# NASD NOTICE TO MEMBERS 97-82

## SEC Approves Amendments To Conduct Rules 2710 And 2720 Regarding Mergers, Acquisitions, And Exchange Offers; Effective December 15, 1997

### Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Continuing Education
- ■ Corporate Finance
- ☐ Government Securities
- ■ Institutional
- ☐ Insurance
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☐ Registered Representatives
- ☐ Registration
- ☐ Research
- ■ Syndicate
- ☐ Systems
- ☐ Trading
- ■ Training
- ☐ Variable Contracts


### Executive Summary

On October 29, 1997, the Securities and Exchange Commission (SEC) approved amendments that clarify the application of Rules 2710 and 2720 of the National Association of Securities Dealers, Inc. (NASD®) Conduct Rules to mergers, acquisitions, exchange offers, and similar transactions, and establish limitations on certain "tail fee" arrangements.[1] The amendments are effective December 15, 1997, with respect to transactions that have not commenced as of that date.


Questions regarding this *Notice* may be directed to Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, Inc., and Richard J. Fortwengler, Associate Director, Corporate Financing, NASD Regulation℠, at (202) 974-2700.

### Background

Rule 2710 of the NASD Conduct Rules (Corporate Financing Rule) requires that members file with the Corporate Financing Department of NASD Regulation proposed 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.[2]

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," but neither rule currently identifies the types of mergers and acquisitions subject to filing and compliance with those rules. NASD Regulation has, therefore, amended 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 to make other related amendments. In view of the increasing amount of merger and acquisition activity, NASD Regulation believes that these amendments eliminate confusion regarding their application to such transactions.

### Review Procedures For Exchange Offers, Mergers, Acquisitions, And Similar Transactions

With respect to the time-sensitive nature of many exchange offers, mergers, acquisitions, and similar corporate reorganizations that are subject to filing as a result of SEC approval of amendments to Rules 2710 and 2720, NASD Regulation previously announced in *Notice to Members 95-73* (September 1995) a policy to expedite the review of such offerings by the Corporate Financing Department. In general, it is anticipated that a comment letter will be issued by the Corporate Financing Department 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.

## Description Of Amendments

### Summary Of Amendments To Filing Requirements

NASD Regulation has adopted amendments to the Corporate Financing and Conflicts Rules to 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 amendments 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 that involves certain unlisted securities or securities that are exempt from registration with the SEC. However, filing of an exchange offer (where a member is participating in distributing activities), that would otherwise not be subject to filing, is 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 are 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.

### Amendments To Filing Requirements Of Rule 2710

Paragraph (b)(9) of Rule 2710 provides clarification of certain types of public offerings required to be filed with the Corporate Financing Department of NASD Regulation for review. Paragraph (b)(9) has been amended to add new subparagraph (H) to 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 the filing of exchange offers registered with the SEC if a member acts a dealer-manager.[3] Active solicitation occurs when a member directly solicits or contacts security holders, acts as dealer-manager, performs tasks that are performed by investor relations firms (*i.e.*, contacts security holders to determine the action they intend to take), contacts security holders to determine whether they have received the offering materials, answers unsolicited contacts, and participates in meetings with security holders or their advisors before or after an exchange offer begins.[4] 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 security holders, nor any other functions that do not involve direct solicitation or direct contact with security holders.[5]

With respect to exchange offers registered with the SEC 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 solicit 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), 3(a)(9) and 3(a)(11) of the Securities Act or registered with the SEC does not fall within the filing requirement in new subparagraph (b)(9)(H) 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."

However, NASD Regulation has also adopted new subparagraph (b)(7)(F) 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 company issuing securities qualifies to register securities on SEC Registration Forms S-3, F-3 or F-10. It is believed that the listing standards of the three markets requiring independent directors on the Board of Directors will ensure that the independent directors of the acquirer 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 (Act) Release No. 29354 (June 21, 1991).[6] This provision requires, 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 worldwide. 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 Rule 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.[7]

Paragraph (b)(9) of the Corporate Financing Rule has also been 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. This latter filing requirement, therefore, only requires the filing of exchange offers, mergers, acquisitions, and corporate reorganizations involving an offering of securities of a member or its parent or that results in the public ownership of the member or its parent. Such offerings would be subject to compliance with Rules 2710 and 2720.[8] 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.[9]

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. NASD Regulation has added 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 or similar form of 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.

Spin-off transactions to existing security holders as a dividend or other distribution generally 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.[10] 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 acquirer or target, that may include an obligation that the member issue a fairness opinion regarding the acquisition price.

**Amendments To Compensation Arrangements Under Rule 2710**

In addition, NASD Regulation has added 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 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 granted by a company to a member in connection with an exchange offer transaction. 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 new "tail fee" prohibition also permits 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 interpret the provision to permit such an arrangement is intended to be used only where the 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 is 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 "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, NASD Regulation 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 NASD'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)(5)(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, NASD Regulation has considered whether other types of fees and expense reimbursement arrangements typically negotiated for and received in connection with exchange offers 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 payments 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.

NASD Regulation 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 *Notice to Members 95-73* (September 1995), which published the original version of the proposed rule change for comment, the NASD 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.

**Amendments To Rule 2720**

NASD Regulation has amended 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 has been 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 Sections 3(a)(4), 3(a)(9), and

3(a)(11) of the Securities Act if the member's participation involves active solicitation activities, and the filing 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.[11] 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.[12]

NASD Regulation also has amended Rule 2720 to clarify the obligations of a qualified independent underwriter[13] 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 Conflict Rule requires 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). NASD Regulation has amended subparagraph (c)(3)(A) 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 includes exemptions 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 subparagraph (b)(8) of Rule 2710.

**Implementation Of The Amendments**

NASD Regulation has considered the impact of these amendments 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 sufficient time for members to bring their arrangements into compliance, the amendments are applicable to proposed exchange offers, mergers, acquisitions, and similar transactions that have not commenced as of December 15, 1997. Therefore, if subject to filing under Rule 2710 or Rule 2720, such transactions are required to be filed for review with the Corporate Financing Department. Further, such transactions, although exempt from filing under subparagraph (b)(7) of Rule 2710, will be required to be made in compliance with the restrictions on "tail fee" arrangements and other provisions of the Corporate Financing Rule.

The new restrictions on "tail fee" arrangements are not, however, applicable to any outstanding "tail fee" arrangement for an exchange offer, merger, acquisition, or similar transaction that has commenced prior to effectiveness of these amendments on December 15, 1997.

## Text Of Amendments

*(Note: New text is underlined; deletions are bracketed.)*

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

**(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 reg-

istered 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 listed on The Nasdaq National Market, 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 security-holders 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, except 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 exchange 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 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 Association that an arrangement of more than two (2) years is not unfair or unreasonable under the circumstances.

Subparagraphs (v) - (xiii) are renumbered (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.

## Endnotes

[1] Securities Exchange Act Release No. 39284 (October 29, 1997).

[2] 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.

[3] The term "exchange offer" refers 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).

[4] Activities by a broker/dealer that would not come within the concept of "soliciting" for purposes of Section 3(a)(9) may nonetheless 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 *Notice*.

[5] 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. *See* Sections 3(a)(5), (6), (10), and (12) of the Securities Act.

[6] *See Notice to Members 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.

[7] *See* description below of proposed rule change to Rule 2720. *See also* footnote 8 *supra*.

[8] 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.

[9] In that *Notice*, the NASD 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.

[10] It should be noted, however, that when a spin-off 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.

[11] *See* footnote 6 *infra*.

[12] 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."

[13] 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.