SUMMARY OF ROUNDTABLE DISCUSSIONS REGARDING THE FUTURE CONTENT OF THE U.S. SECURITIES LAWS

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On April 8-9, 1999, more than sixty securities lawyers, regulators, and academics participated in a roundtable discussion in Washington, D.C., on what should be the future content of the U.S. securities laws. The full participant list (excluding, however, SEC personnel) appears in the Appendix of this report. The conference's co-conveners were Mr. Edward F. Greene of Cleary, Gottlieb, Steen & Hamilton, and Professor James D. Cox of the Duke University School of Law. Our purpose was to see if a consensus could be forged regarding the direction the reform of the U.S. securities laws might take. Coincidentally, the SEC had extended the original comment period for its Aircraft Carrier release[1] to June 30, 1999. With the extended comment period, we were able to discuss many aspects of the reform proposals embodied in the Aircraft Carrier Release. The program was organized around the following six topics:

1. The Changing Regulatory Premises

2. Revamping the Disclosure and Offering Process

3. What Gets Regulated and Exempted

4. Regulatory Strategies to Address Internationalization

5. Liability Standards for a Company Disclosure System

6. The Regulation of Exchanges and Alternative Trading Systems

We offer below a summary of what we believe to be the central beliefs, conclusions, and approaches expressed at the meeting. Knowing that our collective memories could never accurately replicate the conference's discussions, we

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This summary is also available at http://www.law.duke.edu/journals/63LCPCoxSummary.
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1. Securities Act Release No. 7606A, 63 Fed. Reg. 67,174 (Dec. 4, 1998).

commissioned a court reporter to transcribe the conference's commentary. We then reviewed the resulting 419 page transcript to prepare this report. Because we assured each participant that no remarks would be attributed to any individual, no one is mentioned in our report. Instead, what follows is our synthesis of a highly stimulating and thoughtful day-and-a-half debate on the future content of the U.S. securities laws.

A threshold issue we considered is the scope of the SEC's power to implement reform pursuant to its exemptive authority under Section 28 of the Securities Act of 1933.[2] On the one hand, there was a consensus that the SEC could not use this authority to swallow up the Act, such as by exempting all offerings of an issuer, if the effect were to eliminate the responsibilities of the issuer or its directors under Section 11 of the Act. On the other hand, there was recognition that the SEC now enjoys broad authority to reduce the regulatory reach of Section 5, such as by narrowing the current definition of an offer to sell, by modifying the content requirements of the registration statement, by delineating what constitutes delivery of a prospectus, and by expanding the contours of the private placement exemption to permit the deregulation of the offering process and more liquidity with respect to restricted securities.

There was no sentiment for scrapping the current statutory framework of the U.S. securities laws. There was also a consensus that legislative action is both unnecessary and undesirable; any necessary reform can and should occur within the present statutory framework using the broad rulemaking and exemptive authority the Commission currently possesses. The analogy invoked in our discussion was a need to locate and repair "potholes" in the road, rather than constructing a new freeway that will pass through unfamiliar terrain. The strongest sentiment for maintaining the status quo was expressed for initial public offerings for which registration and review by the SEC's staff was not questioned. However, for all types of registrants, the conference participants believed there is a need to rethink the current prospectus delivery requirements, a point discussed below.

A registration statement should continue to be the regulatory cornerstone for public offerings by any issuer. However, the disclosure requirements for any registration statement should not be thought of as embodying all the information an investor should have in order to reach an informed decision to purchase the registrant's security; mandatory disclosure should focus upon those items of information uniquely known to the issuer. The view was expressed that information in the registration statement should be available during the investors' decision-making period. Nevertheless, questions abounded throughout the discussions as to whether availability from issuers and distribution participants should be the same for all registrants and, more particularly, whether any prospectus delivery requirements were needed for seasoned companies. Because seasoned issuers are followed closely by analysts, and their size and im-

2. 15 U.S.C. § 772-3 (Supp. 1998).

pact on their industry and/or the national economy generally assure that they are truly in the public eye, investment decisions respecting their securities occur within an extremely rich information environment. For such companies, to require that any information regarding the issuer be further distributed to possible investors or purchasers, or to require that restrictions be imposed during the offering process on the types of information registrants or distribution participants may release, or the timing of delivery, are each ill-advised. Such restrictions reflect only the historical reference to a more primitive investment environment. For such issuers, the policy should be one that seeks to encourage, not discourage, the dissemination of analysts' reports and other information about the issuer from a variety of sources. Any linkage between such reports and the issuer or its underwriter should be handled through appropriate disclosures and not through the traditional gun-jumping framework, or a requirement that these reports be filed as part of the registration statement. Even more important in considering the regulation of public offers by seasoned issuers is the dominant role of financial institutions, which traditionally enjoy access to a richer information base than that provided by the registration statement. Indeed, some expressed the view that, in a world composed only of reporting companies and in which Exchange Act reports were subject to a due diligence standard, there would be no need for a Securities Act.

A strong consensus was expressed that seasoned issuers should enjoy quick—even instant—access to capital markets, and many proposals in the Aircraft Carrier release were seen as imposing upon seasoned issuers and their investors needless uncertainty as to timing, and therefore, additional costs. The sentiment was repeatedly expressed that the Aircraft Carrier proposals fail to differentiate between the capital-raising process for seasoned issuers and initial public offerings, so that the proposals, if adopted, would introduce significant market risks on seasoned issuers and their investors with no countervailing public benefits. These harmful effects would especially occur under the Aircraft Carrier release's proposal that investors purchasing from seasoned issuers receive at least a written term sheet *before* pricing—in other words, before their investment decision is made. Today, terms are communicated orally and the prospectus or prospectus supplement is delivered after setting the price and with the confirmation. The sentiment of the group was that this system was functioning well, and is responsive to the needs for rapid access to the U.S. capital markets. Many felt that the Aircraft Carrier proposals for seasoned issuers were a step backwards from the current shelf registration practice, which relies heavily on advance preparation of documentation and oral communication. There was general support for advance delivery for initial public offerings ("IPOs"), but an absolute seven-day rule was believed to be too rigid, especially if a transaction was increased in size, in which case one would have to wait seven days from the date the last investor was contacted.

Needless market risks will also be introduced by the Aircraft Carrier's proposal to rescind the *Exxon Capital* No-Action letter[3] in connection with offerings of debt securities. That letter permits debt securities to be sold privately, under Rule 144A or Regulation D, followed by a registered exchange offer of identical securities, the consequence of which is that the holders have unrestricted securities. In its place, the release proposes that all SEC reporting issuers may conduct equity and debt offerings on Form B provided the offering is only to qualified institutional buyers ("QIBs"). This proposal was seen as a substitute for the near-instant capital raising procedure that now occurs routinely with no demonstrated harm to investors. This new system will cause issuers and their underwriters to face delay as they await the effectiveness of the registration statement, heightened liability due to the application of Section 11, and uncertainty regarding the status of QIBs that resell the securities acquired in the offering. The overall sentiment was that the SEC would be well advised to preserve *Exxon Capital*. The proposal that if *Exxon Capital* were repealed then all issuers, regardless of whether they were SEC reporting companies, be permitted to offer their debt securities on Form B prompted some to urge that all offerings to a specified percentage of QIBs be allowed on Form B, regardless of whether it was an IPO. The result of this would be the instant access currently supplied by the *Exxon Capital* letter, because Form B goes effective on demand. This suggestion raised two important regulatory issues among the participants. First, if Form B is available to all issuers, so long as a specified percentage of sales are only to QIBs, the concern was expressed that without significant resale restrictions, offerings on Form A would rarely occur, because most issuers would be guided to the more user-friendly Form B. Second, the proposal could lead to offerings in which QIBs purchase directly from the issuers and quickly resell into the market a major portion of the securities purchased. Even though the presumptive underwriter doctrine has long been rejected by the SEC, doubts arose among the participants as to whether such reselling QIBs would be deemed effective underwriters, particularly if they enjoyed gains because of the resales.

The Aircraft Carrier release extends instant access only to reporting companies issuing to QIBs. It does not help private companies who seek to issue debt followed by a registered exchange offer. Such private companies would have to register their debt securities on Form A, and incur the attendant uncertainty and expense of doing so. Many participants accepted the illogic of *Exxon Capital* on the pragmatic basis that the offerings appear to serve the interests of both investors and issuers. There was some support for repealing the letter, provided that debt offerings would be permitted to be made on Form B, whether the issuers were private or seasoned, when purchased only by QIBs or if a high percentage of the offering were purchased by QIBs.

3. Exxon Capital Holdings Corp., SEC No-Action Letter, WSB File No. 051688008 (May 13, 1988).

In the area of private placements, a consensus was expressed that the SEC should adopt a position similar to that taken in Rule 1001, whereby issuers may engage in general advertisements and solicitations of any kind, in any medium, provided sales occur only to those who satisfy the criteria of a specific exemption. The authorization for broader advertisements and solicitations in connection with exempt offerings than are permitted today would, of course, coexist with resale restrictions on the securities purchasers so as to assure that the offering comes to rest only in the hands of those who meet the exemption's criteria. Some urged the Commission to permit more active trading of the securities among eligible investors during the restricted period. Others noted that in some countries, sales are permitted to professional investors, distinguished from intermediaries, with very limited restrictions on resales.

The participants supported the proposed thirty-day cooling-off period for unseasoned issuers during which traditional restrictions would apply to communications that had the effect of conditioning the market. The participants believed that no cooling-off period is necessary for seasoned issuers; to impose restrictions on information flows of companies that are already in the public eye was seen as counterproductive to the protection of investors, and unrealistic, because a decision to do an offering by shelf issuers could be taken well within the cooling-off period.

A separate program session was devoted to the viability of the Commission continuing to require foreign issuers to reconcile their financial statements to U.S. GAAP as a condition to register or list their securities in the United States. There was consensus that it was not likely that harmonization of reporting standards or accounting principles would occur, or that reciprocity among jurisdictions would expand beyond the Multi-Jurisdictional Disclosure System ("MJDS") that currently exists only with Canada. Conference participants were optimistic that, over time, there would continue to be convergence of financial and general disclosure standards, and supported the idea that the goal is not rigid comparability but sufficient transparency among alternative reporting systems so that issuers may be fairly assessed. However, strong sentiment was expressed that as foreign capital markets continue to gain liquidity (in part because of increasing trading volume from U.S.-based investors) foreign markets will very soon challenge the preeminence of U.S. capital markets. To date, the U.S. market for primary distributions has not felt the full challenge posed by the SEC's requirement that foreign issuers must reconcile their financial statements to U.S. GAAP. The conference participants believed that this challenge is coming very soon. The consensus was that the forthcoming International Accounting Standards Committee ("IASC") proposed core principles project represents an unparalleled opportunity for the SEC to embrace IAS without fear of undercutting its continuing support for the Financial Accounting Standards Board ("FASB"), at least with respect to the European Union. Whatever the outcome, it was also agreed that unlike the MJDS, the SEC must stay engaged in reviewing applications of existing standards and facilitating the development of new standards under both U.S. GAAP and IAS, since international standard setting and enforcement might not be sufficiently rigorous.

The final area of this report's focus on the public offering of securities concerns the appropriate liability standards that should apply to public offering of securities. Among the concerns here was how to improve the overall quality of the information set forth in the issuer's registration statement. This concern was voiced both for registrants engaged in an initial public offering as well as for seasoned issuers involved in a shelf registration. The issue we addressed was simply what liability standard—and more importantly what duty would be enforced through that liability standard—is likely to improve the quality of reported information. A consensus was reached that issuers should continue to have absolute liability to their purchasers should the registration statement contain an omission or misstatement of a material fact if capital were being raised from the public. There was consensus as well that underwriters should continue to have legal responsibilities in connection with the contents of the registration statement. However, these responsibilities should be assessed in the context of a truly meaningful safe harbor, especially for distributions by seasoned issuers. Such a safe harbor would be best developed by an appropriate self-regulatory organization and would set forth best-practice criteria for underwriters. There was a consensus that the best practices that would reflect, among other factors, the type of security being underwritten and the fact that the best practices for investment grade debt securities would be quite different from those set forth for high-yield debt securities. Moreover, we envisioned that because best practices evolve over time, the safe harbor would itself be evolutionary in nature. The constantly evolving nature of such best practices and their incorporation into a safe harbor especially commend the safe harbor's contents to the ongoing efforts of a self-regulatory organization ("SRO") rather than to the Commission, where the efforts might be more episodic.

Though the sentiment was expressed that outside directors who are not on the audit committee are not in a position to engage in serious monitoring responsibilities, the consensus was that outside directors should have well-defined duties with respect to steps they should take to assure themselves that the registration statement is not misleading. The strong preference of the group was that there be a system whereby the obligations of directors, as well as underwriters, not be set on an ad hoc basis and after the fact, as occurs under the current liability-based regime. The consensus was that liability should arise as a means to enforce standards that the directors are able to fulfill. The participants were skeptical of the present requirement that directors sign the registration statement and Form 10-K, and of the proposed requirement in the Aircraft Carrier release that management certify '34 Act filings. Their skepticism was based on there being no definitive guidance of what directors and other signatories are attesting to when they sign the registration statement. There was a clear consensus that the SEC should provide definitive standards of what directors realistically are expected to do. Such an articulation by the SEC would then be the basis for directors, and perhaps others, to attest that they have taken the steps called for by the SEC to satisfy the due diligence requirements of Section 11.

The final session of the conference was devoted to regulatory issues pertaining to exchanges and alternative trading systems. The conference participants believed the foremost distinguishing feature of the New York Stock Exchange is the liquidity it provides investors. Our discussions focused heavily upon whether the emergence of Alternative Trading Systems ("ATSs") and Electronic Communication Networks ("ECNs")—Instinent, Island, Bloomer L.P. and Optimark—will produce harmful effects by fragmenting the market for securities that otherwise would be traded in a single market, such as the NYSE. One obvious concern with fragmentation is that it may lead to wider trading spreads for trades executed on behalf of retail investors such that institutional investors may experience a loss of liquidity. One group of commentators strongly believed that a single market will always provide greater liquidity in terms of depth and continuity than if there were several simultaneously available trading venues for a security. If there are to be multiple markets for a single security, some believed that the regulatory focus should be on the interconnectiveness of those markets in which protocols would provide for time-priced priority among orders that would be exposed to all markets through a single electronic switch. The opposing view took the position that regulation that is designed to connect markets may impose serious obstacles to innovation; the operators of ATSs or ECNs, instead of complying with what they perceive as burdensome regulatory demands, may locate their activities outside the U.S. with the concomitant effect that the SEC or U.S.-based SROs will have no regulatory powers over their internal affairs. A further fear of restricting the development of ATSs or ECNs is that each regulatory curtailment increases the monopoly-like position of the primary exchange for the traded security.

The final issue addressed at the conference was whether the regulatory functions presently carried out by the NYSE and the NASD should be combined into a new, super self-regulatory organization. Among the perceived benefits of such a combination would be reduced compliance costs, since a single, rather than duplicate, regulation would then exist. Though this development may have some cost savings, several concerns must first be addressed. First, there are a wide range of regulatory issues that are best addressed by a body with first-hand experience from operating a market. The current regulatory structure in which the SROs are both regulators and operate markets assures that the regulatory function is informed by the vast reservoir of experience the SRO derives from the markets it operates. Second, the cost savings by combining the organizations may not be great. The new regulatory body would require an administrative structure and support staff that currently is shared with their host SRO. Funding for the operations of a single regulatory body would continue to be provided by the NYSE and NASD, so that there may well not be a significant decline in their overall operating costs. Third, over time, a single private sector regulator, because it lacks a operating connection with the market whose participants it is charged with regulating, may be seen as superfluous to the SEC.

The overall sentiment of the conference participants is that the present regulatory framework of the U.S. securities laws works reasonably well. There is no need for the Congress to supplant the present laws with a new and untried framework. Change in the areas described above is desirable; the changes called for here can occur pursuant to existing rulemaking and exemptive powers that the SEC presently possesses.

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