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“Free” Communications—The Securities and Exchange Commission’s Safe Harbor Provisions in the M&A Release

Christy L. Wells*

I. INTRODUCTION

In the wake of increased merger and acquisition transactions,¹ the Securities and Exchange Commission (SEC)² significantly revised the rules governing takeover transactions in what is considered one of the largest and most dramatic changes to regulations governing transactions involving mergers and acquisitions.³

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1. Takeover activity has surpassed the rate of activity of the 1980s. Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 33-7607, 1998 WL 767321 (S.E.C.), at *2 (Nov. 3, 1998) [hereinafter Securities Act Release No. 33-7607]. In 1996, 7,000 merger and acquisition transactions were completed in the United States and valued at more than \$650 billion. *Id.* In 1997, the activity increased to 7,800 transactions and valued at over \$790 billion. *Id.* In 1998, merger and acquisition activity increased to \$1.65 trillion and 11,715 transactions. Judith Radler Cohen, *Europe Kept on Rocking M&A Boat: At the End of Last Year, as at Outset, Europe Told the Hot M&A Story*, MERGERS & ACQUISITIONS REP., Jan. 3, 2000 WL 8336867. Although some dispute exists as to the statistics, the 1999 transactions measured in at 11,000 with a value in excess of \$1.67 trillion. Mark Cecil, *M&A Activity Strong but Moderating: Bankers Predict Renewed Momentum in the Second Half*, MERGERS & ACQUISITIONS REP., July 10, 2000 WL 8337142. The second quarter results were analyzed to reach a figure of just under 10,000 transactions totaling \$1.75 trillion for 2000. *Id.*

2. The SEC was established in § 4(a) of the Securities Exchange Act of 1934. LOUIS LOSS ET AL., FUNDAMENTALS OF SECURITIES REGULATION 57 (Aspen Law & Business 4th ed., 2001). The SEC’s duties include administering seven statutes: the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisors Act of 1940, and to some extent the Securities Investor Protection Act of 1970. *Id.* at 37-38. Under the Bankruptcy Reform Act of 1978, the SEC maintains an advisory function in corporate reorganization cases. *Id.* at 3.

3. William G. Lawlor & Peter D. Cripps, *New Rules for Pitching Your Deal*, MERGERS & ACQUISITIONS: THE DEAL MAKERS J., Apr. 1, 2000, at 43.

The new rules,⁴ proposed in the highly anticipated M&A Release,⁵ took effect on January 24, 2000.⁶ The drafters intended the rules⁷ to increase communications with security holders and the market,⁸ as well as to continue to provide protection to investors by meeting the necessities and demands of today's market to rapidly disseminate current transaction information.⁹

A significant portion of the M&A Release¹⁰ operates to substantially eliminate existing restrictions¹¹ on oral and written¹² communications with security¹³ holders prior to furnishing a disclosure statement or prospectus or an offer to purchase. In providing for the elimination of said restrictions, the M&A Release conditions that all written communications shall be filed with the SEC.¹⁴ This Note focuses upon the SEC's achievement of eliminating

4. See generally Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 33-7760, 64 Fed. Reg. 61408 (Nov. 10, 1999) [hereinafter Security Act Release No. 33-7760].

5. See generally Securities Act Release No. 33-7607, *supra* note 1.

6. *Id.*

7. Securities Act Release No. 33-7760, *supra* note 4.

8. *Id.*

9. Warren de Wied et al., *The SEC's Proposed Revisions to the Rules Governing Business Combinations Transactions*, 2 No. 8 M & A LAW. 12, 12 (1999). A prevalent concern of the SEC was "to conform to the realities of today's environment surrounding takeover transactions, while maintaining high quality investor protection and enhancing the timing and quality of information available to investors." *Id.*

10. See generally Securities Act Release No. 33-7607, *supra* note 1, at 2.

11. The existing restrictions on communications were proscribed in Section 5 of the 1933 Act by prohibiting any person to buy or sell a security without filing a registration statement regarding such security with the SEC. 15 U.S.C. § 77e (1994); see also *infra* notes 17, 18, 56 and accompanying text.

12. Section 2(a)(9) of the 1933 Act defines "written" to include printed, lithographed, or any means of graphic communication. 15 U.S.C. § 77b(9) (1994). "Written communications include all information disseminated otherwise than orally, including electronic communication and other future applications of changing technology." Securities Act Release No. 33-7760, 64 Fed. Reg. 61412 n.37 (Nov. 10, 1999).

13. A security is defined as:

[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest of participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, . . . or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (1994).

14. See generally Securities Act Release No. 33-7607, *supra* note 1.

communication restrictions¹⁵ while promoting free communications¹⁶ through the adoption of Rules 165¹⁷ and 166¹⁸ as safe harbor¹⁹ provisions from § 5(c)²⁰ and (b)(1)²¹ of the Securities Act of 1933 in business combination transactions.²²

15. *See supra* note 10.

16. Free communication or “free writing” are terms that are coined in the securities industry to mean communications which have not been registered with the SEC and are usually issued during a period in which such documents are prohibited. *See generally* JENNINGS ET AL., *infra* note 26, at 122.

17. Commodity and Security Exchanges, 17 C.F.R. § 230.165 (2000). In general, Rule 165 of the Securities Act of 1933 allows for communications to occur prior to and after the filing of the registration statement in business combinations. These actions are otherwise prohibited. *See generally id.*

18. 17 C.F.R. § 230.166 (2000). In general, Rule 166 prohibits the communication discussed in Rule 165 from being considered an offer or solicitation to buy or sell. *See generally id.*

19. Originating in the tax code, the term “safe harbor” means a provision allowing protection from another restriction upon an activity. *See generally* BLACK’S LAW DICTIONARY 1336 (6th ed. 1990).

20. Section 5(c) of the 1933 Act provides:

[I]t shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

15 U.S.C. § 77e(c) (1994).

21. Section 5(b)(1) of the Securities Act of 1933 provides:

It shall be unlawful for any person, directly or indirectly—(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title.

15 U.S.C. § 77e(b)(1) (1994).

22. “A business combination transaction means any transaction specified in § 230.145(a) or exchange offer.” 17 C.F.R. § 230.165(f)(1) (2000). Section § 230.145 provides:

An “offer”, “offer to sell”, “offer for sale”, or “sale” shall be deemed to be involved, within the meaning of Section 2(3) of the Act, so far as the security holders of a corporation or other person are concerned where, pursuant to statutory provisions of the jurisdiction under which such corporation or other person is organized, or pursuant to provisions contained in its certificate of incorporation or similar controlling instruments, or otherwise, there is submitted for the vote or consent of such security holders a plan or agreement for: (1) Reclassifications . . . ; (2) Mergers of Consolidations . . . ; (3) Transfers of assets . . .

17 C.F.R. § 230.145 (2000).

Although the issuance of these safe harbor provisions focus on business combination transactions, the restrictions of § 5(c)²³ and (b)(1)²⁴ still apply to transactions and stock issues that are not components of a business combination, namely capital-raising and resale transactions. This Note proposes that in order for the SEC “to conform to the realities of today’s environment,”²⁵ and ultimately protect investors, the SEC must issue similar safe harbor amendments applicable to securities involved in capital-raising or resale functions. By issuing such safe harbor amendments, the SEC can establish uniformity between the Securities Act of 1933²⁶ and the Securities Exchange Act of 1934 (the Acts),²⁷ thereby forcing the Acts’ regulation into modern times.

Part I provides an introduction as to the content of the Note. Part II of this Note examines the history behind the Acts in terms of communications of the security distribution system of capital-raising and resale functions. It also provides a specific review of § 5(c) and (b)(1) and the M&A Release. In addition, this Note presents an examination of the resulting amendments to Rules 135 and 145, the adoptions of Rule 165 and Rule 166, and the SEC’s warnings about remaining responsibilities even after the modifications.

Part III of this Note discusses the relevancy of the implementation of Rules 165 and 166, as well as their strengths and weaknesses, and their important impact on the securities industry with respect to communication.

Part IV analyzes the impact of Rules 165 and 166 as safe harbor provisions and their affect upon § 5(c) and (b)(1). Additionally, this Note analyzes the effects of the modifications in light of the specific goals established in the M&A proposal, as well as the SEC’s concern with selective disclosure.

23. *See supra* note 20 and accompanying text.

24. *See supra* note 18 and accompanying text.

25. Wied et al., *supra* note 9.

26. The Securities Act of 1933 aims to accomplish two objectives: “full disclosure in connection with the distribution of securities and the prevention of fraud in the sale of securities.” RICHARD W. JENNINGS ET AL., *SECURITIES REGULATION CASES AND MATERIALS* 605 (8th ed. 1998).

27. The Securities Exchange Act of 1934 is primarily focused on the trading of securities in the secondary markets. *Id.*

Part V proposes the need to implement these modernized communication regulations and anti-restriction provisions throughout the Acts, especially in cases of capital-raising and resale functions. The amendments allowing “free” communications should be applied to other transactions, specifically those involving initial public offerings. The effect of applying the amendments uniformly in the Acts achieves the SEC’s goal of modernizing the governing rules, as well as taking advantage of the rapidity of electronic media.

II. A HISTORY OF THE SECURITIES ACTS

The Securities Act of 1933²⁸ (1933 Act) governs the initial distribution system of securities.²⁹ The dominant provision of the 1933 Act requires a filing with the SEC of any security offered to the public through mail or interstate commerce.³⁰

The Securities Exchange Act of 1934³¹ (1934 Act) governs the subsequent trading, or post-distribution trading, of securities.³² In addition, the 1934 Act focuses upon the regulation of the exchange and over-the-counter markets, prevention of fraud and market manipulation, and control of securities credit by the Board of Governors of the Federal Reserve System.³³ Moreover, the 1934 Act also emphasizes the importance of self-regulation.³⁴

Together, the Acts provide a structured governance system for securities from the initial offering to subsequent transactions. While the Acts remain distinct entities, there still remains an overlap between the Acts’ areas and techniques of governance.³⁵

The Acts’³⁶ broad language is responsible for the primary limitations on communications. The majority of the public’s

28. 15 U.S.C. § 77a (1997).

29. LOSS ET AL., *supra* note 2, at 38.

30. *Id.*

31. 15 U.S.C. § 78j(b) (1994).

32. *See supra* note 29.

33. *Id.*

34. *Id.* at 39. In 1996, the government also granted the SEC the self-regulating ability under the 1933 Act. Thus the SEC retains self-regulating power over both Acts. *Id.*

35. *See* LOSS ET AL., *supra* note 2, at 53.

36. Securities Act Release No. 33-7760, *supra* note 4, at 61410-11.

confusion emanates from the use of the terms “offer”³⁷ and “prospectus”³⁸ under the 1933 Act, “solicitation”³⁹ under the 1934 Act proxy rules, and “commencement”⁴⁰ under the Williams Act⁴¹ tender offer rules.⁴² The confusion results because of the use of such words in communication prohibition sections, such as § 5(c) of the 1933 Act.⁴³

While the M&A Release broadly addresses the Acts,⁴⁴ this Note focuses on the 1933 Act in general, and more specifically on § 5(c) of the 1933 Act.⁴⁵

37. “The term ‘offer to sell’, ‘offer for sale’, or ‘offer’ shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.” 15 U.S.C. § 77b(3) (1994). For the purposes of this Note it is also important to understand the term “offer to buy” in the context of section 5(c).

The terms defined in this paragraph and the term “offer to buy” as used in subsection (c) of section 77e of this title shall not include preliminary negotiations or agreements between an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer) and any underwriter or among underwriters who are or are to be in privity of contract with an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer).

Id.

38. See *infra* note 139 and accompanying text.

39. The term “solicitation” is defined by Rule 14a-1(l)(1) of the 1934 Act as:

(i) [A]ny request for a proxy whether or not accompanied by or included in a form of a proxy; (ii) Any request to execute or not to execute, or to revoke, a proxy; or (iii) The furnishings of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.

17 C.F.R. § 240.14a-1(l)(1) (2001).

40. Commencement of a tender offer is discussed in Rule 14d-2 of the 1934 Act. See 17 C.F.R. § 240.14d-2 (2001).

41. In 1968, Congress enacted the Williams Act to amend the 1934 Act and regulate tender offers. Securities Act Release No. 33-7760, *supra* note 4, at 61411 n.29; see also 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1994).

42. See *supra* note 36. The SEC also realizes that by confining communications by these terms to a single document the investor is actually at a disadvantage, rather than fully informed about investing and voting decisions. *Id.*

43. 15 U.S.C. § 77e (1994) (prohibitions relating to interstate commerce and the mails); see also *infra* note 48 and accompanying text.

44. Securities Act Release No. 33-7607, *supra* note 1, at 2.

45. The M&A Release provided numerous changes to the Acts. This Note focuses upon the changes made within the 1933 Act because these changes concentrate on the relaxation of communications within business combination transactions. The other changes within the M&A Release focus upon business combination transactions, but not specifically regarding the issue of communications. Further, the other changes are limited to a narrow aspect of a business

One of the objectives of the 1933 Act is to provide investors with full disclosure of all pertinent financial information.⁴⁶ A key provision to achieve this goal is § 5, which governs the production of information and the making of offers to buy and sell securities.⁴⁷

In general, § 5⁴⁸ of the 1933 Act establishes the time-line for the allowance of communications.⁴⁹ An underlying assumption⁵⁰ exists as to the sequence of the participation of the movement of securities within the market.⁵¹ The assumption presumes that securities flow from the issuers,⁵² to the underwriters,⁵³ to the dealers,⁵⁴ and then finally to the public investor.⁵⁵

combination, for example tender offers, whereas the changes focused upon in this Note apply to business combination transactions regardless of the means of accomplishing such transactions.

46. JENNINGS ET AL., *supra* note 26, at 112. The 1933 Act aims “to provide investors with material financial and other information concerning new issues of securities offered for sale to the public . . .” *Id.*

47. “The term ‘sale’ or ‘sell’ shall include every contract of sale or disposition of a security or interest in a security, for value.” 15 U.S.C. § 77b(3) (1994); *see also* JENNINGS ET AL., *supra* note 26, at 112.

48. *See supra* notes 20-21 and accompanying text. Section 5 is an important statute in terms of the communication issues because it prevents the communications in certain periods of the foiling stages. The SEC’s issuance of Rules 165 and 166 exempt communications in mergers and acquisitions from these prohibitions.

49. *See infra* notes 59-61 and accompanying text (discussing the pre-filing, waiting, and post-effective periods).

50. All participants and authorities within the securities industry have generally established the assumption; accordingly, it remains a commonly accepted norm.

51. *See infra* notes 59-61 and accompanying text (discussing the pre-filing, waiting, and post-effective periods); *see also* Larry D. Soderquist, *Securities Act Registration: What Can Be Done*, in NUTS & BOLTS OF SECURITIES LAW 2000, at 33 (PLI Corporate Law and Practice Course, Handbook Series No. B-1179, 2000).

52. The 1933 Act defines an “issuer” as “every person who issues or proposes to issue any security . . .” 15 U.S.C. § 77b(4) (1994).

53. The term ‘underwriter’ means 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 undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall 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.

15 U.S.C. § 77b(11) (1994).

54. Section 2(a)(12) defines a “dealer” as “any person who engages for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.” 15 U.S.C. § 77b(12) (1994).

55. *See generally* LOSS ET AL., *supra* note 2, 63-200 (providing an in-depth analysis of the

While the securities are “in registration,”⁵⁶ the rules permit varying degrees as to the level of allowable communications.⁵⁷ The regulation of the communications results in much confusion and debate for individuals directly involved in the security distribution system.⁵⁸ The time sequence pattern, which establishes a pre-filing period,⁵⁹ a waiting period,⁶⁰ and a post-effective period,⁶¹ provides some clarification and classification for the communication restrictions.

Section 5(c) of the Securities Act of 1933 regulates the pre-filing period.⁶² Section 5(c)⁶³ prohibits an offer to either buy or sell through the use of a prospectus.⁶⁴ As a result of the SEC’s broad view of an offer,⁶⁵ communications in this period are strictly regulated.⁶⁶ The only communications allowed during the pre-filing period are those which comply with the strict guidelines of Rule 135.⁶⁷ The SEC reasons that besides formal offers, any advertising may be a questionable attempt of the issuer to reach the public as a part of the selling effort.⁶⁸

security distribution process).

56. The term “in registration” refers “to the entire process of registration,” including the pre-filing period through the post-effective period or “40 to 90 days’ in which the deals must distribute the prospectus.” Guidelines For the Release of Information By Issuers Whose Securities Are In Registration, Securities Act Release No. 33-5180 n.1 (Aug. 16, 1971).

57. *See generally id.*

58. *Id.* The release provides a set of guidelines to help alleviate confusion and aid in the registration process. *Id.*

59. The pre-filing period represents the time prior to filing the registration statement. LOSS ET AL., *supra* note 2, at 91. Sections 5(a)(1) and 5(c) prohibit offering to sell a security during this period. *Id.*

60. The waiting period is the time period directly after the filing of the registration statement and prior to the effective date of the registration statement. LOSS ET AL., *supra* note 2, at 98-99. During this period, no sales may be made and no written offers may be accepted. Soderquist, *supra* note 51, at 37.

61. The post-effective period is the period after the effective date of the registration statement with the SEC. LOSS ET AL., *supra* note 2, at 106.

62. *Supra* note 20 and accompanying text.

63. *Id.*

64. *Infra* note 139 and accompanying text.

65. *Supra* note 37 and accompanying text.

66. *Supra* note 36 and accompanying text. The section explains that restrictions on communication exist in part because of the broad language used within the Acts. *Id.*

67. *Infra* note 117 and accompanying text.

68. Securities Act Release No. 3844 (Oct. 8, 1957). Early advertising “may in fact contribute to condition the public mind or arousing public interest in the issuer in a manner

Pursuant to § 5, a company may make an offer, but not a sale, during the waiting period.⁶⁹ Thus, because a prospectus is defined as any offer in writing,⁷⁰ and § 5 dictates that a prospectus must meet the requirements of § 10,⁷¹ offers in writing cannot be made during the waiting period because the requisite information is not yet available.⁷²

The SEC allows for the distribution of two written documents during the waiting period—the preliminary prospectus,⁷³ often called the red herring,⁷⁴ and the tombstone ad.⁷⁵

The preliminary prospectus does not meet the requirements of a prospectus pursuant to section § 10(a).⁷⁶ Nevertheless, § 10(b) allows the SEC to develop rules which enable the use of a “prospectus,” thus omitting some of the requirements of the § 10(a) prospectus, for purposes of communications pursuant to § 5(b)(1).⁷⁷ The SEC

which raises a serious question whether the publicity is not in fact a part of the selling effort.”
Id.

69.

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or delivery after sale.

15 U.S.C. § 77e(a) (1994); *see also supra* notes 20-21 and accompanying text.

70. *Infra* note 139 and accompanying text.

71. *See infra* note 73 and accompanying text; *see also supra* note 20, 21, 56 and accompanying text. Section 10(a) discusses the information required in a prospectus. 15 U.S.C. § 77j(a) (1994).

72. *See supra* note 60 and accompanying text.

73. The Commission created a preliminary prospectus to “preserve the subtle distinction between ‘solicitation’ and ‘dissemination’.” JENNINGS ET AL., *supra* note 26, at 134. The preliminary prospectus is a document that contains material information regarding the security, but will not be treated as an offer to sell. *Id.* The seller files the document with the SEC and distributes it to possible investors. *Id.*

74. The term “red herring” originated from the red ink legend which contained the disclaimer that the document was not to be treated as an offer to sell. Nathan D. Lubell, *Revision of the Securities Act*, 48 COLUM. L. REV. 324 (1948).

75. Practitioners coined the term “tombstone ad” for the fact that the SEC allows very few facts to be printed in these ads. JENNINGS ET AL., *supra* note 26, at 137. The tombstone ad is statutorily provided for under § 2(a)(10)(b) and is governed by Rule 134. *Id.*

76. *Supra* note 73 and accompanying text.

77. *Supra* note 21 and accompanying text. Section 10(b) provides that:

developed Rule 430 which allows a preliminary prospectus, when filed with the registration statement, to meet the requirements of a § 10(a) prospectus for purposes of § 5(b)(1).⁷⁸

The “tombstone ad” is a communication allowed in the waiting period, but must meet the qualifications of § 2(a)(10)(b).⁷⁹ In order to qualify, the communication must indicate the person who can provide a copy of the written prospectus, the type of security, price, and certain other qualifications instructed by statute.⁸⁰ The additional requirements allowed in § 2(a)(10) are proscribed in Rule 134.⁸¹ The “tombstone ad”⁸² is not intended to be used as a selling device but rather to serve as a tool for testing the public’s interest in the

[T]he Commission shall by rules or regulations deemed necessary or appropriate in the public interest or for the protection of investors permit the use of a prospectus for the purposes of subsection (b)(1) of section 77e of this title which omits in part or summarizes information in the prospectus specified in subsection (a) of this section.

15 U.S.C. § 77j(b) (1994).

78. Rule 430 states that

A form of prospectus filed as a part of the registration statement shall be deemed to meet the requirements of section 10 of the Act for purposes of section 5(b)(1) thereof prior to the effective date of the registration statement, provided such form of prospectus contains . . . substantially that information except for the omission of information with respect to the offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices, or other matters dependent upon the offering price.

17 C.F.R. § 230.430.

79. The rule became an addition to the 1933 Act in 1954 “in view of the wide variations in the types of issuers, securities, and offering subject to the Securities Act and was designed to permit appropriate variations in the contents of such advertisements under such safeguards as may be necessary in the circumstances.” *LOSS ET AL.*, *supra* note 2, at 101 (citations omitted). The extreme strictness as to the content of the rule originates from the reasoning that the literature shall not act as a selling aid. *Id.*

80. 15 U.S.C. § 77b(10)(b) (1994):

[A] written prospectus meeting the requirements of section 77j) of this title may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors

81. Rule 134 provides that a communication shall not be deemed a prospectus pursuant to § 2(a)(10) if it contains only the allowable information set forth within Rule 134. 17 C.F.R. § 230.134 (2000).

82. For an example of a tombstone ad, both during the waiting period and in the post-effective period, see *JENNINGS ET AL.*, *supra* note 26, at 140-41.

security.⁸³

During the post-effective period, the issuers and underwriters engage in the buying and selling of securities.⁸⁴ The post-effective period is the only period when “free writing” is permitted. Solicitors may include pamphlets, advertisements, and other communications with the distribution of the prospectus.⁸⁵

The SEC has long been aware of the need and desire for changes regarding communications in the pre-filing period.⁸⁶ The varied proposals pertained to the entire security distribution process, and not simply to takeover transactions.⁸⁷

An increase in the practice of gun-jumping⁸⁸ also contributed to the increased demand for leniency in pre-filing communications.⁸⁹ The practice emerged as a result of the tension between the issuers who desire to “condition the market”⁹⁰ and the investors who demand timely, and legitimate, information.⁹¹ The SEC previously tried to

83. Memorandum of the Statutory Revision Committee addressed to the Commission, Securities Act Release No. 3224, 1947 WL 25708 (S.E.C.), 2 (June 6, 1947). The tombstone ad is to be used “purely as a screening device to ascertain what persons [are] sufficiently interested to warrant delivery to them of the statutory prospectus.” *Id.*

84. *See supra* note 61, at 106-07.

85. JENNINGS ET AL., *supra* note 26, at 148.

86. *See* Publication of Information Prior to or After the Filing And Effective Date of a Registration Statement under the Securities Act of 1933, Securities Act Release No. 5009, 1969 WL 96374 (S.E.C.) (Oct. 7, 1969). The act discusses the general need for less stringent communication restrictions, as well as recognizing the increased obligations and incentives of corporations to make timely disclosures. *Id.*; *see also In the Matter of Carl M. Loeb, Rhoades and Dominick & Dominick*, 38 S.E.C. 843 (1959) (looking at different interpretations of communications allowed in the pre-filing period).

87. Publication of Information Prior to or After the Filing and Effective Date of a Registration Statement Under the Securities Act of 1933, Securities Act Release No. 5009, 1969 WL 96374 (S.E.C.) (Oct. 7, 1969) (all releases recognize the need for increased communications and a change regarding the regulations); *see also* Public Statements by Corporate Representatives, Securities Act Release No. 6504, 1984 WL 53370 (S.E.C.) (Jan. 13, 1984); Guidelines for Release of Information by Issuers Whose Securities are in Registration, Securities Act Release No. 5180, 1971 WL 11224 (S.E.C.) (Aug. 20, 1971).

88. Gun-jumping is also known as beating the gun. LOSS ET AL., *supra* note 2, at 93. The practice of gun-jumping arises in situations where the issuer may release information early to “condition the market.” *Id.*

89. The issue of gun-jumping extends beyond the pre-filing stage into other stages of the process as well. *Id.*

90. Conditioning the market occurs prior to the filing of a registration statement “through such devices as press interviews, speeches, special reports to stockholders, market letters, and so on.” *Id.*

91. The SEC responded to gun-jumping by stating that the “increasing obligations and

solve gun-jumping by amending Rule 135 and adopting Rules 137-139.⁹² The gun-jumping issue, however, remained a problem even up until the M&A Release.⁹³

The SEC responded with Regulation A to increase the viability of communications within business combination transactions.⁹⁴ Specifically, Rule 254⁹⁵ in Regulation A provides for a “testing the waters” phase to determine the interest in the offered security.⁹⁶ The rationale for implementing the new rule originated in a cost-benefit analysis, as the costs associated with the production of an offering statement could be saved if the interest in the security was absent.⁹⁷

The success of the “testing the waters” phase associated with Regulation A influenced the SEC to implement similar changes regarding communication in business combination transactions.⁹⁸ Thus, the SEC enacted Rules 165 and 166.

The SEC developed the proposals in the M&A Release in response to the overwhelming call for the use of modern technology within the securities industry,⁹⁹ as well as “investor protection and enhancing the timing and quality of information available to investors.”¹⁰⁰

incentives of corporations to make timely disclosures concerning their offerings raise a question as to possible conflict between the obligation to make timely disclosure and the restriction on publication of information concerning an issuer which may have securities ‘in registration’.” LOSS ET AL., *supra* note 2, at 94 (citations omitted).

92. The amendment of Rule 135 provides that an issuer who proposes to make a public offering is not considered to make an “offer” if the issuer publishes a notice containing six categories of information. LOSS ET AL., *supra* note 2, at 95. Rule 137 allows the distribution of information in the ordinary course of business by brokers and dealers not associated with the distribution. *Id.* at 96. Rule 138 allows dealers and brokers who deal in non-convertible securities to publish opinions. *Id.* at 97. Rule 139 allows a broker or dealer, even one involved in the distribution, to publish an opinion on any registrant required to file a prospectus pursuant to § 13 or § 15(d) of the 1934 Act. *Id.*

93. *See supra* note 4.

94. JENNINGS ET AL., *supra* note 26, at 432-33. Regulation A is seen as a form of mini-registration for secondary offerings of existing security holders, up to a maximum of \$1.5 million in any twelve month period. *Id.*

95. Rule 254 allows issuers to “test the waters” by disseminating oral and written information to prospective investors as long as no money or deal is accepted. *Id.*

96. JENNINGS ET AL., *supra* note 26, at 433.

97. *Id.*

98. *Id.* The author foresees the possibility of Regulation A affecting future communication regulations.

99. *Supra* note 1, at 4.

100. Wied et al., *supra* note 9.

In recent years, the use of the Internet in the securities industry has increased. Issuers use the Internet to hold electronic roadshows,¹⁰¹ which enable all interested parties to view the presentation regardless of their physical location.¹⁰² In addition, issuing companies use the Internet to post notices to their individual company Web sites regarding the issuance of securities.¹⁰³ Furthermore, the SEC maintains its own Web site, which provides financial information on companies, SEC releases, and timely information regarding transactions in the securities industry.¹⁰⁴ Accordingly, the Internet has emerged as a critical medium in the dissemination of financial information to the masses.

A concern exists amongst the industry, however, that with the increased use of the Internet, the regulation of communications will become more difficult.¹⁰⁵ For instance, communications may be added to a Web site along with links to other sites, leading investors to obtain a wealth of information, which may, or may not, be considered legal pursuant to the communication regulations.¹⁰⁶ In addition, the links and Web site addresses may easily be removed, therefore decreasing the possibility of investigating a violation of the communication regulations.¹⁰⁷ Gun-jumping, or the risk of gun-jumping, greatly increases with the use of the Web because of the decreased chance to detect the violation.¹⁰⁸

The SEC identified three reasons for the overhaul of the takeover transaction regulations: (1) an increase in the number of transactions

101. In general, roadshows are meetings held with securities firms and institutional investors to publicize the offering and to answer any questions. JENNINGS ET AL., *supra* note 26, at 143.

102. Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 7516, 1998 WL 128173 (S.E.C.), 1 (Mar. 23, 1998).

103. Companies usually have an individual Web site with a link to company news where such information may be found.

104. The SEC's Web site is available at <http://www.sec.gov> (Feb. 18, 2002).

105. Linda C. Quinn et al., *Publicity Considerations For Corporate Issuers: Getting The Message Across Under the New Fair Disclosure Regime*, in 32d ANNUAL INSTITUTE ON SECURITIES REGULATION, CORPORATE LAW AND PRACTICE HANDBOOK COURSE BOOK SERIES NUMBER B-1212 (vol. 1), 25 (2000).

106. *Id.* at 46-47.

107. *Id.*

108. *Id.*

for which securities are offered as consideration; (2) an increase in the number of hostile transactions involving proxy or consent solicitations; and (3) significant technological advances that have resulted in more and faster communications with security holders and markets.¹⁰⁹ The SEC announced that the goals of the modifications are “to promote communication with security holders and the markets, minimize selective disclosure, harmonize inconsistent disclosure requirements and alleviate unnecessary burdens associated with the compliance process, without a reduction in investor protection.”¹¹⁰ The M&A Release and the results¹¹¹ of the proposal impacted takeover transactions far beyond the mere communication aspect.¹¹²

With respect to the communication situation, the SEC recognized the increasing economic and regulatory pressures upon companies to

109. The role of technology and the increased use of electronic media in the securities industry, as well as the securities industry move towards a “modernized” approach to the dissemination of information remains a highly volatile topic. *See generally SEC Approves Issuance of Interpretive Release on the Use of Electronic Media*, SEC News Release No. 00-53, 2000 WL 491108 (Apr. 26, 2000) (Discussing the electronic delivery of information, permissible Web site contents, and online offering. The SEC also calls for a public comment on the topic.); Laura S. Unger, *Getting to Know You: Dealing With the Wired Investor*, Address Before the American Society of Corporate Secretaries, Greenbrier, West Virginia (June 25, 1999), available at 1999 WL 454852 (S.E.C.) (discussing the movement towards communications between issuers and shareholder being conducted over the Internet and the efficiencies of such communications in the securities industry); Securities Act Release No. 7760, *supra* note 4, at 61409.

110. One of the primary purposes of the federal securities laws is to ensure that the investing public is provided with complete and accurate information about companies whose securities are publicly traded. Securities Act Release No. 6504, *supra* note 87, at *1; *see supra* note 109.

111. *See generally* Securities Act Release No. 33-7760, *supra* note 4, at 61408.

112. The new rules:

- (i) permit significantly increased communications between issuers and the market in connection with business combination transactions, (ii) attempt to balance the treatment between cash and stock tender offers, (iii) simplify and integrate the disclosure requirements for takeover transactions, (iv) clarify and simplify the financial statement requirements for takeover transactions, and (v) otherwise update the tender offer rules. They represent a fair balance between protecting the investor and allowing participants in the securities market the necessary flexibility to benefit from the rapid developments in electronic communications and in the Securities Market.

Eduardo N.T. Andrade & David F. Kroenlein, *SEC Overhauls Rules Governing M&A Transactions*, N.Y. L.J., Jan. 31, 2000, at 1.

release information as soon as possible.¹¹³ The pressures forced many companies to release information to the market prior to filing a registration, proxy, or tender offer statement with the SEC.¹¹⁴ As justification for early information disclosure,¹¹⁵ parties to business transactions cite the duty to disclose under Rule 10b-5¹¹⁶ and specific stock exchange requirements.

As a result of the modifications, the SEC amended Rule 135¹¹⁷ and Rule 145¹¹⁸ to consolidate¹¹⁹ the treatment of information that will not be deemed an “offer”¹²⁰ for purposes of § 5 of the 1933 Act

113. Securities Act Release No. 33-7760, *supra* note 4, at 61410.

114. *Id.*

115. *Id.* at 61410 n.24. (discussing the existence of additional disclosure requirements contained in each separate stock exchange on which the security may trade and the requirements contained in inter-dealer quotation systems).

116. Rule 10b-5 of the Securities Exchange Act of 1934 is an anti-fraud provision. Rule 10b-5 states:

[I]t shall be unlawful for any person . . . (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (2000). Companies are releasing information at early dates to avoid liability under the 10b-5 disclosure requirements, especially concerning business combination transactions. *See generally* Securities Act Release No. 33-7760, *supra* note 4, at 61410.

117. Rule 135 provides guidance regarding the issuance of notices. *See* 17 C.F.R. § 230.135 (2000). Rule 135 permits notices containing, *inter alia*,

(1) The name of the issuer; (2) the title, amount and basic terms of the securities to be offered, the amount of the offering, if any, by selling security holders, the anticipated time of the offering, and a brief statement of the manner and purpose of the offering, without naming the underwriters; and (3) any statement or legend required by state law.

Securities Act Release No. 33-7760, *supra* note 4, at 61413 n.60. Additional minor information may be provided in certain circumstances. *See* 17 C.F.R. § 230.135 (2000).

118. Rule 145 defines the type of actions deemed to be a business combination and then provides the registration guidelines for such transactions. Securities Act Release No. 33-7760, *supra* note 4, at 61413 n.60; 17 C.F.R. § 230.145 (2000).

119. Prior to the amendments, Rule 145(b)(1) provided that written communications containing information regarding business combinations offer or would not be deemed a prospectus. Securities Act Release No. 33-7760, *supra* note 4, at 61413 n.62. Similar language was found in Rule 135(a)(4). The amendment removes the similar language in Rule 145(b)(1) and references Rule 135 and the new safe harbor provisions. *See* 17 C.F.R. § 230.145(b) (2000).

120. *Supra* note 26 and accompanying text.

into a single rule.¹²¹ Besides the consolidation effort, the amended Rule 135 also contains a filing requirement for all notices issued under the Rule 135 provisions.¹²² Therefore, because the notices are “written”¹²³ communications relating to a proposed takeover transaction, the filing of the notices is deemed mandatory pursuant to the newly amended Rule 425.¹²⁴

III. THE SIGNIFICANCE OF RULE 165 AND RULE 166

The crux of the modifications relating to communications lies in the adoption of the safe harbor provisions of Rules 165 and 166.¹²⁵ In general, Rule 165 allows for the use of communications both before and after the filing of a registration statement.¹²⁶

The Rule 165 guidelines are only applicable to communications relating to business combinations.¹²⁷ Once a communication qualifies as a business combination, Rule 165 is also applicable to the “offeror”¹²⁸ of securities and any other “participant”¹²⁹ that relies on the use of the Rule 165 guidelines.¹³⁰

121. The new rule is Rule 135. *See generally* Erica H. Steinberger et al., *Comprehensive M&A Reforms Reflect New Market Realities: A Summary And Analysis of the New M&A Rules Promulgated By the Securities and Exchange Commission*, 1191 *PLI/Corp.* 89, 107 (June 2000).

122. Securities Act Release No. 33-7760, *supra* note 4, at 61414.

123. *Supra* note 12 and accompanying text.

124. 17 C.F.R. § 230.425 (2000) (filing of certain prospectuses and communications under § 230.135 in connection with business combination transactions). It should be recognized that “subsequent notices or announcements made under Rule 135 that do not contain new or different information are not required to be filed.” Securities Act Release No. 7760, *supra* note 4, at 61414.

125. Securities Act Release No. 33-7760, *supra* note 4, at 61410–61414.

126. Steinberger et al., *supra* note 121, at 106-07.

127. *Supra* note 22 and accompanying text. 17 C.F.R. § 230.165 (2000). The preliminary note “is available only to communications relating to business combinations. The exemption does not apply to communications that may be in technical compliance with this section, but have the primary purpose or effect of conditioning the market for another transaction, such as a capital-raising or resale transaction.” *Id.*

128. *See supra* note 37 and accompanying text (discussing “offer” in terms of SEC regulations).

129. “A participant is any person or entity that is a party to the business combination transaction and any persons authorized to act on their behalf.” 17 C.F.R. § 230.165(f)(2) (2000).

130. Rule 165 provides a guideline for the applicability of the rule by stating “[t]his section is applicable not only to the offeror of securities in a business combination transaction, but also to any other participant that may need to rely on and complies with this section in

Rule 165(a)¹³¹ grants an exemption to the anti-fraud provision of the 1933 Act, § 5(c),¹³² for communications regarding a business combination prior to the filing of a registration statement,¹³³ but after and including the first public announcement.¹³⁴ The exemption remains valid as long as the written communications are registered pursuant to Rule 425.¹³⁵

Rule 165(b)¹³⁶ grants an exemption from § 10 of the 1933 Act¹³⁷

communicating about the transaction.” 17 C.F.R. § 230.165(d) (2000).

131. The rule provides that:

Notwithstanding section 5(c) of the Act (15 U.S.C. 77e(c) (1994)), the offeror of securities in a business combination transaction to be registered under the Act may make an offer to sell or solicit an offer to buy those securities from and including the first public announcement until the filing of a registration statement related to the transaction, so long as any written communication (other than non-public communications among participants) made in connection with or relating to the transaction (i.e., prospectus) is filed in accordance with § 230.425 and the conditions in paragraph (c) of this section are satisfied.

17 C.F.R. § 230.165(a) (2000).

132. See 15 U.S.C. § 77E(C) (1994).

133. A registration statement is the “statement provided for in section 77f of this title, and includes any amendment thereto and any report, document, or memorandum filed as part of such statement or incorporated therein by reference.” 15 U.S.C. § 77b(8) (1994) (Section 2(a)(8) of the Securities Act of 1933). Section 77f sets forth the basic process of filing a security with a registration statement, registration fee, etc. See 15 U.S.C. § 77f (1994).

134. A public announcement is defined as “any oral or written communication by a participant that is reasonably designed to, or has the effect of, informing the public or security holders in general about the business combination transaction.” 17. C.F.R. § 230.165(f)(3) (2001); see also Steinberger, *supra* note 121, at 107.

135. 17 C.F.R. § 230.425 (2001) (filing of certain prospectuses and communications under § 230.135 in connection with business combination transactions). Rule 425(a) states “all written communications made in reliance on § 230.165 are prospectuses that must be filed with the Commission under this section on the date of first use.” *Id.* The remainder of the rule informs of the registration protocol. See generally *id.*; see also Steinberger et al., *supra* note 121; *supra* note 131 and accompanying text.

136. The rule provides that:

Notwithstanding section 5(b)(1) of the Act (15 U.S.C. § 77e(b)(1) (1994)), any written communication (other than non-public communications among participants) made in connection with or relating to a business combination transaction . . . need not satisfy the requirements of section 10 (15 U.S.C. § 77j (1994)) of the Act, so long as the prospectus is filed in accordance with § 230.424 or § 230.425 and the conditions in paragraph (c) of this section are satisfied.

17 C.F.R. § 230.165(b) (2000).

137. Section 10 of the Securities Act of 1933 provides the information required to be included within a prospectus. See 15 U.S.C. § 77j (1994).

for written communications issued after the filing of a registration statement in a business combination transaction.¹³⁸ The prospectus, however,¹³⁹ must be filed pursuant to the conditions of Rule 424¹⁴⁰ or Rule 425¹⁴¹ to qualify as a valid exemption.¹⁴²

The adoption of certain conditions in Rule 165(c)¹⁴³ are required in order for the communications to qualify for the exemptions in Rule 165(a) and (b).¹⁴⁴ Filing of the communication must occur on or before the first day of use.¹⁴⁵ In addition, the communication must contain a legend¹⁴⁶ urging investors to read all relevant documents, and must inform investors that they may obtain these documents free of charge from the SEC's Web site.¹⁴⁷

138. Steinberger et al., *supra* note 121; *see also supra* note 136 and accompanying text.

139. The Act defines a prospectus as "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except that (a) a communication sent or given after the effective date of the registration statement" shall not be deemed a prospectus if another communication meeting the requirements of a prospectus was sent prior or with the communication in question, and (b) "a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section 77j of this title may be obtained"

15 U.S.C. § 77b(10) (1994) (footnote omitted) (section 2(a)(10) of the 1933 Act).

140. 17 C.F.R. § 230.424 (2001) (filing of prospectuses, number of copies). The rule sets forth procedural mechanisms of preparing and filing prospectuses. *See id.*

141. *Supra* note 114 and accompanying text.

142. Steinberger et al., *supra* note 121; *see also supra* note 135 and accompanying text.

143. Rule 165(c) states that in order

to rely on paragraphs (a) and (b) of this section: (1) Each prospectus must contain a prominent legend that urges investors to read the relevant documents filed or to be filed with the Commission because they contain important information. The legend must also explain to investors that they can get the documents for free at the Commission's web site and describe which documents are available free from the offeror; and (2)

17 C.F.R. § 230.165(c). Rule 165(c)(2) discusses the rules pertaining specifically to exchange offers and several compliance rules from the 1934 Act. *See* 17 C.F.R. § 230.165(c)(2) (2001). The elements of Rule 165(c)(2) are irrelevant for the discussion contained in this Note.

144. Securities Act Release No. 33-7760, *supra* note 4, at 61412 (discussing the required conditions for communications to qualify for a Rule 165 exemption).

145. *See* 17 C.F.R. § 230.165(a) (2001), *supra* note 131 and accompanying text.

146. 17 C.F.R. § 230.165(c) (2001) (conditions to adhere to under Rule 165).

147. The SEC believes "that a prompt filing requirement is to protect security holders and assure that these communications are available to all investors on a timely basis." *Supra* note 144. The SEC references their Web site within the rule because most of the documents will be immediately filed on the EDGAR system and will therefore be "rapidly disseminated to the marketplace." *Id.*; *see also supra* note 144.

The SEC proposed Rule 165(e)¹⁴⁸ in the M&A Release in response to a concern about the requirements placed on issuers. The SEC conducted a poll on whether the same day filing requirement was too burdensome on issuers.¹⁴⁹ The responses expressed concern that a loss of protection of the safe harbor provisions would result if there was a failure to timely file the communications within the same day requirement.¹⁵⁰

Additionally, Rule 165(e) implements a “good faith”¹⁵¹ standard that grants an exemption if it can be shown that the failure to comply was either “immaterial or unintentional.”¹⁵² The SEC, to prevent abuse of the good faith standard, clarifies the rule by stating that the granting of a recession will not occur simply because of a late filing of the communication.¹⁵³

Rule 166,¹⁵⁴ another safe harbor provision, applies only to

148.

An immaterial or unintentional failure to file or delay in filing a prospectus described in this section will not result in a violation of section 5(b)(1) or (c) of the Act (15 U.S.C. 77e(b)(1) and (c) (1994)), so long as: (1) A good faith and reasonable effort was made to comply with the filing requirement; and (2) The prospectus is filed as soon as practicable after discovery of the failure to file.

17 C.F.R. § 230.165(e) (2001).

149. Securities Act Release No. 33-7760, *supra* 4, at 61413.

150. *Id.*

151. The good faith standard contained in Rule 165(e) is similar to the good faith standard in Rule 508(a) of Regulation D (17 C.F.R. § 230.508(a) (2001)). *Supra* note 149, at 61413 n.59.

152. When evaluating the terms “immaterial” and “unintentional” in light of a late filing, the SEC considers factors including: “The nature of the information, the length of the delay, and the surrounding circumstance, including whether a bona fide effort was made to file timely.” *Supra* note 130. The SEC also allows the exemption to be available if the delay was caused by difficulties in electronically filing on the EDGAR system. *Id.*

153. *Supra* note 149.

154. The rule states that:

In a registered offering involving a business combination transaction, any communication made in connection with or relating to the transaction before the first public announcement of the offering will not constitute an offer to sell or a solicitation of an offer to buy the securities offered for purposes of section 5(c) of the Act (15 U.S.C. 77e(c) (1994)), so long as the participants take all reasonable steps within their control to prevent further distribution or publication of the communication until either the first public announcement is made or the registration statement related to the transaction is filed.

17 C.F.R. § 230.166(a) (2001).

business combination transactions.¹⁵⁵ The provision provides that in a business combination transaction any communication made prior to the first public announcement¹⁵⁶ will not be deemed “an offer to sell or solicitation of an offer to buy” such security under § 5(c)¹⁵⁷ of the 1933 Act.¹⁵⁸ The granting of the exemption will only occur as long as the parties take reasonable measures to prevent further dissemination of the information.¹⁵⁹

Regardless of the alterations, the SEC still mandates that security holders receive the proper disclosure statement prior to any voting or investment decisions.¹⁶⁰

The SEC cautions that the new regulations are not “intended to be used as a means to substitute selective oral disclosure for written and oral disclosure that becomes public on a widespread basis.”¹⁶¹ Oral communications are covered by the exemptions, thus, they need not be put in writing and filed.¹⁶² Oral or written communications remain susceptible to liability under the proper anti-fraud and insider trading rules regardless of the exemptions provided.¹⁶³

IV. ANALYSIS OF THE M&A RELEASE CHANGES

A. Achievement of the M&A Release Goals

The M&A Release sought to accomplish numerous changes to the structure of the regulations regarding takeover transactions.¹⁶⁴ The

155. The preliminary language contained in Rule 166 is exactly the same as the preliminary language contained in Rule 165. *See supra* note 127 and accompanying text.

156. *See supra* note 134 and accompanying text.

157. *See supra* note 20.

158. Steinberger et al., *supra* note 121, at 106-07.

159. *Id.*; *see also supra* note 154 and accompanying text.

160. Andrade, *supra* note 112. The requirement of delivering the mandated disclosure document prior to an action addresses the concern of pre-filing communications conditioning the market. *Id.*

161. Steinberger et al., *supra* note 121, at 104.

162. Securities Act Release No. 33-7760, *supra* note 4, at 61412 n.43.

163. *See id.*; Steinberger, *supra* note 161 (providing a detailed look at remaining liabilities even with the safe harbor provisions); Andrade, *supra* note 112 (discussing how pre-filing liability prevents market conditioning).

164. *Supra* note 1, at *5. The primary proposals of the release, applicable to this note, are to: “relax the current restrictions on communication with security holders to provide the market with more information on a timely basis; in particular, permit free communications before the

need for earlier dissemination of information regarding takeover transactions, along with rectifying the shortcomings of previous regulations, were on the forefront of the changes sought.¹⁶⁵

The SEC achieved those changes¹⁶⁶ in the M&A Release by removing the applicability of § 5(c) in limiting and allowing communications in the pre-filing stage by promulgating Rules 165 and 166.¹⁶⁷ Therefore, the relay of communication occurs at an earlier point within the time-sequence¹⁶⁸ of the business combination process.¹⁶⁹

The primary function of both the SEC and the Acts remains to provide investor protection.¹⁷⁰ As such, the SEC raised concern within the market that they were failing to provide investor protection due to the implementation of more relaxed communication regulations.¹⁷¹ Rules 165 and 166, however, effectively provide adequate investor protection, while still providing for advanced information dissemination.¹⁷²

The SEC provides protection to investors by requiring the registration of the “free” communications. The registration process

filing of a registration statement in connection with either a stock tender offer or a stock merger transaction.” *Id.* Also, to “permit free communications about a planned tender offer without triggering the “commencement” of the offer, requiring the filing and dissemination of information.” *Id.*

165. *Id.* In sum, the M&A Release stressed the importance of the new revisions to meet the new realities of today’s market in business transactions. *Id.* The regulations, however, must maintain “high quality investor protection and enhance the timing and quality of the information available to the investors.” *Id.* In addition, “the proposed revisions address changes in deal structure and advances in technology.” *Id.*

166. *See supra* notes 164-65 and accompanying text (discussing goals of the M&A Release).

167. *See supra* note 131 and accompanying text. The actual text of Rule 165 sets forth that this provision is “notwithstanding § 5(c).” 17 C.F.R. § 230.165(a) (2001). For the language pertaining to § 5(c), see *supra* note 20 and accompanying text.

168. *See supra* note 59-61.

169. *See supra* note 59-61 and accompanying text (discussing the time sequence of the offering process). The communications are now allowed in the pre-filing period, as opposed to the rules prior to the SEC’s adoption of the M&A Release. *See supra* note 152 and accompanying text.

170. *See supra* notes 26-27 and accompanying text; *see also supra* note 2 and accompanying text (discussing SEC function).

171. Securities Act Release No. 33-7760, *supra* note 4, at 61408.

172. Investor protection still lies in the SEC’s filing requirement for communications. *See supra* note 135 and accompanying text.

ensures that all investors have equal access to the information. The availability of the early information dissemination option prevents investors from subjecting themselves to gun-jumping procedures, and solves the conflict between strict regulations and investor demands for early information.¹⁷³

In addition, Rules 165 and 166 answer the cry for the SEC to respond to the ever-changing technological advances within the market, while maintaining the investor protection element.¹⁷⁴ The new rules require¹⁷⁵ that all free-writing based communications be filed with the SEC, which allows the reproduction of the communication via the Internet.¹⁷⁶ After filing the communication release, the SEC creates an entry of the communication onto the Electronic Data Gathering Analysis and Retrieval (EDGAR) site.¹⁷⁷ The filing requirement achieves the SEC's goal of providing investor protection in the form of regulation, while allowing for a more rapid dissemination of information, as well as providing an easier method for the investor to obtain such information.¹⁷⁸

173. See *supra* note 91 and accompanying text.

174. In fact, one of the very elements of the proposal is to "address advances in technology." *Supra* note 48 and accompanying text; see also Satu S. Svahn, *Greater Investor Outreach At The Click of A Mouse: Internet And Closed Circuit Road Shows Should Reach Retail Investors*, 65 BROOK. L. REV. 249 (1999); SEC Approves Issuance of Interpretive Release on the Use of Electronic Media, 2000 WL 491108 (2000); Statement of The Commission Regarding Use of Internet Web Sites To Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 33-7516, 1998 WL 128173 (Mar. 23, 1998).

175. See *supra* note 135 and accompanying text.

176. See *infra* note 177 and accompanying text.

177. *Supra* note 174 and accompanying text. The EDGAR system started on September 24, 1984, and first consisted of a floppy disk that transmitted corporate data to agency public files. LOSS ET AL., *supra* note 2, 136. The SEC stated that EDGAR will be able to "provide investors, securities analysts, and the public with instant access to corporate disclosure documents Second, companies will be able to make required filings electronically generally using their existing equipment. And, third, the Commission staff will be able to process and analyze filings more efficiently at computer work stations." The EDGAR system underwent several transitional phases in the 1990s to reach what is today found on the Internet at <http://www.sec.gov>. *Id.* at 137.

178. See *supra* notes 164-65 and accompanying text.

B. Failures of the Regulations

Oral communications and selective disclosure¹⁷⁹ remain unprotected by the implementation of Rules 165 and 166.¹⁸⁰ While the SEC administered the M&A Release in order to answer the demands of investors and those companies regulated by the Acts, oral communications simply cannot be regulated due to the fact that such communications can be made on a small and private basis.¹⁸¹

Often in the context of business combination transactions, the release of information occurs through an oral exchange. Many of these oral communications occur through formal speeches or verbal press releases, which in return allows for the filing of a transcript with the SEC to meet the requirements of Rules 165 and 166.¹⁸² Frequently, the reiteration of such statements and comments regarding the transaction occurs in a less formal setting.¹⁸³ In these less formal settings no one will prepare for the taking of a written transcript of the statements, thus creating the impossibility of a filing for SEC purposes.¹⁸⁴

The issue of selective disclosure arises in conjunction with the problematic documentation of oral statements.¹⁸⁵ Due to the failure to record numerous oral commentaries with the SEC, which remains a well-known fact with many investors and corporate officers, the unrecorded solicitations may contain “special” information only transmitted to a minute number of investors.¹⁸⁶ Thus, this failure

179. See *infra* notes 185-88 and accompanying text.

180. See *supra* notes 17-18 and accompanying text.

181. Oral communications, while hard to regulate, still remain subject to § 12(a)(2) civil liability. Fried, Frank, Harris, Shriver & Jacobsen, *The SEC Adopts Regulations Regarding Business Combinations and Shareholders Communications*, 1217 PLI/Corp. 587, 590-91 (Nov. 2000).

182. See *supra* note 135 and accompanying text.

183. Less formal settings include small private meetings, personal conference calls, private roadshow presentations, and many other practices of meeting with a select and intimate group. See also *infra* note 186 and accompanying text.

184. See *supra* note 135 and accompanying text.

185. Regulation FD (Fair Disclosure) coined the term selective disclosure. Selective Disclosure and Insider Trading, Securities Act Release No. 33-7787, 1999 WL 1217849 (S.E.C.), *2 (Dec. 20, 1999). The term, as used in context of this Note, refers to providing information on a limited and selective basis.

186. Selective disclosure is often found during private meetings or conference calls in which certain analysts and institutional investors are invited, but the public, media, and other

creates the potential for an unfair advantage in the investment process of a business combination transaction.¹⁸⁷ Prior to the enactment of Rules 165 and 166, however, oral communications and selective disclosure in business combination transactions remained an unregulated area.¹⁸⁸

Although the potential disadvantage of unregulated oral communications remains a threat to investors, the adoption of Rules 165 and 166 successfully allows for the early disbursement of information, while providing for well-informed, protected investors.¹⁸⁹ While the M&A Release did not cure all problems and demands in one sweeping legislative overhaul,¹⁹⁰ the SEC proved successful in alleviating a majority of the complaints and problematic issues.

While the SEC allowed for an increase in “free-writing” within business combination transactions, the same problems persist in non-business combination transactions.¹⁹¹ The capital-raising transactions not involved in combination dealings remain governed by the same restrictions as communications in business combination transactions prior to the enactment of Rules 165 and 166.¹⁹² Thus, the same cries

investors are excluded. *Id.*

187. The practice of selective disclosure has greatly increased over the past several years. *Id.* at *3. The practice threatens the integrity of the securities industry, as well as ruining investor confidence in the system. *Id.* For instance, one benefit of the practice allows a party privy to information to make an immediate securities move, and often provides the party with a substantial windfall.

188. “Full and fair disclosure of information by issuers of securities to the investing public is a cornerstone of the federal securities laws.” *Id.* at *2-3. Regulation FD focuses on regulating “the problem of issuers making selective disclosure of material non-public information to analysts, institutional investors,” or other private parties, but excludes the media and public as a whole. *Id.* at *2.

189. *See supra* notes 17-18 and accompanying text.

190. When the SEC proposes to make a broad overhaul of the present laws, such proposals often remain subject to debate and many of the proposed changes fail to pass suggested changes. *See infra* note 203 and accompanying text (discussing the failure of the “Aircraft Carrier”).

191. *See infra* note 203 and accompanying text. The SEC and respondents agree that similar problems are affecting non-business combination transactions. *Id.*

192. *See supra* notes 20, 21, 37 and accompanying text.

for freedom that existed for communications under business combination transactions, have likewise manifested in non-business combination transactions.¹⁹³

V. PROPOSAL TO EXTEND “FREE-WRITING” REGULATIONS

The SEC, as expressed in the M&A Release, believes in protecting investors with prompt filing and dissemination of information to keep them informed.¹⁹⁴ The SEC’s approach in the M&A Release should transcend business combination transactions in order to protect investors in all types of transactions, including, but not limited to, initial public offerings¹⁹⁵ and capital-raising ventures.¹⁹⁶

In implementing the proposals contained in the M&A Release, the SEC viewed the rules as stagnant, outdated, and resistant to change.¹⁹⁷ By failing to realize the stagnation of the regulations pertaining to all business transactions, the SEC is preventing modernization and uniformity amongst the Acts.¹⁹⁸

Extension of the “free-writing” regulations decreases the confusion surrounding this particular area within the Acts. By extending the regulations, a comprehensive and uniform system would exist to govern communications, regardless of the type of transaction involved in the issue.¹⁹⁹ Further, an extension answers the request that exists, and existed in business combination transactions prior to the adoption of Rules 165 and 166, to eliminate the conflict between investor demand for early communications and issuer restrictions on providing the communications.²⁰⁰ In addition, the extension responds to the market’s need for modernization and

193. See *infra* note 203 and accompanying text.

194. See *supra* notes 142–43 and accompanying text.

195. An initial public offering (IPO) occurs the first time that a company decides to publicly offer a security on the market to any interested investor.

196. Capital-raising ventures occur to raise funds for a company, perhaps through an IPO or through a new issue of publicly-held securities.

197. Securities Act Release No. 33-7607, *supra* note 1, at *2. “While the takeover market has evolved dramatically over the past 20 years, the applicable regulatory framework had remained substantially the same.” *Id.*

198. *Id.*

199. See *infra* note 203 and accompanying text.

200. See *supra* note 91 and accompanying text.

increased use of technology.²⁰¹ The extension of the communication regulations to the initial public offering and capital-raising ventures fulfills the SEC's goals in the M&A Release pertaining only to other transactions.²⁰² These other transactions, however, deserve the same consideration as business combination transactions.²⁰³

The necessary changes allowing "free-writing" in the pre-filing period, as in Rule 165(a), may be accomplished in a variety of ways.²⁰⁴ Initially, the SEC may eliminate or adapt the preliminary note to Rules 165 and 166 so as to remove the requirement that the Rules apply only to business combination transactions.²⁰⁵ In addition, this requires the SEC to amend the business combination language contained in Rule 425.²⁰⁶

The SEC may also amend § 5(c)²⁰⁷ so that the action of making an offer through a prospectus is not an unlawful activity as long as the filing of the prospectus/communication with the SEC occurred pursuant to Rule 425.²⁰⁸ Rules 165 and 166 will become obsolete, unless the SEC references the Rules in § 5(c) as a special section pertaining to business combination transactions.²⁰⁹ Under this option, Rule 425 would still require adaptations to be made in order to eliminate the business combination language and reference to § 5(c),

201. See *supra* note 174 and accompanying text. The named articles provide a basis for understanding the SEC's much discussed and agreed upon move to bring technology into the security industry's disbursement of securities.

202. Securities Act Release No. 33-7760, *supra* note 4, at *61409.

203. The Regulation of Securities Offerings, Securities Act Release No. 7606A, 1998 WL 792508 (S.E.C.) (Nov. 17, 1998). The release is termed the "Air Craft Carrier" for the enormous size and breadth of the suggested changes, and addresses areas of communication leniency. Therefore, the SEC has at least considered the idea, if not the method, behind this proposal and recognizes the need for changes regarding communication regulations to all transactions. This proposal failed as a whole due to its size and complexity.

204. See *infra* notes 172-77. Regardless of how the changes are implemented, a thorough examination of the M&A adaptations, proposals, failures, and benefits will allow for an economical redrafting of the legislation. In addition, the study permits an opportunity for a more efficient transition to the new regulations.

205. See *supra* note 127 and accompanying text.

206. See *supra* note 135 and accompanying text.

207. See *supra* note 20 and accompanying text.

208. See *supra* note 157 and accompanying text (discussing Rule 425). The addition of such language, as noted in the proposal, may be done at the end of § 5(c) so as to allow pre-filing communications. *Supra* note 20 and accompanying text.

209. Language may also be added to allow Rules 165 and 166 to apply to business acquisition transactions.

as opposed to Rule 165.²¹⁰ If, however, the SEC maintains Rules 165 and 166 as a section pertaining to business combinations, a reference to § 5(c) in Rule 425 would be the only addition.²¹¹

By allowing free communications, investors and issuers will have increased flexibility in disseminating and assessing the information, thus, bridging the gap between the investor’s desire for timely and accurate information with an issuer’s need to produce and provide the information sought by investors.²¹²

At the same time, the SEC will also improve its regulatory capability, as well as its ability to stay technologically advanced.²¹³ The filing requirement of the early communication will allow the SEC to post the communication to the EDGAR system.²¹⁴ The requirements will also allow issuers to post the information to a Web site specific to the issuing company. The posting of the information on the Internet allows investors immediate, and easy, access to the filed communications.

While the proposal permits leniency in the issue of “free-writing,” penalties will still remain in effect for “gun-jumping” for a failure to file the communication with the SEC.²¹⁵ In addition, the proposal does not alter the stringent criminal regulations pertaining to fraud within the market and insider trading.²¹⁶ Thus, the imposition of sanctions for illicit behavior will remain a principle within the Acts.

VI. CONCLUSION

The SEC’s adoption of Rules 165 and 166 through the M&A Release are a beneficial change in the areas of “free-writing” pertaining to business combination transactions. This new adoption solved many issues surrounding free communications for decades. In

210. *Supra* note 135 and accompanying text. The phrase to be amended is, “all written communications made in reliance on § 230.165.” *Id.*

211. *See supra* note 140 and accompanying text (discussing the language of Rule 425).

212. *See generally* Securities Act Release No. 7607, *supra* note 1, at *3. *See also supra* note 91 and accompanying text (discussing the conflict in restricting information).

213. *See supra* notes 61, 174 and accompanying text.

214. *See supra* note 174.

215. *See supra* notes 77-80 and accompanying text (discussing the practice of gun-jumping).

216. *See* JENNINGS ET AL., *supra* note 26.

addition, the new regulations answer the communication needs of both the investor and issuer.

This proposal suggests that these beneficial changes be made to all business transactions regulated under the Acts. The proposal addresses the needs of the investor, the issuer, and the SEC, and unifies the needs of each party. As discussed in this Note, significant legislative redrafting needs to occur within the Acts, but the end result will produce a far more efficient system of disbursing information, a practice which has already been realized within the business combination transaction industry.

