SAFE HARBORS ONLINE PROGRAM

TUESDAY, MARCH 30, 2004

RICHARD ROWE: Good afternoon. I am Richard Rowe, a trustee of the Securities and Exchange Commission Historical Society. I welcome you to this online program on SEC Safe Harbor Rules. The Securities and Exchange Commission Historical Society is a non-profit organization, separate and independent of the SEC. The Society preserves and shares the history and historic records of the SEC and the securities industry through its virtual museum at www.sechistorical.org. Today's program will be preserved in the museum so you listen to the discussion or read the transcript later.

This online program on Safe Harbor Rules has been coordinated by the Society's Corporation Finance Committee and is being offered today in tribute to Alan Levenson and Linda Quinn, two former directors of the Division of Corporation Finance who passed away in 2003. I am a former director of the Division of Corporation Finance and now I'm practicing law in Washington, DC. I will be the host and moderator of this program. I am joined by Edward H. Fleischman, a former SEC Commissioner who served from 1986 to 1992, and who is now practicing law in New York City, and by Peter J. Romeo, a SEC Division of Corporate Finance staff member from 1969 to 1984, who is now practicing law in Washington, DC. Our remarks today are made solely on our own and are not representative of the Society. We cannot give investment or legal advice.

Our topic is SEC Safe Harbor Rules. There are at least two different types of Safe Harbor Rules; those that which are generally interpretive that if followed, although not exclusive, will not result in a violation of the specific provisions of the Federal Securities Laws, generally the Securities Act of 1933. There are others that are generally provided by rule that under the SEC's exemptive authority that provide that a certain disclosure would not be subject to various provisions of the securities laws, in some cases the anti-fraud provisions. The theory in the latter type rule is it will encourage certain disclosures that might otherwise be provided. We will take SEC Rule 144 as our first example of the type of Safe Harbor that is interpretive in nature.

Ed, what were some of the problems that you saw back in the time you were a practitioner in the late ’60s and early ‘70s that gave impetus to the need for such a rule?

EDWARD FLEISCHMAN: It comes down, Dick, to uncertainty. The problems that we all faced, whether we were lawyers or principals in the matter, of not having confidence in our ability except in the very, very middle of the highway to be able to give advice as to the legal consequences of resales, particularly of privately placed securities, but as well of securities that were held by controlling persons. And if I may take advantage of your question, I think that my reference to securities held by controlling persons is deliberate, because the Rule 154 literature, which now dates just about a decade before 144 and perhaps not quite that much, actually a decade and a half, the 154 literature has got two phrases that seem to me to get us to what Safe Harbor Rules are about.

One is "satisfactory objective circumstances," and I like the adjective particularly "satisfactory" because that will take us into the so-called shoals in Safe Harbors. And the other phrase is "a ready guide for routine cases." That actually is a phrase out of one of the SEC's 154 releases. But it seemed to me in thinking about this program with you and Peter that those two put them together, put together the essence of Safe Harbor Rules. They are, I think, from the Commission's perspective, ready-guides for routine cases, whereas from what was then and is again my perspective of the private practicing bar, one tends to think of guides for not only the routine, but pretty much all but the exceptional cases. And one tends to think of objective circumstances without the satisfactory, the satisfactory importing a lot of history and lore and statutory interpretation that goes back, at least to my understanding, at least as far as Allen Throop and Mr. Lane's article on exemptions back in 1937.

RICHARD ROWE: But Peter, wasn't the staff at this time, weren't they issuing interpretive and No Action letters on the resale of securities?

PETER ROMEO: We were, Dick, and it was a very unsatisfactory process. We would get five to six-thousand letters a year and the staff had this principle called the unforeseen circumstances approach where if you hadn't held your securities for a relatively long period of time, proving that you were not in underwriting, you had not bought and reviewed the distribution, that the only way you could sell in advance of this lengthy period, three years or whatever, was to demonstrate you had unforeseen circumstances that happened to you. And I could tell you right now that never in my life did I understand that cancer was such a dominant factor in the healthcare system because half the letters were "I got cancer," "my wife got cancer," "we have to sell," "we couldn't have predicted this," and it was a tale of woe that no one cared to see. And the worst part was the staff was required in essence to perform a god-like function. You know, this one is okay, that one's not okay, where do you split the hairs. It was very difficult and of course there were timing constraints. People had to wait for a staff letter. So there were a lot of reasons why it wasn't a good situation.

EDWARD FLEISCHMAN: But in the perspective of the private bar at the time, it was not the unforeseen which would have given Peter and colleagues trouble enough, it was the staff's insistence that it be unforeseeable, and the questions that arose as to whether, you know, I'm making one up, but whether the genealogy of the family was such that they should have predicted that somebody was going to get cancer. [Laughs.]

PETER ROMEO: Well, I think that the staff took a rather strict position, and the other problem was that no one knew exactly what the standards were because nothing was published on this. You wrote in and got your own letter, but no one else really knew about it. Now, New York firms sort of passed these letters around and they were kind of in the know, but if you were outside of the big New York firms, you didn't know what the standards were. You were kind of guessing, so there was a need for some guidance out there, whether a Safe Harbor or some sort of interpretive release or whatever, but something was badly needed, and 144 of course often proved to be a tremendously good solution to the problem.

EDWARD FLEISCHMAN: What Peter says is very important, except for the occasional footnote as in the Silver Anniversary editions, one really didn't know what the No Action letters were. The memoranda in our files that are footnoted in the 1959 periodicals were the first notions that many of us had of the process.

RICHARD ROWE: What periodical are you referring to, Ed?

EDWARD FLEISCHMAN: There were two Silver Anniversaries. The one I have with me is Virginia, the other is George Washington University Law Review, but they were seminars in securities law, both of them. They, Peter also leads one to the problem that is cited as well in the Wheat Report, that the notion that since all of these things were interpretations of intention, with the intention to distribute, the idea got currency that one had to have some kind of indefinite intention to hold the securities being purchased in many of these private transactions, so that the very inquiry "when may I sell" was famous for the answer "now that you've asked that question, you clearly have an intent to distribute." I think that was, that was memorialized in an article by, oh, I can't think, it was a very well-known Chicago lawyer but not Ray Garrett, and in a poem that I think is quoted in the Wheat Report.

RICHARD ROWE: The Commission in those days did not have exemptive authority, so they couldn't just propose an exemptive rule and that would be the end of it.

EDWARD FLEISCHMAN: No, but they had, as they still do, the authority Peter used very effectively and imaginatively to define technical trade and accounting terms. And one of the Wheat Report comments has to do with the Commission's authority to adopt this kind of rule which from today's perspective is kind of a strange question. But in 1969 it wasn't strange at all.

PETER ROMEO: Well, I think it's rather difficult in today's light to look back 35 years to 1969 and understand what the landscape was back then. There was no precedent for this sort of thing. This was truly a revolutionary type of approach and when --

EDWARD FLEISCHMAN: Well, only, only if you think of it as exemptive. In '59, the notion of taking the same term "underwriter," the same fundamental term and defining it through a rule, the old Rule 155 expansively to catch more people was taken without any question. It was just the notion of using it to restrict the number of persons who would be subject to the statute that might have been new.

RICHARD ROWE: But hasn't that always been a tension between opening up, permitting capital to be raised or securities to be resold and the concerns that you're going to have abuses, people are going to take advantage of these rules. And the whole concept of filing a form is in part based on we need some handle on what's going on, otherwise we'd never know what's going on. Now, whether the Commission has used that form for those purposes or not is another question.

PETER ROMEO: Well, you raise a point though that has kind of surprised me over the years, how far the Commission has gone down the Safe Harbor road. We started out with Rule 144 that set very objective standards for resales under the '33 Act. And I can remember Stanley Sporkin often saying, when the question would come up, "Well, let's define the term inside information or insider trading," or whatever and Stanley would say, "No, we're not going to do that because then we'll give people a road map to fraud because they'll know, you know, all I've got to do is go beyond that, you know, stay within the confines of that definition I'm fine." And I've seen the Commission, as we all know, now adopt Rule 10b5(1), which of course is a Safe Harbor from any fraud liability. Now we have a more recent addition, Rule 13a11, another Safe Harbor from any fraud liability for non-filings on AK of certain information that will become effective in August. So there has been quite a transformation and a movement forward of this whole process.

RICHARD ROWE: But occasionally there is a need to move backwards. I recall that when Regulation S, which is an interpretive rule actually, was first adopted and there was no provision in the rule that dealt with the flow-back of securities offered overseas back into the United States, so that lawyers were put to using the old lore to determine when that could happen. And it turned out that, at least in the eyes of the SEC, and probably they were right in this case, there were a lot of abuses by U.S. companies selling securities abroad or ostensibly selling securities abroad and then redistributing them immediately or shortly thereafter in the United States, and Reg S was amended to put a stop to that or at least to put limits on it.

EDWARD FLEISCHMAN: It was amended. [Laughter.] The whip was cracked, and practitioners and their clients were warned that these practices would be interpreted in a different way. [Laughter.] Abusive, do you remember the abusive practices for these?

RICHARD ROWE: Yes.

EDWARD FLEISCHMAN: It wasn't, happily it wasn't necessary with 154 or 144. There was some little bit event around Reg D, but not to the extent that crept up in Reg S. And with an acknowledgement that I was a Commissioner at the time that Reg S was adopted, I think the failure is on the part of the draftsman analogizing to our practice and to the way courts look at a document. It is read against the draftsman. If the Commission, including me and the staff at the time, did such a poor job on Reg S as to allow that much of a gaping hole, then it seems to me the Commission shouldn't have been surprised, the staff shouldn't have been surprised with what happened. But that's the other side of a coin that private practitioners have been talking about for at least forty years. Let me read you a quote from one of those 1959 Silver Anniversary articles.

"We suggest that the blunderbuss approach, that is to cover everything lest a single crook or one unscrupulous lawyer get away with something, has proved unnecessarily costly."

That has been, from the private bar's point of view, a problem with the drafting of many of the Safe Harbor and exemptive rules. Reg S is the opposite exception and the only thing to say is that we were all a bit asleep at the switch.

PETER ROMEO: Well, the Commission I think has demonstrated great flexibility with the Safe Harbors. 144 is clearly the prime example because you started out with a rule that was rather stringent at the beginning in terms of holding period requirements and buying limitations and how much you could sell and so forth, and as time went by, those major requirements were relaxed somewhat, because experience had demonstrated the market could allow for more to be sold at shorter intervals and so forth. And the Commission, to its credit, showed that it was willing to re-look at these rules and not allow them just to be static and not be that useful after a time.

RICHARD ROWE: But there are suggestions that they are going to go back and re-look at some of those relaxations because of the dynamics in the marketplace where you can use derivatives and other devices to achieve the economies of a sale without actually selling the rights to the securities.

EDWARD FLEISCHMAN: Well, that has been one particular piece of that rule that has given the Commission problems perhaps from the very beginning. The notion that one had to have paid for the securities, if you remember, and then that the clock would not tick if any of the -- not only if any of the securities hadn't been paid for in full, but if there were any offsetting, what you might call now hedge or what were then called short positions, that were then reconsidered in what mattered, as Peter suggests, and that was deliberately stricken in order to purge the rule of any vestiges of fungability, as I remember. But deliberately and then within just a few years the consequences of that action, aggravated perhaps by the developments in the marketplace, vis-à-vis derivatives, have turned it back round on people, as you say, are concerned. There's this matter in the newspapers of the Enforcement Division wanting to take kind of a street-wide look at how insiders have used derivatives to avoid the strictures and the reporting requirements that go with, not only with Rule 144 but are included in 144.

PETER ROMEO: Well, I questioned whether -- I saw that article. In fact, I was called to comment on it, and I’m quoted in it in a very small way. But I question, at least in my own experience, whether indeed they are being used to evade reporting requirements. It may well be true, but I haven't seen that in my own experience, and I question whoever it was that was quoted in that article who said that some people give advice; you don't have to report those. That's not correct, I don't believe.

RICHARD ROWE: Well, I'm not sure whether Ed was talking about filing a form that says I'm selling the securities or filing a Form 4 report under the ‘34 Act. If you're an insider you have to report that the acquisition or disposition of a derivative security. I agree with Peter on that one, [chuckles] but they're not getting the Rule, or Form 144 is in many of these transactions, but I question whether there is harm there as Peter does.

Another aspect of many of these rules, and Ed touched on this, maybe you two can comment on it, but many of them have introductory notes which are sort of a road map to the rule itself. And those introductory notes and many of the rules, 144 is a perfect example, I'd say this rule is not available for any scheme to evade the registration provisions of the act and also it's not an exemption from the anti-fraud provision obviously. That's an interesting provision, and I think it goes to what Ed was saying. The routine transactions are covered by this rule, but if you're in a non-routine transaction, tread carefully.

EDWARD FLEISCHMAN: Well, the notion of the preliminary notes themselves has always fascinated me. I had, and in a conversation with you as I remember, I attributed that to Alan Levenson, to whom in part this particular program is dedicated. I find, and it may not detract from Alan, but I find that the Wheat Report itself, that is to say three and four years before Rule 144 was proposed, suggested the use of preliminary notes in the 160 Series, as it was then to be called. It has always seemed to me, without understanding what either Frank Wheat or Alan had in mind, that a consequence is that these notes become part of the Code of Federal Regulation. And to the extent that they are out there not only as guidelines for practitioners, but to the extent that they represent the possibility that matters under these rules, may come into dispute. A judge who picks up the CFR will find those notes and they go well beyond the words of the rules that follow, particularly in 144. The notion of what underlayed the determination of how, the determination that someone was not to be considered an underwriter; the need, for example, to preserve the essence of the '33 Act in the information disclosure requirements. I mean, what was Paragraph C actually doing in that rule, is explained in the notes and wouldn't otherwise have been explained.

I do agree with you that the scheme to evade language is difficult to conjure with as a practitioner. I put it in that category of satisfactory objective conditions, '[laughter] satisfactory to the Commission on an after-the-fact look. But the Commission had, in the '50s, lived through an era of persons seeking to take advantage of the exemptive process or seeking to hide behind the exemptive process. Cases like the Ira Haupt case and, what was the name of the fellow, Louie Wilson. So the scheme to evade language, it seems to me, is not strange in the immediate context, and as I say, a lot of these ideas go all the way back to Throop and Lane in the very first years reflected in the 1937 article.

PETER ROMEO: You know, you raise an interesting point though about that it can't be a scheme to evade. As we all know, having gone through the rule-making process, all the divisions have input into what's being proposed, and in some cases, a division or an office can be kind of a stopper in the process, like the Division of Enforcement, unless certain things are included in a rule. And I know for a fact on Rule 144 that there are provisions in there that were demanded by the Division of Enforcement. 144k, which requires this three-month waiting period after you cease to be an insider before you can take advantage of 144k, I guarantee you that was straight out of Stanley Sporkin. [Laughs.] I'm not saying it wasn't a good idea -- I think it probably was -- but it also brings up another point about Safe Harbor provisions, which is that the Commission did not track the exact requirements of the particular exemption that they're providing Safe Harbor for. They can insert their own conditions in there saying, "This is the price you pay for going down this road. If you want to get absolute Safe Harbor protection, you've got to do everything in here including some things that we think are essential, but may not have been thought of by the drafters of the particular statutory provision."

EDWARD FLEISCHMAN: Peter used the word "absolute" Safe Harbor for protection. I think we would agree that there is no "absolute" in any of the Safe Harbors. You started I think, well, perhaps your very first question to me had to do with the No Action process, and to Peter, how often did he have to address the change of circumstances type of argument in the pre-144 days? Remember, however, that once 144 got out there, a five-foot shelf of books of No Action responses built very quickly. That has to be, in retrospect, an evidence of the fact that there were soft places in the rules that once applied, perhaps in non-routine transactions once sought to be applied, had to be interpreted for inclusion or exclusion, for meeting the requirements or failing to meet the requirements. And the notions of shoals in the Safe Harbor, though not necessarily vis-à-vis 144, to my recollection, but certainly in the very first of the private placement rules which wasn't 240, it was 146, wasn't it?

RICHARD ROWE: 146.

EDWARD FLEISCHMAN: Yeah, the bar was, at the time, very, very articulate, as I remember, about the difficulties and uncertainties that the rule-making brought with it replacing the difficulties and uncertainties that had preceded the rule. [Laughter.]

RICHARD ROWE: Well, it's interesting that the regulate -- maybe we move onto Regulation D as another example of a Safe Harbor, but there you have the example of the form that the rule requires that you file, because I remember, as Peter remembers, the Division of Enforcement at one time when the Commission was prepared to do away with the filing of the form. At one time the Division of Enforcement insisted, "No, you can't do away with the form." Well, it's a little bit like when the Japanese under Douglas MacArthur in 1945 or 1946 adopted securities laws. They adopted Section 16b of the ‘34 Act, which is a profit recapture provision, but the Japanese, wily as they are, didn't adopt Section 16a, which is the reporting provision, [laughter] so maybe Enforcement had something up their sleeve. But it's interesting the way the Commission dealt with that, because while it's a requirement, it is not a condition to the exemption under the rule.

EDWARD FLEISCHMAN: Ah, but it was.

RICHARD ROWE: It was, but when they couldn't do away with the form, they said, "Okay, we won't."

EDWARD FLEISCHMAN: Those were two separate actions.

RICHARD ROWE: All right.

EDWARD FLEISCHMAN: The failure to do away with the form was at one time period, and the removal of the filing of the form as a condition came from a different initiative at a different time.

RICHARD ROWE: And again, if the Commission were to bring an action against somebody for failure to file the form, that could preclude them going forward from using the exemption. To my knowledge they've never done that.

EDWARD FLEISCHMAN: No.

PETER ROMEO: Let's talk for a moment, if it's all right with you two, about the form requirement of a 144. You know, that's again, a requirement that you must satisfy if you passed a threshold from the amount you're selling in order to be able to rely on the rule. And I think we've all experienced situations where the form was not filed when the order was given as the rule says it must be, and yet there seems to be nobody who really checks on this down at the Commission or seems to care much, to be perfectly honest. But what do you do when somebody comes to you a week or so after a trade and says, "I forgot to file that form. What should I do?" [Laughs.] I have an answer but I'm curious to hear what your answer is. [Laughter.]

EDWARD FLEISCHMAN: I don't know that I'm going to go near that one. [Laughter.]

RICHARD ROWE: Well, that brings up an interesting point. These are Safe Harbors except for one provision of Rule 144, which was for awhile exclusive and no longer is. They're not exclusive means for compliance, and one answer you could give in a situation that's appropriate, routine and small enough so that nobody is going to be hurt too badly, to just say, "All right, rely on another statute." The statute provides that you can --

EDWARD FLEISCHMAN: It’s all one section?

PETER ROMEO: Right.

RICHARD ROWE: -- you can sell securities if you're not an underwriter unless you are a dealer.

EDWARD FLEISCHMAN: But it's a funny provision that Peter asks about though, because that, as I understand it, that particular form has taken on an economic function over the years. Almost immediately it was talked about as a shadow that should be followed by the analyst community and by quant analysts particularly. But it has taken on a function, and I don't mean by combination with the Section 16 report that often follows, but just as an indication supposedly contemporaneous or in advance of sell-side sentiment by insiders, whether they be inside officers or whether they simply be insiders in the sense of holding restricted securities. And the markets have made something more important of that, I think, than it was originally anticipated to be, and therefore, I have a little bit more difficulty saying to a client, "Well, forget it." [Laughter.]

RICHARD ROWE: Well, depending upon the situation, the Form 144 is transmitted to the Commission when you place the order. That means transmitted by the United States Mail as an appropriate way to do that. Nowadays, the insider at least is filing an electronic report of sales within two business days, so the electronic report may get there well before the other report, and it's much more accessible. God knows where the 144 forms go.

PETER ROMEO: Well, the time may be coming where they make that an electronic filing obligation as well.

RICHARD ROWE: I would assume so. If they keep it I would assume so.

EDWARD FLEISCHMAN: They’ll keep it.

RICHARD ROWE: Maybe we could deal with some of the other types of Safe Harbor Rules that actually protect against liability or remove liability, and one comes immediately to mind is that, and this again comes out of the Wheat Report, that the financial part of the quarterly report that we all know as 110q is not a filed document for purposes of liability provisions of the ‘34 Act. The thought behind that, I think, was we'll encourage people to, you know, this is something they've never done before; we'll give them a little bit of slack in doing it. And the Commission has never really focused on that.

EDWARD FLEISCHMAN: Because 10b5 and that oak tree has so replaced Section 18 of the ‘34 Act. Section 18 is a mighty small faggot on that very large fire.

RICHARD ROWE: Well, but the Commission quite frequently says, "Look what we're giving you. We're exempting you from Section 18." There's actually a District Court case in the District of Columbia where the District Court misread the rules and said that was an exemption from 10b5. [Laughter.]

EDWARD FLEISCHMAN: Now if there had been a preliminary note, they would have understood.

PETER ROMEO: Well, since we're talking about 10b5, I'd like to talk about one aspect of 10b5(1), which is the Safe Harbor for Trading Plans and the like. I was rather surprised to be honest, and continue to be surprised that the Commission said in interpretation that it's perfectly okay to have a trading plan and decide, once you get some inside information, to revoke that trading plan on the basis of that inside information. And it strikes me that that is something that allows an insider to do whereas he couldn't do it otherwise through a trade. And why should you allow him to do that under a Safe Harbor provision? In effect, he's avoiding a loss.

EDWARD FLEISCHMAN: He's avoiding a loss.

PETER ROMEO: Yeah, he's avoiding a loss. And that's sort of verboten in terms of doing a purchase or sale and, of course, the theory here is there is no actual purchase or sale by just deciding not to trade. But you're still taking advantage of inside information in the trading arena, and I find that to be really difficult to understand why the Commission would allow that. Why couldn't they just make that a condition for the Safe Harbor? You cannot use insider trading.

RICHARD ROWE: I could take the other side. First of all, the Supreme Court of the United States has said there has to be a purchase or sale. The Supreme Court of California has said otherwise, because every day the insider with the information is, in a sense, taking advantage of it, if it's because they're deciding not to sell or arguably they are deciding not to sell. And to me it's not to much of a stretch to go to the Safe Harbor Rule and say, well, we may not like it but --

EDWARD FLEISCHMAN: But you are in the Safe Harbor context, as Peter is I think raising the question, shouldn't this be one of those instances in which the Commission says, “If you want the advantage of this Safe Harbor, you can't back away from it in order to avoid a loss that you know you would otherwise have, or avoid a missed profit.” But it's always on that side, isn't it?

RICHARD ROWE: Yes, but what does the Commission charge this person with? Other than the loss of the Safe Harbor, what is this person going to be charged with? There was no purchase or sale. The Supreme Court says you can't do anything to them.

PETER ROMEO: Well, you lose the benefit of the rule for the purchases or sales that you did make. In other words, you didn't have the Safe Harbor if you do that. You lose it.

RICHARD ROWE: Retroactively?

EDWARD FLEISCHMAN: No. At least prospectively, I don't think you could do it retroactively.

PETER ROMEO: Well, I think you're probably right about that.

RICHARD ROWE: Well, it it's prospective, yes, I can understand. Even say, if you do this assuming --

PETER ROMEO: But then you'd better do what the rule says they can do, revoke it. [Laughter.]

RICHARD ROWE: That'd be a losing --

PETER ROMEO: I don't know, I just have a problem. I don't mean to dwell on this unnecessarily but --

RICHARD ROWE: No, it's an interesting aspect of it because while I happen to think that's what the rule provides, I am as surprised as you are that the Commission would admit that, but that's a different issue.

PETER ROMEO: Yeah.

RICHARD ROWE: Other types of Safe Harbor. Let's move from the ‘33 Act the anti-fraud provisions to --

PETER ROMEO: Well, before we leave the ‘33 Act, I want to talk about a pet peeve of mine.

RICHARD ROWE: Okay.

PETER ROMEO: And that is the Integration Safe Harbors which are scattered throughout the various rules under the ‘33 Act. And I don't have a problem with the Safe Harbor, you know, the five factor test and so forth itself, but I have found recently in the last year or so that those Safe Harbors -- the Integration Safe Harbor -- is being interpreted much more narrowly and strictly by the staff than I had been led to believe was the general approach of the staff to that area. In many ways the staff seems to me to be applying the Integration Safe Harbor in a rather wooden fashion and not looking, in all cases, at the surrounding circumstances and who really needs protection here. I've seen the staff apply it in a circumstance where the person that needed protection, quote, "needed protection," was a person who clearly knew everything that was going on with the company. In one case it was a former founder, was a founder who was no longer associated with the company, and it just, I guess it's an aspect of all the Safe Harbor Rules that has to be taken into account, and that is that the staff can interpret them narrowly or broadly, depending on how they choose to apply them. So I guess that's one cautionary note to take into account with respect to any Safe Harbor but particularly so with respect to integration these days, I think.

RICHARD ROWE: I've had similar experiences but I can understand, although maybe they're wrong, they probably are, I can understand why the staff is doing this because techniques for distributing securities are changing so rapidly and new techniques are being developed and there are some abuses going on.

And historically the staff -- and this is not in the context of interpretation of when somebody asks for a letter -- but this is the process, I assume, of reviewing a registration statement, where you don't have very much way to appeal that. I mean, you are sort of stuck with it. Either you persuade them that they're wrong or persuade them that at least let us go forward even if you won't agree with us. You don't have much choice.

EDWARD FLEISCHMAN: But let me be lawyery here. We're not talking about Safe Harbor Rules anymore. The only rule that I remember is actually the six-month period that's in 502 of Reg D. But what Peter is really talking about is the set of interpretations that goes back to Release 4552. Is that the right number?

PETER ROMEO: Yes, that's right.

EDWARD FLEISCHMAN: And that are repeated in Notes to Rules, but not in the rules themselves. They are only interpretations, only interpretations. They are interpretations. They are as flexible as interpretations. They are rubbery. The five individual pieces are rubbery, and when put together, aside from the six months, they give you very little by way of Safe Harbor.

PETER ROMEO: And you're absolutely right about that, Ed. Yeah, I agree with that.

EDWARD FLEISCHMAN: The six months on the other hand, is six months. And the 30 days that is used in one context in the Hedge Fund Report just several months ago, is 30 days. I mean, that's an objective circumstance. Maybe not satisfactory for all purposes but. [Laughs.]

RICHARD ROWE: There's a similar rule for abandoned offerings.

EDWARD FLEISCHMAN: Yes, in 155.

PETER ROMEO: Right. That's correct.

RICHARD ROWE: Which is kind of a 30-day, actually you can shorten the 30 days under certain circumstances if you go through certain hoops. So it's again, but I think all of this shows the flexibility. I mean, sometimes you may not want the staff to have all of that flexibility but these rules are flexible. And if they become inflexible the Commission has over the years revised them to make them more flexible, for the most part.

EDWARD FLEISCHMAN: The Commission and staff have, over the years, been responsive at least to the gathering roar of resentment [laughter] that comes every so often about particular inflexibility in a particular area.

PETER ROWE: Well, you're never going to please everybody and the staff's got a difficult role to play, but I think they do a terrific job. You know, there are occasional areas where you might have some reason to question why they're doing, taking a particular approach or whatever, but I think overall, and I think you all would agree as well, that they generally do a very fine job in terms of administering these rules and making them really work.

RICHARD ROWE: All right. Now we can move to the ‘34 Act? [Laughter.] Another example would be the Safe Harbor for issuers repurchasing their own securities, which is a valuable Safe Harbor, Rule 10b18, and it's done away with a lot of uncertainty. As Ed pointed out, that's one of the real problems, but.

EDWARD FLEISCHMAN: But that was the uncertainty of -- am I not correct -- of direct SEC intervention on the assertion of some kind of Section 9 or Section 10 manipulation charge. And if memory serves, its predecessor took a full 13 years from proposal to adoption. On the other hand, it is notorious as an example of what Peter was talking about; the staff's imaginative use of its own authority. It's notorious for the staff's public statement on October 19 or 20, 1987: “If you want to go in the market, go in the market. We are not going to hold you to every jot and tittle of the various provisions of what was then the Safe Harbor.” Encouraging issues for the benefit, as it was then seen, of the greater marketplace, and the staff was credited with appropriate initiative on that score.

RICHARD ROWE: And the Commission, after 9/11, relaxed the rules on issuer repurchases also, so another example of the Commission and/or the staff reacting as they probably should in particular situations.

EDWARD FLEISCHMAN: But you mentioned one on which there have always been questions of detail as to whether the particular restrictions embodied in the rule are, one, necessary or, two, appropriate. Should the time period at the beginning and the end of the day be shorter or longer or there at all? Are the volume restrictions appropriate in the time frames to which they apply? And that's almost a -- it's an area in which the marketplace activities, the initiatives in the market -- the way the market functions, is what I'm trying to get at -- have a great deal to do with the appropriateness of the provisions of the rule and vary with market conditions from time to time -- a matter to which neither the Commission nor the staff could possibly be expected to be able to address.

PETER ROMEO: You know, 10b18 is an interesting situation because, in my experience at least, it's often used in conjunction with another Safe Harbor, 10b5(1), in the sense that you may set up a repurchase plan having certain parameters, give those parameters to your broker and say, "Do this within the confines of 10b18, but make sure the price is never above a certain price and you don't buy anymore than X-number during a day" or whatever. And we had a situation recently where doing that, combining 10b18 with 10b5(1), resulted in a situation where the broker, through a mistake, actually went over the limit for the amount and the price that could be satisfied. So it was kind of a problem there I haven't had to deal with. I'm won't tell you how it turned out, but I just wanted to mention that this is one of those unusual circumstances where two Safe Harbors can be joined at the hip.

RICHARD ROWE: But again, they're Safe Harbors.

PETER ROMEO: Yes.

RICHARD ROWE: So that if you go over a particular limit, depending upon the circumstances obviously, but if you go over the limit you still haven't necessarily committed a manipulative act.

PETER ROMEO: That's correct. Right.

RICHARD ROWE: And the Commission has proposed to amend 10b18 to reflect more current conditions. Hopefully, Ed, it will not take 13 years this time. [Laughter.] But the interesting thing is that the price that we may get for a little bit more relaxation is that there's going to be more disclosure of issuer repurchasing of their shares, and not only in 10b18 but under any circumstances, so.

PETER ROMEO: Well, I always thought that was a deficiency in 10b18, to be honest with you, that there was no disclosure requirement there. I think most people did make disclosure anyway, but to me it should have been an actual condition of the rule.

RICHARD ROWE: Some people made disclosure and then never made any purchases. [Laughs.]

PETER ROMEO: That's true.

EDWARD FLEISCHMAN: Well, both of those happened and at the same time, the next time there was a filed statement of changes in the capital accounts, that whatever transactions actually took place were reflected in financials filed with the Commission. For a long time I kept in my copy of the appeal book a record of the various changes that has been made in the various places of the -- there was an in and out. The Commission, over time, has required that kind of disclosure by issuers and then withdrawn the requirement because the conclusion had been reached over a decade, or however period of time, that it really wasn't material to the marketplace. And then market conditions changed, or at least the perception is that there's been a change, and the requirement goes back in again.

RICHARD ROWE: Could we, in the few minutes we have left, maybe go to Safe Harbors that have failed? And there have been a few, but the one that springs immediately to mind that failed in its purpose, at least, are the series of rules that protect forward-looking statements, and I'm speaking of the rules before the statutory amendments eight years or so ago. But the purpose of these rules was to encourage companies to, in filings with the Commission in particular, to make forward-looking statements, and they never really accomplished their purpose.

EDWARD FLEISCHMAN: It was at a time in mid '70s when there was a growing realization -- am I not correct? -- that the desire of the investing public was not only to know what the company did yesterday, but the investment decision-making was on the basis of what was anticipated the company would do tomorrow. That blinding flash of insight only took 40 years. [Laughter.] And only took Homer Kripke article after article, and Carl Schneider article after article, of trying to persuade the Commission. But the liability for the failures has always been -- the liability for actual as compared to the projected, and particularly for the points at which the actual did not accomplish what the projected suggested was accomplishable, has as you well know long frightened off lawyers and their clients. There was a time when, for new companies, at least the next 18 months had to be included in the first, in the IPO. New, small companies, am I not correct?

PETER ROMEO: Uh-uh, uh-huh.

EDWARD FLEISCHMAN: I don't even know whether that's true anymore. I haven't done one of those for too long. But everybody knows that the actual will not be what the projected is. The question is whether you get some kind of cornucopia-shaped area, and as long as you come within the area, you get some kind of protection. The words of Rule 175 never gave me any comfort that allowed me to advise a client to go out on that limb.

RICHARD ROWE: I'm more cynical than you are, Ed. I think that the company -- you're right, the Safe Harbor had shoals in it, and why risk the shoals when there are other ways you can get your projections out? I mean, that's the reality of the situation was they didn't need to put them in Commission filings. They could get them out in some other manner.

EDWARD FLEISCHMAN: But they do get them into the 13e3s and 13e4s, don't they?

RICHARD ROWE: Into?

EDWARD FLEISCHMAN: Into the going-private type transactions?

RICHARD ROWE: Because the Commission, in a reversal of a longstanding position, forces them to do that.

EDWARD FLEISCHMAN: Yes.

RICHARD ROWE: They don't force them to create them, but they can force them to put them in if they were created.

EDWARD FLEISCHMAN: Yes.

PETER ROMEO: Well, I'm going to offer a rather heretical thought on the whole idea of projections. As we all know, for 40 years they were basically prohibited in securities law filings. And now, of course, they are encouraged and you can't really operate as a public company without giving projections, but I’m not so sure that the Commission wasn't right for those 40 years, to be honest with you, where they were trying to stifle projections and so forth. How many times have we seen companies, even on short-term projections, have to issue some sort of missive halfway through the period saying, "Oh, my God, we're going to miss our targets." I mean, I don't know whether it's more often than not, but it happens a lot. And the market relies on these, and I don't know why, to be honest with you, because projections are a guess in the end, an educated guess hopefully in all instances, but bottom line is they're not exact, they're often wrong, many times considerably wrong. And yet, I mean, that's just the way the marketplace functions. I'm not saying you can change it. But I think the Commission's discouragement or projections maybe wasn't such a bad idea. As I said, it's heresy.

RICHARD ROWE: But forward-looking statements cover much more than projections and the Commission, in its management discussions and analysis requirements or interpretations or staff prodding, are trying to get more and more forward-looking statements. MD&A is covered by the SEC's rules and presumably, in part, covered by the statutory provisions.

EDWARD FLEISCHMAN: And the notion in the 1989 MD&A release that we really are not mandating forward-looking information has gone by the boards.

PETER ROMEO: Yeah. Well, the type of information Dick is talking about, you know, trends and that sort of thing, that obviously is critical information and that should be in there. What I was getting at was the actual numbers, you know, we're going to hit this number and that number, whatever. That's troublesome to me.

EDWARD FLEISCHMAN: Alan Levenson used to talk about ranges, didn't he, rather than specifics?

RICHARD ROWE: Sure, but some of these projections or many of these projections are in ranges, I mean, will be between 51 and 521Ú2 cents. [Laughter.]

EDWARD FLEISCHMAN: Understood, understood. I think that gets down to a theological rather than a legal argument.

PETER ROMEO: I agree with you, yes.

EDWARD FLEISCHMAN: Do you believe in grace or do you believe in hellfire and damnation? I mean, if you assume that at least the substantial minority of persons running issuers will abuse projections for their own benefit in the marketplace, then you get one answer to that and it's Peter's answer, and if you assume that at least the substantial minority will play it straight and will be wrong most of the time but will still play it straight, you get a different answer. It still becomes the information that investors want more than anything else. It is, to use the SEC's phrase in the MD&A context, it is in fact seeing the company through the eyes of management. What does management expect? [Laughs.]

RICHARD ROWE: Well, in the few minutes we have left, Ed, you have one minute, Peter, you have one minute, and I have one minute. [Laughter.]

EDWARD FLEISCHMAN: Well, I'll use mine as I used in my response to your first question. I think what we're talking about is -- now I'm going to have to remember the exact phrase -- "satisfactory objective circumstances" that are supposed to be guides for routine cases. If seen that way, the Safe Harbor, a tool, delivers its promise. I think -- and I include myself in this group -- I think the bar has always seen it as more and broader, and therefore always been offended by the fact that some of the objective circumstances are clearly not satisfactory, and that the guides should go to more than routine cases. And we as a bar, I think we've been disappointed in the Safe Harbor Rules. Perhaps we oughtn't to be, but I think we have been.

PETER ROMEO: Well, I'd have to disagree a little bit, Ed, in the sense that I think overall Safe Harbors have been successful. I think back to life before they became a reality and I think it's better now that we have those, and we have guides that we can look to and say, "If I fit within these boundaries here, I'm going to be okay. I know absolutely for sure." It's like what you're saying about not being absolute, but I know that I should be safe here and I think that's a tremendous way for the securities laws to operate. The more you can reduce the uncertainty, I think the better off you are. So I think they are a great idea. I think generally they've been executed well by the Commission, maybe not as well as we all would have preferred, but generally well.

RICHARD ROWE: Well, I get the last word. Ed and Peter, thank you for a good discussion of Safe Harbor Rules, and to our audience, just a reminder today's program is now archived in the Society's virtual museum so you can listen to it again and again and again. [Laughter.] A transcript of today's program will soon be posted on the museum.

Now, for the Society's next online program, that will be "Self-Regulation and the Exchanges from an Historical Perspective," live from New York City, on Thursday, April 15, from 4:00 to 5:00 Eastern Daylight Time. Hopefully, yes, it will be daylight time by then, with William Brodsky, Alger Chapman, Gordon Macklin, William Morton and Donald Stone. Please join us, and thank you for being with us today.

(END)