may be used to describe the scope of the authorization, and the types of communications that are authorized.
- The relevant issuer may seek written assurances from the underwriter that the necessary confidentiality agreements will be obtained from the relevant investors before the public announcement of the offering is made.

Alternatively, it is possible that these types of provisions will be documented "after the fact," in the applicable underwriting agreement.

Conclusion

The SEC is soliciting comment on the proposed rule change until January 27, 2010. While the proposed rule change is very limited, it could provide significant additional flexibility for those WKSIs which have chosen not to file an automatic shelf registration statement prior to the time of an anticipated offering. The SEC also provides tacit acknowledgement of (and is seeking to facilitate) the "wall-crossed" method of conducting public offerings

³ The SEC indicates in the proposing release that this condition is not intended to limit or otherwise affect the ability of an underwriter or dealer not acting on behalf of an issuer from making the type of "reverse inquiry" offers that are common in registered offerings of medium term notes, where an issuer has already filed a registration statement, and, thus, the proposed Rule 163(c)(1) condition would not be applicable.

⁴ See Rule 163(e).

for issuers, which could serve to expand the use of that particular offering approach as market volatility and uncertainty persists.

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