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Rhetoric and Reality: Investor Protection and the Securities Regulation Reform of 2005

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RHETORIC AND REALITY: INVESTOR PROTECTION AND THE SECURITIES REGULATION REFORM OF 2005

Joseph F. Morrissey[+]

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"[W]hile investor protection remains a paramount interest . . . ."[1]

I. INTRODUCTION

Amidst all the recent publicity surrounding government action in combating corporate wrongdoing (including the passage of the Sarbanes-Oxley Act[2] and the prosecution of the top brass at Enron[3] and other scandal-ridden companies[4]), little public attention has been focused on a dramatic overhaul of the United States securities regulations. The reforms were adopted in December 2005 as revised and new rules promulgated under the Securities Act of 1933 (Securities Act).[5] Among other things, the reforms provide that companies contemplating an offering of securities will be able to communicate with potential investors much more freely than has been possible in the past.[6] In the past, the securities laws have protected the market against sales campaigns that attempt to lure investors into buying securities before basic quality information about the company and the offering have been submitted to the Securities and Exchange Commission (SEC) and distributed to the market.[7] Those strict regulations are now largely gone and "conditioning the mar-

1. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,731 (Aug. 3, 2005).

2. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); *see also* Joseph F. Morrissey, *Catching the Culprits: Is Sarbanes-Oxley Enough?*, 3 COLUM. BUS. L. REV. 801, 856-57 (2003) (criticizing the Sarbanes-Oxley Act for doing too much and too little: too much regulation that is costly and not helpful in reducing fraud, and too little in terms of real reforms that might have helped combat fraud).

3. *See, e.g.*, John R. Emshwiller, Gary McWilliams & Ann Davis, *Lay, Skilling Are Convicted of Fraud*, WALL ST. J., May 26, 2006, at A1.

4. WorldCom and Tyco are just two examples of high-profile companies to have massive frauds uncovered and their top management prosecuted for its role in those schemes. *See, e.g.*, Simon Romero & Riva D. Atlas, *WorldCom Files for Bankruptcy; Largest U.S. Case*, N.Y. TIMES, July 22, 2002, at A1. WorldCom eventually admitted to overstating its profits by more than *seven billion dollars* through accounting irregularities. *See* Jared Sandberg & Susan Pulliam, *WorldCom Revision Tops $7 Billion*, WALL ST. J., Aug. 9, 2002, at A3. Tyco admitted to overstating profits by $135 million and to extending and then forgiving loans to key corporate executives in an amount close to one hundred million dollars. Further, Tyco executives were accused of looting close to six hundred million dollars from the company. *See* Alex Berenson, *Tyco Troubles*, N.Y. TIMES, Oct. 27, 2002, § 4, at 2; *see also* Anthony Bianco, William Symonds & Nanette Byrnes, *The Rise and Fall of Dennis Kozlowski*, BUS. WK., Dec. 23, 2002, at 64, 65, 68; Monica Gagnier, *Kozlowski's Comeuppance*, BUS. WK., Oct. 3, 2005, at 48, 48.

5. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,722.

6. *See id.* at 44,731-32.

7. *See* Securities Act of 1933 § 5, 15 U.S.C. § 77e (2000).

ket" for an upcoming sale of new securities (something the SEC previously attempted to prevent) is now permissible.[8]

These reforms have been made in the name of improving efficiency and access to capital for corporate America.[9] At the same time, I will argue, investors are being left more vulnerable to the manipulations of corporate wrongdoers. The SEC called for comments on the reforms when they were proposed.[10] Most commentators on the reforms seemed generally pleased with these deregulatory reforms.[11] However, such a position seems to represent the interests of issuers and others who participate in making securities offerings (all of whom are delighted by the deregulation represented by the reforms), not the SEC's more traditional constituency, investors.[12]

In its publication presenting the reforms, the SEC is explicit that efficiency is one of its goals.[13] However, implicit in the reforms seems to be an unquestioning faith in the efficient capital market hypothesis. The reforms appear premised upon that hypothesis—that as long as information about a corporation has been made public in some way, then investors need not receive that information directly but will be protected by the market's efficient absorption of that information. Despite the fact that the new reforms are clearly predicated on this hypothesis, it is never named and no evidence is cited in the SEC release to support the efficiency of the markets, other than a general sense that it must be true.[14]

The new regulations are truly sweeping. Specifically, the reforms affect two broad areas of securities regulations: (i) communications with investors during a securities offering,[15] and (ii) offering procedures.[16] Parts II and III of this Article will analyze and critique the reforms in that order. Part IV will scrutinize the results of the new reforms based on liability for issuers and other market participants. In Part V, the Article will directly call into question whether the SEC has, in fact, exceeded its rulemaking

8. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,734.

9. *See id.* at 44,725 (explaining that the reforms should "[m]ake the capital formation process more efficient").

10. *Id.* at 44,724 & n.18 (stating that the SEC received over 130 comment letters); *see also* U.S. Sec. & Exch. Comm'n, Comments on Proposed Rule: Securities Offering Reform, http://www.sec.gov/rules/proposed/s73804.shtml (last visited Jan. 29, 2007) [hereinafter Comments on Proposed Rule].

11. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,724.

12. *See id.* A survey of those comment letters shows that many, if not most, of those letters come from large law firms and investment banks (groups that are typically regulated by the SEC) and not from groups that would effectively advocate for investor concerns. *See* Comments on Proposed Rule, *supra* note 11. One notable exception to this is a letter from the American Association of Retired Persons. *See id.*

13. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,725.

14. *See id.*

15. *Id.*

16. *Id.*

authority by altering so dramatically the very character of the regulatory regime that the Securities Act sought to construct. Finally, in Part VI, the Article will make a call for a return to investor protection as the top priority of the SEC and its rulemaking.

More specifically, Part II of this Article will discuss the virtual elimination of the restrictions on communications during the three phases of an offering of securities under the Securities Act: (i) the pre-filing period, (ii) the waiting period, and (iii) the post-effective period. In the past, the SEC viewed communications during an offering period with great suspicion. SEC releases referred to the fear that promoters of securities would attempt to "condition the market" in order to increase the sales price of their securities.[17] The restrictions on communications are now largely gone as a result of the recent reforms.[18] The reason for the change proffered by the SEC in its adopting release is that restricting such information was becoming increasingly "unnecessary."[19] Earlier in that same release, the SEC essentially sets forth its new view that investors should get more information, even if that information is unregulated and may indeed serve to "condition the market."[20] This new logic provides support for the SEC's deregulatory reforms. Nonetheless, the logic seems to cater to corporate interests and to ignore the real needs of investors for protection against the market conditioning described above. This new stance also seems to be a complete reversal of the SEC's historical position on this point.

Part III of this Article will move on to discuss some of the reforms that are directly related to the registration process—the process by which a corporation registers its securities with the SEC so that the corporation can sell those securities to the public. As a result of the reforms, "well-known seasoned issuers" (WKSIs) are now able to use a new shelf registration procedure known as "automatic shelf registration."[21] An automatic shelf need not be reviewed by the SEC to be declared effective.[22] It will be effective upon filing, and thereafter, the issuer can sell any securities by filing an amended registration statement specifying the securities that will be offered.[23] With automatic shelf registration, the base prospectus need not identify any specific quantity or type of security to be sold.[24] The prospectus must only provide a basic amount of information about

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17. *See id.* at 44,737.
18. *See id.* at 44,734.
19. *Id.* at 44,791.
20. *Cf. id.* at 44,737.
21. *Id.* at 44,777.
22. *See id.*
23. *See id.*
24. *Id.*

the company.[25] This new automatic shelf registration, combined with the new ability to engage in free communications, results in a regime where a WKSI can essentially sell securities whenever it wishes to do so and can advertise for the sale of those securities on a virtually unrestricted basis. The combination of these two reforms creates an entirely different offering regime than the one contemplated by section 5 of the Securities Act.

Part IV of this Article will discuss the implications of the new reforms on the liability of participants in a securities offering. Historically, the bulk of information that could be communicated to investors during the marketing of a new offering of securities came from the registration statement, and was therefore subject to the strict liability provisions of section 11 of the Securities Act.[26] Section 11 provides that any purchaser of a security in a registered offering can sue "every person" involved in creating a registration statement for any false information contained therein.[27] Further, such authors are all jointly and severally liable for anything that is misleading in the registration statement.[28] There are no additional conditions to presenting a case under section 11 as there are with other anti-fraud provisions.[29] The threat of heightened liability meant heightened care was given to the preparation of that document by issuing participants. The new reforms dismantle this system by allowing free communications in the pre-filing and waiting periods that will not be part of the registration statement, and therefore not subject to either the heightened liability of section 11 or the consequent heightened level of care used in their preparation.[30]

Part V of this Article will assess more directly than the previous sections whether the SEC has indeed exceeded its rulemaking authority by so dramatically recrafting the securities regulatory regime in the United States. This section will look at two questions in this regard. The first question is whether Congress delegated too much legislative authority to the SEC when it specified that the SEC was authorized to exempt anyone and anything from the Securities Act as long as it was "in the public interest" and was "consistent with" investor protection.[31] While uncommon, the federal courts have declared certain broad grants of authority to

25. *Id.* at 44,778.

26. *See* Securities Act of 1933 § 11, 15 U.S.C. § 77k (2000).

27. Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a).

28. Securities Act of 1933 § 11(f), 15 U.S.C. § 77k(f).

29. *Compare* Securities Act of 1933 § 11, 15 U.S.C. § 77k (providing no additional conditions for a suit to be brought), *with* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (applying to "any security not so registered, or any securities-based swap agreement"), *and* 17 C.F.R. § 240.10b-5 (2006) (making the "[e]mployment of manipulative and deceptive devices . . . unlawful").

30. *See* Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a); Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,791.

31. *See* Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

administrative agencies to be an unconstitutional delegation of legislative power.[32] Second, this section examines whether, even if the grant of authority is not overly broad, the SEC has exceeded the power granted to it by Congress. The granting language authorizes the SEC to make exceptions to the Securities Act[33] but, as the previous sections have detailed, the reforms adopted by the SEC virtually remake the Securities Act. This might indeed be more than an administrative agency should be allowed to do.

Finally, Part VI of this Article will conclude with an overall discussion of how, throughout the new reforms, the SEC has given top priority to efficiency and deference to corporate interests while sacrificing the interests of investors. Despite the fact that the SEC has officially announced that it believes that the new reforms will indeed enhance investor interests, the SEC gives little evidence to back up those claims.[34] The Article will conclude with a call for renewed scrutiny of the efficient capital market hypothesis and a renewed vigilance on the part of the SEC to make sure that investor protection is reality, not merely rhetoric.

II. More Communication Allowed During Offerings

The Securities Act specifically restricted communications between those people who were involved in issuing new securities and investors.[35] The restrictions were designed to ensure that investors received only quality information about a new offering of securities and the company issuing those securities in order for the investor to make a reasonable decision about whether or not to invest.[36] The information allowed to be disseminated to investors was typically company- and offering-specific information that was registered with the SEC before being disseminated to investors.[37] The new reforms significantly alter those regulations, allowing far more open communications to potential investors with an entirely lower level of accountability for statements.[38]

The Securities Act's original restrictions recognized specific periods of time that occur in the life of a securities offering, and the regulations were tailored to those time periods.[39] In accordance with the nature of a securities offering, there is: (i) the time period before a new securities offering is first filed with the SEC (the pre-filing period); (ii) the time

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32. *See* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 551 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388, 433 (1935).

33. *See* Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

34. *See* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,731, 44,791.

35. *See* Securities Act of 1933 § 5, 15 U.S.C. § 77e.

36. *See* H.R. REP. NO. 73-85, at 1-3 (1933); S. REP. NO. 73-47, at 1-2 (1933).

37. *See* Securities Act of 1933 § 10, 15 U.S.C. § 77j.

38. *See infra* Part IV (discussing the lower level of accountability).

39. *See* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,731.

period after the filing of the registration statement but before the SEC has finished its review of the registration statement and declared the offering effective (the waiting period); and (iii) the time period after the offering has been declared effective (the post-effective period). This section will discuss the impact of the SEC's recent reforms regarding communications in each of these periods and will demonstrate that the new reforms are indeed allowing much freer communications with a much lower level of accountability.

A. The Pre-Filing Period

This section will first describe the way in which communications were restricted during the pre-filing period before the recent enactment of the securities reforms. This section will then describe how the recent reforms have largely removed those regulations to dramatically expand the universe of permitted communications during the pre-filing period.

(1) Historically, Gun-Jumping Was Prohibited

Section 5(c) of the Securities Act specifically made it unlawful for any person to offer to sell or buy securities before a registration statement had been filed with the SEC.[40] Those efforts have come to be known as "gun-jumping" and have generally been strictly prohibited until the recent SEC reforms.[41] Section 2(a)(3) of the Securities Act defined "offer" as broadly as it could 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."[42] Section 5(c) and section 2(a)(3), taken together, meant that communications between anyone involved in an upcoming offering of securities and potential investors were essentially forbidden. This applied equally to oral and written communications.[43] All forms of gun-jumping were forbidden. The only carve-out from the definition of "offer" was for any negotiations or agreement between an issuer and its underwriters.[44] That carve-out was necessary, of course, for the issuer to plan the offering. However, even the Securities Act kept that carve-out narrow and insisted that the negotiations or agreements take place between the issuer and an underwriter that would be in privity with it (as opposed to underwriters or dealers who would later be recruited by the lead underwriters to participate in the offering).[45]

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40. Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c).
41. *See* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,731.
42. Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3); *see also* Diskin v. Lomasney & Co., 452 F.2d 871, 875 n.2 (2d Cir. 1971); SEC v. Cavanagh, 1 F. Supp. 2d 337, 368 (S.D.N.Y. 1998).
43. *See* Securities Act of 1933 §§ 2(a)(3), 5(c), 15 U.S.C. §§ 77b(a)(3), 77e(c).
44. Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3).
45. *Id.*

(a) SEC Releases and Case Law Clearly Prohibited Gun-Jumping

The SEC made its position on communications during the pre-filing period clear in a series of cases and SEC releases.[46] In 1957, the SEC issued Securities Act Release No. 33-3844, in which it discussed the primacy of regulating communications in the periods of time during an offering that precede effectiveness.[47] In that release, the SEC stated that the express language and legislative history of the Securities Act prohibit any "public sales campaign prior to the filing of a registration statement."[48] This prohibition was designed to promote a basic purpose of the Securities Act: "to require the dissemination of adequate and accurate information concerning issuers and their securities in connection with the offer and sale of securities to the public."[49] But Release No. 3844 went on to describe how publicity efforts could "contribute to conditioning the public mind or arousing public interest in the issuer" even if not specifically made in terms of an express offer.[50]

As early as 1959, the SEC took up the issue in *In re Carl M. Loeb, Rhoades & Co.*[51] In that case, the SEC set forth its position, clearly stating that the prohibitions on communications during the pre-filing period were essential as "Congress was concerned lest inadequate or misleading information be used in connection with the distribution of securities."[52] The SEC continued to discuss its role in that regard:

> We were directed to pursue a vigorous enforcement policy to prevent [gun-jumping] from happening. In obedience to this mandate we have made clear our position that the statute prohibits issuers, underwriters and dealers from initiating a public sales campaign prior to the filing of a registration statement by means of publicity efforts which, even though not couched in terms of an express offer, condition the public mind or arouse public interest in the particular securities.[53]

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46. Chris-Craft Indus., Inc. v. Bangor Punta Corp., 426 F.2d 569, 573-76 (2d Cir. 1970); *In re* Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843, 848-55 (1959); Guidelines for Release of Information by Issuers Whose Securities Are in Registration, Securities Act Release No. 33-5180, 36 Fed. Reg. 16,506, 16,506-07 (Aug. 21, 1971); Publication of Information Prior to or After Filing and Effective Date of Registration Statement, Securities Act Release No. 33-5009, 34 Fed. Reg. 16,870, 16,870-71 (Oct. 18, 1969); Statement of the Commission Relating to Publication of Information Prior to or After the Effective Date of a Registration Statement, Securities Act Release No. 33-3844, 22 Fed. Reg. 8359, 8359-61 (Oct. 24, 1957).
47. Securities Act Release No. 33-3844, 22 Fed. Reg. at 8359.
48. *Id.*
49. *Id.*
50. *Id.*
51. *Loeb, Rhoades*, 38 S.E.C. at 848-54.
52. *Id.* at 850.
53. *Id.* (footnote omitted).

This conditioning of investors to arouse interest was identified as being as prohibited as an outright offer.[54]

As time went on, the business community grew more concerned about what information businesses could disclose in the pre-filing period, and what information would be considered as a sales effort designed to condition the market.[55] Reporting companies, in fact, had duties under the Securities Exchange Act of 1934 (Exchange Act) to disclose certain items of material significance to their businesses.[56] And so, the SEC published Securities Act Release No. 33-5009 in 1969 and Securities Act Release No. 33-5180 in 1971.[57] Both of these releases described what types of information would be considered to condition the market and what types of information a business could rightly disclose in the ordinary course of its operations and pursuant to its duties under the Exchange Act.[58] Release No. 5009 reiterated a position it had taken in the *Loeb, Rhoades* case ten years earlier: "[The] 'flow of normal corporate news, unrelated to a selling effort for an issue of securities is natural, desirable and entirely consistent with the objectives of . . . the federal securities laws.'"[59] However, the SEC was undeterred that selling efforts were still prohibited and believed that the conflict between a business' requirements to disclose material events under the Exchange Act but refrain from any selling efforts for a new securities offering was "more apparent than real."[60] The release specifically authorized the dissemination of factual information that did not include predictions or opinions.[61] Release No. 5180 went further to itemize a list of permitted topics that a business might discuss freely without fear that such communications would be deemed a selling effort.[62] On that list were topics such as normal advertising, periodic reporting, and other typical business communications.[63]

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54. *Id.* at 851.

55. *See* Publication of Information Prior to or After Filing and Effective Date of Registration Statement, Securities Act Release No. 33-5009, 34 Fed. Reg. 16,870, 16,870 (Oct. 18, 1969).

56. Securities Exchange Act of 1934 § 12, 15 U.S.C. § 781 (2000).

57. Guidelines for Release of Information by Issuers Whose Securities Are in Registration, Securities Act Release No. 33-5180, 36 Fed. Reg. 16,506, 16,506-07 (Aug. 21, 1971); Securities Act Release No. 33-5009, 34 Fed. Reg. at 16,870.

58. Securities Act Release No. 33-5180, 36 Fed. Reg. at 16,507; Securities Act Release No. 33-509, 34 Fed. Reg. at 16,870.

59. Securities Act Release No. 33-5009, 34 Fed. Reg. at 16,870 (quoting *In re* Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843, 853 (1959)).

60. *Id.*

61. *Id.*

62. Securities Act Release No. 33-5180, 36 Fed. Reg. at 16,507.

63. *Id.*

(b) Narrow Exceptions Allowed Limited Communications

In 1969, the SEC went so far as to conduct a study on the prohibition against gun-jumping and concluded that the provisions were sound.[64] However, the study did result in the SEC promulgating a series of rules (Rules 135, 137, 138, and 139) that allowed particular exceptions to the prohibition against communications in the pre-filing period (as well as the waiting period).[65]

(i) Rule 135: Basic Information Can Be Published

Rule 135 was designed to give issuers and other parties involved in a sale of securities comfort that notices that simply told the public that there would be an upcoming sale of securities were permitted.[66] The rule itemized exactly what type of information about an upcoming offering was permitted but specifically prohibited information about the intended underwriters.[67] This was done so that investors would not jump the gun and attempt to contact selling agents before the information required by the SEC to be in a registration statement had been filed and then disseminated to potential investors.

(ii) Rule 137: Non-Participating Broker or Dealer Can Publish Research

Rule 137 made a clear exception to the prohibition against communications for brokers or dealers who were not participating in an upcoming offering.[68] Under Rule 137, such brokers or dealers could publish their research information pertaining to the securities to be offered so long as three conditions were satisfied.[69] First, the company issuing the securities had to be a reporting company under the Exchange Act.[70] Second, the broker or dealer needed to make such reports in the ordinary course of its business.[71] Third, the broker or dealer could not receive any consideration for making its report from any of the participants involved in the securities offering (other than a regular subscription fee or normal purchase price for the research report).[72] Rule 137 was designed to promote and encourage ordinary research about companies that were already pub-

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64. U.S. SEC. & EXCH. COMM'N, SEC DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS: THE WHEAT REPORT 16 (1969).

65. *See* 17 C.F.R. §§ 230.135, 230.137-.139 (2005).

66. *See id.* § 230.135.

67. *Id.* § 230.135(a)(2)(v).

68. *Id.* § 230.137.

69. *Id.*

70. *See id.*

71. *Id.* § 230.137(c).

72. *Id.* § 230.137(b).

lic and ensure that such research would continue throughout a registration of new securities. The rule was careful, however, to apply only to those brokers or dealers who had no special financial interest in the upcoming offering, since they were not participating in the offering. The theory was that such research could only help the market understand more about the company issuing the securities and the securities themselves and was not likely to result in any market manipulations because the authors of those reports had no financial incentive to mislead.

(iii) Rule 138: Participating Broker or Dealer Can Publish Research on Securities Not Being Offered

Rule 138 provided another exception from the ban on communications for brokers or dealers with respect to an upcoming offering.[73] The Rule 138 exception applied to brokers and dealers who were participating in the upcoming offering.[74] Despite this participation, Rule 138 essentially allowed those brokers and dealers to continue to publish their ordinary research about securities of the issuer that were not of the type being offered.[75] Therefore, if the company was issuing common stock or anything convertible into common stock, the brokers and dealers could continue to publish their ordinary reports about the company's fixed income securities or preferred stock.[76] Likewise, if the upcoming issuance was of fixed income securities or preferred stock, then the brokers and dealers could continue to publish their ordinary research reports about the company's common stock.[77] In order for brokers and dealers to use this rule, the company issuing the securities must be eligible to register its securities on Form S-3 or F-3.[78] Once again, the SEC was attempting to encourage market research by brokers and dealers who were not reporting about an issuance of securities in which they had any special financial interest. Accordingly, there should have been little risk of market manipulation by these communications.

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73. *Id.* § 230.138.
74. *Id.* § 230.138(a).
75. *See id.* § 230.138(b).
76. *Id.* § 230.138(a).
77. *Id.*
78. *Id.* § 230.138(c). The analysis of whether a company is eligible to file on these forms is complicated and must be done in strict accordance with those forms but generally means that, at a minimum, the issuer has been a reporting company under the Exchange Act for at least a year. *See* S.E.C. Forms S-3, F-3 (2006).

(iv) Rule 139: Participating Broker or Dealer Can Publish Its Regular Reports

Rule 139 also provided an exemption from the prohibition on communications.[79] Rule 139 took the exemptions found in Rules 137 and 138 a step further. Rule 139 applied to brokers and dealers who were participating in an upcoming issuance of securities, allowing those brokers and dealers to continue to issue their research reports about those securities, provided that one of two sets of requirements were met.[80] First, the exemption would apply if the issuing company was of a sufficient size and stature,[81] and the broker or dealer published such reports with reasonable regularity in the ordinary course of its business.[82] Second, the Rule 139 safe harbor would apply if the issuer was a reporting company under the Exchange Act and the research report: (i) was issued regularly in the normal course of the broker or dealer's business;[83] (ii) referred to a substantial number of other companies,[84] giving no greater prominence to the issuing company than to the other companies referenced in the report;[85] and (iii) included information on the issuer that was similar to a previous publication by the broker or dealer.[86]

With Rule 139, as with Rules 137 and 138, the SEC was attempting to encourage and support the continued publication of research reports on companies that are already followed by the markets. At the same time, these SEC rules attempted to ensure that no participant in the offering inappropriately conditioned the market to inflate the price of the securities being offered.[87]

(2) Reforms Repeal Prohibition

In its reforms, the SEC has virtually abolished its prohibitions on communications in the pre-filing period for large well known companies, as well as significantly reducing those prohibitions for all other companies.[88] The reforms categorize issuing companies essentially in a spectrum from large, well-known companies, to companies that are new to the public markets. The reforms then take a different approach to those different categories of issuers. This section will describe the categories that have

79. 17 C.F.R. § 230.139.
80. *Id.*
81. *Id.* § 230.139(a).
82. *Id.*
83. *Id.* § 230.139(b)(1)(i).
84. *Id.* § 230.139(b)(1)(ii).
85. *Id.* § 230.139(b)(2).
86. *Id.* § 230.139(b)(3).
87. *See id.* § 230.137-.139.
88. *See* Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,734 (Aug. 3, 2005).

been developed and then discuss the regulations (or relaxation of regulations) that now apply to the pre-filing period.

(a) Issuer Categories Expand to Include WKSIs

The SEC uses four categories of issuer in its reforms: (1) the well-known seasoned issuer, (2) the seasoned issuer, (3) the unseasoned Exchange Act reporting issuer, and (4) the non-reporting issuer.[89] The WKSI is a new category that the SEC has never used before. The new reforms give WKSIs the most flexibility to communicate to the public without restriction. An issuing company qualifies as a WKSI if it has been a reporting company under the Exchange Act for at least a year, is timely with the reports it files under the Exchange Act, and either: (i) has a worldwide market value of all of its common equity held by non-affiliates of at least seven hundred million dollars, or (ii) has issued in the past three years at least an aggregate principal amount of nonconvertible securities, other than common equity, of one billion dollars.[90] The SEC has created this category of issuer because it believes that such companies are widely followed by the public markets and, therefore, deserve to have communications requirements relaxed.[91]

In establishing the thresholds used to determine which companies would be considered WKSIs, the SEC relied on statistical data from its Office of Economic Analysis.[92] The statistics are staggering. According to the SEC itself, in 2004, WKSIs represented approximately 30% of all listed issuers in the United States, but they "accounted for about 95% of U.S. equity market capitalization . . . [and] more than 96% of the total debt raised in registered offerings over the past eight years by issuers listed on a major exchange or equity market."[93] In accordance with these statistics, it is clear that relaxation of the regulations on WKSIs applies to nearly the entire market. So, despite the fact that there are indeed four categories of issuers and different regulations applying to each, the category that is truly the most important and deserves the most attention when analyzing the reforms are the regulations that apply (or, as a matter of fact, have been eliminated) to WKSIs.

The other categories of issuers used in the reforms are seasoned issuers that are required to file reports under the Exchange Act (but do not qual-

89. *Id.* at 44,726, 44,730-31.

90. *Id.* at 44,727. Note that the requirements also demand that the issuer not be an "ineligible issuer" as that term is now defined in 17 C.F.R. § 230.405. *Id.* at 44,727 & n.45. Among other things, an ineligible issuer is one who is late with its reporting obligations under the Exchange Act or has declared bankruptcy during the previous three years. 17 C.F.R. § 230.405 (2006).

91. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,726-27.

92. *Id.* at 44,727-28, 44,728 n.51.

93. *Id.* at 44,727.

ify as WKSIs), unseasoned issuers that are required to file reports under the Exchange Act, and issuers that are not required to file reports under the Exchange Act. Issuers are considered seasoned if they are eligible to report on Form S-3 or Form F-3.[94] That determination is complicated and must be done in strict accordance with those forms but generally means that the issuer has at least seventy-five million dollars of outstanding securities held by non-affiliates or has a certain minimum investment grade rating on its debt securities.[95] Unseasoned issuers are those issuers that are required to file reports under the Exchange Act but do not meet the criteria to be either WKSIs or seasoned issuers.[96] The final category applies to all other issuers, including those that have chosen to voluntarily file reports under the Exchange Act but are not required to do so.[97]

(b) New Rule 163: Free WKSI Communication Pre-Filing

Under new Rule 163, WKSIs are allowed to communicate freely throughout the pre-filing period.[98] Both oral and written communications are allowed.[99] This is a complete reversal from the previous regulatory regime described above. The SEC has stated that such companies are so widely followed that they should not be prevented from continuing any on-going communications with the investment community.[100] To restrict pre-filing communications, the SEC now states, would be an unnecessary burden on these companies.[101] It bears repeating the SEC's position in *Loeb, Rhoades*, advocating a "vigorous enforcement policy to prevent" gun-jumping.[102] Admittedly, the *Loeb, Rhoades* case is from 1959. Nonetheless, with the adoption of this new Rule 163, the SEC seems to have changed its position in this regard entirely.

(c) New Rule 163A: Free Communications Prior to Thirty Days Before Filing

Rule 163A provides that for *all issuers*, no communication will be deemed a violation of the gun-jumping provisions of the Securities Act if the communication occurs prior to thirty days before the filing of a regis-

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94. *Id.* at 44,730.

95. *See* S.E.C. Forms S-3, F-3 (2006).

96. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,731.

97. *See id.* at 44,730-31.

98. 17 C.F.R. § 230.163 (2006); *see also* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,734.

99. 17 C.F.R. § 230.163(a); *see also* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,734.

100. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,734.

101. *Id.*

102. *In re* Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843, 850 (1959); *see supra* text accompanying note 53.

tration statement.[103] There is one condition on this exemption—the communication cannot specifically refer to the upcoming offering of securities.[104] Beyond that restriction, any market conditioning that occurs prior to that thirty-day window before filing is now entirely legal. The SEC's reasoning is that the thirty-day window will allow for a cooling-off period for any marketing hype that a company has created prior to that window.[105] Again, this change seems out of sync with the SEC's historically vigilant anti-gun-jumping position.

(d) New Rule 168: Reporters Can Publish Regular Facts and Forecasts

Under the new Rule 168, all reporting issuers—WKSIs, seasoned, and unseasoned issuers—are given an exemption from restrictions against communications that are essentially regularly released "factual business information or forward-looking information."[106] The factual business information exemption was already a part of SEC practice in accordance with SEC Release No. 5009 and No. 5180 described above.[107] However, the forward-looking aspect of the new rule has been more controversial. Forward-looking statements do exactly what the SEC had historically not wanted issuers to do before filing a registration statement: condition the market to purchase the securities to be issued. It is true, as the SEC points out in its release adopting the reform, that the SEC has reversed this position in a number of ways to encourage companies to give forward-looking information in certain circumstances.[108] Such information, however, was never allowed to be disclosed during the pre-filing period by a company planning an upcoming offering.[109]

(e) New Rule 169: Even Non-Reporters Can Publish Facts

Even non-reporting issuers are given flexibility with respect to the regular release of factual business communications. New Rule 169 allows any issuer, including an issuer that is not obligated to file reports under the Exchange Act, to issue regular business communications, provided that such communications are made in the ordinary course of business

103. 17 C.F.R. § 230.163A (2006).

104. *Id.* § 230.163A(a).

105. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,740.

106. 17 C.F.R. § 230.168(a).

107. Guidelines for Release of Information by Issuers Whose Securities Are in Registration, Securities Act Release No. 33-5180, 36 Fed. Reg. 16,506, 16,507 (Aug. 21, 1971); Publication of Information Prior to or After Filing and Effective Date of Registration Statement, Securities Act Release No. 33-5009, 34 Fed. Reg. 16,870, 16,870 (Oct. 18, 1969).

108. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,736-37.

109. *See id.* at 44,736 n.127, 44,736-37.

and are released for use by persons, such as customers or suppliers, who are not using the information as potential investors.[110]

(f) Expanded Research Publications Permissible

In addition to the dramatic new rules described above, the SEC has also revised Rules 137, 138, and 139, all of which relate to brokers and dealers being allowed to continue to issue research reports on certain issuing companies. The previous iterations of those rules were discussed above to illustrate the historical position that the dissemination to the market of research on issuing companies has been encouraged. This has been consistent with simultaneous attempts to curb the conditioning of the market by participants in the offering who stood to gain financially from inflating the price of the securities to be offered. However, efforts were made to keep those exceptions narrow with the purpose of avoiding any market hype by analysts who might have a financial interest in an upcoming offering.[111] The reforms expand the exceptions, providing opportunities for financially interested parties to publish research on upcoming securities offerings with fewer restrictions.

(i) Revised Rule 137 Now Applies to All Issuers, Not Just Reporters

As was described above, Rule 137 has been available as a safe harbor for brokers and dealers who issue reports in the ordinary course of their business, and who have no financial interest in the proposed offering, and who are not specially compensated for their reports.[112] The rule was restricted to reports issued about companies that were already reporting companies under the Exchange Act.[113] The theory was that such companies had brokers and dealers already following them and issuing regular research reports. Thus, such ordinary course of business reports were to be encouraged and not inhibited despite the pending new offering. Revised Rule 137 keeps much of the old rule but expands the scope of the rule so that now the company that is the subject of the publication is not required to be a reporting company under the Exchange Act.[114] This undercuts the idea that the company should have been the subject of regular reporting prior to the proposed offering, changing the nature of this rule to allow for promotions of new issuers with new offerings.

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110. 17 C.F.R. § 230.169 (2006).
111. 17 C.F.R. § 230.137-.139 (2005).
112. *Id.* § 230.137.
113. *Id.*
114. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,762.

(ii) Revised Rule 138 Now Applies to All Reporting Companies

Like Rule 137, Rule 138 was designed to allow brokers and dealers to continue to publish research on a company, even though the company was planning an upcoming new offering of securities.[115] Under Rule 138, however, the broker or dealer could participate in the upcoming offering and still publish research reports on the issuing company's securities, as long as those securities were of a different type than the type being offered.[116] So, brokers and dealers could continue to report on fixed income-type securities if they were participating in an offering of common stock. Likewise, Rule 138 allowed brokers and dealers to publish research on common stock of an issuer even if they were participating in an offering of that issuer's fixed income-type security.[117] Rule 138 had been restricted to situations where the issuing company was eligible to file its registration statement with the SEC on Form S-3 or Form F-3.[118] This meant that the rule only applied to companies that had a certain magnitude and following in the market. That restriction is abolished in the revised rule. Under revised Rule 138, the company that is the subject of the report now need only be a reporting company under the Exchange Act or a similar type of foreign company.[119] Just as the recent reforms expand the availability of the Rule 137 safe harbor, so too the reforms greatly expand the availability of the Rule 138 safe harbor.

(iii) Revised Rule 139: No Need to Report Regularly or Restrain Upgrades

Rule 139 has changed dramatically as a result of the revisions. Previous Rule 139 allowed brokers and dealers who were participants in an upcoming offering to publish research reports on the issuer's securities, provided that they did so regularly in the ordinary course of its business and either: (i) the issuing company was of a certain size and stature; or (ii) the publication also reported on other similar types of companies, gave no special prominence to the issuer, and did not upgrade any previous recommendations.[120] Revised Rule 139 continues to have two alternative bases for the safe harbor but both expand the broker's or dealer's ability to qualify for the safe harbor, allowing brokers and dealers who have incentives to condition the market to do so with little restriction.[121]

115. *See* 17 C.F.R. § 230.138 (2005).
116. *Id.*
117. *Id.* § 230.138(a).
118. *Id.* § 230.138(b)-(c).
119. *See* 17 C.F.R. § 230.138 (2006); *see also* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,763.
120. 17 C.F.R. § 230.139 (2005).
121. 17 C.F.R. § 230.139 (2006).

The first alternative in the revised Rule 139 safe harbor is that the issuer qualify as being of a certain size and stature.[122] Those requirements are similar to the previous requirements. The significant change to this part of the safe harbor is that the broker or dealer need not report regularly on the issuer in the ordinary course of its business in order to publish a report covering an upcoming issuance in which it has a financial stake.[123] Once again, this revision undercuts the previous idea underscoring these research publication rules—encouraging the continuation of ordinary course of business research reports. The new requirement is simply that the broker or dealer has published a report about the issuer at least once previously.[124] That new requirement could be met by a report that is published two months prior to the proposed issuance, when a broker or dealer may indeed already have a vested stake in the issuance and, in fact, is attempting to condition the market.

The second alternative in the revised Rule 139 has dramatically changed the old rule. As described above, the old rule allowed for brokers and dealers participating in an upcoming new offering to continue to publish regular research about an issuer as long as they gave the issuer no special prominence and did not upgrade their opinion about the issuer.[125] Revised Rule 139 has eliminated that last safeguard. Accordingly, it seems that a financially interested broker or dealer will be able to take advantage of this revised safe harbor to inflate its rating of an upcoming security despite having great financial incentive to condition the market to increase the price of the securities being offered.

B. The Waiting Period

The waiting period kicks in once the issuer has filed its registration statement regarding an upcoming new issuance of securities. During this time, the gun-jumping restrictions imposed by section 5(c) of the Securities Act no longer apply.[126] As a result, some communications have been permitted during this period. Oral communications, for example, were permitted to allow for a certain amount of selling to occur during the waiting period.[127] However, section 5(b)(1) of the Securities Act has restricted any *written* communications during this period to a prospectus authorized by section 10 of the Act.[128]

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122. *Id.* § 230.139(a)(1).
123. *Id.*
124. *Id.* § 230.139(a)(1)(iii).
125. 17 C.F.R. § 230.139(b) (2005).
126. Section 5(c) applies "unless a registration statement has been filed as to such security." Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c) (2000).
127. Securities Act of 1933 § 5(b), 15 U.S.C. § 77e(b).
128. Securities Act of 1933 § 5(b)(1), 15 U.S.C. § 77e(b)(1).

There were exceptions to the rule that a section 10 prospectus was the only written communication allowed during the waiting period, including exceptions for (i) so-called tombstone ads pursuant to section 2(a)(10) of the Securities Act;[129] (ii) identifying statements issued pursuant to Rule 134;[130] and (iii) broker or dealer reports pursuant to Rules 137, 138, and 139 discussed above.[131] Otherwise, all written communications were required to conform to prospectus requirements outlined in section 10 of the Securities Act.[132] All other writing, referred to as "free writing," was strictly prohibited.[133] The recent reforms, however, have turned this regime on its head, and now, in accordance with the reforms, free writing is permitted during the waiting period.[134] This section will first describe in some detail the regulatory regime regarding communications that used to apply to the waiting period. It will then describe how, in a complete turnabout of policy, the new reforms have essentially removed those regulations.

(1) Historically, Free Writing Was Prohibited

Section 5(b)(1) of the Exchange Act makes it unlawful for anyone to use a prospectus during the waiting period that does not meet the requirements of section 10 of the Securities Act.[135] "Prospectus" is defined in section 2(a)(10) of the Securities Act as broadly as possible to incorporate any communication relating to a security that is to be offered.[136] The result of these two sections is that the only written communication that was generally allowed during the waiting period was a prospectus that contained all the information required by section 10. That information would always be contained in the registration statement filed with the SEC, and thus the information was subject to SEC review and oversight.

This statutory restriction again reflects the SEC's historic concern that issuers and others participating in an upcoming offering not be allowed to communicate freely with the market for fear that unregulated communications might lead to more conditioning of the market and undue inflation of the price of the upcoming offering. In a release discussing the waiting period, the SEC stated clearly its position that "during this period

129. Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10).
130. 17 C.F.R. § 230.134 (2006).
131. *Id.* § 230.137-.139.
132. Securities Act of 1933 § 10, 15 U.S.C. § 77j.
133. Securities Act of 1933 § 5(b)(1), 15 U.S.C. § 77e(b)(1).
134. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,744 (Aug. 3, 2005).
135. Securities Act of 1933 § 5(b)(1), 15 U.S.C. § 77e(b)(1).
136. Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10).

'free writing' is illegal."[137] The SEC went on to explain that during the waiting period, investors should be allowed "to become acquainted with the information contained in the registration statement and to arrive at an unhurried decision concerning the merits of the securities."[138] Further, the SEC reasoned that during this period, investors should have reference to the "preliminary prospectus in order to have a reliable source of information."[139] Clearly, the SEC was suspicious that any free writing allowed during this period might not be reliable. With the passage of the recent reforms, the SEC has reversed its position entirely on this matter.

The SEC promulgated Rules 430 and 431, which effectively relaxed the requirement that a section 10 prospectus be the only communication allowed during the waiting period.[140] These rules provide that a preliminary prospectus and a summary prospectus both meet the requirements of section 10 of the Securities Act.[141] For that reason, either a preliminary prospectus or a summary prospectus can be disseminated to the public during the waiting period.[142] A preliminary prospectus, however, contains all of the information required by a final prospectus, except that it can omit the offering's final pricing information, which is typically only determined immediately before the offering is finalized.[143] Rule 430 further requires a form of the preliminary prospectus to be filed with the SEC as a part of the registration statement.[144] A summary prospectus must meet all the requirements set forth by the summary prospectus rules for the particular form an issuer uses to file its registration statement.[145] In addition, the summary prospectus must be filed with the SEC in order to be used.[146] Because both of these documents essentially contain information that would be in a final section 10 prospectus, their use does not unduly condition the market during the waiting period.

Some other forms of communications beyond just a prospectus were also allowed during the waiting period. These exceptions to the basic rule were designed to allow the securities effectively to be sold by issuers. The exceptions include: (i) tombstone ads in accordance with section 2(a)(10); (ii) expanded tombstone ads (also known as identifying statements) in accordance with Rule 134; and (iii) oral selling efforts.

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137. Offers and Sales of Securities by Underwriters and Dealers, Securities Act Release No. 33-4697, 29 Fed. Reg. 7317, 7317 (June 5, 1964).
138. *Id.* at 7317-18.
139. *Id.* at 7317.
140. 17 C.F.R. §§ 230.430-.431 (2006).
141. *Id.*
142. Securities Act of 1933 § 5(b)(1), 15 U.S.C. § 77e(b)(1) (2000).
143. *See* 17 C.F.R. § 230.430(a).
144. *Id.*
145. *Id.* § 230.431(b).
146. *Id.* § 230.431.

(a) Tombstone Ads Allowed Limited Advertisements

Under the Securities Act, certain limited information was carved out of the definition of a prospectus and could therefore be disseminated during the waiting period without violating section 5(b)(1).[147] That limited information was therefore permissible communication and became referred to as a tombstone ad. The information allowed by this carve-out was extremely limited and included a brief description of the security, the price thereof, and an identification of who can execute orders.[148] The tombstone ad also was required to state where a section 10 prospectus could be obtained.[149] The idea behind a tombstone ad was that some limited selling efforts were necessary during the waiting period in order for a securities offering to be successful. This strictly limited factual communication was not likely to inflate the price of the security to be offered. Further, the requirement that a tombstone ad make the public aware of how to obtain a section 10 prospectus meant that investors reading a tombstone ad at least had access to reliable information that was on file with the SEC.

(b) Rule 134: Identifying Statements Allowed Additional Limited Information

Section 2(a)(10) of the Securities Act goes beyond its carve-out for tombstone ads to authorize the SEC to promulgate rules that allow for more communication to be permitted during the waiting period.[150] In accordance with that authority, the SEC promulgated Rule 134.[151] Rule 134 expanded the scope of information that can be released in an advertisement or other publication during the waiting period.[152] Nonetheless, Rule 134 carefully itemized what information can be disclosed.[153] Information disclosed pursuant to this rule is sometimes referred to as an identifying statement. Rule 134 limited information that could be contained in such a statement to the information allowed by a tombstone ad plus other basic factual information about the offering including: (i) basic information about the issuer's business;[154] (ii) the price of the security;[155] (iii) the yield, if the security is debt;[156] (iv) the name of the sender of the

147. *See* Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10) (2000).
148. *See id.*
149. Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10).
150. *Id.*
151. *See* 17 C.F.R. § 230.134 (2005).
152. *Id.*
153. *Id.*
154. 17 C.F.R. § 230.134(a)(3).
155. *Id.* § 230.134(a)(4).
156. *Id.* § 230.134(a)(5).

communication;[157] (v) information regarding whether the security is legal for certain types of investors to purchase;[158] and (vi) other similar factual information that briefly describes the nature of the security being offered.[159] This expanded ability for issuers to communicate to the public was helpful to issuers in their attempt to sell a new offering of securities but was also sufficiently factual so as not to present an undue risk of misleading the market or inflating the price for the securities to be offered.

(c) Oral Selling Efforts Were Allowed, Including Road Shows

Finally, the Securities Act acknowledged that once a registration statement has been filed, the issuer, its underwriters, and the brokers and dealers participating in the offering should be allowed to communicate orally with potential investors to generate enough interest to sell the securities being offered.[160] Accordingly, oral offers and selling efforts were carved out from the prohibitions on communications during the waiting period. Eventually, issuers and underwriters began to use this oral exemption to conduct meetings with groups of potential investors. These meetings became known as road shows because they were organized across the country, and issuers and underwriters would travel from one city to the next to give their oral presentations to groups of brokers, dealers, and typically sophisticated, well-connected investors.[161] Although these oral presentations may have also used slide shows, all the material that was a part of the road show was, and still is, deemed to be part of an oral communication.[162]

Road shows became increasingly controversial in the 1990s with the advent of Internet companies that created taped versions of road shows available for dissemination to wider audiences.[163] On the one hand, the

157. *Id.* § 230.134(a)(6).

158. *Id.* § 230.134(a)(9).

159. *See, e.g.*, *id.* § 230.134(a)(7)-(8), (10)-(13).

160. Section 5(b)(1) of the Securities Act, which regulates communications during the waiting period, specifically does not restrict oral communications during this period. *See* Securities Act of 1933 § 5(b)(1), 15 U.S.C. § 77e(b)(1) (2000). By comparison, Section 5(c) clearly restricts oral communications during the pre-filing period. *See* Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c).

161. *Cf.* Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Securities Act Release No. 33-7288, 61 Fed. Reg. 24,644, 24,644, 24,650 (May 15, 1996).

162. However, these written or recorded presentation "aides" may not be disseminated to potential investors. *See* Exploration, Inc., SEC No-Action Letter, 1986 WL 67374, at *1 (Nov. 11, 1986).

163. *See, e.g.*, Charles Schwab & Co. SEC No-Action Letter, 2000 WL 146586 (Feb. 9, 2000); Charles Schwab & Co., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 903, at *1 (Nov. 15, 1999); Activate.net Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 766 (Sept. 21, 1999); Thomson Fin. Servs., Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 837 (Sept. 4, 1998); Bloomberg L.P., SEC No-Action Letter, 1997 SEC No-Act.

road show had historically been a permissible type of sales effort during the waiting period. On the other hand, it seems that the road show was permissible because it was typically being communicated only to sophisticated investors, brokers, and dealers, who would not normally need the protection of the SEC in making their investment decisions.[164]

The recent reforms undertaken by the SEC were designed, in part, to resolve this controversy, and they did.[165] As the next sections will detail, recorded road shows are now simply considered free writing and are permitted to be published to any investor, regardless of whether those investors are sophisticated or not, and regardless of whether those investors might benefit from SEC protection.[166]

(2) The Reforms Allow Free Communications During the Waiting Period

Despite the Security Act's design to prohibit free communications during the waiting period, the SEC has now crafted a series of new and revised rules, so that essentially almost all participants in a securities offering can communicate freely with the public. This is an incredible turn around from both the language of the Securities Act itself and the SEC's historical position. This section will describe in detail the rules and revisions that the SEC has enacted in its recent reforms that make free communications during the waiting period possible. More specifically, this section will discuss: (i) the revisions that the SEC has made to rule 134, providing for expanded identifying statements;[167] (ii) the broad permissibility of using free writings during the waiting period under new Rule 164 and revised Rule 433;[168] and (iii) the SEC's new position that road shows can be disseminated widely to the public without restriction.[169]

LEXIS 1023, at *1-5 (Dec. 1, 1997); Net Roadshow, Inc., SEC No-Action Letter [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,367, at 77,849-51 (Sept. 8, 1997); Private Fin. Network, SEC No-Action Letter, [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,332, at 77,674-78 (Mar. 12, 1997).

164. Note that the securities regulations have typically exempted from regulation securities that are offered to sophisticated investors. *See, e.g.*, 17 C.F.R. § 230.506 (2006) (allowing for securities with an unlimited dollar value to be sold without registration at all so long as they are only sold to sophisticated investors or investors represented by sophisticated advisors).

165. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,753-54 (Aug. 3, 2005).

166. 17 C.F.R. § 230.433(d)(8).

167. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,742-44.

168. *Id.* at 44,746-49.

169. *Id.* at 44,753-55.

(a) Revised Rule 134 Provides for Additional Disclosures

As discussed above, Rule 134 was made available to issuers under section 2(a)(10) of the Securities Act, which provides the definition of "prospectus."[170] Rule 134 created an exception within the definition of a prospectus for an identifying statement about an upcoming securities offering that contained only limited information.[171] Again, the theory was that the factual information allowed in an identifying statement was essential for an issuer to be able to market its securities during the waiting period but did not create significant risk that the market would be conditioned to overprice the securities being offered. Revised Rule 134 amplifies the gambit of information that may now be included in an identifying statement.[172] The SEC has stated that this revision is designed to help the issuer market its securities but still ensure that the information disclosed does not create the potential for offering abuses.[173]

The additional information allowed under revised Rule 134 includes: (i) information on how to contact the issuer;[174] (ii) the price of the security;[175] (iii) information about how to contact the sender of the information;[176] (iv) information about who will be the underwriters;[177] and (vi) other limited factual information about the offering.[178] From the very description of the newly authorized information, it is clear that this new information is designed to allow the investor to more easily contact the issuer, the party who disseminated the information, or any of the underwriters involved in the offering. From there, those offering participants can continue their selling effort with more ease.

(b) New Rules 164 and 433 Allow Free Writing

Much more startling than the expanded information permitted to be disclosed under Rule 134 is the outright permission provided by the new reforms for the publication of a free writing during the waiting period.[179] Rule 164 introduces a new concept—a "free writing prospectus"—and states that such information will be deemed a section 10 prospectus under the Securities Act and therefore is allowed to be published during the waiting period under section 5(b)(1) of the Act.[180] "Free writing prospec-

170. Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10) (2000).
171. 17 C.F.R. § 230.134 (2005).
172. 17 C.F.R. § 230.134 (2006).
173. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,742.
174. 17 C.F.R. § 230.134(a)(1) (2006).
175. *Id.* § 230.134(a)(4).
176. *Id.* § 230.134(a)(8).
177. *Id.* § 230.134(a)(10).
178. *See id.* § 230.134.
179. *See id.* §§ 230.164, 230.433.
180. *Id.* § 230.164.

tus" is then defined in revised Rule 405 to be any written communication pertaining to a securities offering made after a registration statement is filed with respect to that offering.[181] These sections together mean that any written communication regarding an offering is allowed to be publicly disseminated during the waiting period.

There are some restrictions, however. Rule 164 states that the use of a free writing prospectus is subject to the requirements set forth in new Rule 433.[182] And so the plot thickens. Rule 433 enumerates many complex requirements for use of the free writing prospectus, but none of those rules represent significant limitations on offering participants freely communicating with the public during the waiting period.[183]

Rule 433 requires that a registration statement be on file to use a free writing prospectus.[184] In the case of unseasoned and non-reporting issuers, there must be a registration statement on file that specifies the price range at which its offering will be conducted, and the free writing prospectus must be accompanied or preceded by such registration statement.[185] Note well that WKSIs are not constrained by this requirement and, as was discussed earlier, in 2004, WKSIs "accounted for about 95% of U.S. equity market capitalization."[186] Even for the unseasoned and non-reporting issuers who are constrained by this requirement, such issuers are still able to communicate anything they wish to the public; they simply must follow the rules.

Rule 433 describes the information that can be included in the free writing prospectus as, essentially, anything that does not conflict with information in an issuer's registration statement or periodic reports filed under the Exchange Act.[187] Again, this condition does not represent a significant limitation on communications to the public during the waiting period.

Rule 433 requires that the free writing prospectus be filed with the SEC at the time of its use in certain circumstances.[188] An issuer must file the communication with the SEC if any of the following apply: (i) the issuer uses the communication; (ii) the communication is used by another offering participant but contains information about the issuer not in the registration statement; or (iii) the communication contains the final terms of

181. *Id.* § 230.405.
182. *Id.* § 230.164.
183. *See id.* § 230.433.
184. *Id.* § 230.433(b).
185. *Id.* § 230.433(b)(2).
186. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,727 (Aug. 3, 2005).
187. 17 C.F.R. § 230.433(c).
188. *Id.* § 230.433(d).

the securities in the offering.[189] Any offering participant other than the issuer that uses a free writing prospectus must file that prospectus if it is disseminated to a broad, unrestricted audience.[190] These filing conditions do not seem to limit the ability for any offering participant to communicate freely with the public concerning an upcoming offering.

(c) New Rule 433: Road Shows Can Be Freely Presented to the Public

In stark contrast to the treatment of road shows prior to the new reforms, a road show is now either: (i) freely permitted as oral communication if it originates as a live presentation before an interactive audience, or (ii) freely permitted as a free writing prospectus if it is recorded.[191] In either case, road shows are no longer restricted to small audiences made up mostly of brokers, dealers, and sophisticated investors.

In its reforms, the SEC specifically focused on clarifying the treatment of road shows and their electronic transmission over the Internet or cable television stations.[192] As applied to road shows, the new rule is relatively simple. If a road show originates before a live audience, even if it is broadcast to a large audience, it will be considered oral, and therefore, permitted under section 5(b)(1) of the Securities Act.[193] This means that a road show originally given in front of a live audience could be rebroadcast and would still be considered oral and permissible. On the other hand, a road show that does not originate as a live presentation to an interactive audience but is recorded and then broadcast will be considered a free writing prospectus.[194] In accordance with the free writing prospectus rules, such communication is also freely permitted, though the free writing prospectus requirements must be satisfied. There is a special exemption from filing, however, for a road show that is a free writing prospectus.[195] Such communications typically need not be filed with the SEC.[196]

In accordance with the categorization of the road show itself, any documents, slides, or other materials used in connection with that road show will be included in that same category.[197] Therefore, if a road show

189. *Id.*

190. *Id.*

191. *Id.* § 230.433(d)(8).

192. *See* Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,753-54 (Aug. 3, 2005).

193. *Id.* at 44,753.

194. 17 C.F.R. § 230.433(d)(8) (2006).

195. *Id.*

196. There is an exception for issuers that are not required to file reports under the Exchange Act. Such issuers must file a copy of the road show unless such show is readily available to any investor. *See id.*

197. *Id.*

is live and is considered to be oral and permitted, then the supporting written materials that are used are also considered to be oral (provided they are not distributed to the audience).[198] Likewise, if the road show is recorded and is therefore deemed to be a free writing prospectus, then the supporting written materials will be deemed to be part of that free writing prospectus.[199]

Again, this new SEC policy of allowing broad dissemination of road shows is contrary to the SEC's historical treatment of road shows as being allowed but restricted. Now, road shows can reach an undifferentiated broad public audience, can contain any promotional materials, and are freely permissible.

C. The Post-Effective Period

The final phase of a securities offering is the post-effective period. This period occurs after the SEC has declared an issuer's registration statement effective. Unlike in previous periods, in this period, an issuer and its participating parties can actually confirm their sales of securities.[200] However, in accordance with the Securities Act, a confirmation of sale could not be delivered unless and until the purchaser had received a final prospectus.[201] Once again, the recent reforms have completely changed the previous requirements. Under the new reforms, a final prospectus need only be on file with the SEC for a sales confirmation to be made.[202] This section will describe more specifically the restrictions on communications that existed in the post-effective period prior to the recent reforms enacted by the SEC and will then describe the changes wrought by those reforms.

(1) Historically, Investors Had to Receive a Final Prospectus Prior to Sale

Section 5(a) of the Securities Act makes it illegal to sell securities until a registration statement has been declared effective by the SEC.[203] In the post-effective period, that is exactly what has happened—a registration statement has been declared effective—and thus, sales of the securities being offered are finally permitted. Section 5(b)(2) of the Securities Act, however, makes it illegal to transmit those securities being sold to the investor if the transmission is not accompanied or preceded by the final

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198. *See id.*

199. *See id.*

200. *See* Securities Act of 1933 § 5(b)(2), 15 U.S.C. § 77e(b)(2) (2000).

201. *Id.*

202. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,783 (Aug. 3, 2005).

203. Securities Act of 1933 § 5(a), 15 U.S.C. § 77e(a).

prospectus described by section 10(a) of the Securities Act.[204] Further, this Article described earlier that section 5(b)(1) of the Securities Act prohibits sending any prospectus to investors concerning a registered offering.[205] "Prospectus" is defined broadly in section 2(a)(10) as any communication regarding the offering.[206] But this definition specifically excludes any communication regarding an offering that is made to an investor after a section 10(a) final prospectus has been delivered to that investor.[207] Thus, the prohibition against sending any prospectus to investors concerning an offering—set forth in section 5(b)(1) of the Securities Act—is of no significance where a final prospectus has already been delivered to the investor. Although this is a complex regulatory regime, the result is that once a registration statement has been declared effective, investors must be given a final prospectus in order to either have their sale confirmed or to receive any other communications regarding the offering.

In the preceding discussion about the waiting period, it was noted that the SEC considered that period the time during which an investor should be able to come to a reasonable and "unhurried decision" with respect to whether to purchase a new security being offered.[208] In the post-effective period, the regulatory regime mandated that all investors receive the final prospectus to ensure that investors would have all the required, balanced, and reliable information that they needed in order to finalize their investment decision.[209]

(2) The Reforms Provide that Access to a Prospectus Equals Delivery

Once again, the recent SEC reforms are in stark contrast to the regime set up by the Securities Act. The reforms provide that an issuer or any participant in an offering need not make sure that an investor has received a final prospectus before finalizing its decision to invest in the new offering.[210] Rule 172 is simple and reverses the old regulatory regime. Rule 172 provides that as long as a registration statement is on file with the SEC and has been declared effective, there is no need for delivery of a final prospectus as required by section 5(b)(2) of the Securities Act.[211] Likewise, the prohibition on communications contained in section 5(b)(1) is no longer effective with respect to communications confirming a sale,

204. Securities Act of 1933 § 5(b)(2), 15 U.S.C. § 77e(b)(2).
205. Securities Act of 1933 § 5(b), 15 U.S.C. § 77e(b).
206. Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10).
207. *Id.*
208. Offers and Sales of Securities by Underwriters and Dealers, Securities Act Release No. 33-4697, 29 Fed. Reg. 7317, 7317-18 (June 5, 1964).
209. *See* Securities Act of 1933 § 5(b), 15 U.S.C. § 77e(b).
210. 17 C.F.R. § 230.172 (2006).
211. *Id.*

including a broad definition of the types of communication that might accompany such communication.[212]

The SEC describes this new regime as "access equals delivery."[213] The theory is that as long as investors have access to the information, it is not required to be delivered. Further, this idea is buttressed by the concept that access to the information is made easy through the SEC's online filing system, EDGAR.[214] Nonetheless, with Rule 172, the requirement designed by the Securities Act that investors actually have received the final prospectus, including all of its required and reliable information, is now gone.[215]

This particular reform seems to be a particularly glaring example of how the SEC's recent reforms appear to turn away from the notion that the SEC should proactively protect the interests of all investors. As this reform item suggests, the SEC now seems to expect or presume that investors are sophisticated enough to conduct their own legal research on the Internet to find the relevant information that previously would have been delivered to them. It is also quite striking that the SEC bases its reform on the presumption that all investors have access to the Internet, and moreover, that they know how to effectively research information on the Internet. As easily as the SEC presumes that investors are savvy enough to use the Internet and find legal documents, it is far easier to imagine investors who neither have the Internet nor have ever heard of the SEC's website. To shift the basic presumption that investors should be given the appropriate information by issuers, to a presumption that the investors should be forced to find that information for themselves, is truly remarkable—and, in fact, telling—for an agency whose mandate is the protection of the investor.

III. NEW OFFERING PROCEDURES MEAN LESS OVERSIGHT

Among the most dramatic features of the new securities reform is the introduction of the automatic shelf registration for WKSIs.[216] Shelf registrations have been specifically allowed in the United States under Rule 415 of the Securities Act since the early 1980s.[217] However, the new

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212. *See id.*

213. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,783 (Aug. 3, 2005).

214. EDGAR is the name of the SEC's database of company filings. It stands for the Electronic Data Gathering, Analysis, and Retrieval system. *See* U.S. Sec. & Exch. Comm'n, Important Information About Edgar, http://www.sec.gov/edgar.shtml (last visited Jan. 29, 2007).

215. *See* 17 C.F.R. § 230.172.

216. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,777.

217. *See* Shelf Registration, Securities Act Release No. 33-6499, 48 Fed. Reg. 52,890, 52,892 & n.19 (Nov. 23, 1983).

automatic shelf registration provides new freedom to WKSIs to register a base prospectus that will be automatically effective without SEC approval and then offer any securities they want, at any time.

A. Historically, Shelf Registration Was Limited Under Rule 415

Shelf registrations allowed many issuers to file a registration statement that would cover any securities that such issuer wanted to sell in the subsequent two years. The shelf registration statement would contain basic information about the issuer and the securities it was "placing on the shelf" to sell over the subsequent two years.[218] As with any registration statement, the basic shelf registration statement needed to be reviewed and declared effective by the SEC.[219] Then, when the issuer was ready to actually sell some or all of those shelf securities, the registration statement would need to be updated with the specific details of the offering.[220] In order to qualify to use a shelf registration, the securities being issued had to meet one of the categories enumerated in the rule. Most of those categories involved securities that would naturally be offered on a delayed or continuous basis, such as securities offered in a dividend reinvestment plan or securities issued upon the exercise of outstanding warrants or options.[221] Shelf registration covering these securities was necessary to allow such securities to be issued over time. However, Rule 415 also allowed any securities that could be registered on Form S-3 or Form F-3 to be included in a shelf registration.[222] That meant that the issuers qualified to use such forms (typically well-established and well-followed companies) could take advantage of shelf registrations for their basic equity and debt securities.

Prior to the recent reforms, the initial filing of a shelf registration needed to specify basic information about the issuer and also needed to specify the type and value of the securities to be sold in the period covered by the shelf registration.[223] Registration fees for securities being so "registered to the shelf" needed to be paid for when the shelf was registered.[224] Finally, any offerings of equity securities that were to be "at the market" price had to be restricted to essentially 10% of the value of the then-outstanding voting securities and was subject to other restrictions.[225]

Overall, the shelf registration rules provided for desired flexibility where securities needed to be offered on a delayed or continuous basis,

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218. 17 C.F.R. § 230.415 (2005).
219. *See* Securities Act of 1933 § 5(a), 15 U.S.C. § 77e(a) (2000).
220. *See* 17 C.F.R. § 230.415(a)(3).
221. *Id.* § 230.415(a)(1)(ii), (iii).
222. *Id.* § 230.415(a)(1)(x).
223. *See id.* § 230.415.
224. *See id.*
225. *Id.* § 230.415(a)(4).

while also allowing well-known issuers additional flexibility to sell other securities on this delayed basis. This has been particularly valuable for debt securities because issuers are able to issue debt securities that are subject to a shelf registration with very short notice. This has allowed issuers to take advantage of "market windows" when interest rates are favorable to the issuer.[226]

Still, the restrictions on the shelf registration procedures meant that shelf registrations would be the exception to general registration procedures, not the rule. It is interesting to note that when the SEC published its original release concerning Rule 415, then-SEC Commissioner Thomas expressed strong concerns about shelf registration procedures "reduce[ing] the quality and timeliness of disclosure available to investors."[227] She went on to state that "[i]ncurring these risks is antithetical to the statutory duty of the Commission to protect investors and to maintain the integrity of our capital markets."[228]

B. Revised Rule 415 Allows Unrestricted Sales of Securities for WKSIs

Under the revised rules, WKSIs are now allowed to file automatic shelf registration statements.[229] This new mechanism, coupled with the new communication rules described above, provides WKSIs with an incredible amount of freedom to sell securities whenever they wish and with whatever promotional materials they wish.

These registration statements are called automatic because they will be automatically effective upon filing; therefore, issuers do not need to await SEC approval to begin selling securities immediately.[230] Other restrictions that applied to Rule 415 have also been removed. The value of securities being offered need not be discussed.[231] Accordingly, it is impossible to pay registration fees on securities put on this shelf. Instead, issuers will pay registration fees "as they go."[232] In other words, an issuer will pay registration fees as it actually sells securities. The new Rule 415 allows for even more information to be excluded from the initial shelf registration statement, so long as it is included in the prospectus supplement

226. *See* Shelf Registration, Securities Act Release No. 33-6499, 48 Fed. Reg. 52,890, 52,891 (Nov. 23, 1983).
227. Delayed or Continuous Offering and Sale of Securities, Securities Act Release No. 33-6423, 47 Fed. Reg. 39,799, 39,803 (Sept. 10, 1982) (Thomas, Comm'r, dissenting).
228. *Id.*
229. 17 C.F.R. § 230.415 (2006).
230. *See id.*
231. *See id.*
232. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,777 (Aug. 3, 2005) (describing the "pay-as-you-go" approach).

that precedes an actual offering.[233] Finally, an automatic shelf registration is valid for three years, at which time an issuer can simply file a new automatic shelf to cover the next three years.[234]

When the new automatic shelf registration is coupled with the ability for WKSIs to use a free writing prospectus, the resulting regime is one in which a WKSI that takes advantage of an automatic shelf can offer securities essentially whenever it wants to, and can communicate to the market freely about the offering. Once the shelf is in place, a WKSI is only constrained in making an offering by having to file updates to the base prospectus that is already on file with the SEC. It must do this to update any information in the base prospectus that might be misleading at the time the offering is contemplated, and it must also file information specific to the securities that it intends to sell. But the issuer need not wait for SEC authorization before going ahead with the offering. Further, in accordance with the communications reforms discussed above, a WKSI can use free writing prospectuses at any time, although such communications may also need to be filed.[235] The automatic shelf registration and the ability to use free writing prospectuses effectively eliminate any true restrictions on a WKSI's access to the public capital markets. As long as a WKSI follows the filing rules, it can sell securities freely to the public, as well as being able to communicate about them freely.[236] This result is remarkable: it effectively reverses the regulatory regime set up by the Securities Act—at least with respect to WKSIs.

IV. NEW COMMUNICATIONS WITHOUT SECTION 11 STRICT LIABILITY

As the new communications rules show, there will now be much more communication between issuers and other participants in an upcoming securities offering, and the public. Ironically, these newly permitted communications also have a lower standard for liability that attaches to any false or misleading statements than had been the case for pre-offering communications prior to the reforms. This section will discuss the heightened liability that existed for most communications that were used to sell securities in the pre-reform world. It will then discuss how that heightened liability was dismantled by the reforms.

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233. In addition to information that could have been excluded under Rule 415 previously, issuers can now exclude: (i) whether the offering is primary or secondary; (ii) description of the securities beyond name or class; (iii) names of any selling security holders; and (iv) any plan of distribution. *See* 17 C.F.R. § 230.415.

234. *Id.* § 230.415(a)(5).

235. *See* Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,777.

236. *See id.*

A. Section 11 Created Heightened Liability for Registration Statements

As has been discussed, historically, communications during a securities offering were greatly restricted in order to prevent conditioning of the market and inflating the value of the securities that were to be sold. Almost no communication with the public was allowed during the pre-filing period.[237] During the waiting period, the only communication allowed to be disseminated to the public was a prospectus, the brief factual information contained in tombstone ads, or identifying statements.[238] Section 5 of the Securities Act ensured that communications were thus limited. But the Securities Act went on in its effort to ensure that only high quality information reached the public about public securities offerings by including section 11.[239]

Section 11 created a special heightened liability for registration statements that are false or misleading at the time they become effective.[240] Section 11 instructs that any of the parties who in any way participated in creating the registration statement could be found jointly and severally liable under its provisions.[241] The preliminary prospectus, which was the main written sales document used by offerors and other offering participants during the waiting period, is a part of the registration statement that is filed with the Securities and Exchange Commission so that it can be declared effective. Once the registration statement is declared effective the entire document is subject to Section 11 liability, including the prospectus.[242] By making all of the authors of the registration statement jointly and severally liable for any misstatements, the Securities Act created incentives for all of such authors to ensure that the registration statement (and, therefore, the prospectus) contain high-quality information that was not likely to mislead the public.[243]

Section 11 provides for a heightened standard of liability for any false or misleading statements or omissions in a registration statement because the plaintiff who purchased the security need not prove some of the traditional elements required to state a claim for fraud.[244] In a section 11 action, the plaintiff must allege merely that the registration statement contained a false or misleading statement (or omitted a statement necessary to make other statements not misleading) and that the plaintiff acquired

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237. *See* Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c) (2000).

238. *See* Securities Act of 1933 § 5(b)(1), 15 U.S.C. § 77e(b)(1).

239. *See* Securities Act of 1933 § 11, 15 U.S.C. § 77k (discussing civil liabilities for false registration statements).

240. *Id.*

241. *Id.*

242. *See* 17 C.F.R. § 229.501-.512 (2005).

243. *See* Securities Act of 1933 § 11(f), 15 U.S.C. § 77k(f).

244. *Compare* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2000), *and* 17 C.F.R. § 240.10b-5 (2006), *with* Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a).

securities that were subject to such registration statement.[245] The traditional fraud elements of reliance and causation are not required.[246] Further, when the issuer is the defendant, the plaintiff need not even prove that the issuer knew of the misstatement or omission, as long as there was such a statement (or, again, omission) in the registration statement.[247] Lack of knowledge of the misstatement is a defense for all participants in an offering, except for the issuer.[248]

The Securities Act was so concerned about the quality of information disseminated to the public in a registered offering that the liability associated with that information was heightened. This heightened standard was designed to deter anyone participating in preparing the registration statement from the temptation to mislead the market in order to inflate the value of the securities to be sold.[249] Section 11 specifically names the categories of people who might be liable under its provision.[250] Those people include anyone who signs the registration statement (including the issuer itself), any director of the issuer, and any underwriter.[251] In addition, any expert (such as accountants, engineers, or attorneys) whose statements are contained in a registration statement will be liable under section 11 for its own statements.[252] The joint and several liability that attaches to each of these offering participants provides them with a great incentive to ensure that the registration statement is not misleading. The practical result of this has been that when a registration statement is prepared, representatives from all of these parties are on hand to approve the final language. Each of the participants in the preparation of the document thus became a "gatekeeper" of the information that would be disseminated to the public.[253] Each gatekeeper was therefore motivated by fear of section 11 liability to ensure the registration statement was free from anything misleading.

As mentioned above, section 11 requires a certain degree of knowledge of the misrepresentation to establish culpability for a defendant other than the issuer. This element is embedded in section 11's "due diligence" defense.[254] Section 11 establishes a due diligence defense for parties

245. Securities Act of 1933 § 11(a), 15 U.S.C. 77k(a).
246. *See id.*
247. *See* Securities Act of 1933 § 11(a)-(b), 15 U.S.C. § 77k(a)-(b).
248. *See* Securities Act of 1933 § 11(b), 15 U.S.C. § 77k(b).
249. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 381-82 (1983).
250. Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a).
251. *See* Securities Act of 1933 § 11(a)(1)-(2), (5), 15 U.S.C. § 77k(a)(1)-(2), (5).
252. *See* Securities Act of 1933 § 11(a)(4), 15 U.S.C. § 77k(a)(4).
253. *See generally* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1296-97 (2003).
254. *See* Securities Act of 1933 § 11(b), 15 U.S.C. § 77k(b); Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 682-92 (S.D.N.Y. 1968) (discussing and detailing the due diligence defense as it may apply to the various possible defendants in a Section 11 suit).

(other than the issuer) who might otherwise be liable under section 11 if they can show, "after reasonable investigation," that they did not know of the false or misleading statement in the registration statement.[255] This "due diligence" defense is not available for issuers who remain strictly liable for any false or misleading statements in the registration statement.[256]

B. The Reforms Allow Free Writing Without Heightened Liability

As a result of the reforms, virtually any offering participant can prepare and use their own free writing prospectus during the waiting period in an attempt to sell the securities subject to the offering. As discussed earlier, participants in an offering by a WKSI are allowed to use free writing prospectuses throughout the offering process (including during the pre-filing period).[257] These free writing prospectuses are, by design of the reforms, not subject to the heightened anti-fraud provisions of section 11.[258] This means that much of the information disseminated to the public during the selling phases of an offering will simply not be subject to the discipline that has been applied historically to writing a registration statement (and the prospectus contained therein).

In its offering release, the SEC explains that liability still exists for any misleading statement contained in these documents in accordance with section 12 of the Securities Act and sections 10b and 17 of the Exchange Act. None of these anti-fraud provisions, however, are as strict as section 11, and each is much more difficult for potential plaintiffs to use.[259]

Section 12 of the Securities Act is the anti-fraud section that is most likely to be applied to free writing prospectuses.[260] It is simply not as strict as section 11 in combating fraud. Section 12(a)(2) makes any person who sells a security by means of a false or misleading prospectus liable to the purchaser.[261] It should already be apparent that this section is not as effective as section 11 because there is no joint and several liability for all of the authors of the misleading communication. Liability under section 12 attaches only to the party who sold the security.[262] In addition, as under section 11, section 12 allows for a due diligence defense for de-

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255. Securities Act of 1933 § 11(b), 15 U.S.C. § 77k(b).

256. *See id.*

257. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,744 (Aug. 3, 2005).

258. *See id.* at 44,759.

259. *Compare* 17 C.F.R. § 240.10b-5 (2006), *and* Securities Act of 1933 § 12, 15 U.S.C. § 77l(a), *and* Securities Exchange Act of 1934 § 10, 15 U.S.C. § 78j, *with* Securities Act of 1933 § 11, 15 U.S.C. § 77k.

260. Securities Act of 1933 § 12, 15 U.S.C. § 77l.

261. Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2).

262. Securities Act of 1933 § 12(a), 15 U.S.C. § 77l(a).

fendants. However, under section 12, an issuer is able to use the due diligence defense, in contrast to section 11. Further, the due diligence defense is much easier to satisfy than the standard set forth in section 11. Under section 12, a defendant need only prove that such person did not know of the false or misleading statement or omission and "in the exercise of reasonable care" could not have known.[263] This standard is much easier to satisfy than section 11's standard, which provides that a party must not have known "after a reasonable investigation."[264]

In sum, the new reform allows for more communications than were previously allowed, but the communications that are permitted are not subject to the same high standard of anti-fraud liability as statements that were previously allowed. It is only logical, therefore, that the quality of the information being disseminated to the markets will suffer. Once again, it seems the SEC has erred on the side of accommodating issuers and other market participants at the expense of investors.

V. HAS THE SEC EXCEEDED ITS RULEMAKING AUTHORITY?

In the previous sections, this Article has pointed out how the reforms enacted by the SEC seem to completely rewrite the regulatory regime designed by Congress in section 5 of the Securities Act. This section of the Article will discuss, as an administrative law matter, whether the SEC has the authority to so dramatically override an act of Congress, even if the act is over seventy years old.

A. Agencies Are Authorized to Act Narrowly on Administrative Matters

Legislative authority is the province of the United States Congress. The source for this basic presumption is nothing less than the United States Constitution.[265] Nonetheless, Congress can, and does, delegate some of its legislative power to administrative agencies.[266] The agencies enact rules, which then have the power of law, provided that they are enacted in accordance with the specific delegation of power given to them by Congress.[267] This delegation of authority is generally accepted and has been greeted with approval by the courts for many years.[268] There are a variety of reasons that justify the ability of Congress to delegate rulemaking authority to administrative agencies. Chief among these reasons is that an administrative agency can harness expertise to develop

263. Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2).

264. Securities Act of 1933 § 11(b), 15 U.S.C. § 77k(b).

265. U.S. CONST. art. I, § 1 ("All legislative Powers herein granted shall be vested in a Congress of the United States . . . .").

266. *See* Mistretta v. United States, 488 U.S. 361, 372-73 (1989).

267. *See* United States v. Mead Corp., 533 U.S. 218, 226-27 (2001).

268. *See, e.g.*, Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 401-03 (1940).

specific and detailed regulations necessary to carry out a legislative act of Congress that would take enormous amounts of time for Congress to develop.[269]

(1) Delegations of Authority Are Limited to Discrete Matters

Delegations of legislative power to administrative agencies, however, are not without their limits. While technical, detailed matters have been deemed appropriate for administrative agencies, larger questions that have important social impact have not been deemed appropriate for delegation to administrative agencies.[270] Scholars frequently cite the very nature of the United States government to justify this maxim.[271] The notion is that the United States government was meant to be a system whereby elected officials debate issues of social importance to arrive at decisions by consensus. To abdicate this process on important questions of policy is to undercut the Constitution and our very system of government. Moreover, scholars have frequently commented on the fact that administrative agencies by their very nature may "unduly favor organized interests, especially the interests of regulated or client business firms and other organized groups at the expense of diffuse, comparatively unorganized interests."[272] In the context of the SEC, this means that the SEC may favor issuers and those organized interests that it was designed to regulate at the expense of the diffuse, unorganized interests of investors. Such a potential systematic bias makes delegation to the SEC of large questions that have grave social implications potentially inappropriate, and could lead to results that are contrary to those presupposed in a representative democracy.

At various times, Congress has attempted to delegate broad issues of social concern to administrative agencies. In a few of those circumstances, the act of Congress authorizing such delegation was declared unconstitutional.[273] In the 1930s, the Supreme Court acted in two cases to nullify a congressional delegation of power to an administrative agency.[274] In those cases, the Court discussed its view that Congress cannot abdicate

269. *See, e.g.*, *Mistretta*, 488 U.S. at 379 (discussing an administrative agency's unique ability to handle detailed and technical matters better than Congress).

270. *See, e.g.*, Arizona v. California, 373 U.S. 546, 626 (1963) ("[T]he fundamental policy decisions in our society will be made not by an appointed official but by the body immediately responsible to the people.").

271. *See, e.g.*, Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667 (1975).

272. *Id.* at 1684.

273. *See* A.L.A. Schecter Poultry Corp. v. United States, 295 U.S. 495, 542 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388, 433 (1935).

274. *See Schecter*, 295 U.S. at 541-42; *Panama Refining*, 293 U.S. at 421.

its duties to establish national policy on fundamental issues.[275] Further, Congress must delineate clear standards or procedures by which the administrative agency is to operate.[276]

But the courts also have upheld broad congressional grants of power. The landmark case in this regard is *National Broadcasting Co. v. United States*,[277] in which Congress delegated broad regulatory power to the Federal Communications Commission to regulate the broadcast industry in accordance with the public interest.[278] The Court recognized the broad grant of authority but nevertheless upheld the delegation.[279] This case has been much criticized, including in a strong dissent by one of the Justices.[280]

Despite *National Broadcasting*, the courts continue to review congressional grants of authority that seem overly broad or vague.[281] As recently as 1995, the Eighth Circuit held that an open-ended delegation of authority by Congress violated the Constitution.[282] That court announced that a delegation of authority must contain "an 'intelligible principle'" so that the courts can measure an agency's behavior by the grant of authority established by Congress.[283]

It is important to note, however, that the Supreme Court vacated the 1995 opinion, and it is therefore no longer binding.[284] Additionally, the Eighth Circuit revisited the issue in 2005 and came to quite the opposite conclusion.[285] The court reasoned that when examining the broad circumstances surrounding the delegation, the delegation in question was not overly broad.[286] The court relied on *Mistretta v. United States*[287] for the proposition that courts should give Congress wide latitude to delegate authority to administrative agencies.[288]

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275. *See Schecter*, 295 U.S. at 541-42; *Panama Refining*, 293 U.S. at 430.

276. *See Schecter*, 295 U.S. at 541; *Panama Refining*, 293 U.S. at 430.

277. 319 U.S. 190 (1943).

278. *Id.* at 215-19.

279. *Id.* at 227.

280. *Id.* at 227-38 (Murphy, J., dissenting); *see also* Louis L. Jaffe, *The Illusion of the Ideal Administration*, 86 HARV. L. REV. 1183, 1191 (1973).

281. *See, e.g.*, Nat'l Cable Television Ass'n v. United States, 415 U.S. 336, 337-42 (1974) (construing the Independent Offices Appropriation Act narrowly to avoid unconstitutional delegation).

282. South Dakota v. Dep't of Interior (*South Dakota I*), 69 F.3d 878 (8th Cir. 1995), *vacated*, 519 U.S. 919 (1996).

283. *Id.* at 881-83 (quoting J.W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409 (1928)).

284. South Dakota v. Dep't of Interior (*South Dakota II*), 519 U.S. 919, 919-20 (1996).

285. South Dakota v. Dep't of Interior (*South Dakota III*), 423 F.3d 790, 795-99 (8th Cir. 2005).

286. *Id.* at 799.

287. 488 U.S. 361 (1989).

288. *South Dakota III*, 423 F.3d at 797.

Moreover, in 2001, the Court upheld an extremely broad grant of authority to an administrative agency in *Whitman v. American Trucking Ass'ns*.[289] In that case, the Court upheld the Clean Air Act's grant of authority to the Environmental Protection Agency "to set air quality standards at the level that is 'requisite' . . . to protect the public health."[290] This case is now cited for the proposition that the modern Supreme Court is unlikely to override a congressional grant of authority to an executive agency, no matter how broad.[291] Still, this particular case involved just the kind of technical standard setting that is perfect for an executive agency. It is hard to imagine Congress taking on the task of setting air quality standards for a discrete set of pollutants based on the latest scientific knowledge.

As the foregoing discussion shows, modern courts have typically deferred to Congress in its delegation of broad authority to executive agencies. Nonetheless, claims of unconstitutional delegation are still viable, and federal courts are struggling to arrive at the appropriate rulings.

(2) Agencies Must Also Act Within Their Express Delegation of Power

In addition to the general maxim that important policy questions not be left to administrative agencies, there is a second crucial limitation on delegations of legislative authority by Congress. An administrative agency is not allowed to exceed the express delegation of authority made to it by Congress.[292] If the agency does, a court is empowered to nullify the administrative action that exceeded the agency's authority. The courts have exercised this ability frequently.[293] Still, it is important to note that courts show special deference to administrative agencies' special expertise to interpret and apply the statutes that govern them.[294]

B. In its Reforms, the SEC Has Recast Securities Regulation

In accordance with the general paradigm for agency authority, the SEC was established by an act of Congress to oversee the implementation of

289. *See* Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 475-76 (2001).

290. *Id.* (citation omitted).

291. *See, e.g.*, Ronald J. Krotoszynski, Jr., *Reconsidering the Nondelegation Doctrine: Universal Service, the Power to Tax, and the Ratification Doctrine*, 80 IND. L.J. 239, 298 n.443 (2005) ("*Whitman* restates and reaffirms that almost *any* delegation meets the intelligible principle standard.").

292. Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-44 (1984).

293. *See, e.g.*, Nat'l Mining Ass'n v. Fowler, 324 F.3d 752, 754, 758-60 (D.C. Cir. 2003); Cent. Forwarding, Inc. v. ICC, 698 F.2d 1266, 1284 (5th Cir. 1983).

294. *Chevron*, 467 U.S. at 844-45.

the Securities Act and the Exchange Act.[295] Recently, Congress added section 28 to the Securities Act to clarify the role of the SEC with respect to that Act.[296] Section 28 was enacted by Congress as part of the National Securities Markets Improvements Act of 1996.[297] Section 28 expressly grants broad authority to the SEC to oversee the Securities Act and thereby regulate the U.S. securities market.[298] In enacting its recent set of reforms, the SEC is acting pursuant to authority it believes it has under section 28. It is possible, however, that in accordance with the general administrative law principals set forth in the preceding section: (i) section 28 is an overly broad, unconstitutional delegation of authority to an administrative agency; or (ii) even if section 28 is not an unconstitutional delegation of authority, the SEC has exceeded the express grant of authority contained therein.

(1) Section 28 May Be an Unconstitutional Grant of Broad Authority to the SEC

In the first instance, section 28 of the Securities Act may indeed be an unconstitutional grant of authority to the SEC under the Constitution[299] and previous case law. As discussed above, Congress may delegate some of its legislative authority to administrative agencies but may not delegate broad questions of important social concern. To do so defeats the very foundation of our government, which requires that our elected officials consider questions of fundamental importance and arrive at consensus before new laws are enacted. Previous cases have nullified delegations to an administrative agency on this basis.[300] On the other hand, landmark cases, including *National Broadcasting* and *Whitman*, saw the Supreme Court uphold extremely broad grants of authority.[301] Accordingly, it is unclear how a court would rule if it were presented with the question of whether section 28 is indeed an unconstitutional grant of authority. Nonetheless, a strong argument exists in support of its unconstitutionality.

Section 28 states that:

> The Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or

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295. *See* Securities Exchange Act § 4, 15 U.S.C. § 78d (2000); *see also* U.S. Sec. & Exch. Comm'n, About the SEC, What We Do, http://www.sec.gov/about/whatwedo.shtml (last visited Jan. 29, 2007) [hereinafter About the SEC].

296. *See* Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

297. National Securities Markets Improvements Act of 1996, Pub. L. No. 104-290, § 105, 110 Stat. 3416, 3424 (codified as amended at 15 U.S.C. § 77z-3).

298. *See* Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

299. *See* U.S. CONST. art. I, § 1.

300. *See supra* notes 273-76 and accompanying text.

301. *See supra* notes 277-79, 289-90 and accompanying text.

> any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation issued under this subchapter, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[302]

It is likely no coincidence that this express language includes the words "in the public interest" just as the delegation of authority in *National Broadcasting*. As discussed above, that language was declared constitutional in *National Broadcasting*. Nonetheless, *National Broadcasting* was widely criticized and there was a strong dissent.[303] In accordance with the theory of delegation discussed above, this delegation seems to be the kind of broad-based delegation that the courts find inappropriate. In fact, it would be difficult to draft a provision that would give the SEC more power over the securities registration process. The express language allows the SEC to undermine the Securities Act in any way it sees fit (by exempting anyone or anything from its regulation), as long as such action is done in the public interest and is consistent with the protection of investors. The section gives no indication how a court might assess what is in the public interest or the interest of investors.

Similar to the cases referenced above, where courts found the delegation of legislative authority to be unconstitutional,[304] the delegation of legislative authority in section 28 is quite broad. In fact, in section 28, the delegation seems to be as broad as possible, making this a more extreme case than many of the cases involving broad delegations of authority.

Further, this delegation gives the courts no guidance for figuring out when the SEC might actually exceed the authority granted to it. How could a court assess whether exempting anyone or anything from regulation of the securities laws would be in the public's interest, or, for that matter, in the interest of investor protection? As the Eighth Circuit mentioned in *Dole*, there should be some intelligibility so that the courts can figure out what the agency can and cannot do.[305] Without any limits, an agency would have too much legislative power and that would amount to an unconstitutional reallocation of legislative authority.[306] As Justice Cardozo stated, such a delegation would amount to "delegation running riot."[307]

The philosophical underpinnings of the nondelegation doctrine buttress the argument for why the SEC has exceeded its authority in its reforms.

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302. Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

303. *See supra* note 280.

304. *See, e.g.*, A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 542 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388, 433 (1935).

305. *See supra* notes 282-83 and accompanying text.

306. *See supra* notes 282-83 and accompanying text.

307. *Schechter*, 295 U.S. at 555 (Cardozo, J., concurring).

The idea that issues with important social implications should be considered and debated by the elected officials in Congress and only resolved through the considered action of those officials could not apply more aptly than to securities law reform. The problem for the SEC, of course, is that Congress may not have been able to muster the political clout to pass such a sweeping reform package—especially at a time when the public has become painfully aware of many recent market abuses by corporate actors.

(2) The SEC Also May Have Exceeded the Authority Given to it in Section 28

Even if a court was unwilling to find the delegation of authority granted in section 28 of the Securities Act to be unconstitutional, it is possible that a court might find that the SEC exceeded its specific grant of authority when it enacted its recent reforms. A court might find the SEC to have exceeded its authority on the basis of two potentially restrictive provisions contained in the grant of authority to the SEC.

(a) Authority to Create Exemptions Is Not Authority to Re-write the Basic Rules

First, the grant of authority in section 28 states that the SEC can "exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions" from the scope of the Securities Act.[308] As was described in great detail earlier, the SEC's reforms have gone beyond merely exempting particular persons, securities, or transactions or classes thereof from the provisions of the Securities Act. The reforms have essentially rewritten the Securities Act. This complete overhaul of the legislative act could easily be viewed by a court as beyond the scope of what Congress envisaged when it granted the SEC authority to create "exemptions."

More specifically, the reforms have wrought a crucial number of changes to the Securities Act itself. Whereas section 5(c) mandates no pre-filing communication, the reforms now freely allow WKSIs to communicate.[309] Perhaps WKSIs could be seen as simply a class of people exempted from the provision of section 5(c). But WKSIs account for almost the entire equity and debt securities market in the United States.[310] To exempt WKSIs from section 5(c) is to exempt almost the entire market, or, stated otherwise, to delete section 5(c) from the Securities Act.

308. *See* Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

309. *See* discussion *supra* Part II.A.

310. Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44,722, 44,727 (Aug. 3, 2005).

Whereas section 5(b)(1) requires that only a prospectus that contains statutorily mandated information be used to advertise securities to the public during the waiting period, the reforms have now allowed for almost all issuers to advertise their securities using whatever written information they want.[311] Again, this is tantamount to deleting section 5(b)(1).

Whereas 5(b)(2) mandates that sales of securities are not allowed until the investor received a physical copy of the information in the statutory prospectus, the reforms allow the filing of the document with the SEC to constitute delivery to the investor.[312] Once again, this is potentially equivalent to deleting section 5(b)(2) of the Securities Act.

Finally, whereas section 5 generally requires companies to register their securities and respect the various communications restrictions that apply when conducting an offering, the reforms have now authorized WKSIs to conduct automatic registrations in which, upon filing a brief registration document, those WKSIs will essentially be able to sell securities upon demand. Again, this dramatic reform of the basic provision of the Securities Act could easily be seen as beyond the scope of section 28 where the SEC is only given authority to craft exemptions.

(b) The Reforms May Not Be Consistent With the Protection of Investors

There is, however, crucial limiting language found in section 28 of the Securities Act: administrative action by the SEC must be taken in accordance with the public interest and consistent with the protection of investors.[313] It is difficult to assess what the economic consequences of the newly enacted reforms will be, and therefore, whether they are indeed in the interest of the public and consistent with the protection of investors. Nonetheless, as this Article has pointed out, there are many areas where the reforms on their face seem to oppose the interests of investor protection and instead are more concerned with providing ease of access to the capital markets for issuers and a relaxation of liability standards that would have otherwise applied to offering participants.

Again, where the reforms have allowed for much more and freer communication from issuers and others marketing a new issuance of securities and the public, investor protection seems to have been sacrificed for the interests of those marketing their securities. The restrictions on communications during a securities offering were always founded on protecting the investors from the hyperbole that is expected from parties hyping new securities. To remove those restrictions and allow such free communications hardly seems consistent with investor protection. Simi-

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311. *See* discussion *supra* Part II.B.
312. *See* discussion *supra* Part III.C.
313. *See* Securities Act of 1933 § 28, 15 U.S.C. § 77z-3.

larly, allowing WKSIs to automatically register any securities that they wish to sell at any time without SEC approval hardly seems consistent with investor protection. SEC approval and registration had been required in the past specifically to protect investors. Dismantling the regulatory system that has protected investors in the past in the name of improving efficiency and access to capital markets is not in accord with section 28, which demands that the SEC act to protect investors.

VI. CONCLUSION: INVESTOR PROTECTION SHOULD BE PARAMOUNT

The SEC's website sets forth its mission: "The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[314] The website goes on to explain that its mission is now more important than ever because more and more Americans are investing in the markets to help plan for their futures and their children's futures.[315] This Article has sought to explain and analyze the complex set of reforms that the SEC adopted in December 2005, in light of that mission statement.

While the SEC has declared that investor protection is paramount, it has adopted reforms that undo much of the regulatory regime that the Securities Act sought to establish. The Securities Act was premised on the idea that as long as investors had access to quality, balanced information about an upcoming issuance of securities, then they could fairly make an investment decision with respect to that potential purchase. The Securities Act was highly suspicious of the communications that issuers and other marketers of securities might publish in an attempt to promote the sales of their securities. Accordingly, the Securities Act restricted communications during a registered offering to very limited factual matters (such as those allowed by Rule 135, tombstones ads, and identifying statements), in addition to the statutorily mandated information filed in the registration statement.

The main written selling document allowed during a registered offering was the prospectus, and it was a part of the registration statement making it subject to a high standard of joint and several liability under section 11 for misleading statements. This strict regulation on the flow of information, and the heightened liability associated with the information, was specifically designed by Congress to protect investors and combat the natural tendency of promoters to hype their securities in an effort to generate more proceeds.

The SEC has undone much of this regulatory regime with its reforms. According to the SEC, the reforms are necessary in order to keep up with modern developments in the markets, reporting standards under the Ex-

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314. About the SEC, *supra* note 295.

315. *Id.*

change Act, and technology.[316] The SEC has stressed that technological developments such as the Internet have increased both (i) the market's demand for timely information and (ii) the ability of issuers to meet that demand.[317] The reforms that were adopted are, according to the SEC, meant to meet that demand, make access to capital easier and perhaps less costly for issuers, and preserve investor protection.[318]

The SEC undertook a cost-benefit analysis of its reforms in its adopting release. There, the SEC continued to reiterate that its reforms were designed to improve the capital formation process and still preserve investor protection.[319] Still, there is scant hard evidence that investors' interests are being protected at all. Although the reforms include additional disclosure requirements for Exchange Act reports, few of the main aspects of the reforms seem targeted to the protection of investors.[320] On the contrary, most of the reforms seem designed to make it easier for issuers and other parties involved in a registered offering to sell the securities that are the subject of that offering.

However, nowhere in the adopting release is there any evidence that investors will continue to enjoy the protection against potentially misleading information that existed before the reforms were adopted. In fact, it seems intuitive that the technological advancements that the SEC claims are driving this reform effort actually make restricting communications more important than ever. Indeed, with the ability of issuers and others marketing new securities to use the Internet, the potential to disseminate false or misleading communications about upcoming securities has increased dramatically. In the face of those risks, and in the wake of many large-scale corporate scandals in the late 1990s and early part of this century, the SEC has deemed it appropriate, indeed somehow necessary, to deregulate communications pertaining to securities offerings.

This Article has described and analyzed the reforms but has gone on to also question whether the SEC has the appropriate authority to make this kind of sweeping amendment to an act of Congress. As we have seen, administrative agencies are normally tasked with the promulgation of discrete, detail-oriented regulations that fill in the gaps left by broader legislative enactments made by Congress. In addition, such agencies are not allowed to go beyond the express delegation of authority made to them by Congress. Section 28 of the Securities Act empowers the SEC to

316. Securities Act Release No. 33-8591, 70 Fed. Reg. at 44,726.

317. *See id.*

318. *See id.* at 44,725.

319. *Id.* at 44,792-95.

320. For example, the reforms include provisions that will increase the information disclosed in annual and other similar reports under the Exchange Act to include (i) investment risk factors, (ii) unresolved SEC staff comments on any issuer filings, and (iii) status as a voluntary filer. *Id.* at 44,786-88.

create any exemptions from the enforcement of the Securities Act regulations for certain people, securities, or transactions deemed to be in the public interest and consistent with investor protection. It is very possible that this congressional grant of authority is an overbroad delegation of legislative authority that does not comport with the Constitution. Even if section 28 is a legitimate delegation of power, the SEC may have overstepped its bounds by doing more than just exempting small classes of people, securities, or transactions, but instead effectively rewriting the Securities Act altogether.

Finally, the SEC may have violated its congressional mandate in section 28 by not crafting regulations that pay enough heed to the interest of the public and the protection of investors. As scholars have mentioned generally in regards to administrative agencies, it is very easy for such agencies to end up serving organized interests—the interests of those whom the agency regulates—and not the broader dispersed interests of others, like the investing public that the SEC was organized to serve.[321]

321. Stewart, *supra* note 271, at 1684-86.