
Legal Updates & News

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SEC Expands Eligibility Requirements of Forms S-3 and F-3 to Include Smaller Reporting Companies

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On December 11, 2007, the Securities and Exchange Commission (the "SEC") approved the adoption of amendments (the "Amendments") to Form S-3 and Form F-3 (the "Forms"). The Amendments will increase the number of smaller public companies eligible to use these Forms to register primary offerings of equity and unrated debt, and to use these forms to file a shelf registration statement. Accordingly, these Amendments are expected to provide these companies with greater and more cost-effective access to the public securities market.

The Amendments will enable a company that has less than \$75 million in public equity float to register its primary securities offerings on one of the Forms if it:

- meets the other eligibility requirements of the relevant Form;
- is not and has not been a shell company for at least 12 calendar months prior to the filing of the Form;
- has a class of common equity securities listed on a national securities exchange; and
- does not sell in a 12-month period more than the equivalent of one-third of its public float.

The SEC's adopting release, which includes the text of the Amendments, may be found at: <http://www.sec.gov/rules/final/2007/33-8878.pdf>.

I. Background and Purpose of Form S-3 and Form F-3.

Form S-3 is the "short form" that domestic issuers meeting certain requirements can use to register their securities with the SEC under the Securities Act of 1933, as amended (the "Securities Act"). Form F-3 is the corresponding form used by foreign private issuers. The Forms can each incorporate by reference periodic reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), both before and after the effective date of the registration statement, which can reduce the length of the registration statement considerably and eliminate the need for post-effective amendments to address developments after the effective date. In addition, a company eligible to use the Forms may conduct primary offerings "off the shelf" under Rule 415 of the Securities Act and may offer securities in one or more tranches. Companies using one of the Forms, consequently, may expeditiously take down debt, equity and other securities.

II. Elimination of \$75 Million Minimum Public Float Requirement.

Each Form currently requires that companies registering primary offerings have a public float of at least \$75 million. The \$75 million public float requirement was initially designed to help protect investors by ensuring that only companies that were widely followed in the market would obtain the benefit of registering their offerings on a short-form registration statement. However, various developments, such as technology allowing the public to access SEC filings through EDGAR and company websites over the Internet on a real-time basis, have minimized the need for this

requirement.

By eliminating the \$75 million threshold, the SEC estimates that approximately 1,400 additional smaller reporting companies will now be eligible to use the Forms for primary offerings. This change will allow these companies to broaden their capital raising strategies by providing them with an alternative to private financing transactions. For example, many of these companies will now be able to offer their equity securities using a shelf registration statement in an underwritten public offering or in the registered direct format, which may involve a smaller discount to market price than a PIPE or another form of private placement.

III. Non-Shell Company Requirement.

The SEC noted in its adopting release that thinly traded securities are likely to be more vulnerable to potential manipulative practices. To address this concern, the SEC's new eligibility criteria for the Forms require that an issuer with a public float of less than \$75 million not be a "shell company" (which includes so-called "special purpose acquisition companies" or SPACs), as defined in Rule 405 of the Securities Act, either at the time of filing or in the 12-month period prior to filing.

Former shell companies will also be subject to certain filing requirements in order to benefit from these Amendments, including timely filing of their periodic reports for at least 12 months.

IV. Requirement to Have a Class of Common Equity Securities Listed on a National Securities Exchange.

For a company that does not have a \$75 million public float to use one of the Forms for a primary offering, the Amendments require the company to have a class of equity securities listed on a national securities exchange, such as the NYSE, the NASDAQ Stock Market or the AMEX. The SEC's rationale for this requirement is that there is likely to be an increased level of investor protection if there is widely available evidence that there is a market for a company's securities, and that the company has the ability to comply with the rules of the exchange or exchanges on which its securities are listed. Accordingly, companies that trade only in the "pink sheets" or on the "Over-the-Counter Bulletin Board" will not be able to use the Forms for primary offerings.

V. Limit of Sales Equal to One-Third of a Company's Public Float During 12 Consecutive Calendar Months.

In its June 2007 proposing release, the SEC proposed that a company be permitted to sell up to 20% of its public float in primary offerings during any 12 consecutive months. Commentators, including Morrison & Foerster LLP, raised a number of objections to the 20% cap. First, they expressed concern that the proposed 20% cap was an arbitrarily low ceiling that would not satisfy the capital needs of smaller companies. Second, they argued that this 20% cap would discourage smaller companies from using their new access to short-form registration, as the advantages of registering a relatively small amount of securities could be outweighed by the disadvantages of the expense involved with filing and processing a registration statement. Third, they noted that, traditionally, the SEC has not used a disclosure regulation, such as the registration forms under the Securities Act, to address concerns about trading volume and the overall liquidity of markets, and therefore should not do so in this instance. Additionally, commentators requested the SEC to reconcile the cap with its recent position that a resale registration statement would generally not be available to register securities originally sold to investors in a PIPE, if those securities exceeded one-third of the issuer's public float. For these reasons and others, our firm and other commentators suggested the SEC not adopt the 20% cap, or, at a minimum, set a higher cap. Accordingly, the SEC approved the adoption of a cap of one-third of a company's public float, noting that this threshold will allow for an offering that is large enough to help a company raise a relatively significant amount of capital when market opportunities arise. Companies that seek to exceed this cap would still be able to utilize other SEC forms, such as Form S-1 or Form F-1.

Under the Amendments, the determination of the issuer's public float will be made immediately prior to the relevant sale, and may be based on any date in the 60 days prior to the proposed sale. The price of all securities sold under the Form in the previous 12 months, whether debt or equity, including those to be sold in the proposed sale, will be used to determine whether the one-third cap has been exceeded. By calculating in this manner, an issuer's ability to use its shelf may increase or decrease during the life of the shelf, depending upon changes in its public float. Issuers that rely on this Amendment to use the Forms will need to set forth on the front cover of the relevant prospectus the amount of the public float, and the amount of securities offered in reliance on this rule.

The one-third cap will be removed if the issuer's public float increases to \$75 million after the effective date of the registration statement. However, if the public float of the company falls below \$75 million at the time that its next annual report is filed, the cap will be reimposed. In contrast, companies that satisfy the \$75 million threshold at the time the Form is filed will not be subject to the one-third restriction, even if their public float falls below \$75 million after the effective date.

In connection with the one-third cap, the Amendments revise the eligibility rules to provide that a violation of this restriction will also violate the requirements as to using the proper registration form, even though the relevant registration statement has already been declared effective. Prior to the Amendments, once a registration statement was declared effective, it would be deemed to have been filed on the proper form.

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Effectiveness of New Amendments.

The amendments will become effective on January 28, 2008.