

March 2012

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Recommended Citation

D'Alimonte, John S.; Carty, Mary C.; and Finkelstein, Thomas (2001) "Securities Law in the New Millennium," *St. John's Law Review*: Vol. 75 : No. 1 , Article 4.

Available at: <https://scholarship.law.stjohns.edu/lawreview/vol75/iss1/4>

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SECURITIES LAW IN THE NEW MILLENNIUM

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Remarkable changes have occurred in the capital markets and capital raising process since the passage of the Securities Act of 1933,¹ (the “1933 Act”), and the Securities and Exchange Act of 1934,² (the “1934 Act” and, together with the 1933 Act, the “Securities Acts”). Perhaps the most striking changes have been the recent, unprecedented rise in the use and impact of modern technology by investors and issuers, the escalation in speed and volume of capital raising, and the increasing globalization of the markets. Over the years, the primary responses to changes have been piecemeal revisions to either or both of the Securities Acts. Proposals designed to revamp the Securities Acts, particularly the 1933 Act, have been put forward from time to time with, in some instances, attendant hearings and voluminous documentation. None, however, have resulted in the sort of wholesale changes that many believe, and have proposed, are necessary.

The most recent attempt to make changes was the ill-fated “Aircraft Carrier”³ launched by the Securities and Exchange Commission (the “SEC”) in November 1998. The SEC removed the “Aircraft Carrier” from consideration, at least in its current form, due to the negative responses of attorneys and the securities industry.⁴ Despite the urgent need to modernize securities

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¹ 15 U.S.C. § 77 (2001).

² 15 U.S.C. § 78 (2001).

³ Regulation of Securities Offerings, Securities Act Release No. 33-7606A, [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,108, at 81,461-3 (Nov. 13, 1998) [hereinafter the Aircraft Carrier].

⁴ The comment period for the Aircraft Carrier ended on June 30, 1999. See

regulations that were designed for the capital markets of seventy years ago, ideally in the form of a paradigmatic statutory shift, there is currently no proposal from the SEC that would result in such legislative changes. What regulatory changes can we nevertheless expect (or hope) to see in the next few years that will adapt the federal securities regulatory scheme to the ever-changing capital markets?

This article is divided into three parts. Part I contains a brief overview of the history of the events which gave rise to the enactment of the 1933 Act, and subsequent attempts by the SEC to respond to later changes in the capital markets. Part II discusses recent and dramatic transformations in those markets. It focuses on changes in capital formation, including types of securities and financing techniques, the increased frequency and speed at which offerings are made in the capital markets, and the rise in the number of institutional investors actively participating in the capital markets. It details the advances in information technology leading to the availability of greater amounts of investor information, securities offerings on the Internet, the international scope of companies and economic activity that has led to increased globalization, and the need for more consistency in disclosure across national borders. Part III makes some modest predictions about what changes in federal securities regulations we may see in the near future. The issues surrounding modernization of the Securities Acts are complex and numerous. This article is not intended to examine all the issues or offer a forum for anything more than a selective discussion.

HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, EMERGING TRENDS IN SECURITIES LAW § 1.32, at 87–88 (1999-2000 ed. 1999). By that time, the SEC had received substantial negative comments on the securities offering portion of the Aircraft Carrier from a number of sources, including the Securities Industry Association and The Association of the Bar of the City of New York. *Id.* (noting the concerns of the securities industry in regard to the Aircraft Carrier). Both organizations recommended discarding the securities offering portion of the Aircraft Carrier. *Id.* The Association of the Bar of the City of New York also recommended replacing the Aircraft Carrier with a company-based registration model. *Id.* The concept of a company-based registration model is described in Part I of this article. The Aircraft Carrier has been effectively withdrawn from consideration in its current form. See Amy L. Goodman, *It's Past Time to Rethink the Securities Act of 1933*, INSIGHTS, July, 2000, at 2.

I. HISTORICAL PERSPECTIVE

A. *The Enactment of the Securities Act of 1933*

The principal impetus for the drafting and enactment of the 1933 Act⁵ was the stock market crash of 1929 and the concomitant economic depression and securities sales abuses occurring at that time.⁶ The 1929 stock market crash resulted in a two and a half-year loss of over eighty percent of the total value of all stocks listed on the New York Stock Exchange.⁷ It was believed that investor fraud was one of the main causes of the crash. Caught up in a heady period of booming prosperity and without the protection of federal disclosure requirements, investors during the 1920s purchased securities with little knowledge about the nature of the securities or the companies issuing them. This willingness

⁵ The 1933 Act regulates the “public offering” of securities by prohibiting the offer or sale of a security unless a specific exemption is available or a registration statement is in effect and a prospectus containing certain prescribed information has been delivered to investors. The 1933 Act provides for the registration of securities and the disclosure of information to the public in connection with the public offering. The cornerstone of the 1933 Act is section 5. Securities Act of 1933 § 5, 15 U.S.C. § 77e (2001). Section 5(c) prohibits securities offers made prior to the filing with the SEC of a registration statement, unless there is an exemption available. *Id.* § 5(c). The information that must be included in the registration statement is prescribed by the SEC, including the information in the prospectus, which is the primary marketing document and forms part of the registration statement. A preliminary prospectus (generally referred to as a “red herring” prospectus must accompany any offers to prospective investors. Sales may not be made until the SEC declares the registration statement effective, and prior to each sale the offeree must receive the final prospectus. The 1933 Act provides for civil and criminal liability for the issuer and for certain other parties involved in the preparation of the registration statement for any material misstatements and omissions made in the registration statement. *Id.* § 11; see also 15 U.S.C. § 77(k) (creating liability for false statements in a registration statement). There are several registration exemptions available which, although broadened over the years, remain generally narrow. For an account of how a small start-up company at the turn of the century might have fared in its attempt to raise capital and fall under one of three exemptions had the Securities Acts then been in existence, see Stuart R. Cohn, Essay, *The Impact of Securities Laws on Developing Companies: Would the Wright Brothers Have Gotten off the Ground?*, 3 J. SMALL & EMERGING BUS. L. 315, 315 (1999).

⁶ Prior to the enactment of the 1933 Act and the 1934 Act, there had been a series of regulatory enactments by various states, and regulation of securities offerings and brokers in Great Britain. For a history of the events leading up to these earlier legislative enactments, see LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 3–9, 31–43 (1998).

⁷ See *id.* at 167.

of investors to throw caution to the wind in their quest for handsome profits brought out the worst in human nature. Highly questionable enterprises and securities with little more behind them than the paper they were printed on were marketed with relative ease. State securities regulations were enacted in response to these abuses, but such regulations could not reach across state lines.⁸ The crash of the market in 1929 highlighted the need for a securities regulation system at the federal level and led to congressional hearings in 1933 that examined the securities industry and the abuses that were rampant.⁹ In his 1932 presidential campaign, Franklin Delano Roosevelt promised to enact federal securities legislation aimed at preventing such abuses.¹⁰ One of his first acts as President was to send a message to Congress urging the passage of federal securities legislation.¹¹

The original draft of the 1933 Act, submitted to Congress in March 1933,¹² was slanted toward merit regulation, e.g., it was designed to give the government the power to "pass upon the merits of securities offerings and to prevent unworthy offerings."¹³ This draft was similar to the state securities laws which had been enacted over the previous two decades and which allowed state regulators to review securities offerings for their fairness.¹⁴ There was considerable debate, however, over whether the federal securities laws should be merit regulation or regulation requiring adequate disclosure. President Roosevelt preferred legislation that would give the government the power to require disclosure rather than legislation that would provide for a merit-based evaluation of the issuer or the securities being offered.¹⁵ In April

⁸ See Michael McDonough, *Death in One Act: The Case for Company Registration*, 24 PEPP. L. REV. 563, 566 (1997).

⁹ See S. Res. 84, 72d Cong. (1932) (introducing a resolution to have the Senate's Banking and Currency Committee investigate securities abuses).

¹⁰ See Laylin K. James, *Why the Federal Securities Act Was Passed*, 13 CONG. DIG. 130, 131 (1934).

¹¹ See S. REP. NO. 73-47, at 6-7 (1933); H.R. REP NO. 73-85, at 1-2 (1933).

¹² See James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959).

¹³ Larry D. Soderquist, *Approaching Securities Law*, in 1 UNDERSTANDING THE SECURITIES LAWS 1998, 9 (3d ed., Prac. L. Inst. 1998) [hereinafter UNDERSTANDING THE SECURITIES LAWS].

¹⁴ See James, *supra* note 10, at 130-32 (explaining the impetus of the Federal Securities Act).

¹⁵ President Roosevelt noted in his message to Congress:

Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that

1933, a completely new version of the 1933 Act was drafted under the aegis of Felix Frankfurter.¹⁶

*B. The Securities and Exchange Act of 1934*¹⁷

Although the 1933 Act required detailed disclosure of information about the issuer and securities offered to the public, it did not regulate sales that were not made in a “public offering,” e.g., private sales transactions or market sales.¹⁸ Nor did the 1933 Act contain provisions for updating information on companies whose securities were already publicly traded.¹⁹ The 1933 Act was aimed at disclosure that would inform an investor about an investment in a public offering, but was not aimed at providing future or ongoing information about the issuer. Once the public offering was complete, the 1933 Act required no further disclosure, despite the fact that the security would continue to be actively traded in the public marketplace on a stock exchange.

The original statutory enactment of the 1934 Act attempted to complete the regulatory scheme by requiring that no SEC-registered broker-dealer could trade a security on a national securities exchange (the then-predominant marketplace) unless that class of securities had been registered under the 1934 Act.²⁰

newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.

There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

Landis, *supra* note 13, at 30, *citing* H.R. REP. NO. 73-85, at 1-2 (1933).

¹⁶ See Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1199, 1213 (1999).

¹⁷ The 1934 Act established the Securities and Exchange Commission and, among other things, mandated the registration of securities before they could be traded on a national securities exchange or, in some instances, over-the-counter. The 1934 Act also required the registration of the national securities exchanges and broker-dealers with the SEC. Thus, the 1934 Act primarily regulates securities trading after the issuer has effected the original issuance. See John S. D'Alimonte & Eugene J. Park, *The Securities Exchange Act of 1934*, in 2 UNDERSTANDING THE SECURITIES LAWS, *supra* note 13, 1072 PRAC. L. INST./CORP. L. & PRAC. 339. The 1934 Act extends farther than the 1933 Act regulating, among other things, proxy solicitations and tender offers. McDonough, *supra* note 8, at 580.

¹⁸ See Securities Act of 1933 § 4(2), 15 U.S.C. § 77(b)(2) (2001).

¹⁹ See HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 3.01, at 57 (2001 ed.).

²⁰ Securities Exchange Act of 1934, Pub. L. No. 73-291, § 12, 48 Stat. 881,

Once a class of securities is registered under the 1934 Act,²¹ the issuer must periodically file reports with the SEC containing specified information designed to keep the publicly available information about the issuer current.²²

It has been suggested that if the 1934 Act had been enacted before the 1933 Act, our system of federal securities regulation might look quite different today.²³ In particular, such a reversal might well have resulted in a scheme based on a one-time registration of an issuer with on-going public disclosure (sometimes referred to as a "company registration model"), rather than event-related disclosure, as is required by the 1933 Act. In a company-based registration model, upon issuing securities to the public for the first time the issuer would be required to register with the SEC by filing a full disclosure document and would thereafter enter into a regimen of ongoing disclosure (similar to the periodic reporting requirements of the 1934 Act). This would make available to all investors and prospective investors the information adequate to enable them to make buy, hold, and sell decisions about those securities. The initial establishment of such a system would have reduced the regulatory primacy of—or even eliminated almost entirely—the registration statement, because most of the information investors and prospective investors need would already be publicly available.²⁴

892 (1934) (codified at 15 U.S.C. §§ 78a–78jj (1999)) As the U.S. securities markets shifted from exchanges based almost entirely on national stock exchanges to over-the-counter markets, it became necessary to expand the reach of federal securities regulation. *Id.* The 1964 amendments to the 1934 Act required, among other things, that any company with more than \$1 million (subsequently raised to \$10 million under Rule 12g-1, pursuant to the SEC's rule-making authority) in total assets register any class of equity securities for which there are more than 500 shareholders of record. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565, 566–67 (1964).

²¹ The statutory amendments of 1964 also required, pursuant to section 15(d) of the 1934 Act, that a company with securities registered under the 1933 Act file periodic reports under the 1934 Act. *Id.* at 574.

²² Securities Exchange Act of 1934, Pub. L. No. 73-291, § 13, 48 Stat. 881, 894–95 (1934). Registration under the 1933 Act is event-based, e.g., it relates only to a particular transaction; registration under the 1934 Act relates to a one-time registration of a class of securities and does not require additional registrations upon additional issuances. See Milton H. Cohen, *Truth in Securities Revisited*, 79 HARV. L. REV. 1340, 1341 (1966).

²³ See Cohen, *supra* note 22, at 1341–42.

²⁴ See *id.* at 1357.

C. *The SEC "Special Study"*

It became evident to both frustrated securities law professors²⁵ and corporate attorneys alike, that the disclosure requirements of the Securities Acts were at times overlapping, inconsistent, and, in some instances, there were gaps. In 1963, the SEC commissioned a "Special Study of Securities Markets"²⁶ to study the Securities Acts, recommend methods of integrating the disclosure requirements, eliminating overlaps, and closing gaps. In recognition of the theoretical primacy of the 1934 Act, one of the main recommendations made by the Special Study was a system of abbreviated disclosure for registered public offerings in the form of 'short form' registration statements for those issuers who were already subject to the reporting requirements of the 1934 Act.²⁷ The proposals of the Special Study, along with an influential article by Milton Cohen who directed the Special Study and suggested that the continuous disclosure system of the 1934 Act should be emphasized over the one-time registration statement of the 1933 Act,²⁸ led to the proposed Federal Securities Code.

D. *The Federal Securities Code and Subsequent Amendments to the 1933 and 1934 Acts*

The preparation of the proposed Federal Securities Code was a monumental undertaking that occupied more than eight years of study and drafting. It was a massive attempt to integrate all of the federal laws relating to securities, financing and capital markets into one code. The primary tasks were to streamline the various federal securities laws, including the Securities Acts, and eliminate duplicate regulations.²⁹

One key component of the Federal Securities Code provided for company-based, rather than offering or transaction-based registration. The drafters recognized that "[a] great deal of the needless complexity, as well as a major loss of efficiency in the

²⁵ See LOSS & SELIGMAN, *supra* note 6, at 281.

²⁶ SEC, *Report of Special Study of Securities Markets*, H.R. DOC. NO. 88-95 PT. 1, at 482 (1st Sess. 1963) [hereinafter the Special Study].

²⁷ See *id.* at 595.

²⁸ See Cohen, *supra* note 22, at 1381.

²⁹ 1 FEDERAL SECURITIES CODE vii-viii (Am. L. Inst. 1980). The Federal Securities Code was also intended to replace many administrative regulations and court decisions with statutory enactments. *Id.* at xix.

regulatory system, is caused by the archaic centrality of section 5, the registration provision of the Securities Act of 1933.³⁰ Consequently, the Federal Securities Code mandated company-based registration for any company having at least \$1 million in assets and an aggregate of 500 holders of all its securities. Only companies registered under the Federal Securities Code could have their securities listed on either a national securities exchange or NASDAQ. A registered company would be subject to periodic disclosure requirements similar to those of the 1934 Act. Thus, registration of companies would replace registration of securities.

When a registered company sought to issue securities, it would be required to file an offering statement instead of the present 1933 Act registration statement. The offering statement³¹ was to include a prospectus and "whatever information, financial statements, material contracts, and other documents the Commission specifies by rule."³² The amount of disclosure required in the offering statement would vary depending upon whether the registered company had been registered under the Federal Securities Code, e.g., subject to periodic disclosure requirements, for a period of at least one year.³³ After revisions recommended by the SEC, the Federal Securities Code was completed in 1980. Ultimately, it faded from view as the level of support from the SEC and other sources was inadequate to overcome Congress's disinclination to overthrow a system of regulation, which, despite its sporadic inefficiencies, had proven to be relatively effective for over forty years.³⁴

Many of the concepts contained in the Federal Securities Code can be found in subsequent amendments to the Act, as well as in the rules and regulations thereunder, resulting in the development of the integrated disclosure system. Regulation S-

³⁰ *Id.* at xix-xx.

³¹ *See id.* at xxviii. If a company that wished to issue securities had not yet registered as a company, it would simultaneously file a company-based registration and an offering document. *Id.*

³² *Id.* at 244.

³³ *Id.* at 261-62.

³⁴ *See* McDonough, *supra* note 8, at 587. Louis Loss, the Reporter for the Federal Securities Code, maintained that certain legislative amendments have used the Federal Securities Code as a model and that the Federal Securities Code has been cited by courts almost in the same manner as a restatement of the law. *See* LOSS & SELIGMAN, *supra* note 6, at 287.

K,³⁵ adopted under amendments enacted in 1977,³⁶ provides for the “integrated disclosure” of certain requirements in a centralized and standardized format under both the Securities Acts. The SEC’s Advisory Committee on the Capital Formation and Regulatory Processes called the development of this integrated disclosure system the “precursor” to the development of a company-based registration model.³⁷ Additional regulatory changes enacted by the SEC³⁸ in 1982 created a three-tiered registration system.³⁹ This system allowed certain registrants to use ‘short form’ registration statements utilizing “incorporation by reference” of some of the registrant’s 1934 Act reports into their 1933 Act registration statements. The 1982 amendments came even closer to recognizing the importance and greater effectiveness of the 1934 Act, but continued the dual reporting

³⁵ 17 C.F.R. § 229.1 (2000).

³⁶ Although the long-simmering Federal Securities Code was the impetus for the development of Regulation S-K, the immediate triggers were the report of the ‘Wheat Committee’. See SEC, DISCLOSURE TO INVESTORS, A REAPPRAISAL OF ADMINISTRATIVE POLICIES UNDER THE ‘33 AND ‘34 SECURITIES ACT 55–62, 267–296 (La Salle St. Press, 1969); ADVISORY COMM. ON CORPORATE DISCLOSURE, 95TH CONG., REPORT OF THE ADVISORY COMM. ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION (Comm. Print 1977). As with earlier and later reports and recommendations, the inefficiencies of dual reporting systems and a preference to emphasize the reporting requirements of the 1934 Act were recognized.

³⁷ Report of the Advisory Committee on the Capital Formation and Regulatory Processes, [1996-97 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,834, at 88,404 (July 24, 1996) [hereinafter Wallman Commission].

³⁸ One of the reasons why the present regulatory system operates inefficiently *vis-à-vis* the present capital markets is that for the most part, those changes that have been introduced have been enacted via regulatory changes by the SEC, rather than statutory enactments by Congress. Thus, the present system has grafted onto the original Securities Acts (with a few statutory amendments) a series of piecemeal regulatory revisions, each of which was an attempt to address a need that was viewed as compelling at the particular time. What is needed presently is a new legislative enactment by Congress that would repeal the Securities Acts and replace them with modern legislation tailored to the needs of the twenty-first century. Since this seems highly unlikely to occur anytime soon, this article in Part II suggests some regulatory and rule revisions that would allow the present statutory and regulatory system to better respond to present-day needs.

³⁹ Issuers may use forms S-1, S-2 or S-3 to register securities, depending upon certain eligibility requirements. This system allows certain registrants who have been subject to the reporting requirements of the 1934 Act for certain periods of time and had filed their reports in a timely fashion to use ‘short form’ registration statements utilizing “incorporation by reference” of certain of the registrant’s 1934 Act reports into the registrant’s 1933 Act registration statements.

system. Ultimately, the concept of shelf registration of securities, discussed later in this article, developed from the integrated disclosure system and integration by reference.⁴⁰

E. The Task Force on Disclosure Simplification and the Advisory Committee on Capital Formation and Regulatory Processes

In 1995, the SEC organized the Task Force on Disclosure Simplification (the "Task Force")⁴¹ and the Advisory Committee on Capital Formation and Regulatory Processes (frequently referred to as the "Wallman Commission" after its chair, Commissioner Steven M. H. Wallman). The primary aims of the Task Force were to identify ways to simplify disclosure requirements and increase the efficiency of the registration process.⁴² The Wallman Commission's goal was to analyze the capital markets in an attempt to identify ways to make the process of securities registration more responsive to the needs of the capital markets.⁴³ In 1996 the Task Force and the Commission issued reports that called for significant changes in securities registration requirements.

The Wallman Commission, echoing the recommendations of Professor Cohen nearly two decades earlier, advocated a transition to a company-based registration model that focused on periodic filings by issuers as the primary source of information for investors.

The Task Force reviewed the forms and rules related to capital-raising transactions, the periodic reporting requirements of the 1934 Act, proxy solicitations, and tender offers and beneficial ownership reporting under the Williams Act. It recommended the elimination of a number of rules and forms it considered duplicative and/or no longer necessary,⁴⁴ and endorsed

⁴⁰ See McDonough, *supra* note 8, at 564.

⁴¹ SEC, Report of the Task Force on Disclosure Simplification (1996), available at <http://www.sec.gov/news/studies/smpl.htm> [hereinafter Task Force Report].

⁴² See *id.* at 9.

⁴³ See Wallman Commission, *supra* note 37, at 88, 404.

⁴⁴ The Task Force's recommendations resulted in a series of releases by the SEC proposing the elimination of certain forms and rules under the Securities Acts, which were duplicative or served no useful purpose; most of these forms and rules were ultimately eliminated. See John D'Alimonte, Emily Rixinger & Alec C. Sherod, *Streamlining the Task Force Report on Disclosure Simplification: A Summary of the Task Force Proposals and Securities and Exchange Commission Responses*, 963 PRAC. L. INST./CORP L. & PRAC. 47, 48 (1996).

the proposed company-based registration model then under consideration by the Wallman Commission.⁴⁵ The Task Force also made the following recommendations: liberalization of the requirements for and availability of shelf registration;⁴⁶ modification of the prospectus delivery requirement under the 1933 Act to permit “seasoned issuers”⁴⁷ offering common stock, not in an initial public offering, to utilize full incorporation by reference into a confirmation of sale, rather than requiring delivery of a prospectus,⁴⁸ and; development of the use of “Plain English” in registration statements and other documents regulated by the Securities Acts.⁴⁹

The Wallman Commission recommended a company-based registration model rather than a transaction-based model for seasoned issuers.⁵⁰ It called company-based registration the “logical culmination” of the development “away from the transaction-based framework for the registration of securities,” and noted:

[T]ransactional concepts still underlying the current scheme for registration of securities continue to impose unnecessary costs and restrictions on issuer access to capital. Perhaps more importantly, in many instances the transactional system also serves as an impediment to full and timely disclosure to investors and the markets, and the realization of the full potential for investor protection provided by the 1933 Act.⁵¹

The Wallman Commission claimed the following advantages would result from company-based registration: (i) increased speed and flexibility of access to the capital markets; (ii) decreased concerns related to “gun-jumping,” restricted securities, and integration, (of separate offerings, which can destroy a

⁴⁵ See Task Force Report, *supra* note 41, at 46.

⁴⁶ See *id.* at 48–54.

⁴⁷ As defined by the Wallman Commission, “seasoned issuers” would be issuers which had timely filed all required periodic reports for a certain length of time, were listed on a national securities exchange or on NASDAQ’s National Market System and had at least \$75 million of outstanding securities of the class being registered held by nonaffiliates. See Wallman Commission, *supra* note 37, at 88,404–05.

⁴⁸ See Task Force Report, *supra* note 41, at 43; see also Wallman Commission, *supra* note 37, ¶ 88,404.

⁴⁹ See Wallman Commission *supra* note 37, at 88,405.

⁵⁰ See Wallman Commission, *supra* note 37, at 88,404–05.

⁵¹ *Id.* at 88,404.

registration exemption), as these concepts related to the distinction between public and private offerings, a concept which would either be eliminated or greatly diminished under the company-based registration model; and (iii) lower costs of raising capital, which would ultimately benefit shareholders.⁵² Under the proposed model, a company would file a registration statement to provide company-related disclosure and indicate its intent to issue securities from time to time, thereby effectuating a generic registration of its securities. Once registered, a company wishing to issue securities would file certain types of disclosure (to the extent such disclosure was not already publicly available) dependent upon the type of security being offered. If a company filed its required periodic reports, the SEC would no longer review offering documents except for certain "nonroutine" and "extraordinary" transactions.⁵³ Thus, there would generally be no waiting period while the SEC reviewed the registration statement. Initial public offerings, however, would not be covered by the company-based registration model.⁵⁴

F. *The Aircraft Carrier Release*

In July 1996, the SEC issued a release requesting comments on ways to improve the capital formation process.⁵⁵ To aid the SEC, Congress passed the National Securities Markets Improvement Act of 1996. This act gave the SEC broad discretion in regulating the securities markets. As a result of its expanded exemptive authority and in response to the proposals of the Wallman Commission and the Task Force, the SEC began to examine different approaches to improve the securities markets and the capital formation process.⁵⁶ The SEC's inquiry culminated in a 1998 release that was so extensive and wide ranging it was dubbed the "Aircraft Carrier."⁵⁷

⁵² *See id.*

⁵³ *See id.*

⁵⁴ *See id.*

⁵⁵ *See* Gerald S. Blackman, *The SEC's Aircraft Carrier - Is It Seaworthy? A Summary and Critique*, 1109 PRAC. L. INST./J. CORP. L. & PRAC. 191, 193.

⁵⁶ *See id.* at 193-94.

⁵⁷ *See* Linda C. Quinn & Otilie L. Jarmel, *Publicity Considerations for Corporate Issuers: Getting the Message Across Under the Federal Securities Laws "Aircraft Carrier" Release Annotation*, in *SECURITIES OFFERINGS: WHAT ISSUERS NEED TO KNOW NOW*, 1174 PRAC L. INST./CORP. L. & PRAC. 69, 121 n.1 (April 27, 2000) [hereinafter *SECURITIES OFFERINGS*] (noting that the Aircraft Carrier was so named due to its "magnitude").

The Aircraft Carrier consisted of a proposed overhaul of the current securities offering regime in several key areas, including registration system changes, revisions of regulations governing communications at the time of securities offerings, elimination of final prospectus delivery requirements, defining the appropriate scope of underwriter due diligence, expanding the contents of periodic reports under the 1934 Act, and guidelines for the integration of private and public offerings. The most dramatic change was the proposed elimination of the eight forms currently used in public offerings and their replacement with three forms. The three new forms, titled Forms A, B, and C, would have been used in offerings by smaller unseasoned companies and all initial public offerings, for offerings by large seasoned companies, and for mergers and acquisitions, respectively.

Although the securities offering proposals of the Aircraft Carrier represented a striking change from the current regime, they did not constitute a change to a company-based registration model similar to the one recommended by the Wallman Commission.⁵⁸ The Aircraft Carrier attempted to build upon the Securities Acts and institute change through the SEC's rulemaking powers. The Aircraft Carrier proposals would continue to require that every non-exempt offering be registered under the 1933 Act. Within the framework of the Securities Acts the Aircraft Carrier did, however, attempt to move toward a system which emphasized the importance of ongoing company disclosure through periodic 1934 Act filings, over the event-oriented transactional disclosure of the registration statement required by the 1933 Act.

The proposed Form A would have contained most of the information currently required to be included in Form S-1. A company typically uses form S-1 when no other form is authorized for use. Certain company information could have been incorporated by reference by seasoned issuers.⁵⁹

⁵⁸ See BLOOMENTHAL & WOOLF, *supra* note 4, § 1.04, at 2; *see also supra* note 38 and accompanying text (discussing piecemeal regulatory changes instituted by the SEC, in response to changes in the capital markets, as opposed to the wholesale legislative statutory revisions that would most effectively deal with these changes).

⁵⁹ The definition of a "seasoned issuer" for purposes of Form A included issuers who had a two-year 1934 Act reporting history and either a public float of at least \$75 million or had filed at least two annual reports. *See* BLOOMENTHAL & WOOLF, *supra* note 4, § 1.14, at 31.

Form B represented the SEC's most radical departure from the current securities offering regime. Under Form B, large and/or well-followed seasoned issuers⁶⁰ could have effected offerings by means of a prospectus containing certain offering information, (comparable to, but less than what is presently required under the 1933 Act), incorporation by reference of 1934 Act reports, and a prospectus term sheet. The SEC would not have reviewed a Form B registration statement prior to effectiveness (although it would have been screened by the SEC to determine if the registrant was eligible to use Form B).⁶¹ The issuer could file a Form B registration statement and then determine when it was to become effective.⁶² Fees would be paid not upon filing, but upon first sale of the securities. Additionally, marketing of the securities—making offers to sell and soliciting offers to buy—could begin as determined by the issuer and before filing the registration statement. Thus, Form B represented an attempt to allow certain issuers increased flexibility in determining when to issue their securities, but did not represent the company-based registration model envisioned by the Wallman Commission, as it still required the provision of considerable information in the registration statement. Its advantage over the current system is that it would have allowed an eligible issuer to quickly issue securities in response to market conditions.⁶³

Many commentators expressed grave concerns about the Aircraft Carrier. In particular, the Aircraft Carrier proposed to impose section 11 liability for material misstatements and omissions in an issuer's 1934 Act reports. Absent a safe harbor,

⁶⁰ For purposes of Form B, a "seasoned issuer" included those issuers who have a one year 1934 Act reporting history and had filed at least one annual report. A large and/or well-followed issuer had a public float of \$75 million and a \$1 million average daily trading volume or a \$250 million public float. *See id.* § 1.02, at 3-4. The criteria to use Form B, although similar to the present S-3 criteria, were more stringent and therefore a number of companies who presently meet S-3 eligibility criteria would not meet Form B criteria. *See id.* §1.32, at 90.

⁶¹ Companies that filed on Form A and met certain eligibility criteria would also not have their forms reviewed. *See Aircraft Carrier, supra* note 3, at 81,517-19.

⁶² *See id.* at 121; *see also* Blackman, *supra* note 55, at 195.

⁶³ The SEC believed that institution of Form B would have effectively eliminated the need for a shelf registration for most types of securities issuances, as it would have provided similar flexibility and the added advantage of payment of fees at the time of sale instead of at filing. *See* Blackman, *supra* note 55, at 196.

this would have made the registrant and some of its directors and officers strictly liable. Additionally, a number of companies that are currently able to file on S-3 would not have been eligible to file on the roughly equivalent Form B.⁶⁴ Based on all the criticisms received, the Aircraft Carrier was formally withdrawn by the SEC.⁶⁵

II. CHARACTERISTICS OF TODAY'S CAPITAL MARKETS

Three major characteristics of today's capital markets demonstrate the utility and importance of a securities offering scheme patterned on a company-based registration model: (i) the structure and composition of today's capital markets, in particular, the increasing variations in the types of securities offered and the speed with which offerings are made; (ii) developments in information technology and the Internet; and (iii) globalization. This portion of this article will discuss each of these characteristics and describe how it is affected by the current offering-based securities regime and whether a company-based or closely analogous registration model for offerings would affect the status quo.⁶⁶

A. *The Structure and Composition of the Capital Markets*

1. The Offering-Based Registration Model of the 1933 Act Cannot Keep Pace with the Wide Variety of Securities Issued in Today's Capital Markets

The capital markets of today are significantly different from those that existed when the Securities Acts were promulgated. Today's markets are populated by a large variety of financial instruments and transactions. New variations on spin-offs, hybrid offerings, various kinds of exchange offers, convertible and

⁶⁴ See BLOOMENTHAL & WOLFF, *supra* note 4, § 1.32, at 90. Two of the primary commentators were the Securities Industry Association and The Association of the Bar of the City of New York, both of whom provided negative comment. *Id.* at 87-91.

⁶⁵ Some of the comments went so far as to recommend rejecting all Aircraft Carrier proposals. See *supra* note 4 (discussing the SEC's withdrawal of the Aircraft Carrier).

⁶⁶ As discussed *infra*, an expanded shelf registration system can provide many of the advantages of a company-based registration model and, in many ways, resembles a company-based registration model.

preferred debt issuances and other means of raising capital are constantly being invented.⁶⁷ Since the SEC and Congress move slowly in implementing changes in securities regulation and legislation, proposed laws or regulations relating to new types of securities can be superseded by still newer forms of capital-raising, even as proposals are approved. An offering-based registration model presents a significant problem, as the SEC and Congress are constantly playing the game of "catch-up" with the capital markets.⁶⁸

In a company-based registration system, the regulation focuses primarily on the terms of a particular offering. At the time of an offering, regulators would focus less on the issuer and more on the particular offering. Adequate disclosure about the issuer is readily available through the issuer's periodic filings. By placing the focus of its inquiry on the particular offering rather than the particular issuer, the regulatory agency charged with overseeing capital formation would achieve two desirable ends. First, the "outpacing" problem described in the preceding paragraph is minimized since the object of review is the offering and not the company. Second, costs associated with offerings should be significantly reduced.⁶⁹ By allowing issuers to simply file periodic reports about their status and operations, and then conduct offerings pursuant to abbreviated registration statements, issuers could save money that would otherwise be spent on accounting fees, legal fees, printing costs and state and federal filing fees.⁷⁰ In fact, the aggregation of these costs can sometimes be an insurmountable hurdle for smaller companies seeking access to capital markets.⁷¹

⁶⁷ See McDonough, *supra* note 8, at 604-09 (indicating that investors have abandoned public offerings under the 1933 Act in favor of new and developing alternative methods of raising capital).

⁶⁸ As discussed in section III of this article, one advantage of the universal shelf registration system is that it allows an issuer to register a wide variety of securities. Expansion of the use of a universal shelf registration system would allow issuers more flexibility in their attempts to keep pace with the capital markets.

⁶⁹ In the early 1990s the costs of compliance in an initial public offering represented eleven percent of the total proceeds from the offering. See McDonough, *supra* note 8, at 595.

⁷⁰ See *id.* at 595 n.250.

⁷¹ See generally Joseph Kershenbaum, *Securities Offerings Online by Small Nonpublic Businesses*, 25 VT. BAR J. 19 (Sept. 1999).

2. The Rise of the Institutional Investor in the Capital Markets May Make the 1933 Act's Offering-Based Focus Unnecessary

When the Securities Acts were first promulgated, their aim was to protect financially unsophisticated individuals from those trying to sell them pieces of "blue sky."⁷² This was also the aim of many state securities laws, dubbed "Blue Sky Laws."⁷³ Larger, sophisticated institutional investors including banks, pension funds, mutual funds and casualty insurance companies, however, dominate today's capital markets.⁷⁴ In 1990, institutional investors accounted for almost fifty-four percent of all equity holdings in the United States capital markets, compared with thirty-eight percent in 1981 and twenty-three percent in 1955.⁷⁵ Additionally, institutional investors currently own a majority of the equity of the fifty largest companies in the United States.⁷⁶

The rise in the number of institutional investors underscores the problems of the current securities registration regime. Institutional investors may have a lesser need for the "extra" protection afforded by the current offering-based model in the securities laws in part because of their ability to gather and process information about issuers, and in part because of their ability to deal with complicated financial issues and transactions in a short timeframe. This enables issuers and institutional buyers to effect transactions during market windows and other periods of investment opportunity. An offering-based registration process, with the attendant registration statement drafting, possible SEC review, and prospectus delivery requirements, may preclude the issuer from effectuating its offering in a manner consistent with opportunities afforded by the capital markets.⁷⁷ A company-based registration regime permits issuers to seize opportunities for raising capital more quickly, particularly in transactions with institutional investors who have tracked and monitored the issuer's growth and might not need the extensive disclosure required by the 1933 Act.

⁷² See Cohn, *supra* note 5, at 323.

⁷³ *Id.* at 323 n.19.

⁷⁴ See McDonough, *supra* note 8, at 593-94.

⁷⁵ See *id.* at 593 n.239 (citations omitted).

⁷⁶ See Joseph Evan Calio & Rafael Xavier Zahraiddin, *The Securities and Exchange Commission's 1992 Proxy Amendments: Questions of Accountability*, 14 PACE L. REV. 459, 476 (1994) (stating that, as of 1994, institutional investors owned over sixty percent of the equity securities in the fifty largest companies).

⁷⁷ See McDonough, *supra* note 8, at 595.

3. Modern Markets Demand a Faster Means of Effecting Offerings and Other Transactions

Notwithstanding the recent slump in initial public offerings, the capital markets have been moving at increased rates. The time between inception of business concepts, commencement of operations, and initial public offerings has become progressively shorter. Given this ever-shortening time span between inception and public offering, newer, faster means of effecting capital raising for emerging companies, as well as for more developed companies, are needed. While a company-based registration system could not eliminate the need for a rapidly developing issuer to file frequently to keep public information about its business current, it would permit the issuer to do so at times when it is not pressured to effectuate capital raising. Furthermore, a company-based registration system would presumably eliminate the potential delay posed by SEC review of a registration statement at the time of each offering of securities.

B. The Internet and the Capital Markets

The second characteristic that distinguishes modern capital markets from capital markets of the past is the extent to which technological advances have played a part in structuring and defining the operation of capital markets. In today's markets, investors have ever-increasing amounts of information about issuers and businesses from a wide variety of sources.⁷⁸ Many argue that this access enables investors to make investment decisions on par with decisions made by Wall Street professionals.⁷⁹ This deluge of data, however, underscores the tension inherent in the 1933 Act between a free flow of

⁷⁸ See generally Stephen Kundenholdt & Warren Gottlieb, *Securities Law Issues and the Use of Electronic Media in the Capital Market Place*, 2 WALL ST. LAW. 17 (1998). The SEC has recently promulgated Regulation FD (for "fair disclosure"), which requires issuers to disclose to the public the same information previously released only to analysts monitoring an issuer's performance, and sets out a road map for the means by which such disclosure can be achieved. See 17 C.F.R. § 243 (2001); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716-37 (Aug. 24, 2000) (explaining the purpose behind and intended effect of Regulation FD).

⁷⁹ See *Securities Fraud on the Internet: Hearings Before the Permanent Subcomm. On Investigations of the Senate Comm. on Governmental Affairs*, 106th Cong. 79-91 (Mar. 22-23, 1999) (testimony of Thomas M. Gardner, founder of The Motley Fool, Inc.), available at 1999 WL 8085871.

information on the one hand and the need to protect investors from fraudulent or manipulative practices by regulating communications, on the other.

Strict adherence to the current securities offering model thwarts some of the technological efficiencies offered by the Internet. Conversely, allowing information to flow unchecked over the Internet could potentially lead to serious abuses. Generally, the SEC has taken a cautious pro-technology stance on some of the issues raised by the advent of the Internet.⁸⁰ While several key issues currently under review by the SEC should help clarify the role of the Internet in the capital markets, other issues remain unsettled.

1. The SEC's Interpretation of Prohibited "Offers" Must Be Revisited in Light of Recent Technological Developments

Questions remain as to the treatment of corporate communications on a company's web site. Generally, in a securities offering under the current regime, written offers, except preliminary prospectuses labeled as such, to potential investors are prohibited prior to the declaration of effectiveness of a registration statement by the SEC.⁸¹ After effectiveness, offers must be accompanied or preceded by delivery of a final prospectus. The SEC interprets the term "offer" very broadly, as any communication that primes the market for interest in an offering.⁸² The SEC views material posted on a web site as written information. Companies could therefore be subject to significant liability if the website materials could be interpreted as offering materials and the requirements of the 1933 Act have not been adhered to.⁸³ To further complicate the issue, hyperlinks on a company's website that could be construed as promoting the company's securities, e.g., analyst reports or information about a company's strategic partners, could also serve as a basis of

⁸⁰ See Kundenholdt & Gottlieb, *supra* note 78, at 17.

⁸¹ See Cohn, *supra* note 5, at 327 n.34.

⁸² See *id.* at 331 n.47. An offer is defined to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." *Id.*

⁸³ See Statement of the Commission Regarding Use of Internet Websites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 33-7516 (March 23, 1998), *available at* 1998 WL 128173; see also Quinn & Jarmel, *supra* note 57, at 110.

liability.⁸⁴ The SEC should evaluate its position regarding offering materials on websites and the role such materials play in the offering of securities. The SEC has indicated an intention to clarify certain of these issues in the year 2000, but has not yet issued any releases on the subject.

2. Revisions of Delivery Requirements to Take Advantage of the Internet

The SEC has made some revisions to its prospectus delivery requirements to accommodate the use of the Internet. Generally, the new SEC electronic delivery guidelines are analogous to delivery procedures used for traditional paper media.⁸⁵ The touchstones of the SEC's analysis were: (i) an investor should be given quantitatively similar notice via electronic means as is given when paper is used; (ii) an investor should have qualitatively similar access to the electronically delivered material as would be the case if the material were mailed to the investor, e.g., the investor should be able to easily access the material, retain a copy of the material for later use, and, to the extent material is delivered through the Internet or other online medium, such material should be available for review for as long as the delivery requirement applies; (iii) an investor should, upon request, be permitted to receive from the issuer paper copies of the offering materials; and (iv) the person or issuer providing the offering material by electronic means must demonstrate that the delivery requirement was satisfied in a qualitatively similar fashion to a traditional mailing, e.g., an e-mail confirming receipt of the information, or a hyperlink to a required document such as a prospectus accompanying a free writing.⁸⁶

The current paper delivery requirements create significant expense for issuers.⁸⁷ Electronic delivery should significantly reduce the costs of an offering by greatly reducing, if not

⁸⁴ See Quinn & Jarmel, *supra* note 57, at 151.

⁸⁵ See *id.* at 148-49.

⁸⁶ See *id.*

⁸⁷ See Brian Eddy, *Internet Road Shows: It's Time to Open the Door for the Retail Investor*, 25 IOWA J. CORP. L. 867, 876 (2000) (noting that paper-based distribution is less cost-effective than dissemination through electronic media); Satu S. Svahn, Note, *Greater Investor Outreach at the Click of a Mouse: Internet and Closed-Circuit Road Shows Should Reach Retail Investors*, 65 BROOK. L. REV. 249, 278 (1999) (noting the low costs of Internet delivery as compared with paper-based delivery).

eliminating, the printing and distribution costs of prospectuses.⁸⁸ Furthermore, it should save time, as electronic transmission is nearly instantaneous.

3. Electronic Road Shows Offer Significant Benefits to Smaller Businesses that Have Previously Been Excluded from Participating in the Capital Markets

Another important technological development that has had an impact on the offering regime is the use of electronic road shows to arouse interest in an issuer and its securities. In traditional offerings, issuers and their underwriters travel the country and meet potential investors, usually institutions or broker dealers, to describe the issuer and the offering.⁸⁹ Electronic road shows, whereby the issuer's presentation is made available over the Internet or a closed circuit television network, are becoming commonplace.⁹⁰

The SEC has approved the use of electronic road shows conducted under specific guidelines in several no-action letters. These guidelines include delivery of a preliminary prospectus as filed with the SEC prior to transmission, providing a "crawl" that directs potential investors to review the aforementioned preliminary prospectus and ensures that information presented in the electronic road show is not inconsistent with the information in the preliminary prospectus.⁹¹ The SEC has agreed that

⁸⁸ See Svahn, *supra* note 87, at 279 (noting that uploading financial statements and other disclosures on the Internet is easier and cheaper than the current paper delivery system); see also Nancy Gondo, *Internet May Open Road Shows to Small Investors*, INVESTOR'S BUS. DAILY, Dec. 10, 1997 at A9 (stating that the Internet makes distribution costs "negligible").

⁸⁹ See Svahn, *supra* note 87, at 252, 278 (noting the low cost of Internet road shows and the greater access provided to small investors through Internet road shows); Eddy, *supra* note 87, at 868 (stating that traditional methods for generating potential investor interest involved travelling "from city to city").

⁹⁰ See Svahn, *supra* note 87, at 250 n.2; see also Quinn & Jarmel, *supra* note 57 (noting that the expanding use of electronic media in the securities field prompted the SEC to allow electronic road shows).

⁹¹ To date, six companies have been given approval by the SEC to conduct road shows over the Internet or through closed-circuit television. The companies are Private Financial Network, see Private Fin. Network, SEC No-Action Letter, at 1997 SEC No-Act. LEXIS 406 (Mar. 12, 1997); Net Roadshow, Inc., see Net Roadshow, Inc., SEC No-Action Letter, at 1997 SEC No-Act. LEXIS 864 (Sept. 8, 1997); Bloomberg, L.P., see Bloomberg, L.P., SEC No-Action Letter, at 1997 SEC No-Act. LEXIS 1023 (Dec. 1, 1997); Activate Net Corporation, see Activate Net Corp., SEC No-Action Letter, at 1999 SEC No-Act. LEXIS 766 (Sept. 21, 1999); Thomson Financial Services, Inc., see Thomson Fin. Svcs., Inc., SEC No-Action

electronic road shows can be considered distinct from those conducted over television or radio broadcast, which are considered to be prohibited "writings," so long as electronic road shows are conducted over private networks.⁹² The rationale behind this seems to be that the SEC believes that the statutory reference to broadcasting refers to only broadcasting to an undifferentiated audience, not the use of similar technology for closed-circuit broadcasting or other controlled transmissions directed at a limited investor audience.⁹³

Subsequent no-action letters addressing electronic road shows have clarified that Internet road shows are permissible under certain circumstances. Road show viewers must appreciate the importance of the prospectus delivered to them, must not have an unlimited opportunity to view the road show, and they must not record and redistribute the road show.⁹⁴ The most recent no-action letter on the subject of electronic road shows would allow the issuer to present the road shows to certain retail investors over the Internet provided: (i) the road show would only be transmitted after the registration statement is filed and a preliminary prospectus is distributed; (ii) the investor could click a button to indicate they would not re-transmit the road show or make it available to persons who would not otherwise qualify to view the show; (iii) the preliminary prospectus would be made available for download and printing with a restrictive legend stating that the offering is made by a prospectus only; (iv) the Internet road show is consistent with the prospectus; (v) the entire road show, together with its question and answer session, is transmitted; and (v) passwords to view the road show would only be issued to qualified investors.⁹⁵ The SEC has indicated that it intends to propose rules addressing electronic road shows some time in 2000.⁹⁶

Letter, at 1998 SEC No-Act. LEXIS 837 (Sept. 4, 1998); and Charles Schwab & Co., Inc., *see* Charles Schwab & Co., Inc., SEC No-Action Letter, at 1999 WL 1038050 (Nov. 12, 1999).

⁹² *See* Private Fin. Network, SEC No-Action Letter, at 1997 SEC No-Act. LEXIS 406 (Mar. 12, 1997).

⁹³ *See id.* The SEC agreed without discussion to the terms of the no-action letter that argued that broadcasting contemplated an undifferentiated offering which was materially distinct from the facts in the no-action letter. *See id.*

⁹⁴ *See id.*

⁹⁵ *See* Charles Schwab & Co., Inc., SEC No-Action Letter, 1999 WL 1038050 (Nov. 12, 1999).

⁹⁶ *See* Quinn & Jarmel, *supra* note 57, at 143.

The SEC's apparently increasing acceptance of Internet road shows is significant for several reasons. By allowing Internet road shows to be made available to retail investors, the SEC is acknowledging the effect of developing technology on the enfranchisement of retail investors and allowing these investors to form an opinion and take actions that were previously limited to institutional investors and Wall Street professionals.⁹⁷ Also, the cost of an electronic road show can be substantially less than the cost of a traditional road show.⁹⁸ As a result, the use of electronic road shows should make the capital markets accessible to smaller businesses for which offerings would have otherwise been cost prohibitive. Provided that underwriters are willing to commit to such small business offerings, the capital markets could become an even more fertile breeding ground for new ventures. Eventually, the broad acceptance of electronic road shows, together with expansive electronic prospectus delivery requirements, should pave the way for offerings to be conducted entirely over the Internet with no "paper" involved.

4. The Rise of Securities Fraud and Manipulation on the Internet Will Continue to Lead to Increased Enforcement Efforts by the SEC

As the Internet progressively makes the capital markets accessible to a broader array of investors and lay individuals, the potential for abuse will increase.

In response, the SEC has nearly doubled the size of its Internet surveillance team, the Cyberforce.⁹⁹ Currently, the Cyberforce is not permitted to conduct undercover operations, is limited to monitoring the content of Internet bulletin boards and chat rooms, and must reveal its presence and purpose.¹⁰⁰ If

⁹⁷ See Svahn, *supra* note 87, at 179 (suggesting the benefits of Internet road shows, including a wider audience, outweigh the disadvantages, such as expansion of liability).

⁹⁸ See Nancy Gondo, *Internet May Open Road Shows to Small Investors*, INVESTOR'S BUS. DAILY, Dec. 10, 1997, at A9 (noting that while typical road shows can cost up to \$150,000, Internet road shows generally cost as little as \$15,000).

⁹⁹ See Quinn & Jarmel, *supra* note 57, at 158.

¹⁰⁰ See Electronic Commerce: Levitt Announces Increased Inspections, Enforcement for Internet Brokerage Firms, 31 BNA SEC. REG. L. REP. 18 (May 7, 1999); see also Joseph J. Cella III and John Reed Stark, *SEC Enforcement and the Internet: Meeting the Challenge of the Next Millennium*, 52 BUS. LAW. 815, 835-37 (May 1997) (recognizing that the only restriction is that the Division

Internet fraud continues to grow, it may be necessary to expand Cyberforce's mandate to include more extensive investigative operations.¹⁰¹

Further, in recent years the SEC has increased its commitment to pursuing and prosecuting enforcement actions relating to violations of the securities laws by way of the Internet. The SEC has conducted three fraud "sweeps" in part to increase awareness of the existence of Internet securities fraud.¹⁰² The enforcement actions were targeted at individuals and companies that engaged in illegal touting of stocks that failed to disclose their affiliation with and compensation by the issuers whose stocks they touted. Also targeted were companies and individuals who fraudulently sold unregistered securities and who made false representations about investment returns.¹⁰³

It is important to note that the Internet is, at its core, a communications tool and, as such, can be abused like any other communications tool.¹⁰⁴ The trail it leaves behind and the anonymity it offers, however, creates significant advantages for the SEC in pursuing its enforcement role.¹⁰⁵ Thus, the New Yorker cartoon lampooning the anonymity of the Internet by showing a dog sitting at a keyboard with a caption that reads "on the Internet no one knows you're a dog" is applicable to the SEC's enforcement role in cyberspace as well; in the words of The Motley Fool, "[N]obody in cyberspace knows you are a securities regulator."¹⁰⁶

C. Globalization

The third major characteristic of modern capital markets is the substantial interdependence of the world markets.¹⁰⁷ Today's

cannot participate in undercover operations, and before communicating any staff person must identify themselves and their purpose and comply with a variety of other due process requirements).

¹⁰¹ See Quinn & Jarmel, *supra* note 57, at 160 (describing proposed legislation that would allow the use of state regulatory findings, rather than the investigation of each charge independently, enabling faster enforcement).

¹⁰² See *id.* at 159.

¹⁰³ See *id.* at 159-60.

¹⁰⁴ See *supra* note 79.

¹⁰⁵ See *id.*

¹⁰⁶ See *id.*

¹⁰⁷ See Lee E. Michaels & Marc I. Steinberg, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207, 208 (1999).

United States capital markets affect and are affected by other markets throughout the world. This has resulted from, among other things, the relaxation of foreign exchange controls, diversification of funding and investment resources by issuers and investors, floating interest rates, and technological advances in communication and transportation.¹⁰⁸ In view of this interdependence, countries have tried and must continue to try to harmonize and coordinate securities regulations worldwide in order to facilitate global offerings.¹⁰⁹

There have been two significant developments in efforts to implement a global securities regulation regime. The first has been referred to as the cooperative approach, whereby a uniform set of rules and regulations (including a uniform disclosure document) is promulgated for use by participants in international capital markets.¹¹⁰ The second, reciprocity, strives to have one country accord "full faith and credit" to the regulatory regime of another country when the second country's securities are sold in the first country, provided certain minimum thresholds are met.¹¹¹ Neither of these approaches have had great success in forming an international consensus on the appropriate standards to govern international offerings of securities.¹¹²

Most countries with developed securities markets identify two basic principles, disclosure and registration, as vital components of a robust capital market.¹¹³ Despite this consensus, ideas between countries diverge significantly when it comes to defining these tenets of securities regulation. For example, the standards of required disclosure vary widely. While disclosure of offering

¹⁰⁸ *See id.*

¹⁰⁹ *See id.* at 208-09 ("[E]nterprises focus on foreign markets for financing based on their desire to expand the geographic base of their investors, to meet certain financing goals which cannot be met within their home countries, and to create a more international presence for strategic or marketing reasons.").

¹¹⁰ *Id.* at 236.

¹¹¹ *Id.*

¹¹² *Id.* at 265-66; *see also* Trig R. Smith, Note and Comment: *The S.E.C. and Regulation of Foreign Private Issuers: Another Missed Opportunity at Meaningful Regulatory Change*, 26 BROOK. J. INT'L L. 765, 774 (2000) (noting that, while the E.U. harmonization plan follows the reciprocity model, the SEC has been reluctant to adopt such an approach beyond its M.J.D.S. plan with Canada).

¹¹³ The European Community, the United Kingdom, France, Germany, Italy, Canada, Mexico, Japan and Australia all have securities regimes based on the concepts of disclosure and registration of some sort (although generally these regimes are company-based). *See* Michaels & Sternberg, *supra* note 107, at 210-36.

materials and issuer information are required in general, the specific contents vary from country to country. Some countries require that the prospectus contain only information about an issuer, others require that there be data about a particular offering, still others require that a prospectus contain information about both the issuer and the proposed securities being offered. Similarly, the standards governing the scope of disclosure requirements vary significantly.¹¹⁴ Another hurdle to international uniformity has been concern about accounting practices.¹¹⁵ While the International Accounting Standards Committee ("IASC") has worked to develop international accounting standards, it remains unclear whether the world's securities regulators will accept its standards.¹¹⁶

The goal of the International Organization of Securities Commissions ("IOSCO") is the unification of international disclosure standards. It urges the adoption of similar guidelines internationally and promotes cooperation among its member countries. Its efforts have met with some resistance because of the broad range of cultural differences, sovereignty concerns, differences in market structure, differences in the development and maturity of markets, and a myriad of other disparities among its constituent members.¹¹⁷ To compound the problem, IOSCO

¹¹⁴ See David S. Ruder, Preface, *Reconciling U.S. Disclosure Policy with International Accounting and Disclosure Standards*, 17 N.W. J. INT'L L. & BUS. 1, 5 (1996) (stating that the standards imposed by the SEC require much more disclosure than foreign regulatory standards and "as a result many foreign issuers do not wish to comply with these different accounting and disclosure requirements and, therefore, are unwilling to enter the U.S. market").

¹¹⁵ See Michaels & Sternberg, *supra* note 107, at 242-43. In 1995, IOSCO and IASC reached an agreement about international accounting practices whereby IASC would develop the principles and standards and IOSCO would endeavor to promulgate these practices in all global markets. The United States' endorsement of these practices was left an unresolved question. Subsequently, the SEC expressed reservations about the proposed international practices. See *id.*

¹¹⁶ See *id.* at 265 (concluding that thus far "efforts at harmonization have been challenging" and "largely unsuccessful").

¹¹⁷ See *id.* at 208-09 (recognizing that consensus among countries regarding an optimal approach to the international economy because of the wide divergence in their economies is difficult to obtain); see also Todd A. Sulger, Comment, *Harmonization of Securities Market Regulations in the European Union: Is the Price Tag Too High?*, 29 CAL W. INT'L L.J. 221, 236 (stating that standards developed by IOSCO "need to be flexible enough to support variations resulting from peculiarities in legal, tax, and regulatory structure; differing economic environments; and circumstances unique to specific countries").

lacks the power to implement policies that would govern the various regulators and often has difficulty gaining their unanimous support on positions.¹¹⁸ Notwithstanding the foregoing, IOSCO has attempted to help its member countries develop compatible regulations affecting the Internet. Although the IOSCO's recommendations are not enforceable against any particular country, they are likely to be highly influential in the development of any international securities regulation.

While it seems clear that there is a strong desire for an international accounting and disclosure regime, it is difficult to predict when such a regime will be established. Until such time, international issuers will continue to walk through a maze of securities regulations in each of the countries they sell their securities.

III. THE NEXT FIVE YEARS

A. *Expanded Use of Universal Shelf Registration*

It is almost certain that the company-based registration model, recommended by the Wallman Commission and the Task Force report, will not become a reality within the near future. Although such a system offers advantages in dealing with today's capital markets by providing the requisite speed and flexibility that issuers need while providing investors with necessary information, it is doubtful that the legislature will develop the necessary fortitude to enact such far-reaching statutory changes. The Aircraft Carrier, which was not a true company-based registration model but did attempt to offer greater flexibility and speed of offering for a broader universe of issuers, was formally withdrawn by the SEC with the expressed intention not to reintroduce it in a similar form. Given the unlikelihood of any far-reaching regulatory or statutory enactments by the SEC or Congress within the next few years, the needs of today's capital markets must be met by working within the current system. Expanded use of the shelf registration process is an alternative way to meet many of the needs of today's capital markets.¹¹⁹

¹¹⁸ See Michaels & Sternberg, *supra* note 107, at 239.

¹¹⁹ The Task Force also recommended expanding the availability of the universal shelf registration system. See Task Force Report, *supra* note 41, at 48-54. The SEC believed that the introduction of the Aircraft Carrier proposals

Although the universal shelf registration system is regulated under the 1933 Act and does not fit within the parameters of a company-based registration model, it is a quicker and more efficient way for issuers to issue securities and access capital markets than the traditional registration statement. Shelf registration registers securities essentially on a transaction basis, rather than registering the issuer, but moves away from the one-time, transaction-based approach towards continuous registration. Expanded availability of the shelf registration process allows issuers greater potential to accomplish many of the objectives, particularly increased flexibility and speed in getting issues to the market that a company-based registration model might provide.

Shelf registration allows issuers to register securities on a continuous or delayed basis. A qualified registrant may register for the future offering either: (a) the total dollar amount of securities to be offered, identifying the classes and types of securities, without specifying the number or dollar amount of any particular class or type of securities; or (b) the dollar amount of a particular class or classes of securities without specifying the exact terms of each offering. In either case, the aggregate amount of securities registered cannot be more than the issuer reasonably expects to issue within the next two years.

As a practical matter, although the shelf registration process is available to all issuers, it is utilized almost exclusively by larger, seasoned issuers who qualify to register securities on Form S-3. This is because Form S-3 allows incorporation by reference to the issuer's 1934 Act filings, allowing the issuer to automatically update its 1933 Act registration statement when it files a 1934 Act report. Only reporting companies that have made periodic filings under the 1934 Act for a period of at least one year and have a minimum public float of seventy-five million dollars may register securities on Form S-3 for an offering on a delayed basis.¹²⁰ The seasoned issuer's periodic reports filed under the 1934 Act are automatically incorporated by reference into the S-3. Once declared effective, the registration statement remains

would in large part do away with the advantages of a shelf registration system for many issuances. See *Aircraft Carrier*, *supra* note 3; see also *Blackman*, *supra* note 55.

¹²⁰ No minimum public float is required if the offering is of non-convertible investment grade securities.

available and allows the issuer to offer securities off the shelf by preparing and filing a prospectus supplement that discloses the particular terms of the securities and the offering.

As it presently stands, the universal shelf registration system has a number of advantages over the traditional registration system. By permitting an issuer to declare its general intent to issue securities and then take down those securities it wishes to sell without obtaining further SEC approval, issuers can more readily keep pace with today's markets. Universal shelf registration also allows issuers to take advantage of positive market conditions; they can issue the amount and type of security on favorable terms for that particular time.¹²¹

Several revisions to the rules governing universal shelf registration may make it a more effective tool in capital markets, as they continue to evolve. The Task Force suggested some of these changes. First, it would be useful to expand the universe of issuers eligible to use shelf registration. The Task Force report recommended expansion of shelf registration to permit smaller companies to utilize universal shelf registration.¹²² Second, eliminating the requirement that an issuer may only register securities it has an intention to sell within a two-year period will encourage the use of the universal shelf registration system. This would come closest to the models proposed by the Wallman Commission and the Aircraft Carrier in that the "event" of the registration statement would be minimized and the importance of the disclosure in the 1934 Act reports would be emphasized.¹²³ Finally, amending the regulations to require payment only at the time securities are actually sold will make shelf registration more attractive. Current regulations require that a fee based on the

¹²¹ Transaction fees can be lower for shelf registrations than traditional securities registrations. See John Floegel, *Equity Financing for Public Corporations: Reasons and Methods to Encourage It*, 138 U. PA. L. REV. 1411, 1442-43 (1990). Since the adoption of the universal shelf rules in 1992, the use of this registration system has increased dramatically. See John F. Olson, et. al., *Recent Developments in Federal Securities Regulation of Corporate Finance*, 1 A.L.I.-A.B.A. COURSE OF STUDY MATERIALS, POSTGRADUATE COURSE IN FEDERAL SECURITIES LAW SE10 (1999) citing Simplification of Registration Procedures for Primary Securities Offerings, Securities Act Release No. 33-6943, 51 SEC DOCKET (CCH) 1501 (July 16, 1992).

¹²² See Task Force Report, *supra* note 41, at 48-49.

¹²³ The Task Force suggested the use of post-effective amendments to amend a shelf registration to allow the seasoned issuer to add new types or classes of securities. See *id.* at 52-53.

total amount of securities to be registered must be paid at the time of the initial filing of the registration statement.¹²⁴ Issuers thus incur substantial expense whether or not they actually issue the securities.

B. Integration of Offerings: Public to Private and Private to Public

Section 5 of the 1933 Act requires that every offer and sale of securities be pursuant to an effective 1933 Act registration statement or an exemption from registration. The SEC's integration doctrine expresses the SEC's general view that where there are multiple types of offerings made within the same general time frame, they will be treated as a single offering. This is in response to the SEC's concern that issuers will attempt to use a combination of private placement and safe harbor exemptions to, in effect, avoid registration of what could be deemed a public offering.¹²⁵ Thus, an otherwise exempt private placement could, if viewed by the SEC as integrated with another private or public offering, lose its private placement exemption.

Although the SEC has established certain guidelines for determining whether issuances by the same issuer should be integrated,¹²⁶ the application of these guidelines is not clear or

¹²⁴ The Task Force also noted this disadvantage to the issuer and recommended that the SEC adopt a "pay-as-you-go" policy for seasoned issuers. See Task Force Report, *supra* note 41, at 54.

¹²⁵ The SEC has established a safe harbor under Regulation D for private placements more than six months after a failed public offering. 17 C.F.R. § 230.502(a) (1996). The speed of today's capital markets, however, often makes a six-month wait highly impracticable.

¹²⁶ The SEC has set forth a five-factor test for determining whether two offerings should be integrated. The five factors are "whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of securities, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, [and] (5) the offerings are made for the general purpose." Non-Public Offering Exemption, Securities Act Release No. 33-4552, 27 Fed. Reg. 11,316 (Nov. 6, 1962). These guidelines, however, have been described as "subjective" and as providing "little certainty." William P. Rogers, Jr. & John W. White, *The Statutory Arrangement for Public and Private Securities Offerings Under the Securities Act of 1933*, in SECURITIES OFFERINGS, *supra* note 57, at 7, 22. The SEC in a series of no-action letters has also set forth an exemption from integration in those instances where a private placement is offered to qualified institutional buyers and a very small number of institutional accredited investors; such a private placement will not be integrated with a concurrent public offering. See Black Box Inc., SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. ¶ 79,510, at 77,571 (June 26,

foolproof. Extensive analysis is therefore required, and complicated legal issues need to be resolved, when an issuer makes a public and private (exempt) offering within the same approximate time frame.

The SEC should clarify those circumstances that give rise to the integration of offerings. They should enact regulatory provisions that expand integration safe harbors. These measures would reduce the confusion and uncertainty surrounding the application of the integration concept and the resulting preclusion of issuers from the capital markets.¹²⁷

These types of clarification and expansion have become particularly important given the present reality that many e-commerce (and other) companies face, with the slowdown in the capital markets and initial public offerings they have abandoned planned public offerings after the filing of a registration statement. These companies must subsequently raise capital through private offerings and try to determine whether the SEC will require that subsequent private offerings be integrated with the abandoned public offering.¹²⁸ This type of analysis had become fraught with uncertainty, given the fact that the SEC did not provide guidelines until very recently.

In an attempt to provide greater clarity in circumstances where an issuer has abandoned a planned public offering, the SEC has adopted Rule 155¹²⁹ under the 1933 Act. Rule 155 provides a safe harbor for unregistered private offerings that follow an abandoned registered offering, by not requiring integration of the two offerings. The new rule also provides a safe harbor for a registered offering following an abandoned private

1990); Squadron, Ellenoff, Pleasant & Lehrer, SEC No-Action Letter, 1992 SEC No-Act. LEXIS 313 (Feb. 28, 1992). The "Black Box" exemption, as it is known, however, is narrow in scope.

¹²⁷ One of the proposals in the Aircraft Carrier would have expanded the Rule 152 safe harbor to allow conversion from an abandoned public offering to a private offering, conversion from an abandoned unregistered private offering to a registered public offering, and would have set forth the requirements to prevent integration of a completed unregistered private offering with a subsequent private offering. See Aircraft Carrier, *supra* note 3, at 81,556. Rule 155, recently adopted under the 1933 Act was an adoption, in part, of the Aircraft Carrier's proposed expansion of Rule 152.

¹²⁸ See Stanley Keller, *What Can We Do Now That Our Public Offering Has Aborted?*, INSIGHTS, July, 2000, at 3.

¹²⁹ 17 C.F.R. § 230.155 (2001). Rule 155 became effective March 7, 2001. See *id.* The adopting release is posted on the SEC's website at <http://www.sec.gov/rules/final/33-7943.htm> [hereinafter Adopting Release].

offering. Under this rule, if an issuer commences a registered offering but sells no securities, e.g., the registration statement has not yet become effective, it may withdraw the registration statement and begin a private offering after meeting certain conditions. For example, the issuer must observe a thirty-day waiting period, after the effective date of withdrawal of the registration statement, before it begins the private offering.¹³⁰

Although Rule 155 provides this safe harbor, and thus, to some extent, alleviates uncertainty for issuers who must abandon a registered or private (exempt) offering and use an alternative method of raising capital, it does not clarify the SEC's guidelines for determining when an issuer's completed offerings will be considered integrated.¹³¹ As noted above, extensive legal analysis is required in these circumstances. The safe harbors of Rule 155 have not changed the need for extensive legal analysis or its attendant uncertainty. The participants in today's capital markets need clearer SEC guidance under these circumstances.

C. *Increase in the Use of the Internet to Facilitate Offerings*

The Internet has already had a significant impact on the operation of the capital markets and it will surely become increasingly important in the near and long-term future. The SEC has publicly stated its intent to issue rules and proposals to

¹³⁰ In addition, the issuer must provide the offerees in the private offering with certain disclosures about the withdrawal of the registration statement and other matters. 17 C.F.R. § 230.155(c) (2001). If an issuer wishes to commence a registered offering after abandoning a private offering in which no securities were sold, it may rely on the safe harbor and begin the process of commencing the registered offering if it terminates the private offering and provides certain disclosures in the registration statement. The issuer will also have to wait thirty days after abandoning the private offering before filing the registration statement, unless securities in the private offering were offered only to persons who were, or who the issuer reasonably believed were, either "accredited investors" or "sophisticated," as defined under the rules of the 1933 Act and by the SEC. In addition, the original private offering must have met the requirements to constitute a bona fide private offering. 17 C.F.R. § 230.155(b) (2001).

¹³¹ See *supra* note 122 and accompanying text (noting the impracticability of the present six-month waiting period under Regulation D to ensure that a subsequent private placement is not integrated with a previous registered offering); *supra* note 123 and accompanying text (noting the difficulties of applying the five-factor test for determining whether offerings that are less than six months apart will be considered integrated). The SEC noted in its adopting release for Rule 155 that the new rule did not modify the five-factor test. Adopting Release, *supra* note 127, at 3.

address the issues relating to electronic delivery requirements and the meaning of written offers as applied to electronic communication, and has also issued guidelines regulating the conduct and implementation of electronic road shows.¹³² SEC enforcement is likely to expand in scope to match developing technologies and the growing prevalence of Internet-based securities fraud.

The changes brought about by the Internet are, and will most likely continue to be, infrastructure related rather than substantive changes to the securities regulation regime. If the SEC is able to effectively tailor its guidelines to significant technological advances, then it could potentially implement sweeping changes in the process of capital formation. An example would be increased market accessibility by smaller companies, previously locked out because of the high costs of offerings and road shows, but now fully enfranchised as a result of relaxed restrictions on electronic delivery and Internet road shows.¹³³

While it is unlikely that, in the near future, paper documents will be completely eliminated in favor of purely electronic offerings, it seems clear that the SEC will continue to take steps to facilitate the use of new technologies in the offering process. This will accelerate the time frame of offerings and allow smaller companies and non-institutional investors, who had previously been locked out of the capital markets, unprecedented access to information through the use of recent technological advances.

D. The Integration of Global Securities Regimes Should Result in Adjustment by the SEC of Some Disclosure Standards

While a uniform global securities regime is still far off, the advantages of such a system for companies trying to effectuate cross-border financings are apparent. To date, the SEC has tried to take a leadership role in paving the way for a uniform set of international securities laws, and will presumably continue to do

¹³² See Electronic Delivery of Proxy Materials, Exchange Act Release No. 34-44133 ¶ 18134, at 18135 (March 29, 2001) (proposing amendments for electronic delivery).

¹³³ Cf. George Ponds Kobler, *Shareholder Voting Over the Internet: A Proposal for Increasing Shareholder Participation in Corporate Governance*, 49 ALA. L. REV. 673, 694 (1998) (noting the argument that increased access to information on the Internet levels the playing field between smaller and larger investors).

so.¹³⁴ In the future, it is likely that more countries will develop "full faith and credit" systems.¹³⁵

The U.S. securities regime is regarded by many other countries as unduly invasive and burdensome.¹³⁶ As a result, the SEC has made significant advances to facilitate the use of the U.S. capital markets by issuers from less regulated countries.¹³⁷ These advances are likely to continue and may include the relaxation of disclosure requirements and acceptance of disclosure materials acceptable under other systems.

CONCLUSION

Since their adoption, the Securities Acts have served the U.S. capital markets well. The facts and circumstances surrounding the Securities Acts, however, have changed significantly. While the fundamental need for the protection of investors has not changed, the rapid and significant developments in the capital markets may have made the basic structure of the Securities Acts, and particularly the 1933 Act, overly cumbersome, if not obsolete.

If the U.S. securities markets are to retain their pre-eminent position in the global financial community, methods must be found to modify provisions of the Securities Acts to respond to the current status of the marketplace. While a fundamental legislative revamping may be ideal, it is more likely that change will be achieved through significant regulatory revisions that adapt the original legislative scheme to the flux of modern capital markets.

¹³⁴ See Kellye Y. Testy, *Comity and Cooperation: Securities Regulations in a Global Marketplace*, 45 ALA. L. REV. 927, 938 (1994) (discussing the SEC's efforts to reach its goal of a global market system).

¹³⁵ See *id.* at 949.

¹³⁶ See *id.* at 933, 939, 957.

¹³⁷ See *id.* at 942.