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The Office of the Secretary at (202) 942-7070.

Dated: July 14, 1997.

**Jonathan G. Katz,**

Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38822; File No. SR-NASD-97-38]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. ("NASD" or "Association") Relating to the Application of the NASD Corporate Financing Requirements To Exchange Offers, Mergers/Acquisitions, and Other Similar Transactions

July 8, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> notice is hereby given that on May 23, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. On June 19, 1997, the NASD filed Amendment No. 1 to its proposal.<sup>2</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASD is proposing to amend Rules 2710 and 2720 of the Conduct Rules of the Association to clarify their applicability to exchange offers, merger

and acquisition transactions, and other similar transactions. Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in brackets.

#### Rule 2710. Corporate Financing Rule—Underwriting Terms and Arrangements

##### (a) Definitions

\* \* \* \* \*

##### (b) Filing Requirements

\* \* \* \* \*

##### (7) Offerings Exempt from Filing.

Notwithstanding the provisions of subparagraph (1) above, documents and information related to the following public offerings need not be filed with the Association for review, unless subject to the provisions of Rule 2720. However, it shall be deemed a violation of this Rule or Rule 2810, for a member to participate in any way in such public offerings if the underwriting or other arrangements in connection with the offering are not in compliance with this Rule or Rule 2810, as applicable:

\* \* \* \* \*

##### (A)–(C)—No change.

(D) securities offered pursuant to a redemption standby "firm commitment" underwriting arrangement registered with the Securities and Exchange Commission on Forms S-3, F-3 or F-10 (only with respect to Canadian issuers); [and]

(E) financing instrument-backed securities which are rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories; and  
(F) exchange offers of securities where:

(i) the securities to be issued or the securities of the company being acquired are designated as a Nasdaq National Market security or listed on the New York Stock Exchange or American Stock Exchange; or

(ii) the company issuing securities qualifies to register securities with the Commission on registration statement Forms S-3, F-3, or F-10, pursuant to the standards for those Forms as set forth in subparagraphs (c) (i) and (ii) of this paragraph.

##### (8) Exempt Offerings.

Notwithstanding the provisions of subparagraph (1) above, the following offerings are exempt from this Rule, Rule 2720, and Rule 2810. Documents and information relating to the following offerings need not be filed for review:

##### (A)–(F)—No change.

(G) tender offers made pursuant to Regulation 14D adopted under the Securities Exchange Act of 1934, as amended; [and]

(H) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act of 1935, as amended[.];

(I) securities of a subsidiary or other affiliate distributed by a company in a spin-off or reverse spin-off or similar transaction to its existing securityholders exclusively as a dividend or other distribution; and

(J) securities registered with the Commission in connection with a merger or acquisition transaction or other similar business combination, expect for offerings required to be filed pursuant to subparagraph (9)(I) below.

##### (9) Offerings Required to be Filed.

Documents and information relating to all other public offerings including, but not limited to, the following must be filed with the NASD for review:

##### (A)–(F)—No change.

(G) securities offered pursuant to Regulation A or Regulation B adopted under the Securities Act of 1933, as amended; [and]

(H) exchange offers that are exempt from registration with the Commission under Sections 3(a)(4), 3(a)(9), 3(a)(11) of the Securities Act of 1933 (if a member's participation involves active solicitation activities) or registered with the Commission (if a member is acting as dealer-manager) (collectively "exchange offers"), except for exchange offers exempt from filing pursuant to subparagraph (7)(F) above that are not subject to filing by subparagraph (9)(I) below;

(I) any change offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; and

(J) any offerings of a similar nature that are not exempt under paragraphs (7) or (8) above.

\* \* \* \* \*

##### (c) Underwriting Compensation and Arrangements

\* \* \* \* \*

##### (6) Unreasonable Terms and Arrangements.

(A) No member or person associated with a member shall participate in any manner in a public offering of securities after any arrangement proposed in connection with the public offering, or the terms and conditions relating thereto, has been determined to be unfair or unreasonable pursuant to this Rule or inconsistent with any By-Law or any Rule or regulation of the NASD.

(B) Without limiting the foregoing, the following terms and arrangements, when proposed in connection with the

<sup>1</sup> 15 U.S.C. § 78s(b)(1).

<sup>2</sup> In Amendment No. 1, the NASD amended Rule 2710(b)(7)(F)(i) to replace the phrase "listed on The Nasdaq National Market, the New York Stock Exchange, or American Stock Exchange" with "designated as a Nasdaq National Market security or listed on the New York Stock Exchange or American Stock Exchange."

distribution of a public offering of securities, shall be unfair and unreasonable:

\* \* \* \* \*

(v) any "tail fee" arrangement granted to the underwriter and related persons that has a duration of more than two (2) years from the date the member's services are terminated, in the event that the offering is not completed in accordance with the agreement between the issuer and the underwriter and the issuer subsequently consummates a similar transaction, except that a member may demonstrate on the basis of information satisfactory to the NASD that an arrangement of more than two (2) years is not unfair or unreasonable under the circumstances.

Subparagraphs (v)–(xiii) are renumber (vi)–(xiv).

\* \* \* \* \*

#### Rule 2720. Distribution of Securities of Members and Affiliates—Conflicts of Interest

##### (a) General

(1) No member or person associated with a member shall participate in the distribution of a public offering of debt or equity securities issued or to be issued by the member, the parent of the member, or an affiliate of the member and no member or parent of a member shall issue securities except in accordance with this Schedule.

(2) No member or person associated with a member shall participate in the distribution of a public offering of debt or equity securities issued or to be issued by a company if the member and/or its associated persons, parent or affiliates have a conflict of interest with the company, as defined herein, except in accordance with this Schedule.

(3) In the case of an exchange offer, merger and acquisition transaction, or similar corporate reorganization, this Rule shall only apply if the offering is described in:

(a) Rule 2710(b)(9)(H) and the issuance of securities is by a member or the parent of a member; or

(b) Rule 2710(b)(9)(I).

\* \* \* \* \*

##### (c) Participation in Distribution of Securities of Member or Affiliate

(1) and (2)—No change.

(3) If a member proposes to underwrite, participate as a member of the underwriting syndicate or selling group, or otherwise assist in the distribution of a public offering of its own or an affiliate's securities, or of securities of a company with which it or its associated persons, parent or affiliates have a conflict of interest, one

or more of the following three criteria shall be met:

(A) The price at which an equity issue or the yield at which a debt issue is to be distributed to the public is established at a price no higher or yield no lower than that recommended by a qualified independent underwriter which shall also participate in the preparation of the registration statement and the prospectus, offering circular, or similar document and which shall exercise the usual standards of "due diligence" in respect thereto; provided, however, that:

(i) An offering of securities by a member which has not been actively engaged in the investment banking or securities business, in its present form or as a predecessor broker/dealer, for at least the five years immediately preceding the filing of the registration statement shall be managed by a qualified independent underwriter; and

(ii) The provision of this paragraph which requires that the price or yield of the securities be established based on the recommendation of a qualified independent underwriter shall not apply to an offering of equity or debt securities if:

a. The securities (except for the securities of a broker/dealer or its parent) are issued in an exchange offer or other transaction relating to a recapitalization or restructuring of a company; and

b. The member that is affiliated with the issuer or with which the member or its associated persons, parent or affiliates have a conflict of interest is not obligated to and does not provide a recommendation with respect to the price, yield, or exchange value of the transaction; or

(iii) In any exchange offer, merger and acquisition transaction, or similar corporate reorganization subject to this Rule under subparagraph (a)(3) above, the provision of this paragraph which requires that the price or yield of the securities be established based on the recommendation of a qualified independent underwriter shall not apply and, instead, the exchange value of the securities being offered in the transaction shall not be less than that recommended by a qualified independent underwriter; or (B) and (C)—No change.

\* \* \* \* \*

##### (o) Predominance of Rule 2720

If the provisions of this Rule are inconsistent with any other provisions of the Association's By-Laws or Rules, or of any interpretation thereof, the provisions of this Rule shall prevail, except to the extent that subparagraph

(b)(8) of Rule 2710 provides an exemption from this Rule for certain offerings.

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statement.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

Rule 2710 of the Conduct Rules of the NASD ("Corporate Financing Rule") requires that members file with the Corporate Financing Department of the NASD public offerings of securities for review of the proposed underwriting terms and arrangements, which terms and arrangements must comply with that rule. Rule 2720 of the Conduct Rules ("Conflicts Rule") establishes standards in addition to those in Rule 2710 to address the conflicts-of-interest that occur in connection with a public offering of the securities of a member, the parent of a member, an affiliate of a member, or other issuer with whom the member has a conflict-of-interest. For an offering to be subject to filing under the Corporate Financing and Conflicts Rules, a member must be considered to be "participating" in the offering and the offering must be one that is subject to the filing requirements. Paragraph (a)(5) of Rule 2710 defines "participation or participating in a public offering" to include participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis, furnishing of customer and/or broker lists for solicitation, or participation in any advisory or consulting capacity to the issuer related to the offering, but not the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEC Rule 13e-3.

With respect to offerings subject to compliance with the Rules, the Corporate Financing and Conflict Rules

apply to most "public offerings" of securities, which is defined in Rule 2720(b)(14) to include, among other things, "offerings made pursuant to a merger or acquisition." Neither the Corporate Financing Rule nor the Conflicts Rule currently identifies the types of mergers and acquisitions subject to filing and compliance with those rules. The NASD has, therefore, determined to amend Rules 2710 and 2720 to clarify the application of the requirements of the Corporate Financing and Conflicts Rules to exchange offers, mergers and acquisitions, and similar corporate reorganizations and make other related amendments. In view of the increasing amount of merger and acquisition activity, the NASD believes that the proposed amendments to Rules 2710 and 2720 will provide certainty and eliminate confusion regarding their application to such transactions.

With respect to the time-sensitive nature of many mergers and acquisitions, exchange offers, and similar corporate reorganizations that would become subject to filing as a result of approval of the proposed rule change, the NASD previously announced in Notice to Members 95-73 (September 1995) ("NTM 95-73") a policy to expedite the review of such offerings by the Corporate Financing Department.<sup>3</sup> In general, it is anticipated that a comment letter will be issued by the Corporate Financing Department of the NASD within 48 hours of receipt of the filing of the documents related to such a transaction, so long as the documentation and related information submitted meet the requirements set forth in subparagraphs (b) (5) and (6) of Rule 2710 and the appropriate filing fee is included.

#### *Summary of Proposed Rule Change*

The NASD is proposing to amend the Corporate Financing and Conflicts Rules to clarify their application to exchange offers, merger and acquisition transactions, and other similar corporate reorganizations and make other related changes. The amendments limit the application of the rules to narrow situations where pre-offering review under the Corporate Financing Rule or the application of the Conflicts Rule is believed necessary to protect investors. Thus, in general, the proposed rule change would require that an exchange offer be filed with the Corporate Financing Department for review only when a member is participating in

solicitation activities related to an offer involving unlisted securities or securities that are exempt from SEC registration. However, filing of an exchange offer (where a member is participating in solicitation activities) will be required if the offering is subject to the Conflicts Rule because the offering is of securities of a member or its parent or the offer will result in the direct or indirect public ownership of a member. In addition, exchange offers, merger and acquisition transactions, and other similar corporate reorganizations will be subject to the Conflicts Rule, and required to be filed for review, if there is an issuance of securities that results in the direct or indirect public ownership of a member.

#### *Description of Proposed Rule Change to Rule 2710*

The filing requirements of the Corporate Financing Rule subject an offering to compliance with that rule and, if the offering is of securities issued by a member, the parent of a member, an affiliate of a member, or an issuer with which the member has a conflict-or-interest (as that latter term is defined in Rule 2720), to compliance with the Conflicts Rule. Paragraph (b)(9) of Rule 2710 is intended to provide clarification of certain types of public offerings required to be filed with the Corporate Financing Department of the NASD for review. Paragraph (b)(9) is proposed to be amended to add new subparagraph (H) that would require the filing of exchange offers exempt from registration under Sections 3(a)(4), 3(a)(9), and 3(a)(11) of the Securities Act of 1933 ("Securities Act"), where the member engages in active solicitation, and exchange offers registered with the Commission if a member acts as a dealer manager.<sup>4</sup> Active solicitation occurs when a member directly solicits or contacts securityholders, acts as a dealer manager, performs tasks that are performed by investor relations firms. (i.e., contacts securityholders to determine the action they intend to take), contacts securityholders to determine whether they have received the offering materials, answers unsolicited contacts, and participates in meetings with securityholders or their advisors before or after an exchange offer begins.<sup>5</sup> In contrast, active

solicitation does not encompass the delivery of a "fairness opinion," advice as to the structure and terms of the exchange offer, assistance in the preparation of the offering documents to be sent to securityholders, nor any other functions that do not involve direct solicitation or direct contact with securityholders.

The NASD is not extending the filing requirement to other public exchange offers exempt from registration because such offerings are either subject to the oversight of a bankruptcy court or of another Federal review authority, such as the Comptroller of the Currency or the Federal Deposit Insurance Corporation.<sup>6</sup>

With respect to exchange offers registered on Forms S-4 or F-4, filing is expressly limited to those distributions where the member is engaged by the company to act as dealer manager and solicits consents on behalf of the company to the proposed reorganization and to otherwise facilitate the exchange of securities. In such exchange offers, the member generally acts as a financial advisor to help structure the transaction and will receive a fee, as well as distribution-related compensation for services rendered.

To the extent an exchange offer exempt under Sections 3(a)(4), (9), and (11) of the Securities Act or registered with the SEC does not fall within the filing requirement in new subparagraph (b)(9)(H) to Rule 2710 because the member is not engaging in solicitation activities or is not acting as dealer manager, respectively, the exchange offer is considered exempt from compliance with the Corporate Financing and Conflicts Rules because the member is not considered to be "participating in the offering."

The NASD, however, is also proposing to add new subparagraph (b)(7)(F) to Rule 2710 to exempt from filing exchange offers where the securities to be issued or the securities of the company to be acquired are designated as a Nasdaq National Market security or listed on the New York Stock Exchange ("NYSE") or American Stock Exchange ("AMEX") or where the

purposes of Section 3(a)(9) may none-the-less come within the concept of "solicitation" for purposes of the requirement to file an offering with NASD Regulation for review under Rules 2710 and 2720. See applicable SEC no-action letters on Section 3(a)(9). Further, the application of the filing requirements of Rule 2710 does not depend upon whether remuneration is paid to the member. Thus, regardless of whether a member is paid for soliciting the exchange, an exchange offer would be subject to filing if the member engages in solicitation activities as described in this rule filing.

<sup>3</sup> A copy of NTM 95-73 was submitted as Exhibit 2 to the NASD's proposal and is available for inspection and copying in the Commission's Public Reference Room.

<sup>4</sup> The term "exchange offer" is intended to refer to transactions where one security is issued in exchange for another security of the issuer or another entity, and is distinguished from mergers, acquisitions and other corporate reorganizations (except if accomplished through an exchange offer) registered on a Form S-4 or F-4.

<sup>5</sup> Activities by a broker/dealer that would not come within the concept of "soliciting" for

<sup>6</sup> See 15 U.S.C. §§ 3(a)(5), 3(a)(6), 3(a)(10), and 3(a)(12).

company issuing securities qualifies to register securities on SEC Registration Forms S-3 or F-10. It is believed that the listing standards of the three markets requiring independent directors of the Board of Directors will ensure that the independent directors of the acquiror or target will evaluate the offer and that sufficient information will be distributed to shareholders and to the markets, so that investors can make a decision regarding whether to sell or hold the securities they hold or will receive.

The exemption for companies qualified to register securities on SEC registration Forms S-3, F-3, or F-10 applies to those companies that meet the standards for the Forms in subparagraphs (C)(i) and (ii) of paragraph (b)(7) of Rule 2710 in order to restrict the exemption to domestic companies that meet the standards for Forms S-3 and F-3 prior to October 21, 1992 and to Canadian-incorporated foreign private issuers that meet the standards for Form F-10 approved in Securities Exchange Act Release No. 6902 (June 21, 1991).<sup>7</sup> This provision would require, in general, that a domestic company have a three-year history as a public reporting company, and be in compliance with the current year's periodic reporting requirements of the Act (with respect to the timely filing of Form 10-Qs and 10-Ks). In addition, the minimum required market value of a company's common stock must be as follows: Form S-3, \$150 million (or \$100 million market value of voting stock and three million shares annual trading volume); and Form F-3, \$300 million held world-wide. For Form F-10, Canadian private issuers must have (CN) \$360 aggregate value of voting stock and a public float of (CN) \$754 million.

Paragraph (b)(7) of the Corporate Financing Rule, which includes the two filing exemptions for exchange offers discussed above, lists those public offerings not required to be filed for review with the Corporate Financing Department. However, the underwriting terms and arrangements of such exempt offerings must be in compliance with the requirements of Rule 2710 or 2810, as applicable. Moreover, any offering exempt from filing under paragraph (b)(7) must nonetheless be filed if the offering is subject to Rule 2720, the Conflicts Rule, and is subject to review by the Corporate Financing Department

for compliance with Rules 2710 and 2720.<sup>8</sup>

Paragraph (b)(9) of the Corporate Financing Rule is also proposed to be amended to add new subparagraph (I) to require the filing of any exchange offer, merger or acquisition transaction, and similar corporate reorganization that involves an issuance of securities that results in the direct or indirect public ownership of a member.<sup>9</sup> Such offerings would be subject to compliance with Rule 2710 and Rule 2720.<sup>10</sup> The NASD has long held the view that pre-offering review is vital to protect investors when the member and the issuer are in a control relationship that is addressed through the application of Rule 2720. The NASD has previously clarified in Notice to Members 88-100 (December 1988) that mergers or acquisitions involving an issuer and a member or its parent that result in the direct or indirect public ownership of a member are subject to compliance with Rule 2720, regardless of whether the merger or acquisition occurs subsequent to the issuer's initial public offering.<sup>11</sup>

Paragraph (b)(8) of Rule 2710 lists those offerings that, although within the definition of "public offering," are exempted from compliance with Rules 2710 and 2720. The NASD is proposing to add new subparagraphs (I) and (J) to paragraph (b)(8) to provide an exemption from filing and compliance with Rules 2710 and 2720 for:

1. Spin-off and reverse spin-off transactions involving a subsidiary or affiliate of the issuer, where the securities are issued as a dividend or distribution to current shareholders; and
2. Securities registered with the SEC in connection with a merger, acquisition, or other similar business combination, except if the offering would be filed under subparagraph (b)(9)(I), described above, because it involves a transaction that results in the direct or indirect public ownership of a member.

<sup>8</sup> See *infra* note 10.

<sup>9</sup> This latter filing requirement does not, it is important to note, require the filing of exchange offers, mergers, acquisitions, and corporate reorganizations involving an offering of securities of an affiliate of a member other than a parent or of an issuer that otherwise has a conflict-of-interest with a member.

<sup>10</sup> Paragraph (n) of Rule 2720 provides that all offerings of securities included within the scope of that Rule are also subject to the provisions of Rule 2710, even though an exemption from filing may be available under Rule 2720.

<sup>11</sup> In the notice, the Association expressed its special concerns regarding the merger of blank check companies in the penny stock market with privately held holding companies of members, indirectly creating a publicly-held NASD member without having to comply with Rule 2720.

Spin-off transactions to existing securityholders as a dividend or other distribution do not involve an investment decision by shareholders and, consequently, any member acting as a financial advisor to the parent company is not generally involved in any public solicitation in connection with the transaction.<sup>12</sup> Merger transactions and similar business combinations registered with the SEC generally only involve a member in providing financial advice to the Board of Directors of the acquiror or target, that may include an obligation that the member issue a fairness opinion regarding the acquisition price.

In addition, the NASD is proposing to add new subparagraph (c)(6)(B)(v) to Rule 2710 to provide that it is an unreasonable term and arrangement for a member to receive a right to receive a "tail fee" arrangement that has a duration of more than two years from the date the member's services are terminated, in the event an offering is not completed and the issuer subsequently consummates a similar transaction. Such arrangements are currently only provided in connection with exchange offers. It is believed that the real benefit derived by a company that grants a "tail fee" arrangement is the creativity of the strategic advice given by the member for the particular transaction that may include, among other things, assisting the company in defining objectives, performing valuation analyses, formulating restructuring alternatives, and structuring the offering. In particular, in the case of an exchange offer, a member providing financial advice will generally have provided considerable ongoing financial advisory services to the company.

The proposed "tail fee" prohibition also, however, would permit a member to demonstrate on the basis of information satisfactory to the NASD that an arrangement of more than two years is not unfair or unreasonable under the circumstances. The ability of the staff of the Corporate Financing Department to grant exceptions upon request is intended to be used where the

<sup>12</sup> It should be noted, however, that where a spin-off that is followed by a traditional public offering by the spun-off company to raise capital, the company's initial public offering would be subject to the Corporate Financing Rule's filing requirements and to compliance with Rule 2720. The same analysis would require the filing of any public offering to raise capital that follows a merger, acquisition, exchange offer or other corporate reorganization that would be exempt from filing under Rule 2710 or exempt from compliance with Rules 2710 and 2720. In the latter case, the offering may nonetheless fall within another exemption from filing, such as the filing exemptions provided by subparagraphs (b)(7) (A), (C), or (D) of Rule 2710.

<sup>7</sup> See Notice to Member 93-88 (December 1993), which includes a copy of Forms S-3 and F-3 as those Forms existed prior to October 21, 1992 and Form F-10 as approved by the SEC on June 21, 1991.

member can demonstrate that the creativity of the strategic advice provided by the member has a potential benefit to the company for more than two years. In the case of exchange offers exempt from filing but subject to compliance with the Rule under subparagraph (b)(7)(F), where the "tail fee" arrangement is proposed to have a duration of longer than two years, a member would be required to request an opinion of the staff as to whether the arrangement is permissible under the Rule. In the case of any other offering exempt from filing under subparagraph (b)(7), a member is required to request an opinion of the staff as to whether it has an opinion of "no objections" as to any proposed "tail fee" arrangement.

As set forth above, although "tail fee" arrangements are currently granted only in connection with exchange offers, the provision is written to regulate such an arrangement in connection with any type of public offering subject to compliance with the Corporate Financing Rule. Where a "tail fee" arrangement is proposed in connection with public offerings that are not exchange offers, the NASD staff will consider whether such an arrangement is justified by the services provided by the member to the issuer. Where the member does not appear to have provided the type of substantial structuring and/or advisory services to the issuer similar to those that are described above, other than those services traditionally provided in connection with a distribution of a public offering, a proposed "tail fee" arrangement will be considered to be unfair and unreasonable on the basis that the arrangement would violate Rule 2110 (the Association's basic ethical rule) and Rule 2430 since the member is proposing to be paid for services that the member has not provided to the issuer. This position is consistent with subparagraph (c)(6)(B)(iv) of Rule 2710, which prohibits a member from receiving compensation in connection with an offering of securities that is not completed, except for compensation received in connection with a transaction (*i.e.*, a merger transaction) that occurs in lieu of the proposed offering as a result of the member's efforts and the reimbursement of the member's reasonable out-of-pocket accountable expenses.

In addition, the NASD has considered whether other types of fees and expense reimbursement arrangements that are typically negotiated for and received in connection with exchange offers proposed to be subject to compliance with Rule 2710 are inconsistent with or prohibited by subparagraphs

(c)(6)(B)(iii) and (iv) of the Corporate Financing Rule. Subparagraph (c)(6)(B)(iii) of Rule 2710 currently prohibits as unfair and unreasonable any payment of commissions or reimbursement of expenses directly or indirectly to the underwriter and related persons prior to commencement of the public sale of the securities being offered, with certain limited exceptions. As set forth above, subparagraph (c)(6)(B)(iv) of Rule 2710 currently prohibits as unfair and unreasonable the payment of any compensation by an issuer to a member or person associated with a member in connection with an offering of securities which is not completed according to the terms of agreement between the issuer and underwriter, except those negotiated and paid in connection with a transaction that occurs in lieu of the proposed offering as a result of the efforts of the underwriter and related persons and provided, however, that the reimbursement of out-of-pocket accountable expenses actually incurred by the member or person associated with a member is not presumed to be unfair or unreasonable under normal circumstances. The NASD has determined that it is not inconsistent with the Corporate Financing Rule for a member acting as financial advisor in an exchange offering to receive a "time and efforts" or similar fee for the services it renders in connection with an exchange offer that is not completed, where the member does not receive the agreed-upon success fee. In addition, it is deemed not inconsistent with the Corporate Financing Rule for a member to receive reimbursement of certain expenses, including, but not limited to, travel costs, document production, and legal fees of the financial advisor, whether or not the transaction is consummated. In NTM 95-73, publishing the original version of the proposed rule change for comment, the Association stated that these and similar types of reimbursement arrangements in exchange offers are not prohibited by the Corporate Financing Rule because such arrangements are not viewed as directly connected to the issuance of securities.

#### *Description of Proposed Rule Change to Rule 2720*

The NASD is proposing to amend the Conflicts Rule to conform the scope section of the Rule to the amendments to the filing requirements of Rule 2710 and to clarify the responsibilities of a qualified independent underwriter in an exchange offer subject to compliance with Rule 2720. Paragraph (a) of Rule 2720 is proposed to be amended to add

new subparagraph (3) to provide that in the case of an exchange offer, merger and acquisition transaction, or similar corporate reorganization, compliance with Rule 2720 is required only if the offering comes within subparagraph (b)(9)(H) of Rule 2710, where the issuance of securities is by a member or the parent of a member or if the offering comes within subparagraph (b)(9)(I). As set forth above, proposed subparagraph (b)(9)(H) would require the filing of exchange offers exempt under Section 3(a)(4), 3(a)(9), and 3(a)(11) of the Securities Act, if the member's participation involves active solicitation activities, and of exchange offers registered with the SEC, if the member is acting as dealer manager. Thus, the exemption from filing for such exchange offers provided by proposed subparagraph (b)(7)(F), where the securities are designated as a Nasdaq National Market security or listed on the NYSE or AMEX or the issuer qualifies to register securities on Forms S-3, F-3 or F-10, is not available if the exchange offer is by a member or parent of a member.<sup>13</sup> As further set forth above, proposed subparagraph (b)(9)(I) would require the filing of any exchange offer, merger and acquisition transaction, or similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of a member.<sup>14</sup>

The NASD is also proposing to amend Rule 2720 to clarify the obligations of a qualified independent underwriter<sup>15</sup> that would be required by subparagraph (c)(3) of Rule 2720 to perform due diligence with respect to the offering document and provide a recommendation with respect to the exchange value of an exchange offer, merger and acquisition transaction, or similar corporate reorganization. Currently, the Conflicts Rule requires

<sup>13</sup> See *supra* note 9.

<sup>14</sup> This filing requirement is consistent with the position announced in notice to members 88-100 (December 1988) and paragraph (i) of Rule 2720 which states: " \* \* \* if an issuer proposes to engage in any offering which results in the public ownership of a member \* \* \* the offering shall be subject to the provisions of this Rule to the same extent as if the transaction had occurred prior to the filing of the offering."

<sup>15</sup> A member must meet a number of requirements in order to be a qualified independent underwriter under subparagraph (b)(15) of Rule 2720, including the requirement that the member "has agreed in acting as a qualified independent underwriter to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act of 1933, specifically including those inherent in Section 11 thereof." Participation of a qualified independent underwriter is not required by Rule 2720 if the offering is of equity securities that meet the test of having a "bona fide independent market" or is of debt that is rated investment grade.

that the price at which an equity issue or the yield at which a debt issue is to be distributed to the public be established at a price no higher or yield no lower than that recommended by a qualified independent underwriter (who shall also participate in the preparation of the registration statement and shall exercise the usual standards of "due diligence" in respect thereto). The NASD is proposing to amend subparagraph (c)(3)(A) of Rule 2720 by adding a new exception to state that in any exchange offer, merger and acquisition transaction or corporate reorganization subject to Rule 2720, the provision which requires that the price or yield of the securities be established based on the recommendation of a qualified independent underwriter shall not apply and, instead, the exchange value of the securities being offered in the transaction shall not be less than that recommended by a qualified independent underwriter. Thus, the proposed new provision would clarify that the obligation of the qualified independent underwriter is to ensure that the recipient of the exchange offer, which is the party intended to be protected by the participation of a qualified independent underwriter, shall not receive fewer of the securities being issued in exchange for each security held by the recipient than is recommended by the qualified independent underwriter.

Finally, in order to make clear that the exemptions in subparagraph (b)(8) of Rule 2710 (that include exemptions for offerings of securities issued in a spin-off or in a merger registered with the SEC on Forms S-4 or F-4) are also exempt from Rule 2720, paragraph (o) of Rule 2720 is proposed to be amended to reference the exemptions from Rule 2720 that are provided in subparagraph (b)(8) of Rule 2710.

#### *Implementation of the Proposed Rule Change*

The NASD has considered the impact of the proposed rule change on pending transactions that would be required to be filed with the Corporate Financing Department for review as a result of the application of Rule 2710 or Rule 2720 or would be subject to compliance with Rule 2710 even though exempt from filing. In order to provide timely notice to the membership of the SEC's approval of the proposed rule change, the NASD is proposing to make the proposed rule change effective on a date that is 30 calendar days after the issuance of a Notice to Members announcing SEC approval of the proposed rule change. The Notice to Members will be issued within 45

calendar days of SEC approval. Thus, proposed exchange offers, mergers, acquisitions, and similar transactions that have not commenced at the time the proposed rule change becomes effective will be required to be filed for review with the Corporate Financing Department, if subject to filing under Rule 2710 or Rule 2720. Further, such transactions, although exempt from filing under subparagraph (b)(7) of Rule 2710, will be required to be made in compliance with the proposed restrictions on "tail fee" arrangements and other provisions of the Corporate Financing Rule. The proposed restrictions on "tail fee" arrangements will not be applicable to any outstanding "tail fee" arrangements for an exchange offer, merger, acquisition, or similar transaction that has commenced prior to effectiveness of the proposed rule change.

#### *2. Statutory Basis*

The NASD believes that the proposal to establish filing requirements for the review of exchange offers, mergers and acquisitions, and other corporate reorganizations under Rules 2710 and 2720, to limit "tail fee" arrangements to two years, and to provide clarification as to the obligations of a qualified independent underwriter in exchange offers is consistent with the provisions of Section 15A(b)(6) of the Act<sup>16</sup> in that the proposed rule change promotes just and equitable principles of trade and protects investors and the public interest.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Association does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

The proposed rule change was published for comment in NTM 95-73.<sup>17</sup> Two comments were received in response thereto.<sup>18</sup> The amendments published for comment would require filing when members act as dealer/managers of merger transactions or exchange offers registered with the SEC on Form S-4 or are engaged in

solicitation activities in connection with unregistered exchange offerings or the transaction involves mergers/exchange offerings that are subject to Rule 2720. Under the proposal, exchange offers would be exempt from the filing requirements if the issuer of the securities is qualified to register on the SEC's short-form registration statements, i.e., Forms S-3, F-3 or F-10, or the companies' securities held or to be received in connection with the exchange offer by the securityholder are listed on the Nasdaq National Market or the NYSE or AMEX. The Notice also proposed that "tail fee" arrangements in exchange offers should be limited to a two-year period from the termination of a member's services, provided that the NASD may permit longer periods in certain circumstances on a case-by-case basis. No amendments were proposed to Rule 2720.

The first commentor questioned the rationale for applying Rule 2720 to a transaction where a company is seeking to acquire the securities of a target company and the member with which it is affiliated is either soliciting securityholders of the target company or merely acting as a financial advisor to the acquiring company. The commentor was unable to determine the exact role that a qualified independent underwriter would have in such a transaction and whether the qualified independent underwriter should be required to recommend a price at which the equity issue or debt offering could be distributed to the public. The commentor claimed that it would be extremely difficult for a qualified independent underwriter to make such a recommendation.

The other commentor stated that the proposal was drafted too broadly and would require the filing of any merger and acquisition transaction by a member that provides financial advice to an affiliated issuer in the transaction, even if the member does not solicit proxies or otherwise have any direct contact with investors. The commentor recommended that the proposed amendments to the Corporate Financing Rule be revised to make clear that members are required to file exchange offers for review only if the member engages in "solicitation activities" and the exchange offer does not qualify for any of the exemptions from filing set forth in the Rule.

To address these comments, language was added to proposed subparagraph (b)(9)(H) of Rule 2710 to clarify that an exchange offer under Sections 3(a)(4), 3(a)(9), and 3(a)(11) of the Securities Act are subject to filing only if the member's participation involves active solicitation

<sup>16</sup> 15 U.S.C. § 78o-3.

<sup>17</sup> NTM 95-73, *supra* note 3.

<sup>18</sup> Copies of the comment letters received in response thereto were submitted as Exhibit 3 to the NASD's proposal and are available for inspection and copying in the Commission's Public Reference Room.

activities and an exchange offer (not a merger transaction) registered with the SEC is subject to filing only if there is a member acting as a dealer manager, thereby clarifying that filing is not required where the member's role in the transaction is limited to providing financial advice. In addition, as recommended by the second commentor, the provision was amended to clarify that filing is not required if the exchange offer comes within the exemption from filing in subparagraph (b)(7)(F) for listed securities and securities of an issuer that qualify to register on Forms S-3, F-3, or F-10. Consistent with this latter change, proposed subparagraph (b)(8)(I) of Rule 2710 that would exempt from the Rule mergers (not exchange offers) registered with the SEC, was also amended to clarify that such a merger is nonetheless subject to filing if the merger involves the securities of a member or the parent of a member (as provided in subparagraph (b)(9)(I)).

Also consistent with the request of the second commentor for greater clarity in the operation of the filing requirements, new subparagraph (a)(3) was added to Rule 2720 to clarify that any exchange offer, merger and acquisition transaction, or similar corporate reorganization exempt from registration under Sections 3(a)(4), 3(a)(9), and 3(a)(11) where the member is actively soliciting securityholders or registered with the SEC where a member is acting as dealer manager, will be required to be filed with the Corporate Financing Department and is subject to compliance with the requirements of the Rule if the issuance of securities is by a member or parent of a member. In addition, by reference to subparagraph (b)(9)(I) of Rule 2710, the new subparagraph of the Conflicts Rule provides that any exchange offer, merger or acquisition transaction, or similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of a member will be required to be filed under Rule 2720. In order to make clear, moreover, that the exemption in subparagraph (b)(8) of Rule 2710 for offerings of securities issued in a spin-off or in a merger registered with the SEC are also exempt from Rule 2720, paragraph (o) of Rule 2720 is proposed to be amended to reference the exemptions from Rule 2720 that are provided in Rule 2710.

Finally, to address the concerns of the first commentor regarding the role of the qualified independent underwriter in an exchange offer, merger and acquisition transaction, or similar corporate reorganization subject to the Conflicts

Rule, subparagraph (c) of Rule 2720 is proposed to be amended to add a provision that requires that the exchange value of the securities being offered in the transaction not be less than that recommended by the qualified independent underwriter.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to file No. SR-NASD-97-38 and should be submitted by August 6, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-18605 Filed 7-15-97; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38831; File No. SR-NASD-97-28]

### Self-Regulatory Organizations; Notice of Filing of Amendment No. 2 to a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Procedures for Limitations on Operations, Suspensions, Cancellations, Bars, Denials of Access, Eligibility Proceedings and Exemptions

July 11, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on July 10, 1997, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") Amendment No. 2 to the proposed rule change, as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization.<sup>3</sup> The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASD is proposing to amend the proposed rule change filed in SR-NASD-97-28. The Amendment contains revisions to the proposed Rule 9400 and 9500 Series of the Code of Procedure of the NASD and a proposed Rule 9600 Series setting forth procedures for applying for exemptions. As amended, the proposed Rule 9400-9500 Rule Series sets forth procedures for limitations on operations, suspensions, cancellations, bars, denials of access to NASD services, and eligibility proceedings. As noted in the Original Proposal, the NASD proposes to rescind the Rule 9500 and 9600 Series. The Association is requesting permanent approval of the proposed rule change as set forth in this

<sup>1</sup> 15 U.S.C. § 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The proposed rule change, including Amendment No. 1, was previously noticed in the **Federal Register**. See Exchange Act Release No. 38545 (April 24, 1997), 62 FR 25226 (May 8, 1997) (the "Original Proposal"). Two comment letters were received on the Original Proposal. See letter from Faith Colish, Attorney, Faith Colish P.C., to Jonathan G. Katz, Secretary, Commission, dated June 9, 1997; letter from George S. Frazza, Chair, Section of Business Law and Barry F. McNeil, Chair, Section of Litigation, American Bar Association, to Jonathan G. Katz, Secretary, Commission, date June 17, 1997.