

Negative Assurance in Securities Offerings (2008 Revision)

Report of the Subcommittee on Securities Law Opinions,
Committee on Federal Regulation of Securities,
ABA Section of Business Law

INTRODUCTION

In 2004, a report entitled *Negative Assurance in Securities Offerings* by the Task Force on Securities Law Opinions of the ABA Section of Business Law was published in *The Business Lawyer*.¹ The five-page report and accompanying three-paragraph “Illustrative Form of Negative Assurance” envisaged that a single disclosure document would contain all material information provided to prospective investors.

A year after the report was published, the U.S. Securities and Exchange Commission (“SEC”) significantly altered the landscape for public offerings by adopting securities offering reform proposals.² The new rules codified the SEC’s view that the potential liability of a seller of securities for deficiencies in disclosure is based on the information about the issuer and the offering conveyed to prospective investors at or before the time when the contract of sale is entered into, rather than the information in the prospectus sent with the confirmation of sale.³ Moreover, the new rules permitted use of written communications other than the statutory prospectus, called “free writing prospectuses,” to convey information to prospective investors,⁴ and the requirement that the final prospectus be physically delivered to the purchasers was eliminated so long as the final prospectus is filed with the SEC and the purchasers receive notice that they have purchased

1. 59 Bus. Law. 1513 (2004). After the Task Force completed its negative assurance report in 2004, the Subcommittee, which was a part of the Task Force, continued to work in this area.

2. See Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44722 (Aug. 3, 2005) (codified at 17 C.F.R. pts. 200, 228, 229, 230, 239, 240, 243, 249, and 274).

3. Under Rule 159, 17 C.F.R. § 230.159 (2008), information “conveyed” to the purchaser after the “time of sale (including, without limitation, a contract of sale)” is not taken into account in determining liability under sections 12(a)(2) and 17(a)(2) of the Securities Act of 1933, 15 U.S.C. §§ 77f(a)(2), 77q(a)(2) (2006). The final prospectus, if filed as required, is taken into account for purposes of liability under section 11, 15 U.S.C. § 77k (2006).

4. Rule 164, 17 C.F.R. § 230.164 (2008), permits use of a free writing prospectus by an eligible issuer if the conditions of Rule 433, 17 C.F.R. § 230.433 (2008), are met. These conditions relate to delivery or availability of the statutory prospectus, inclusion of information that does not conflict with the prospectus, legending, and filing.

securities in a registered offering.⁵ In addition, the use of offering documents that incorporate by reference the issuer's reports filed pursuant to the Securities Exchange Act of 1934 ("Exchange Act") has continued to increase.

In light of these developments, the Subcommittee is updating the 2004 report and illustrative form of negative assurance to reflect current law and practice.⁶

HISTORY AND PURPOSE

Under the Securities Act of 1933 ("Securities Act"), registered public offerings of securities are required to be made by means of a registration statement that includes a prospectus.⁷ If any part of the registration statement, as of its effective date, contains a misstatement of a material fact or omits a material fact that is required to be included or necessary to make the statements therein not misleading, the purchasers have a cause of action under section 11 of the Securities Act against the issuer, its directors, and others, including the underwriters.⁸ However, an underwriter is not liable under section 11 if it sustains the burden of proof that, after reasonable investigation, it had reasonable ground to believe, and did believe, that the statements were true and that the registration statement contained no such omission.⁹

To help them establish the statutory "due diligence" defense in registered offerings, underwriters have long followed the practice of requiring, as a condition to the closing, that counsel¹⁰ participating in the preparation of the registration statement provide negative assurance regarding the disclosures in the registration statement and prospectus.¹¹ More recently, that practice has been extended to some unregistered offerings (e.g., under Rule 144A¹² or Regulation S¹³) in

5. Under Rule 174(b), 17 C.F.R. § 230.174(b) (2008), a prospectus need not be delivered if the issuer is a reporting company under the Securities Exchange Act of 1934, with specified exceptions. Rule 173(a), 17 C.F.R. § 230.173(a) (2008), requires only that a notice be given to each purchaser to the effect that the sale was made pursuant to a registration statement.

6. This Report supersedes the 2004 report.

7. Securities Act § 5(b)(2), 15 U.S.C. § 77e(b)(2) (2006).

8. *Id.* § 11, 15 U.S.C. § 77k (2006). In addition, section 12(a)(2) of the Securities Act, 15 U.S.C. § 77l(a)(2) (2006), provides a purchaser with a cause of action against a person who has offered or sold a security by means of a prospectus or oral communication that includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading.

9. *See id.* § 11, 15 U.S.C. § 77k (2006). A similar defense is available under section 12(a)(2) of the Securities Act if an underwriter sustains the burden of proof that it did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. 15 U.S.C. § 77l(a)(2) (2006). Other persons potentially liable under section 11, except the issuer, have similar defenses.

10. Both issuer's counsel and underwriter's counsel generally provide negative assurance and use forms of letters that in practice are essentially identical.

11. Receipt of negative assurance letters from counsel is only one part of an underwriter's "due diligence." It also includes, among other things, receipt of "comfort letters" from accountants, conversations with the issuer's management, representations from the issuer, certifications from the issuer's officers, and other procedures the underwriter considers appropriate under the circumstances.

12. 17 C.F.R. § 230.144A (2008).

13. *Id.* §§ 230.901–905.

which an offering document comparable to the statutory prospectus in a registered offering is delivered and the process of preparing it is comparable to that followed in a registered offering.¹⁴ Although sections 11 and 12(a)(2) of the Securities Act do not apply to unregistered offerings,¹⁵ financial intermediaries and placement agents may request negative assurance to help them establish a defense to claims that might be brought pursuant to Rule 10b-5 under the Exchange Act.¹⁶ The practice of requesting negative assurance has been further extended to some offerings outside the United States.¹⁷

Negative assurance is not a “legal opinion.” Rather, it is a statement of belief, unique to securities offerings, based principally on counsel’s participation in the process of preparing and discussing the registration statement or other offering document with the various participants in the process.¹⁸

This Report offers guidance on providing negative assurance in both registered and, where appropriate, unregistered securities offerings, and includes an illustrative form. The form does not address other matters that may be covered in negative assurance letters.¹⁹

14. In a Rule 144A offering, the issuer typically sells securities pursuant to the exemption from registration provided by section 4(2) of the Securities Act, 15 U.S.C. § 17d(2) (2006), to a limited number of financial intermediaries who promptly resell the securities to “qualified institutional buyers” pursuant to the resale exemption provided by Rule 144A. Regulation S provides an exemption for certain offshore offerings. Sometimes the issuer sells securities directly to ultimate purchasers solicited by financial intermediaries, who may agree to purchase any securities not sold.

Underwriters of municipal securities sold to the public but exempt from registration under section 3(a)(2) of the Securities Act, 15 U.S.C. § 77c(a)(2) (2006), often request negative assurance. Dealer-managers in exchange offers by companies offering to exchange their securities for securities of another company or another class of their own securities sometimes request negative assurance.

15. See *Gustafson v. Alloyd Co.*, 513 U.S. 561, 581 (1995).

16. Rule 10b-5, 17 C.F.R. § 240.10b-5 (2008), requires “scienter,” i.e., intent to deceive, manipulate, or defraud or similar reckless conduct. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). “Due diligence” as such is not a defense under Rule 10b-5, but, if established, it would help to demonstrate the absence of scienter.

17. Some underwriters ask for negative assurance letters in non-U.S. transactions not involving U.S. investors or U.S. law because they believe that their ability to demonstrate that they conducted the “due diligence” customary in U.S. offerings may be helpful in defending claims brought under foreign law. However, U.S. lawyers may be reluctant to provide negative assurance letters to help underwriters establish a defense against potential liability under foreign laws, even if those laws contemplate a “due diligence” type defense.

18. See “Procedures Undertaken by Counsel Providing Negative Assurance” and “Basis for Providing Negative Assurance” below. Giving a negative assurance letter does not imply that counsel has made an investigation of every statement in the offering document. It only confirms that the work that counsel did perform in connection with preparing and reviewing the offering document and other issuer documents did not cause counsel to believe that the offering document contained a misstatement or omission of material fact.

19. For example, a negative assurance letter in a registered offering or an accompanying opinion letter often contains statements to the effect that the registration statement and prospectus complied as to form in all material respects with the requirements of the Securities Act of 1933 and (where applicable) the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbbb (2006), and the rules and regulations thereunder or, alternatively, that the registration statement and prospectus appeared on their face to be appropriately responsive in all material respects to those requirements. Lawyers generally view such

RECIPIENTS OF NEGATIVE ASSURANCE

The purpose of negative assurance is to assist the recipient in establishing a due diligence or similar defense. Therefore, negative assurance is customarily provided only to underwriters or other third parties that can avoid liability in a securities offering by establishing such a defense.²⁰ Ultimate purchasers of securities, unlike underwriters or other financial intermediaries, do not have liability under the securities laws and accordingly do not need a defense against liability. For this reason, requests for counsel to provide negative assurance to ultimate purchasers, or to issuers,²¹ are not appropriate.²²

INCORPORATION OF DOCUMENTS BY REFERENCE

Today, prospectuses used in almost all registered public offerings, except initial public offerings, and offering documents used in many unregistered offerings, incorporate by reference documents filed by the issuer under the Exchange Act that contain business information and financial statements.²³ The new form of negative assurance contemplates incorporation of documents by reference and defines the terms "Prospectus" and "Offering Document" as including the documents incorporated by reference.²⁴

A registration statement on Form S-3 or F-3 must incorporate by reference the issuer's latest annual report on Form 10-K, 20-F, or 40-F, as applicable, and all reports on Form 10-Q or Form 8-K filed since the end of the fiscal year covered by the annual report.²⁵ The incorporated documents typically do not include

a "compliance as to form" statement as addressing only the apparent responsiveness of the relevant document to particular disclosure requirements and not as confirming that all applicable disclosure requirements have been satisfied or that the apparently responsive disclosure is accurate or complete. Because a "compliance as to form" statement does not address the substance of the information, it is usually given only as of a single relevant date.

20. In global offerings, underwriters sometimes also perform other roles, such as acting as "sponsor" or "listing agent" for a foreign stock exchange listing, for which they may be subject to potential liabilities under foreign law. However, lawyers may be reluctant to address negative assurance letters to underwriters acting in any capacity other than as underwriters, since their potential liabilities for other roles arise under foreign law that may not contemplate a "due diligence" defense.

21. Issuers have potential securities law liability, but no "due diligence" defense, under section 11 of the Securities Act, 15 U.S.C. § 77k (2006).

22. Although directors have a "due diligence" defense under section 11, negative assurance letters are usually not addressed to them. Directors usually have better access than outside lawyers to information that enables them to assess the accuracy and completeness of disclosure and generally establish their "due diligence" defense in other ways.

23. Incorporation by reference means that the document being given to investors is deemed to include the incorporated documents as if they had been physically attached in full text. The issuer usually undertakes to provide copies of the incorporated documents on request and without charge to any person who receives a prospectus, and the incorporated documents are generally available through the issuer's web site and other web sites such as the SEC's EDGAR system.

24. If documents are not incorporated by reference, references to them in the form may be deleted.

25. Registration statements on Form S-1 or F-1 for public offerings by reporting companies that are not eligible for Form S-3 or F-3 frequently incorporate the same documents by reference. Because Form 10-K either incorporates information from the issuer's proxy or information statement filed

information about the offering, such as the terms and price of the securities being offered. That information is included in the prospectus. Many offerings today are made by means of a “shelf” registration statement that covers multiple offerings of different kinds of securities and often becomes effective well before the issuer is ready to proceed with any particular securities offering.²⁶ When an offering does not occur immediately after the shelf registration statement becomes effective, any reports on Form 10-K (or 20-F or 40-F), 10-Q, or 8-K filed by the issuer after the effective date are deemed incorporated by reference in the registration statement so that, when the offering occurs, the registration statement includes the most recent information filed by the issuer concerning its business and the issuer’s most recent financial statements.²⁷

Liability under section 11 of the Securities Act is determined by reference to whether “any part of the registration statement, when such part became effective,” contains a material misstatement or omission.²⁸ When an offering commences immediately after a registration statement becomes effective, liability under section 11 of the Securities Act will depend on the “total mix” of information in the registration statement and any documents incorporated by reference in it as of the effective date of the registration statement. However, after the 2005 rule revisions, a new effective date of the registration statement is deemed to be established when the issuer offers securities “off the shelf” pursuant to a new form of prospectus required to be filed with the SEC pursuant to Rule 424(b)(2), (b)(5), or (b)(7).²⁹ Under Rule 430B(f),³⁰ this effective date is the earlier of the date that the new form of prospectus is first used or the date and time of the first contract of sale of the securities to which it relates.³¹ When more than one document is incorporated by reference in the prospectus, any statement contained in an earlier document is deemed modified or superseded to whatever extent it has been modified or

pursuant to Regulation 14A, 17 C.F.R. §§ 240.14a-1, 240.14b-2 (2008), or includes the information required by Regulation 14A, registration statements that incorporate Form 10-K reports also incorporate information filed by the issuer pursuant to section 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a) (2006).

26. If the registration statement is on Form S-3 or F-3, Rule 415, 17 C.F.R. § 230.415 (2008), allows the securities to be offered on a delayed or continuous basis for a period of three years after its effective date.

27. This is not so, however, for information included in reports on Form 6-K subsequently submitted to the SEC by a foreign private issuer. That information is incorporated by reference only when the registration statement and Form 6-K expressly so provide. Offering documents used outside the United States may also incorporate documents filed by the issuer with an offshore regulatory authority or securities exchange.

28. 15 U.S.C. § 77k (2006).

29. See 17 C.F.R. § 230.424(b)(2), (b)(5), (b)(7) (2008). Occasionally, a negative assurance letter is given before a prospectus has been prepared for a particular offering. In such a case, the letter will address the registration statement as of its effective date or, if a document filed by the issuer after the effective date is incorporated by reference in the prospectus, it may refer to “each part of the registration statement, when such part became effective.”

30. 17 C.F.R. § 230.430B(f) (2008).

31. This effective date relates to the issuer and the underwriters participating in the offering to which the prospectus relates, but not to accountants, other experts, directors, and signing officers, who are covered by other provisions of Rule 430B(f) that look to earlier dates.

replaced in a subsequent document, and the superseded information is no longer deemed to be included in the registration statement.³²

In shelf offerings, the registration statement may describe multiple classes of securities that the issuer may offer, but when the issuer actually makes an offering, it may offer just one of the classes. The lawyers providing negative assurance may seek to narrow their review of the offering documents to the description of the class being offered and exclude the descriptions of the other classes.³³ In these circumstances lawyers may limit their negative assurance on the registration statement to apply only “insofar as it relates to the offering of the Securities.” The new form of negative assurance includes optional language to that effect.³⁴

PRICING DISCLOSURE PACKAGE

Because Rule 159³⁵ provides that information conveyed to purchasers after the time of sale is not taken into account in determining liability under section 12(a)(2) of the Securities Act,³⁶ the new form focuses on the documents that are available to be conveyed to purchasers at or before the time of sale, which it refers to collectively as the “Pricing Disclosure Package.” Different terms may be used in practice. The form provides for the documents in the Pricing Disclosure Package to be listed in Exhibit A to the letter. They would normally include a prospectus that is made available or distributed to investors before pricing (e.g., a preliminary prospectus or a base prospectus with one or more prospectus supplements), as well as certain other written documents (“free writing prospectuses”) prepared at or before pricing that contain additional disclosures (e.g., a term sheet) and a description of any material information conveyed orally (e.g., the price in an initial public offering).³⁷

32. See Rule 412, 17 C.F.R. § 230.412 (2008). The modifying or superseding statement need not state that it is modifying an earlier statement. This can result in difficult determinations regarding precisely what information is included in the “total mix” of the information in all the documents.

33. A similar circumstance can arise with respect to documents incorporated by reference, which may include information (e.g., some risk factors in Form 10-K reports, or certain Form 8-K reports) relating primarily to classes of securities that are not being offered.

34. This issue may also be addressed in some cases by defining the terms “Registration Statement” and “Prospectus” so as to include only the information relevant to the offering. In defining “Registration Statement” and “Prospectus,” lawyers often refer specifically to particular amendments to the registration statement, base prospectuses, prospectus supplements, and other documents that have been filed with the SEC to make clear which ones are part of the “Registration Statement” and “Prospectus” for purposes of the letter.

35. 17 C.F.R. § 230.159 (2008).

36. See *supra* note 3.

37. The documents included in the Pricing Disclosure Package will vary depending on the circumstances of the offering. Drafts that are superseded by later drafts (e.g., preliminary prospectuses that are amended) and supplemental marketing materials (e.g., free writing prospectuses that are derived from the preliminary prospectus and do not contain additional material information) will not be included. In offerings of asset-backed securities, counsel may provide negative assurance only on a preliminary prospectus or a “virtual red” (a free writing prospectus containing substantially the same information as a preliminary prospectus) and not on other documents sent by underwriters or dealers to prospective investors prior to pricing.

Financial intermediaries in unregistered offerings often follow the practice of providing purchasers with a Pricing Disclosure Package.³⁸ The new form includes alternative language that may be used when this is done.

TIME AS OF WHICH NEGATIVE ASSURANCE SPEAKS

Because the purpose of negative assurance is to assist the recipients in establishing a due diligence defense, negative assurance letters in registered offerings address the documents on which liability may be based as of the date liability is determined under the Securities Act. Thus, for purposes of section 11 liability, the new form addresses the registration statement as of its effective date. Because of possible uncertainty as to what that date may be, some letters simply refer to “the effective date” or, in a shelf takedown, the “most recent effective date” of the registration statement. Other letters refer to a specific date, which is usually the same date as the prospectus but not identified as such. The new form allows for both alternatives.

Liability under section 12(a)(2) of the Securities Act is determined as of the date of the use or delivery of the allegedly misleading prospectus or oral communication.³⁹ The form addresses the prospectus as of its date and the Pricing Disclosure Package as of a precise time on a specified day, which is immediately before any sale has been made or contract of sale entered into and is generally the time when the offering price is fixed.⁴⁰ In the case of offerings exempt from Securities Act registration, the form addresses the offering document as of its date.

MANNER OF EXPRESSING NEGATIVE ASSURANCE

The illustrative form expresses negative assurance with the words “nothing came to our attention that caused us to believe.” Alternative formulations are also common, such as “led us to conclude” in place of “caused us to believe,” “no facts” in place of “nothing,” and “nothing that came to our attention caused us to believe.” These differences in formulation do not change the subjective nature of the negative assurance being given.

PROCEDURES UNDERTAKEN BY COUNSEL PROVIDING NEGATIVE ASSURANCE

Negative assurance letters generally state that counsel has read the registration statement or offering document and participated in discussions with representatives of the issuer and others but do not describe in detail all the work that counsel

38. This is true for domestic offerings. The documents used in offshore offerings by non-U.S. issuers, even when they include a Rule 144A component, are likely to be influenced by local market practices. If a Pricing Disclosure Package is used, it may include a preliminary prospectus that has been distributed to institutional investors before the prospectus to be used in the local market has been approved by the local regulator.

39. See 15 U.S.C. § 771(a)(2) (2006).

40. Because counsel generally is not in a position to know when sales of securities actually began, the time described is usually a time that the underwriters have informed counsel preceded the first sale of the securities.

has done in connection with the offering.⁴¹ Historically, counsel for the issuer in a securities offering gave a legal opinion on the validity of the securities being offered.⁴² In addition, counsel participated in preparing the registration statement or other offering document, and this work provided the basis for giving negative assurance.

Today, however, the lawyers engaged to work on a securities offering may not have been involved in the preparation of the documents incorporated by reference.⁴³ In these circumstances, they may include additional language in the letter to emphasize the limited nature of the work they performed in connection with these documents. Some state that they did not participate in preparing the documents incorporated by reference.

Offerings using short-form registration statements and take-downs from shelf registration statements under Rule 415,⁴⁴ as well as comparable unregistered offerings, often take place within a short time—sometimes even overnight. In these offerings, lawyers customarily provide negative assurance based on their review, within the limited time available, of the offering document and the documents incorporated by reference, discussions with representatives of the issuer about these documents, and whatever knowledge they may have gained in prior representation of the issuer or participation in prior offerings by the issuer.⁴⁵

CUSTOMARY QUALIFICATIONS

A lawyer is not an insurer of the adequacy of the disclosure in an offering document or a “reputational intermediary.” Virtually all negative assurance letters state that counsel does not assume any responsibility for the accuracy, completeness, or fairness of the offering document, except to the extent that specific sections are addressed in a separate opinion or confirmation. Some letters refer to limitations on counsel’s professional engagement and the fact that many of the disclosures in an offering document are of a non-legal character. Some state that counsel is relying on the judgment of management or others regarding the adequacy of disclosure. Many state that counsel has not undertaken to verify the facts contained in the disclosure document.

41. Unlike standard opinion letters, negative assurance letters typically do not state that in preparing the letter counsel has carried out such procedures as counsel has considered necessary or appropriate to provide negative assurance.

42. Schedule A to the Securities Act requires that “an opinion or opinions of counsel in respect to the legality of the issue” be filed with the registration statement. See 15 U.S.C. § 77aa(29). For a discussion of such opinions, see the article cited in *infra* note 55.

43. This is especially true in the case of underwriters’ counsel, who may have had no prior contact with the issuer but is still expected to provide negative assurance.

44. 17 C.F.R. § 230.415 (2008).

45. When there is concern with the existing disclosure, the prospectus may be modified by means of a preliminary prospectus supplement or free writing prospectus or by a report filed on Form 8-K that has the effect of amending the prospectus through incorporation by reference.

BASIS FOR PROVIDING NEGATIVE ASSURANCE

A statement of negative assurance by a law firm necessarily expresses only the actual subjective belief (i.e., conscious awareness) of those lawyers in the firm who have actively participated in the process of preparing the offering document.⁴⁶ That belief is subject to a good-faith standard and is based on their familiarity with the issuer and what they learned as a result of the procedures described in the negative assurance letter and their work in connection with the offering. When a law firm is acting as counsel to the issuer in an offering, the lawyers involved in the offering often consult with other lawyers in the firm who have performed other work for the issuer. When a law firm acts as counsel to the underwriters, the lawyers who work on the offering are likely to be the only lawyers in the firm who are knowledgeable about the issuer.⁴⁷

SUBJECTS NOT ADDRESSED

Negative assurance letters expressly exclude coverage of financial statements, as such, and this exclusion is understood to encompass the accountants' report, notes to the financial statements and financial statement schedules, whether or not expressly stated. Many negative assurance letters also expressly exclude financial, accounting, and/or statistical data⁴⁸ and assessments or reports on the effectiveness of internal control over financial reporting. In addition, many letters expressly exclude other "expertized" material, such as reserve information covered by an engineer's report and appraisals.

Underwriters may object to exclusions of matters that are not being covered by other participants in the offering process, such as accountants or other experts.⁴⁹ They reason that the letter is not only providing them negative assurance but is giving them the benefit of counsel's reading of the entire disclosure document. Accordingly, they may argue that the lawyers should suggest corrections to any

46. While some underwriters object to the inclusion in a negative assurance letter of "ring fencing" language to this effect, most lawyers believe that, based on custom and practice, the negative assurance statement should be understood by the recipient to be based solely on the knowledge of this limited group of lawyers. They believe that underwriters do not, and could not justifiably, believe that every lawyer in the firm would be consulted about every negative assurance letter. On occasion, underwriters have requested a statement that the belief expressed in the negative assurance encompasses all lawyers in the firm who have performed services for the client. Providing such a statement could require canvassing numerous lawyers in multiple offices who are not securities lawyers and have not devoted attention to the offering document. In addition, it would require those lawyers to make judgments beyond their expertise regarding the application of the federal securities laws to that document. Many lawyers would consider such an approach to be impractical and uneconomic.

47. Unlike counsel for the issuer, which is providing negative assurance to a third party, counsel for the underwriters is providing negative assurance to its clients, the underwriters.

48. Some lawyers refer to "information" instead of "data" or to data or information "derived from" the financial statements or the accounting records of the issuer. Even if statistical data or some financial information are not expressly excluded, underwriters understand that there are inherent limitations in the nature of a negative assurance letter insofar as it addresses disclosure outside the expertise of the lawyers providing it.

49. Accountants' comfort letters do not generally cover all financial or accounting data in the prospectus and never address non-financial statistical data.

perceived misstatements or omissions that the lawyers identify anywhere in the document, recognizing that lawyers will not necessarily have a full understanding of all matters. While in practice lawyers may suggest corrections throughout the document, many lawyers insist upon exclusions because they do not want to be perceived as providing even negative assurance on specialized information as to which other offering participants are more qualified to express a view.⁵⁰

ADDRESSING DISCLOSURE AS OF THE CLOSING DATE

Recipients often request that negative assurance letters address the prospectus or offering document both as of its date and as of the closing date (i.e., the date of the negative assurance letter).⁵¹ Many lawyers are willing to give negative assurance as of the closing date, even when it is unclear that the recipients' liability would be determined by reference to that date.⁵² Lawyers who give negative assurance as of the closing date often perform additional procedures to update their work to the closing date and may describe such procedures in the letter.⁵³ The new form includes bracketed language in subparagraph (3) to be inserted when the letter covers the final offering document as of the closing date.

ROLE OF COUNSEL

Negative assurance normally is provided only by counsel having overall responsibility for advising the issuer or underwriters (or other financial intermediaries) concerning the offering document. When other counsel has been retained to advise the issuer on a particular aspect of a transaction (e.g., tax, foreign law, intellectual property, or regulatory matters), such counsel usually addresses the portion of the offering document dealing with that matter by giving an opinion on the accuracy of the description rather than by providing negative assurance.⁵⁴

50. Because a negative assurance letter is intended to be only one component of underwriters' "due diligence" and is informed by the other components, lawyers may decline to give negative assurance if other customary aspects of underwriters' "due diligence," such as receipt of accountants' comfort letters, are not contemplated.

51. Addressing the Pricing Disclosure Package as of the closing date is not appropriate since the Pricing Disclosure Package is superseded by the prospectus or final offering document shortly after the price and terms of the securities have been determined. Therefore, by the closing date the Pricing Disclosure Package, as such, is no longer being used.

52. Under the securities offering reform rules, the time of sale is the key reference point, but even when the underwriters have sold all the securities on the date of pricing and the closing date is three trading days later, underwriters may request that the negative assurance letter be updated to cover the final offering document as of the closing date.

53. A similar issue arises when counsel is asked to update negative assurance in connection with the closing of the underwriters' exercise of an overallotment option days or even weeks after the initial closing of an offering. Although the relevance of the subsequent closing date to the underwriters' potential liability is questionable (since the securities usually have been sold to purchasers long before the exercise of the overallotment option), many lawyers are willing to provide negative assurance at a subsequent closing, in which case they often perform additional procedures during the intervening period and describe those procedures in the letter.

54. Other counsel ordinarily should not be asked to provide negative assurance. However, such a request may be appropriate when such counsel has been retained specifically to advise the issuer

In some cases, such counsel may also provide an opinion to be filed with the registration statement.⁵⁵

CONVEYANCE NOT ADDRESSED

Some negative assurance letters state that counsel expresses no view on whether documents included in the Pricing Disclosure Package have been “conveyed” to purchasers by the underwriters. The new form does not include that disclaimer because in practice lawyers are not in a position to address conveyance, and the negative assurance given does not address it. Counsel cannot be expected to have knowledge of communications between the underwriters and the purchasers and, therefore, would have no basis for expressing a view.⁵⁶

LOCATION OF NEGATIVE ASSURANCE

Because negative assurance is not a legal opinion, it is generally provided in a separate letter⁵⁷ or in a separate unnumbered paragraph of a closing opinion. Either way, counsel’s responsibility and the meaning of the negative assurance are the same.

IRS CIRCULAR 230

Some lawyers include a legend or paragraph referring to IRS Circular 230.⁵⁸ Many lawyers have concluded that a reference to IRS Circular 230 is unnecessary

regarding the disclosure in a particular area that is material to the issuer, such as patent or regulatory matters, is experienced in applicable securities law standards, and has had sufficient involvement with the disclosure document. When other counsel has been consulted with regard to particular matters, counsel principally involved in the preparation of the offering document may wish to indicate that, to the extent its negative assurance covers those matters, its belief is based on the advice of the other counsel. For example, in global offerings by foreign issuers, U.S. counsel may work closely with a local law firm regarding issues of foreign law or documentation in a language other than English and may seek to rely on that counsel in giving the negative assurance letter. Even in the absence of express reliance on other counsel, the recipient of a negative assurance letter should understand that the negative assurance it is receiving is necessarily based on the advice of the other counsel as part of the total mix of information.

55. Providing an opinion filed with the registration statement may result in an assertion of “expert’s” liability under section 11(a)(4) of the Securities Act, 15 U.S.C. § 77k(a)(4) (2008), which imposes liability on persons whose profession gives authority to statements made by them that have been included in the registration statement with their consent. Legal opinions filed with registration statements sometimes state that counsel does not admit to being an “expert” within the meaning of the Securities Act. See *Special Report of the Task Force on Securities Law Opinions*, ABA Section of Business Law, *Legal Opinions in SEC Filings*, 59 BUS. LAW. 1505, 1506 (2004).

56. If counsel representing the underwriters believes that the Pricing Disclosure Package has not in fact been conveyed to purchasers, counsel should consider whether to advise the underwriters separately of the potential consequences of non-conveyance.

57. The separate letter approach may help counsel limit the recipients of negative assurance to those for whom it is appropriate. As stated above under “Recipients of Negative Assurance,” negative assurance is normally not directed to all the recipients of a closing opinion or all those identified as entitled to rely on it, such as trustees or transfer agents. Counsel providing negative assurance generally restricts distribution of copies of the letter, as discussed below.

58. 31 C.E.R. §§ 10.0–.93 (2008).

if the underlying disclosure document has been filed with the SEC or contains appropriate legends.⁵⁹

CONCLUDING PARAGRAPH

Since the purpose of negative assurance is to assist the underwriters in establishing a “due diligence” defense, negative assurance letters normally include a paragraph similar to the concluding paragraph of the new form to emphasize that they are being furnished only to the underwriters (or other financial intermediaries) in their capacity as such and are not to be relied on by anyone else. Some letters state expressly that their purpose is to assist the recipient in establishing defenses under applicable securities laws.

⁵⁹ IRS Circular 230 requires lawyers to include in documents they send to clients that contain any advice on taxes prominent legends stating that the advice cannot be used for the purpose of avoiding tax penalties that may be imposed and also requires lawyers to conform to specified standards if such advice is intended to be provided.

ILLUSTRATIVE FORM OF NEGATIVE ASSURANCE¹

ALTERNATIVE FIRST PARAGRAPH—REGISTERED OFFERING

Reference is made to the Registration Statement on Form [S/F]-[1/3] (File No. _____) (the “Registration Statement”) and the Prospectus, dated _____, 20__ (including the documents incorporated by reference therein, collectively,]² the “Prospectus”),³ relating to _____ (the “Securities”) of _____ (the “Company”). As [counsel to the Company] [your counsel], we reviewed the Registration Statement and Prospectus together with the documents and information listed in Exhibit A hereto (such documents and information hereinafter referred to collectively as the “Pricing Disclosure Package”)⁴ and participated in discussions with your representatives and representatives of the Company, [its counsel,]⁵ [and] its independent registered public accounting firm [and your counsel]⁶ regarding such documents and information and related matters. [We did not participate in the preparation of the documents incorporated by reference in the Prospectus.]⁷

* * * * *

ALTERNATIVE FIRST PARAGRAPH—UNREGISTERED OFFERING

Reference is made to the Offering Document,⁸ dated _____, 20__ (including the documents incorporated by reference therein, collectively,]² the “Offering Document”), relating to _____ (the “Securities”) of _____ (the “Company”). As [counsel to the Company] [your counsel], we reviewed the Offering Document [together with the documents and information listed in Exhibit A hereto (such documents and information hereinafter referred to collectively as the “Pricing Disclosure Package”)]⁴ and participated in discussions with your representatives and representatives of the Company, [its counsel,]⁵ [and] its independent registered public accounting firm [and your counsel]⁶ regarding such documents and information and related matters. [We did not participate in the preparation of the documents incorporated by reference in the Offering Document.]⁷

* * * * *

1. This form is included solely for illustrative purposes. The Subcommittee does not recommend any particular form of negative assurance.

2. See “Incorporation of Documents by Reference” in the Report.

3. See note 34 in the Report.

4. See “Pricing Disclosure Package” in the Report.

5. Insert where counsel providing negative assurance is representing the recipients.

6. Insert where counsel providing negative assurance is representing the Company.

7. See “Procedures Undertaken by Counsel Providing Negative Assurance” in the Report.

8. This form uses “Offering Document” for an unregistered offering. Change terminology to “Offering Memorandum,” “Offering Circular,” or other appropriate document as needed.

The purpose of our professional engagement was not to establish or to confirm factual matters set forth in the [Registration Statement, the Prospectus]—[Offering Document]—[or the Pricing Disclosure Package], and we have not undertaken to verify independently any of such factual matters. Moreover, many of the determinations required to be made in the preparation of the [Registration Statement, the Prospectus]—[Offering Document]—[and the Pricing Disclosure Package] involve matters of a non-legal nature.

Subject to the foregoing and on the basis of the information we gained in the course of performing the services referred to above, we confirm to you that nothing came to our attention that caused us to believe⁹ that:

[(1) the Registration Statement, as of [its [most recent] effective date]—[_____, 20__],¹⁰ [insofar as it relates to the offering of the Securities,]¹¹ contained any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading, or]¹²

[(1)(2)] the Pricing Disclosure Package, as of __: __ .m. on _____, 20__,¹³ [insofar as it relates to the offering of the Securities,]¹¹ contained any untrue statement of a material fact or omitted to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, or]

[(1)(2)(3)] the [Prospectus]—[Offering Document], as of its date [and as of the date hereof],¹⁴ [insofar as it relates to the offering of the Securities,]¹¹ contained [or contains]¹⁴ any untrue statement of a material fact or omitted [or omits]¹⁴ to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading;

provided, however, that we do not assume any responsibility for the accuracy, completeness or fairness of the statements contained in the [Registration Statement, the Prospectus]—[Offering Document]—[or the Pricing Disclosure Package] (except for _____),¹⁵ and we do not express any belief with respect to the financial statements [or other financial[, statistical] or accounting data or information]¹⁶ or assessments of or reports on the effectiveness of internal control over financial reporting contained in¹⁷ [the Registration Statement, the Prospectus]—[Offering Document]—[or the Pricing Disclosure Package].

9. See “Manner of Expressing Negative Assurance” and “Basis for Providing Negative Assurance” in the Report.

10. See “Time as of Which Negative Assurance Speaks” in the Report.

11. See “Incorporation of Documents by Reference” in the Report.

12. Include this subparagraph only in a registered offering.

13. See “Time as of Which Negative Assurance Speaks” in the Report.

14. See “Addressing Disclosure as of the Closing Date” in the Report.

15. Refer to any specific portions of the disclosure document—e.g., the description of a contract or a particular area of the law—when broader coverage is intended to be provided.

16. See “Subjects Not Addressed” in the Report.

17. Some lawyers add “or omitted from” to make explicit what is understood without that phrase.

This letter is being furnished by us only to you, is solely for your benefit in your capacity as [Underwriters]¹⁸ [to assist you in establishing defenses under applicable securities laws] and may not be used, quoted, relied upon or otherwise referred to for any other purpose or by any other person (including any person purchasing any of the Securities from you).¹⁹

18. In unregistered offerings, use term referring to financial intermediaries distributing the Securities.

19. See “Concluding Paragraph” in the Report.

APPENDIX A

PRICING DISCLOSURE PACKAGE

1. [Prospectus or Offering Document]
2. [Free writing prospectus; term sheet]
3. [Description of any material information conveyed orally]