

**PROPOSED NEW NASD AND NYSE IPO RULES PUBLISHED FOR COMMENT**

The Securities and Exchange Commission (“SEC”) has published for comment new versions of proposed NASD and NYSE rules that would prohibit certain practices in connection with initial public offerings (“IPOs”). These proposals had previously been filed with the SEC and published for comment and have now been revised and are being republished for additional public comment.<sup>1</sup> It is anticipated that the SEC will approve these proposed rules in substantially this form shortly thereafter. The comment period ends January 18, 2005.

The proposed rules, NYSE Rule 470 and NASD Rule 2712, are similar and would impose the following major new requirements on NYSE and NASD member firms (“Members”) involved in IPOs.

*Quid Pro Quo Allocations.* Members and their associated persons would be prohibited from offering or threatening to withhold IPO shares as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the Member.<sup>2</sup>

*Spinning.* Members and their associated persons would be prohibited from allocating IPO shares to an executive officer or director of a company, or to a person materially supported by such executive officer or director:

1. If the Member has received compensation from the company for investment banking services<sup>3</sup> in the past 12 months;

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<sup>1</sup> SEC Release No. 34-50896; File Nos. SR-NYSE-2004-12; SR-NASD-2003-140, December 20, 2004 (the “Release”). The NYSE filed on September 10, 2004 with the SEC Amendment No. 1 to its proposed Rule 470, which it originally filed on February 25, 2004. On August 4, 2004, the NASD filed with the SEC Amendment No. 2 to its proposed Rule 2712, which it originally filed on September 15, 2003, and then amended on December 9, 2003.

<sup>2</sup> NASD proposed Rule 2712(a) and NYSE proposed Rule 470(A).

<sup>3</sup> NYSE proposed Rule 470(F)(4) states “Investment Banking Services” are defined in NYSE Rule 472.20 which provides that the term “includes, without limitation, acting as an underwriter in an offering by the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPES (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.”

2. If the Member expects to receive or intends to seek investment banking business from the company in the next 6 months;<sup>4</sup> or
3. On the express or implied condition that such executive officer or director direct future investment banking business to the Member on behalf of the company.

*“Flipping.”*<sup>5</sup> Members and their associated persons would be prohibited directly or indirectly from recouping, or attempting to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares in an IPO that are subsequently flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate.<sup>6</sup>

*Reports of Indications of Interest and Final Allocations.* The book-running lead manager in an equity IPO would have to provide to the issuer’s pricing committee (or, if the issuer has no pricing committee, its board of directors<sup>7</sup>):

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<sup>4</sup> NASD proposed Rule 2712(b) and NYSE proposed Rule 470(B). The rules presume the allocation was made with the expectation of investment banking business if such business is, in fact, received by the Member in the six-month period. However, a Member may rebut the presumption. As described in the Release, both the NASD and the NYSE would include procedures adopted by the Member to insure that investment banking personnel involved in allocations do not have any information about the beneficial owners of the retail accounts that received allocations as evidence supporting rebuttal of the presumption. NASD proposed Rule 2712(d)(3) and NYSE proposed Rule 470(F)(3) define “Material Support” as directly or indirectly providing more than 25% of a person’s income in the prior calendar year and deem persons living in the same household to be providing material support to each other.

<sup>5</sup> NASD proposed Rule 2712(c) and (d) and NYSE proposed Rule 470(C). In addition to any obligation to maintain records relating to penalty bids under SEC Rule 17a-2(c)(1), these Rules require Members to promptly record and maintain information regarding any penalties or disincentives assessed on their associated persons in connection with a penalty bid.

<sup>6</sup> In NASD proposed Rule 2712(d) and NYSE proposed Rule 470(F)(5) (which also cites NYSE Rule 472.120), “Flipped” is defined to mean the initial sale of IPO shares purchased in an offering within 30 days following the offering date of such offering. “Penalty bid” is defined in NASD proposed Rule 2712(d)(2) and NYSE proposed Rule 470(F)(6) to mean an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions. NYSE proposed Rule 470(F)(6) also cites Rule 100 of SEC Regulation M. NASD proposed Rule 2712(c)(2) and NYSE proposed Rule 470(C)(2) also require that Members promptly record and maintain information regarding any penalties or disincentives assessed on their associated persons in connection with a penalty bid, in addition to such requirements in SEC Rule 17a-2(c)(1).

<sup>7</sup> NASD proposed Rule 2712(e)(1) and NYSE proposed Rule 470(D)(1). The NYSE proposed Rule also allows for any other similar managing group authorized to oversee and address pricing and allocation of the IPO shares at the issuer to receive the reports.

1. A regular report of indications of interest, including the names of interested institutional investors and the number of shares indicated by each, as reflected in the book-running lead manager's book of potential institutional orders, and a report of aggregate demand from retail investors; and
2. After the settlement date of the IPO, a report of the final allocation of shares to institutional investors as reflected in the books and records of the book-running lead manager, including the names of purchasers and the number of shares purchased by each, and aggregate sales to retail investors.

*Lock-Up Agreements.*<sup>8</sup> Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer in an equity IPO would have to provide that:

1. The lock-up or restrictions will apply to their issuer-directed shares; and
2. At least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the book-running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a major news service.

*Agreement Among Underwriters.* The agreement between the book-running lead manager and other syndicate members in an equity IPO would have to provide that any shares returned by a purchaser to a syndicate member after secondary market trading commences would (a) be used to offset any existing syndicate short position, and then, upon exhaustion of any such short position, (b) be offered at the public offering price to unfilled customers' orders pursuant to a random allocation methodology.<sup>9</sup>

*Market Orders.*<sup>10</sup> Members would be prohibited from accepting market orders for the purchase of equity IPO shares during the first day that such IPO shares commence trading on the secondary market.

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<sup>8</sup> NASD proposed Rule 2712(e)(2) and NYSE proposed Rule 470(D)(2).

<sup>9</sup> NASD proposed Rule 2712(e)(3) and NYSE proposed Rule 470(D)(3). NYSE proposed Rule 470(D)(3)(b) specifically states the requirement to offer returned shares pursuant to a random allocation methodology would also apply if all the existing short positions have been covered.

<sup>10</sup> NASD proposed Rule 2712(e)(4) and NYSE proposed Rule 470(E).

If you have any questions concerning these proposed amendments, please call William Grant (212-728-8223, [wgrant@willkie.com](mailto:wgrant@willkie.com)), Roger D. Blanc (212-728-8206, [rblanc@willkie.com](mailto:rblanc@willkie.com)), Martin R. Miller (212-728-8690, [mmiller@willkie.com](mailto:mmiller@willkie.com)) or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at [www.willkie.com](http://www.willkie.com).

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