



DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

1999 SEC No-Act. LEXIS 903
Securities Act of 1933 -- Section 5

November 15, 1999

CORE TERMS: investor, prospectus, Securities Act, internet, transmission, offering, television, no-action, presentation, public offering, staff, retail, radio, registration statement, password-protected, electronic, broadcast, customer, medium, advisers, disclosure, safeguards, purchasers, technology, registered, roadshow, website, viewing, enforcement action, underwriting

[*1] Charles Schwab & Co., Inc.

TOTAL NUMBER OF LETTERS: 3

SEC-REPLY-1: SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

November 15, 1999

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF CORPORATION FINANCE

Re: Charles Schwab & Co., Inc. ("Schwab")

Incoming letter dated November 12, 1999

Based on the facts presented, but without necessarily agreeing with your analysis, the Division will not recommend enforcement action to the Commission if Schwab transmits roadshows over the Internet in the manner described in your letter (i.e., either directly or indirectly, through third-party providers of electronic production and/or transmission services whose procedures satisfy the conditions set forth in pertinent Division no-action precedent beginning with Private Financial Network (March 12, 1997) ("Authorized Providers")), to the limited audience of Schwab retail customers, Independent Investment Advisers (as defined in your letter) and specified eligible customers of such Advisers (all three groups collectively referred to as "Eligible Offerees"), in reliance on your opinion of counsel that such transmissions are not prospectuses within the meaning of Section 2(a)(10) of the Securities Act of 1933 ("Securities [*2] Act"). We note that Schwab is responsible as a Securities Act seller with respect to the content of each roadshow that it transmits to Eligible Offerees, either directly or indirectly through an Authorized Provider, regardless of whether another broker-dealer participating in the distribution of the securities and/or the issuer is primarily responsible for such content.

This no-action position is limited to registered initial public offerings underwritten on a firm-commitment basis in which Schwab is a member of the underwriting syndicate or selling group. In addition, we remind you that any offers to buy solicited pursuant to a given IPO roadshow (or any other means) cannot be accepted at

least until after pricing where Rule 430A pricing procedures are used. To the extent indications of interest are solicited, of course, such indications would not constitute offers to buy capable of acceptance.

Because the Commission is considering various issues arising from the use of electronic communications in capital-raising transactions in Securities Act Release No. 7606A (Nov. 13, 1998), including the appropriate regulatory treatment of electronic roadshows, you should be aware that our [*3] no-action position is subject to change by the Commission. For this reason, we particularly do not address here whether Internet-based or other electronic communications should be treated as "written" or "oral" for purposes of Securities Act regulation. Our position rests on policy considerations alone, including the Commission's goal of reducing selective disclosure of material, offering-related information typically provided during roadshows, and should not be viewed as taking a substantive position on any of the issues presented in Securities Act Release No. 7606A.

Your request for confidential treatment pursuant to Rule 81(b) of the Commission's Regulation Concerning Information and Requests [17 C.F.R. § 200.81(b)], submitted by separate letter dated November 12, 1999, has been granted until the earlier of (a) 30 days from the date of this response; or (2) the date that any information contained in your letter or this response is made publicly available by Schwab.

This position is based on the representations made in your letter, as well as your opinion of counsel. Different facts or conditions therefore might require a different result. Moreover, this letter expresses the Division's [*4] position on enforcement action only, and does not express any legal conclusion on the question presented. Finally, because regulatory responses to legal issues raised by rapid developments in information technology necessarily must evolve, this no-action position may be re-evaluated by the Division or, as previously noted, changed by the Commission.

Sincerely,

Brian J. Lane

Director

INQUIRY-1: Munger, Tolles & Olson LLP

355 South Grand Avenue

thirty-fifth floor

los angeles, california 90071-1560

telephone (213) 683-9139

facsimile (213) 687-3702

Ms. Catherine T. Dixon

Chief Counsel

Division of Corporation Finance

United States Securities and

Exchange Commission

450 Fifth Street, N.W.

Washington, DC 20549

November 12, 1999

re: Charles Schwab & Co., Inc.

CONFIDENTIAL TREATMENT REQUEST

Dear Ms. Dixon:

We are this date submitting, under separate cover, a request (the "Request Letter") that the staff take a no-action position regarding certain proposed activities of Charles Schwab & Co., Inc. ("Schwab") regarding internet transmissions of road shows.

Pursuant to Rule 81(b) of the Commission's Regulation Concerning Information and Requests, 17 C.F.R. § 200.81(b), we hereby request that [*5] the staff accord confidential treatment of the Request Letter, the information contained in it, and the staff response to it, until the earlier of 30 days from the date of such response or the first public announcement by Schwab of the information contained in the Request Letter. This request for confidential treatment is being submitted because certain of the facts set forth in that Request Letter are not now public and are to some degree proprietary to Schwab, so that a premature disclosure of them could adversely affect Schwab.

Thank you for your cooperation in this respect.

Very truly yours,

Simon M. Lorne

INQUIRY-2: Munger, Tolles & Olson LLP

355 South Grand Avenue

thirty-fifth floor

los angeles, california 90071-1560

telephone (213) 683-9139

facsimile (213) 687-3702

Ms. Catherine T. Dixon

Chief Counsel

Division of Corporation Finance

United States Securities and

Exchange Commission

450 Fifth Street, N.W.

Washington, DC 20549

November 12, 1999

1933 Act §§ 2(a)(10), 5

re: Charles Schwab & Co., Inc.

Dear Ms. Dixon:

We are writing on behalf of Charles Schwab & Co., Inc. ("Schwab"), the second largest broker-dealer in the United States in number of customer accounts, and [*6] the largest "online" broker-dealer, measured in accounts, assets or volume of trades. While Schwab has some institutional accounts, the firm primarily serves retail investors.

On behalf of Schwab, we write this letter to request your confirmation that the Division of Corporation Finance (the "Division") would not recommend that the Commission commence enforcement action pursuant to the Securities Act of 1933, as amended (the "Securities Act"), as a result of Schwab's making "road show" meetings available (as live presentations or as recordings of live presentations) in a password-protected internet environment in the manner described below. The road shows would be available only to customers who have met the financial criteria for Schwab Signature Services TM Gold accounts and to certain independent investment advisers. Our request is based on our legal and policy analyses of the relevant factors set forth in the remainder of this letter.

Pursuant to Securities Act Releases No. 5127 (Jan 25, 1971) and 6269 (Dec. 5, 1980), seven copies of this letter are being submitted, and the specific statutory provisions to which this letter pertains are identified in the upper right-hand corner [*7] of the first page of the letter. If the staff were preliminarily to reach the conclusion that it would be inclined in any material respect to deny the request contained in this letter, we would appreciate the opportunity to discuss the relevant issues further.

Background. Originally, road shows in connection with public offerings of securities were intended as meetings between potential underwriting syndicate and selling group members (together, "Participants") of a proposed public offering and the issuer and the managing underwriter or underwriters. The function of the meeting was two-fold. First, it provided the potential Participants with the opportunity to understand the proposed offering better and to evaluate whether they wanted to become Participants, committing their capital if they joined as members of the formal underwriting syndicate. Second, at least after passage of the Securities Act, it provided those Participants with the opportunity to satisfy some of the elements of the "due diligence" defense to potential liability under the Securities Act as provided by §§ 11(b)(3)(A) and 12(a)(2) of that Act.

Over time, large, typically institutional, investors came also [*8] to be invited to such road shows, and the road shows became more directly a part of the selling process. At least by 1994, if not 10 to 15 years prior to that, such participation by potential purchasers had come to be common, as noted in the proceedings of the 26th Annual Inst. on Sec. Reg. (PLI)(1994). (See, e.g., Schulte, "IPO Road Shows: A Primer for the Petitioner"; Sonsini, Char & Hussick, "The Regulation of the Registration and Distribution Process under the Securities Act of 1933" [both in the proceedings of that Institute].)

The statutory analysis during this period was that road shows, after the filing of a registration statement (and even before its effectiveness), were permissible communications under Section 5 of the Securities Act because they were oral, rather than written, communications. Although not necessarily required, preliminary prospectuses were typically distributed at the door to all who came into the meeting (See Quinn and Jarmel, "Publicity Considerations for Corporate Issuers: Getting the Message Across Under the Federal Securities Laws, 'Aircraft Carrier' Release Annotation," in Advanced Securities Law Workshop, 1999 (PLI) at 29). The communications at the [*9] meetings themselves, being oral, were viewed as not being a "prospectus" within

the meaning of Securities Act § 2(a)(10) [formerly § 2(10)]. It was universally recognized that the antifraud provisions of the securities laws applied to such presentations and that they should not contain material information that would have been required to be included in the prospectus and registration statement for the offering. Any written materials, such as charts, etc., used at the meeting were presented in slide format (generally as a result of a view that such a presentation would not involve a "written" communication within the § 2(a)(10) meaning). Those conducting the meetings were typically instructed not to distribute any written materials other than the preliminary prospectus.

Enhanced Access. As communications technology advanced, so did the desire for greater dissemination of road show-type information. Information presented to the institutional investors who attended a road show would also be useful to institutional investors in more remote locations who were not able to attend. Video-recording or audio-recording was the first medium utilized for such enhanced dissemination. This, [*10] however, raised a potential issue under the Securities Act, in that § 2(a)(10) provides that the term "prospectus" includes any "communication, written or by radio or television, which offers any security" [Emphasis added. The words "or television" were added to the Statute by amendment in 1954.]

The first no-action requests to address the issues involving such recordings were concerned with the use of videotapes to be played for others. Merchants National Corp. (Dec 12, 1975); Producers Funding Corp. (Dec. 28, 1981), (March 9, 1982); Exploration, Inc. (Oct. 9, 1986). These first letters distinguished a video cassette from a "communication ... by ... television" primarily on the ground that a video cassette was not a broadcast medium even though it might use television technology (and would typically be played over a television set). The statutory reference, it was argued, referred to television as a broadcast medium, not as a type of technology. References were also made to such communications as not being "directed to the public at large" (Exploration, Inc. incoming letter dated July 22, 1986).

Apparently, the first no action request dealing with the live transmission [*11] of a road show was Private Financial Network (March 12, 1997). That letter, building on the distinctions in the prior no-action letters, took the position that the references to radio and television in § 2(a)(10) were necessarily to radio and television broadcasts and that such broadcasts necessarily meant "broadcasts scattered over a 360-degree radius, not person-to-person transmissions." As a result, counsel concluded that the transmissions to a carefully limited audience were not such "broadcasts."

Subsequent no-action requests then argued that the § 2(a)(10) analysis did not pose concerns as long as those who were permitted to view the non-broadcasts were a select and relatively exclusive group. Net Roadshow, Inc. (July 30, 1997); Bloomberg L.P. (Oct. 22, 1997); Thomson Fin. Services, Inc. (Sept. 4, 1998). A typical formulation of the limitation on who might view the presentation is that contained in the request of Activate.net Corporation (Sept. 21, 1999): "institutional investors or other persons of a type the underwriter would customarily invite to a road show" We understand that attendees at actual (live) road show presentations often were not screened in any [*12] way to confirm "eligibility" to attend. Nonetheless, given the limitations set forth in the no-action responses, the group of persons allowed to view recorded road shows was monitored.

In chronological order, it appears that the permissible group of viewers was initially limited to the largest institutions, was then broadened to include Rule 144A-type "qualified institutional buyers" (in transactions within the framework of Rule 144A), and was then broadened further in an oral interpretation by the staff to permit road show access in registered offerings to individual investors who qualified as Rule 501 "accredited investors," provided that the underwriters responsible for the road show customarily invited such investors to road shows in connection with such offerings.

While this line of analysis had a plausible compatibility with the statutory language, it inevitably had the unfortunate side effect of supporting a selective disclosure environment, as the staff (and the Commission) properly noted in Sec. Act Rel. No. 7606(A) (Nov. 13, 1998) (the "Release"), § VII.A.2. As practices relating

to access to road shows have evolved, it is now the case, if unintentionally, that of the various [*13] groups who might participate in a public offering, only retail investors are discriminated against by being precluded from getting the benefits available from receiving road show information.

If only a select few investors are entitled to view an electronic transmission of the road show, via cassettes, closed circuit television-type transmissions, or the internet, it follows that only retail investors will be in the position of having to make investment decisions without access to the same information. At the policy level, such an approach could be justified if the oral information communicated during a road show were viewed as completely immaterial to the investment decision. That conclusion, however, is difficult to support when it appears that institutional investors find the information useful in making investment decisions.

The Schwab Procedures. Schwab's operating philosophy is precisely opposite the implicit (if unintentional) endorsement of selective disclosure procedures contained in the no action requests to date dealing with electronic road shows, and properly criticized by the staff and the Commission in the Release. Schwab's view is that advances in information technology [*14] should empower investors by making appropriate information accessible as widely, as quickly and as efficiently as possible.

Consistent with that philosophy, Schwab believes that road show information should not be reserved for a select few, but should be more broadly available to investors who are considering participation in a given offering, regardless of their individual size or market power. Schwab acknowledges that access might be restricted (by website password protection) to accounts for which participation in such investments is generally appropriate, and is not proposing to make road shows generally available. In Schwab's specific case, such concerns are covered by making road shows available only (a) through its public offering website, which, as noted, is available only to accounts that qualify at the Schwab Signature Services TM Gold n1 level (or above) and is password-protected, and (b) to independent registered investment advisers, or advisers exempt from registration, for, among others, individual investors who trade through Schwab ("Independent Investment Advisers") n2 whose access to the internet presentation would also be password-protected.

n1 Schwab Signature Services TM accounts are those that meet specific criteria of trading and investment experience. They, together with the Independent Investment Advisers referred to in note 2 below, and those advisees of the Independent Investment Advisers who might have access to the road shows as indicated in note 2 below (i.e., the universe of those to whom the road shows would be accessible through Schwab) currently comprise less than 20% of Schwab's 6.3 million active customer accounts. The Gold level -- which is the minimum level at which Schwab makes access to the public offering website available -- requires significant trading experience (at least 24 trades per year) or asset accumulation (at least \$500,000 equity in household investment positions). [*15]

n2 These are a limited number (fewer than 10,000) of registered (or exempt) investment advisers, and the accounts that they advise are administered independently of the Schwab Signature Services TM accounts. All of the Independent Investment Advisers have accounts with Schwab. All of the Independent Investment Advisers are of such a nature that they would be entitled to view road show presentations under the existing no-action positions referred to in the text, and in most instances the Independent Investment Advisers have discretionary trading authority over the account. In any event, it is the Independent Investment Adviser, and not the account holder, to whom Schwab proposes to provide access to the road show. Schwab will make it a condition of access to road shows by such Independent Investment Advisers that they agree not to make the road show presentations available to persons who would not otherwise be entitled to view them (e.g. as the equivalent of Schwab Signature Services TM customers themselves).

Schwab believes that it is not appropriate to make artificial distinctions that keep relevant information hidden from retail investors who might participate in the offering, [*16] while it is made available to all others who might buy in the offering.

We would particularly argue that § 2(a)(10) of the Securities Act should not be read in such a way as to make an internet transmission of a road show a "prospectus" if it is viewed by retail investors, but not if it is viewed by other categories of investors. We also believe, for the reasons described later in this letter, that a fair legal analysis of the issues supports the view that the Schwab approach is consistent with investor protection and a sound interpretation of the Securities Law.

In communicating road shows over the internet, Schwab proposes to follow the following guidelines: n3

n3 In addition to these limitations of direct relevance to the communication of road shows, Schwab would continue to apply its normal processes to subsequent sales.

1. Road shows would be communicated over the internet only with respect to initial public offerings of securities, and only after the relevant registration statement has been filed and a preliminary prospectus is being distributed. Included in the process of viewing (e.g., as part of the log-in process) will be a representation that the viewer, by electing [*17] to view the transmission, agrees not to re-transmit the content of the transmission, or otherwise make it available, to others who are not eligible to view it under the criteria identified in this letter.

2. A preliminary prospectus will be available to all those who are able to view the road show, and a button will be available on the screen displaying the road show, enabling the investor to view, print or download the preliminary prospectus. A legend will be provided including language substantially to the following effect:

"An offering of the securities of this issuer is in process, but is made only by the prospectus. That prospectus is included in a registration statement that has been filed with the Securities and Exchange Commission but has not yet become effective. We urge you to review that prospectus carefully before making any investment decision. To obtain it, double-click on the 'prospectus' icon appearing on the screen.

"These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This communication shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any [*18] sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such State. The Securities and Exchange Commission does not endorse this offering, nor does any state regulatory authority."

3. As noted above, these road shows for initial public offerings will be made available only to (a) accounts that qualify for access to public offerings through Schwab, at least as Schwab Signature Services TM Gold accounts, with access to Schwab's password-protected public offering website or (b) Independent Investment Advisers (and those to whom they provide access as indicated in footnote 2), whose access would also be password-protected. As noted above, these are all accounts that have met established financial criteria.

4. If (as it is considering) Schwab presents such road shows through arrangements with third-party vendors who have already adopted procedural safeguards satisfactory to the staff of the Commission under existing no-action precedent relating to electronic road shows, Schwab will abide by (and be subject to) those same safeguards (other than limitations on the qualifications [*19] of persons entitled to view the presentation, to the extent they are more restrictive than those identified in this letter).

5. If Schwab presents such road shows itself, then it will adopt and apply safeguards substantially the same as those referred to in item 3, specifically including the procedures and safeguards identified below. Schwab may also, on occasion, seek to include remote questions when the road show is presented "live." To the extent Schwab can influence the presentation (as, for example, the lead manager of a public offering typically can), Schwab will also seek to ensure that the information presented is consistent with that contained in the prospectus. The specific procedures and safeguards to be applied in connection with any such road show will include (subject to the staff's satisfaction with other procedures at the time):

- (a) Ensuring that the road show transmitted over the internet is a "live" or recorded transmission of a road show that is or was actually presented live before a physically present audience of persons who are underwriting Participants, eligible investors or both, and who have the ability to ask questions and receive responses;
- (b) Ensuring [*20] that the entire presentation, with questions and answers, is included in the internet transmission (subject to unintended technological malfunctions, editing to remove "dead" time, and overlays to provide updates or correction of misstatements, omissions or mistakes and the like, and contact information at Schwab, all as identified in prior no-action letters that have received favorable responses);
- (c) Limiting access, through assignment of a password, to any electronic road show that it transmits, to persons or entities that have Schwab Signature Service TM accounts at the Gold level or higher, or are Independent Investment Advisers, as described above.
- (d) Limiting the viewings by recipients in a manner heretofore described in a no-action request that received a favorable response, such as a limitation of two viewings per subscriber (Private Financial Network), viewings on one day only (Net Roadshow) or unlimited viewings within a single 24-hour period (Bloomberg; Thomson Financial Services);
- (e) Giving only a single password to any one account or Independent Investment Adviser;
- (f) Transmitting only one version of a particular IPO road show during the waiting period for that IPO [*21] (subject to editing as identified in (b) above); and
- (g) Requiring, as noted above in (1) above, that any recipient of a road show transmission represent that the recipient will not copy, download or re-transmit the content of the transmission, or otherwise make it available, to others who are not eligible to view it under the criteria identified in this letter.

Legal Analysis. As the prior no action requests have properly identified, the key element of the legal analysis is determining whether the road show constitutes a statutory "prospectus" within the meaning of Securities Act § 2(a)(10). However, we believe that the approach utilized for the analysis should be carefully structured to eliminate unwarranted selectivity in the disclosure process.

In applying § 2(a)(10) to the present request, we begin with a simple review of the statutory words. We would first argue that the internet as a medium is simply not included within the statute, so that the internet-distributed road show is no more within the definition of "prospectus" than a live road show. The Congress faced a similar issue in 1954 with television, the then-new media entrant. At that time, it appears that the [*22] Congress was not satisfied that the words "communication, written or by radio ..." were sufficient to embrace television, and the statute was specifically amended to include television as a medium of communication. The relevant provisions of the statute have not since been amended.

Under these circumstances, it would seem to us that internet communications, particularly those accompanied by appropriate controls, including password protection, as envisioned by Schwab (and identified above), are further removed from "radio or television" than "television" was from "radio" in 1954. The essential element of the television communication relevant to these questions is, in almost all instances, far more the verbal content than the visual content. Nonetheless, the Congress was satisfied that "communication ... by radio" would not include televised communications. Similarly, internet communications are simply not radio or television communications.

Second, we believe that the proposed manner of distribution is fully consistent with prior no-action requests, and is far more fairly available to investors who are eligible to participate in the offering. As noted above, prior no-action letters [*23] have been issued for closed circuit transmission of a road show. Private Financial

Network (March 12, 1997). An internet transmission in a password-protected environment is essentially no different, except that the internet, rather than television, medium is used in the controlled environment. In the system presently proposed, accounts at the Schwab Signature Services TM Gold level or higher, who have met the specified criteria, and Independent Investment Advisers, would be able to view the road show. Others would not be able to. Whatever public interest there may be in restricting the audience has been satisfied. (Although we would note our continuing view that such limitations were not the intended thrust of the relevant language in Securities Act § 2(a)(10).)

Finally, we believe that the term "prospectus" itself must be recognized as being subject to a flexible interpretation, consistent with the Supreme Court's decision in *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561; 115 S. Ct. 1061; 31 L. Ed. 2d 1 (1995). While we might come to a different conclusion in the absence of a controlled environment -- [*24] where the road shows themselves might have an enhanced risk of encouraging investments by accounts for which they would not be appropriate -- that is not the case in the present context. In this context, as described above, Schwab's procedures are reasonably designed to ensure both (1) that road show information is transmitted only to those with access to a password-protected public offering website, and (2) that a formal prospectus, in the form included in the registration statement, is readily and easily available to each account that views the road show.

We understand, of course, that the anti-fraud proscriptions of Securities Act § 17(a), Securities Exchange Act § 10(b), and the Commission's Rule 10b-5, as well as Securities Act § 12(a)(2), would be fully applicable to the statements made at the road show, whether or not it is communicated over the internet.

Conclusions. For the reasons described above, we believe that an internet presentation of a road show for a public offering of securities, appropriately prepared and shown (such as in accordance with the procedures described above), when preceded or accompanied by a preliminary prospectus containing the information [*25] set forth in the registration statement for the offering, is not and should not be considered to be a "prospectus" within the meaning of Securities Act § 2(a)(10). Our conclusion is based on sound policy analysis and is consistent with a literal reading of Securities Act § 2(a)(10).

As access to information generally, and the availability of road shows in particular, have evolved, it is no longer defensible to maintain an environment in which all potential purchasers in a public offering other than retail investors have the opportunity to see and hear the officers of the issuer discuss the company. Step by step over the last several years the circle of potential purchasers given that opportunity has expanded. Now it is time to permit all potential purchasers in an offering to make their decision based on the same available information. In the context of registered public offerings, the norm should be equal public access of all potential purchasers to all relevant information. Retail investors should not be the only category to whom this information is denied.

We believe that under all of these circumstances the Commission should not consider, and the Division should not recommend, [*26] enforcement action if Schwab were to proceed as outlined above.

Please do not hesitate to call the undersigned if there is additional information that we can provide you.

Very truly yours,

Simon M. Lorne

This material is protected by copyright. Copyright © 2000 various authors and the American Corporate Counsel Association (ACCA).