A guide through the web

Knowing exactly what to do and when to issue into the US capital markets is not easy. In the following three chapters, Morrison & Foerster provide some helpful hints

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The danger of blogging

The SEC needs to be careful in its encouragement of using the internet to disseminate material information

Innovation is, by its nature, exciting. New approaches based on technological advances are often exhilarating. But when the excitement dies down, we are occasionally left with the uncomfortable suspicion that we are no better off than we were before.

Recently, SEC chairman Chris Cox surprised the public by publishing an official SEC communication in a corporate blog. In a November 2 blog posting, Cox responded to Sun Microsystems CEO Jonathan Schwartz's letter to the chairman requesting that the SEC consider blog postings as widely disseminated information satisfying a public company's Regulation FD disclosure obligations. Cox's means of communication generated more commentary than the substance of his response, and there was little discussion of the implications of using blogs for corporate communications.

The SEC adopted Regulation FD (Selective Disclosure and Insider Trading), or Reg FD, in 2000 to prevent public companies disclosing material non-public information on a selective basis to market professionals (principally research analysts) who might be able to use that information to their own advantage at the expense of the public. The regulation applies to communications on behalf of the issuer with market professionals and with security holders who might trade on the basis of the disclosed information. Reg FD requires that, whenever an issuer intentionally discloses material non-public information, it must do so through a general public disclosure. If it learns that it has made an unintentional selective disclosure, it must make public disclosure promptly. Public disclosure must be made through FD-compliant means, such as distributing a press release through a widely circulated news or wire service or holding a press conference to which the public is granted access. Most companies use pre-announced conference calls and press releases to satisfy these requirements. Although the regulation applies to selective disclosure of material non-public information, Reg FD does not define materiality, leaving it up to case law and other SEC guidance. Consistent with its policy goal of ensuring that market participants receive timely access to information, since adopting Reg FD, the SEC has adopted amendments to the Form 8-K disclosure requirements, mandating that companies disclose the occurrence of additional events by filing a current report. The SEC also has pursued several highly publicized enforcement actions for Reg FD violations.

> "Are blogs useful in conveying material information? Conversation and disclosure are, by their nature, different"

Public companies and their advisers struggle with the challenges of communicating responsibly with stockholders and other market participants in light of the dangers associated with corporate communications in a litigious environment. After Reg FD came into force, public companies revisited their corporate communications practices and many adopted Reg FD disclosure policies, training policies or other well-iterated practices relating to their communications – understanding that these communications would be carefully scrutinized.

Since Reg FD was adopted in 2000, there have been continuing advances in communications. More means of electronic communications are available, all of which allow for immediate dissemination of information. Access to the internet and internet use has grown. Companies now use their websites to provide investors with increased access to information about their governance policies, products and other developments. According to news reports, 30 Fortune 500 companies publish corporate blogs.

The SEC recognizes the value of electronic communications and has implemented a number of regulatory changes permitting broader use of electronic means of communication. For example, as part of securities offering reform, the SEC adopted the access-equals-delivery model for prospectus delivery, which presumes that investors have access to a final prospectus once it is filed. The SEC has also proposed the e-proxy rule, which would permit delivery of proxy materials by posting to a company's website and notifying stockholders that the materials are available. Chairman Cox has been championing the interactive data XBRL initiative, requiring electronic tagging of financial data in company filings to make filings easier to use, compare and analyze. All of these changes are intended to bring the securities regulatory scheme, originally conceived in the 1930s, into the internet age.

The SEC has studied Reg FD's effects on public disclosure and considered changes to increase its effectiveness. In a 2001 Reg FD study, a roundtable suggested that the SEC explore additional uses of technology that would satisfy the broad, non-exclusionary standard, including adequately noticed website postings, fully accessible webcasts and electronic email alerts. The study noted that the regulations of securities exchanges, including the NYSE and Nasdaq, should be reviewed, because they require that listed companies make disclosures through press releases.

In his response to Sun's CEO, Cox applauds the use of corporate websites as a source of information to the market and investors. However, the chairman does not take a particular point of view regarding the use of blogs. The letter expresses interest in the idea of web postings being considered widespread information. Cox notes that, among the questions the SEC would need to address is "whether there exist effective means to guarantee that a corporation uses its website in ways that assure broad non-exclusionary access" and that "the extent to which a determination that particular methods are effective in that regard depends on the particular facts". Presumably, for example, corporate websites that require users to register, obtain a password and log on would not satisfy the SEC's broad non-exclusionary access test. Cox concluded by inviting Sun's CEO to discuss the issue further with the SEC.

Using blogs as a Reg FD-compliant means of communication requires more discussion. In many respects, the nature of a blog renders it a highly questionable tool for the disclosure of material information. A blog is, in essence, an electronic forum for conveying information, exchanging ideas, posing and responding to questions, and commenting on specific topics, which might include any topic that comes into a blogger's head. Much of the discussion on the suitability of blogs as a means of satisfying Reg FD obligations has focused on whether use of this technology would constitute wide dissemination of information. It is true that companies cannot presume that their stockholders will regularly read corporate blogs. It is also true that communicating information through blogs could shift the balance and put the onus on an investor to watch for information, as opposed the company bearing an affirmative obligation to disseminate information. Some of these concerns could be alleviated by technology, for example, alerting investors once a blog posting has occurred. It is also true that some blogs might not be easy to search. That too is a problem that could be addressed by technology.

It's not that simple

These discussions are interesting, but they are not all that important for public companies. We can all agree that websites and blogs have become established and popular means of sharing information. If widespread dissemination were the only issue, we could stop there, congratulate one another for embracing technology and observe that this is what websites and blogs were intended to do – make information broadly available. But the analysis is not so simple.

Reg FD focuses on the broad disclosure of *material* information, not just any information. Reg FD did not provide guidance on which information would be considered material. In its FD release, the SEC noted that information would be material if a reasonable shareholder would find it important in making an investment decision. A number of judicial standards have developed to define information that is material. For example, the Supreme Court has held that information is material if it "would have been viewed by the reasonable investor has having significantly altered the 'total mix' of information made available". Other courts have considered the likely effect of the information disclosure on the issuer's stock price. Undoubtedly, websites and even blogs would be useful in conveying information about a company – but are they useful in conveying material information? A blog encourages conversation and dialogue, but this dialogue is usually informal. Conversation and disclosure are, by their nature, different. In a blog, a high volume of unimportant chatting might obscure important disclosures. An important piece of information could be lost in the flow of a discussion.

If information on a corporate blog is combined with submissions or commentary from stockholders or other third parties (which is the intention of blogs – providing an interactive forum), this poses additional dangers. Blogs encourage one-on-one communications. A corporate official posts information; a blogger responds or poses a question; and a corporate official responds to the blogger's posting. These one-on-one communications might be tricky to handle. At the time Reg FD was promulgated, legal advisers suggested that companies carefully script their communications and refrain from responding to impromptu questions. One objective of this guidance was to avoid miscommunication and avoid introducing variations in the information that was being communicated. These variations might be viewed as qualitatively significant or somehow altering the overall mix of available information. Blog discussions might, due to their informality, prompt company officials to extend beyond the parameters of their script in ways that could have unintended negative consequences. It also might be difficult to establish ground rules for blogs. For example, on an earnings call, a public company may choose not to take questions or may indicate that it has no comment in response to questions. It is quite easy for a company official to be lulled into responding to a blogger's question in the context of a stream-of-consciousness discussion. Individual questions from bloggers might cause a company to deviate from its intended and consistent disclosure pattern. Would it be possible to achieve consistency in blog communications? If so, once a company has established a particular pattern of response, will it be held by investors and others to that standard going forward?

"It is quite easy for a company official to be lulled into responding to a blogger's question in a stream-of-consciousness discussion"

All of this suggests that public companies and their advisers need to think carefully about the implications of blogs. In particular, it means revisiting many of the best practices for Reg FD communications and investor relations that have developed and thinking about how these might be translated to an online interactive medium. For example, will only a single company official or a handful of officials be responsible for online communications? Will investor relations and in-house legal staff review blog communications before posting? Will public companies set out policies and procedures in connection with their blogs? It also means re-evaluating some principles that have become well accepted. For example, it is widely presumed that public companies have no affirmative duty to correct incorrect information on a website or chat room and no duty to correct or verify marketplace rumours unless those rumours are attributable to the company. Will that change in the blogosphere? If a company official is engaged in a dialogue with third parties, will the company official take on an affirmative duty to correct incorrect information conveyed by the third party? If company-originated blog postings are combined with third-party postings, can the public presume the same standards of accuracy and balance apply to all of the blog communications? Similarly, public companies now include disclaimers, risk disclosures and cautionary notes regarding forward-looking information in their filings and press releases. Will these disclaimers begin appearing in blogs?

Blogs are here to stay. They will continue to address important needs. Whether blogs should serve as the exclusive or a principal means for satisfying Reg FD requirements should only be answered after questions such these are considered and answered with precision and care.

By Anna T Pinedo and James R Tanenbaum of Morrison & Foerster

When a primary is not a primary

Large volumes of Pipe securities now cannot be easily sold on

There have been highly respected opponents of the view that the earth is round. Yet it always was, and always will be, round. Similarly, most corporate finance textbooks explain that, when an issuer sells its securities to an investor, it is, and always will be, a primary sale of securities. When that investor turns around and sells those securities to another investor, these textbooks explain that is a secondary sale of securities.

Pretty straightforward? Perfectly clear? Not exactly. Physicists have told us that the earth is mostly, but not perfectly, round. And the US Securities and Exchange Commission has informed us that, in certain circumstances, secondary offerings are primary offerings. The SEC has served notice that the textbook definitions of primary and secondary offerings might not necessarily capture the substance of a particular transaction. And for this reason the SEC has stated that the traditional approach for determining when primary or secondary registration requirements should apply is in need of some basic change.

The SEC has recently taken the position that, for certain issuers, a resale registration statement might not be available in connection with the registration of securities originally sold to investors in a Pipe (Private Investment in Public Equity). Several capital-raising techniques involving some element of a private financing by an already-public company are referred to as Pipes. In a traditional Pipe, investors contract to purchase an issuer's securities in a private placement and receive restricted securities. The issuer undertakes to file with the SEC a registration statement covering the investors' resale from time to time of those restricted securities. So investors obtain reasonable certainty of prompt liquidity.

The issuer typically would use a short-form, or Form S-3, registration statement to register the resale, even if the issuer would not be eligible to use that form for its primary offerings. To be eligible to use Form S-3 on a primary basis, an issuer must have a public float of at least $75 million (held by non-affiliates) and must not have been delinquent in its SEC filings and not have defaulted in certain of its payment obligations during the preceding 12 months. Although for now the SEC's position applies only to issuers that have a public float of less than $75 million, it raises a number of questions of broader application.

Historically, an issuer did not consider the magnitude of a completed and valid private placement when assessing the availability of a resale registration statement for its Pipe investors. For issuers that are not S-3 eligible on a primary basis, the SEC has said that a resale registration statement might not be available if the issuer sold a disproportionately large (relative to the issuer's pre-transaction total shares outstanding) number of securities in a Pipe. The SEC takes the view that the purported secondary offering could in fact be a primary offering, with the selling securityholders acting as underwriters that are selling their securities on the issuer's behalf. Registration statements in these circumstances contemplate that the selling securityholders will offer their securities from time to time at prevailing market prices, or in a continuous offering. However, an issuer must be S-3 eligible on a primary basis to register a continuous offering.

The SEC has raised concerns about Pipes in the past. In the mid-1990s, the SEC focused on the private aspect of the Pipe – was there a bona fide private placement? The SEC observed that many Pipes were completed at substantial discounts to the trading price of the issuer's common stock; that many Pipe purchasers were flipping their Pipe shares; and that many closing conditions had gradually been introduced in the documentation, which threatened the validity of the private placement exemption. The SEC clarified that the only acceptable conditions to closing are conditions whose satisfaction are outside the purchaser's control. In equity line transactions structured as private placements, the SEC required that disclosure be included in the related registration statement identifying issues relating to potential violations of Section 5 (the registration requirement) of the 1933 Act in connection with the private element of these transactions.

In its recent comments, the SEC has not requested similar language for Pipe registration statements. The SEC's comments do not question the availability of the private placement exemption, nor do they raise the possibility of a burst Pipe, or Section 5 violation. But the SEC has reasoned that, due to the magnitude of the original private placement, the purported secondary offering is in fact a primary offering – without any regard to the beneficiary of the proposed resale (or sale) of securities. To conclude that the selling securityholders were underwriters, one must assume that the selling securityholders must have been acting on the issuer's behalf in connection with the resale or sale of the securities they held. This suggests that the private placement and the subsequent sale of the Pipe securities were part of a single plan of financing that should have been structured as a registered transaction. The issuer only received proceeds from the initial private placement, and the issuer will not receive any proceeds from future sales by the selling securityholders pursuant to the registration statement of their restricted securities. If the private placement and the subsequent sales by the selling securityholders were, indeed, part of a single plan of financing for the issuer's benefit, it would make sense to question whether the private placement exemption would have been available in the first place.

In 1999, during the ascendancy of convertible Pipe transactions, the SEC staff reaffirmed support for the traditional Pipe structure – a private placement followed by the filing of a registration statement for the resale of the restricted securities. During this period, the SEC staff were focused on whether the Pipe investor bore market risk in respect of the restricted securities purchased in the Pipe. In a published interpretation, the SEC noted that it would "not object if a company registers the resale of securities prior to their issuance if the company has completed a Section 4(2)-exempt sale of the securities...to the investor, and the investor is at market risk at the time of filing of the resale registration statement. The investor must be irrevocably bound to purchase a set number of securities for a set purchase price that is not based on market price, or a fluctuating ratio, either at the time of effectiveness of the resale registration statement or at any subsequent date".

> **"The SEC has informed us that, in certain circumstances, secondary offerings are primary offerings"**

Outside of the Pipe context, the SEC applied a similar analysis in its review of forward equity recapitalization transactions undertaken by many Reits (Real Estate Investment Trusts) with derivatives dealers. In these transactions, the Reit issuer sold securities to the dealer in a private placement and entered into a contemporaneous forward sale contract, which was subject to price adjustment. In those transactions, the existence of a derivatives contract that mitigated market risk was seen as vitiating the private placement exemption, rendering the dealers underwriters.

As underwriters, the dealers could not avail of a resale registration statement for the restricted securities they had purchased from the Reit issuer. Consistent with this view, in 2001, the SEC provided additional guidance on equity lines of credit, many of which were structured as initial private placements to an investor or investor group. The SEC views equity lines as indirect primary offerings because equity line investors do not bear market risk. As a result, equity line investors must be identified as underwriters (as well as identified as selling securityholders) in the related registration statements. Although the SEC has never clarified how much market risk an investor must bear for the initial offering to be deemed a valid private placement, it is clear that if a countervailing transaction mitigates market risk for the investor, one must ask whether the investor should be characterized as an underwriter and whether the transaction should be characterized as a primary offering. In their analysis of Pipe transactions completed by smaller companies, where the SEC staff concluded that the offering by the selling securityholders was a primary offering, the staff have not focused much on the presence or absence of market risk.

The SEC also has begun looking closely at the hedging activities of Pipe purchasers. Hedge funds have become active Pipe purchasers. Their trading in close proximity to Pipes caught the attention of the SEC's enforcement area. In some cases, hedge funds have traded in advance of news of a Pipe being made public or in possession of other material non-public information. Other funds have engaged in manipulative trading practices, usually short selling, in connection with Pipes. The effect of these hedging activities could be aggravated in the case of transactions involving convertible securities with a variable conversion price. Although most of the regulatory inquiries and investigations have been led by the enforcement division, these hedging transactions have raised a number of questions similar to those discussed above. Is the hedging transaction a Section 5 violation? If a Pipe purchaser hedges the risk associated with its investment, has it retained enough market risk? Has the purchaser's countervailing transaction mitigated its investment intent? In its comments on Pipe resale registration statements, the SEC has been requesting additional details regarding the activities of the Pipe purchasers in the issuer's securities. It will be interesting to see whether the SEC will make assessments regarding the presence or lack of, or the extent and sufficiency of, market risk, or whether it will limit its inquiries to the nature of the purchaser's shorting or short-covering activities.

The SEC has reiterated that properly structured Pipe transactions are not problematic. For issuers seeking guidance regarding primary offerings and secondary offerings, the SEC has pointed to 1997 interpretative guidance in which it identified various factors that should be assessed in making this determination. These include: the amount of securities involved; how long the securities have been held; whether the investors are at market risk from the time they purchase the securities; the circumstances in which the securities were acquired; the relationship between the selling securityholders and the issuer; whether the seller is in the business of underwriting securities; and whether it appears the seller is acting as a conduit for the issuer. This determination involves a case-by-case analysis of the facts and circumstances of each transaction. As a guidepost, and not a bright line test, the SEC has indicated that it will subject Pipe transactions resulting in the issuance of shares in excess of 33% of the issuer's pre-transaction total shares outstanding (held by non-affiliates) to closer scrutiny. The SEC might also subject transactions involving smaller share amounts but raising other concerns (based on the factors above) to more careful analysis. Similarly, transactions involving in excess of 33% of the issuer's pre-transaction float might not necessarily be deemed primary offerings – the decision will be based on the specific facts and circumstances, although size matters. In fact, of all of the factors that should be considered, offering size is the most significant.

"Hedge funds trading in close proximity to Pipes caught the attention of the SEC's enforcement"

That size matters so much is interesting. It harkens back to historic SEC views regarding presumptive underwriter status that had long since been repudiated. The emphasis on magnitude of an offering also runs counter to the SEC's view that an institutional investor's purchase of a large number of a registrant's securities made in the ordinary course of its business should not, on its own, result in the investor being deemed an underwriter.

The SEC staff also emphasized that they view transactions involving common stock and fixed price convertible securities as less problematic than transactions involving variable-priced securities. This is consistent with the views expressed in the late 1990s, as well as with their more recent hedging concerns. A structure involving variable-priced securities introduces the possibility of future dilution, and could invite shorting by investors in the Pipe, as well as third parties not participating in the transaction.

The SEC's views have a number of consequences. An issuer might not be able to comply with its obligations to have declared effective a resale registration statement within the required time and, as a result, might incur penalty payments in connection with any delays. Investors anticipating delays in obtaining liquidity might demand greater discounts in Pipe transactions for smaller companies. Transaction structures are likely to shift toward common stock sold at a discount, or fixed price convertible securities.

If a secondary offering (offering by selling securityholders) is recharacterized by the SEC as a primary offering, the selling securityholders will be deemed underwriters. Investors will have to be identified as underwriters (perhaps in addition to being identified as selling securityholders, as with equity lines) and will have the associated liability. The imperative to have an entity or series of entities responsible for the registrant's disclosure in a registration statement covering the resale (or sale) of a substantial number of the registrant's securities might actually be driving the SEC's analysis. Will this prompt better or more meaningful disclosure by issuers? The SEC has suggested that registration statements after Pipe transactions should include more details regarding payments made to financial intermediaries and the selling securityholders, details about any relationships among the selling securityholders and the registrant, and details regarding the securities issued or issuable, as well as the issuer's capitalization. Will these additional items, which one would think would otherwise already have been included by registrants attuned to the need for fulsome disclosure, change the overall mix of information available about a registrant? Are investors in transactions going to undertake additional diligence, or will transactions get restructured to obviate the issue? With its recent comments, the SEC has created a good deal of uncertainty and left many unanswered questions about its direction on primary and secondary offerings. Was it worth it for some incremental disclosure?

In the next year, we do not expect to learn much more about the shape of the earth. But we do expect to learn a lot more about how primary and secondary public offerings of securities will be executed in the US. The SEC has suggested that, as a means of easing these new burdens, it might consider other measures designed to improve the efficiency of the capital-raising process. The SEC has suggested that these could include lowering the thresholds for S-3 eligibility on a primary basis, as well as revising the criteria for use of Rule 415 for primary offerings. These would be welcome changes, but they would not clear up any of the confusion raised by recent analysis of primary and secondary offerings. In any case, this SEC initiative will have a profound impact on the ways in which US public companies raise capital.

By Anna T Pinedo and James R Tanenbaum of Morrison & Foerster

The art of dribbling

Research issues for banks organising equity distribution programmes

Dribbling – the very word has negative connotations. We tend to think of a bad shower in a bad hotel. Yet, in at least one context, dribbling is viewed as a good thing. Equity distribution programmes, often called dribble-out programmes, have become a popular way for issuers to sell small amounts of their equity at various intervals during the life of a programme. Some issuers think of an equity distribution programme as the equity equivalent of a medium-term note programme.

Equity distribution programmes provide a means to issue and sell securities from time to time using a shelf registration statement to, or through, a broker-dealer. The broker-dealer acts either on a principal or agency basis to effect at-the-market offerings of the issuer's securities. An issuer eligible to use a registration statement on Form S-3 on a primary basis may register its securities for sale in at-the-market offerings. Before securities offering reforms, in such a sale an issuer was limited to registering securities not exceeding 10% of its aggregate market value. An issuer may choose to allocate a portion of an unallocated universal or so-called kitchen sink shelf registration statement to at-the-market offerings, or use a shelf registration statement established for this purpose. The registration statement's plan of distribution must describe the general terms of the at-the-market offerings to be conducted and identify the participating broker-dealers.

Before carrying out an equity distribution programme, the investment bank and its counsel will conduct diligence regarding the issuer and its business. The bank and the issuer will enter into a distribution agreement establishing the term of the programme and setting out the terms and conditions on which they will conduct the offerings. A standard distribution agreement generally provides both for principal and for agency transactions. The agreement contains representations, warranties and covenants from the issuer and requires the issuer to deliver legal opinions (including a 10b-5 negative assurance from issuer's counsel) and comfort letters at the outset. The distribution agreement provides for the issuer's representations and warranties to be refreshed at each issuance, and for periodic updates to the issuer's deliveries to the bank. The distribution agreement also contains standard market-out termination provisions.

Whether acting as principal or agent, the investment bank will sell the issuer's securities through market-makers or electronic trading systems at prices related to the volume-weighted average price for the securities. These transactions generally will not involve special selling efforts (such as a road show) and will not involve a large amount of the issuer's securities relative to the issuer's public float or daily trading volume. The commission or spread the issuer pays to the bank is consistent with that payable to a dealer executing trades rather than the spread that would be payable to a broker-dealer acting as an underwriter in connection with a distribution. The investment bank's execution of at-the-market offerings under these programmes more closely resembles ordinary dealer activity than participation as an underwriter in a securities distribution.

"The investment bank acting as distribution agent will have to be attentive to restricted lists, research coverage and conflicts"

Central to the success of an equity distribution programme is the capability of the investment bank acting as distribution agent. That bank will have to be attentive to restricted lists, research coverage and conflicts. Most investment banks maintain grey or watch lists, and black or restricted lists, which identify securities that might be the subject of investment banking or other corporate finance activity by the institution. The grey list identifies securities that the banking department is active in. Putting a security on the grey list allows the compliance department to monitor the firm's trading, as well as publication of research, or commencement of research coverage, relating to the issuer. Usually, the grey list's content is known only to the compliance and legal groups and is not broadly disseminated. A black or restricted list is broadly distributed within the firm and identifies all those stocks in which trading by the firm as principal and by employees is prohibited or restricted while the security remains on the list.

In connection with the investment bank's participation in equity distribution programmes, the bank should consider whether, once it has entered into a distribution agreement with an issuer, that issuer's securities should be placed on either the grey or black list for the programme term. We suggest that the bank consider placing the issuer's securities on the firm's grey list so the compliance and legal departments can monitor the firm's activities related to that issuer. These departments could then monitor whether the bank may undertake other engagements on the issuer's behalf; whether an engagement might pose a business conflict; whether the bank may begin research coverage, change its research recommendations, or release a new research report; whether the bank has appropriate trading wall procedures in place; and whether the bank can undertake proprietary trading activity in the security.

The investment bank could include the issuer on the firm's black list but, given the long-term nature of an equity distribution programme and the limited nature of the bank's execution activities regarding a programme, this could be limiting and suggestive of more active banking involvement by the bank.

An investment bank serving as a distribution agent in an equity distribution programme also needs to consider how to address research coverage. A bank might participate in a programme for an issuer for

"Given the continuous nature of a programme, the timing of research coverage is complex"

which it does not provide research coverage. Of course, the bank also might already provide research coverage for the issuer. In either case, questions arise concerning the bank's research activities in light of the services that it provides for the issuer in its distribution agent role. If the bank does not provide research coverage for an issuer for whom it acts as a distribution agent, when may it begin research coverage? If the bank already provides research coverage for the issuer, does it need to monitor timing of new research reports, the recommendations they include, and whether they are published with reasonable regularity?

All of these questions assume that the investment bank's participation as a distribution agent would constitute acting as a distribution participant in connection with the issuance of securities. The SEC has said that having a shelf registration statement in place does not, alone, constitute a distribution but that individual takedowns from the shelf registration statement would constitute distributions. It is not clear whether an issuer with an equity distribution programme would be presumed to be "in distribution" during the term of the programme. This seems unlikely, given that an issuer might have a programme in place for several months and not access it during that time. Without conceding any conclusion on this issue, we have assumed that the bank would choose to conduct its research activities as if it were a distribution participant in respect of equity distribution programmes.

Some questions can be answered by analogy relying on the safe harbour provided by Rule 139 under the Securities Act. Rule 139 permits a broker-dealer participating in a distribution of securities offered by an S-3 eligible issuer to publish research about any issuer or class of securities without the report being considered an offer or a non-conforming prospectus, provided that the research appears in a publication distributed with reasonable regularity in the normal course of the broker-dealer's business. All of the issuers that participate in equity distribution programmes must be eligible to use a registration statement on Form S-3 on a primary basis, so these issuers will meet the conditions set out in Rule 139(a).

If the investment bank already provides research coverage to an issuer for whom it acts as a distribution participant under an equity distribution programme, the bank should monitor its research activities, but rely on the Rule 139 safe harbour. To comply with the safe harbour, the bank will have to monitor that, during the term of the programme: (1) the information, opinion or recommendation is contained in a publication that (a) is distributed with reasonable regularity in the normal course of business and (b) includes similar information with respect to a large number of companies in the issuer's industry or sub-industry or contains a comprehensive list of securities recommended by the broker or dealer; (2) the information, opinion or recommendation is given no greater space or prominence in the publication than that given to other securities or registrants; and (3) an opinion or recommendation as favourable regarding the issuer or any class of its securities was published by the broker or dealer in its last publication addressing the registrant or its securities before participation in the distribution.

If the investment bank is a distribution agent for an issuer's equity distribution programme but does not provide research coverage, a question might arise if the bank chooses to begin research coverage during the term of the programme. Given the continuous nature of a programme, the timing of research coverage is complex. Here less guidance is available but, again, it might be useful to analogize and rely on the regulatory guidance regarding research coverage after a follow-on public offering. An NASD member cannot publish a research report on an issuer for which the issuer acted as a manager or co-manager of a secondary (follow-on) offering for 10 calendar days after the offering date. In this case, the investment bank could institute a policy that it will not begin research coverage or provide a research report for at least 10 calendar days after an equity distribution programme is set up.

The investment bank will probably want to consider guidelines regarding the review process undertaken regarding research on the securities of issuers for which the bank acts as a distribution agent. These should include procedures for handling research reports that include a change in rating, that include projections, and that are issued outside of the regular course of business.

An investment bank should also consider potential conflicts of interest in connection with its role as distribution agent. For example, if the bank were being considered as a financial adviser to render a fairness opinion regarding a transaction involving an issuer for which it acts as a distribution agent, would its activities raise concerns regarding independence? Generally, it is unlikely that the investment bank's activities as a distribution agent would raise any issues regarding its independence in this context. The SEC and court cases considering the independence of financial advisers have focused on the questions raised by payments of success fees in connection with a transaction. A conflict might arise if the bank were being considered as a financial adviser in connection with an issuer's financial restructuring. Here, acting the issuer's distribution agent could raise concerns regarding independence. Other conflict questions might arise during the bank's involvement as a distribution participant in connection with an equity distribution programme. These conflict issues are difficult to anticipate and not amenable to any generalized policy.

For an issuer that seeks the flexibility to control the timing and size of its stock sales, the ability to match its capital raising closely to its capital needs, and the opportunity to sell securities into the regular market flow, whether or not the underwritten public offering window is open, an equity distribution programme, or dribble out, has become an attractive option. Reits, utilities, energy companies and other companies that have continuous financing needs and the desire to engage in balance-sheet management are good candidates for equity distribution programmes. That these programmes have minimal impact on the price of their stocks is particularly important to these companies. For an investment bank that is inclined to act as a distribution agent, it is critical to consider the relevant compliance, regulatory and conflict issues at the outset. Once considered, these issues will rarely prevent participation in a successful programme. So, to an increasing extent, dribbling is proving to be a good thing.

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