

## Legal Updates & News

### Bulletins

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## SEC Releases Proposed Rules that Provide for Significant Capital Raising and Reporting Reforms for Smaller Public Companies

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On May 23, 2007, the Securities and Exchange Commission (the "SEC") voted to propose several modifications to its existing rules governing capital formation and reporting requirements for smaller public companies. Last week, the SEC published the full text of these much-anticipated proposed rules in two releases. Release 33-8813 proposes amending Rule 144 under the Securities Act of 1933, as amended (the "Securities Act"), to, among other things, shorten the holding period required before restricted securities held by "affiliates" (e.g., directors, executive officers and shareholders with control positions) and non-affiliates may be resold under the Rule, and amending Securities Act Rule 145 to eliminate the "presumptive underwriter" provisions for companies other than shell companies and to make it otherwise consistent with revised Rule 144.<sup>[1]</sup> Release 33-8812 proposes broadening the eligibility requirements for "short form" registration of public offerings on Forms S-3 and F-3 so that companies with a public float below \$75 million can have easier access to the public securities markets.<sup>[2]</sup> If adopted, these proposals have the potential to reduce the regulatory burden imposed upon and facilitate capital formation by smaller companies.

### Amendments to Securities Act Rules 144 and 145

Stating an intention to decrease the cost of capital for all companies and increase the liquidity of "restricted securities," which generally are securities purchased in a transaction that is not registered under the Securities Act, the SEC proposed modifications to Rules 144 and 145 under the Securities Act that would reduce applicable holding periods and eliminate other restrictions. These rules provide safe harbors for resales of restricted securities and control securities (those held by affiliates), which market participants use extensively. The amendments would make the safe harbors easier to use and would increase the tradability of affected securities. Even though the SEC has indicated that the primary driver of the proposals is to aid smaller public companies, the Rule 144 and 145 amendments will also significantly benefit larger public companies.

If adopted, the revised Rule 144 would reduce the holding period for restricted securities of reporting companies (companies required to file reports with the SEC) to six months (currently, it is one year). Non-affiliates (who have not otherwise been affiliates for the prior three months) would be able to resell securities without restriction, so long as the issuing company is current in its SEC reporting, and would be able to resell such securities without restriction after one year from the date of acquiring such securities. Affiliates would also be able to resell after six months, but would continue to be subject to the same volume limitations and, except with respect to debt securities, the same manner of sale restrictions as apply under the current Rule 144, as well as the requirement that the issuer be current in its SEC reporting. In either case, the six month holding period would be tolled for up to six months if the holder engages in certain hedging transactions with respect to the securities during the original six month period.

Rule 144 would also be modified to allow unlimited resales of restricted securities by non-affiliates (who have not otherwise been affiliates for the prior three months) of non-reporting companies after a one year holding period (currently, it is two years) with no tolling provision. However, as with reporting companies, resales by affiliates of non-reporting companies would be subject to Rule 144's volume, manner of sale and current public

information requirements.

Consistent with the objective of increasing liquidity, the SEC has also proposed to modify the Form 144 notice filing requirement, which currently obliges certain parties reselling under Rule 144 to file a short form with the SEC prior to selling greater than 500 shares or \$10,000 worth of securities in a three-month period. The proposal would eliminate the requirement for non-affiliates, and raise the threshold at which the requirement would apply to affiliates to 1,000 shares or \$50,000.

Finally, the SEC is proposing to revise Rule 145 to eliminate restrictions on resale of securities received in Rule 145 transactions (e.g., business combinations), excluding transactions involving blank check or shell companies. The proposal would also make the resale provisions for securities that continue to be subject to Rule 145 conform with the new resale restrictions proposed for Rule 144.

### **Access to Form S-3 and Form F-3**

Citing the great advances in electronic dissemination of information, including the public's enhanced ability to access companies' disclosures over the Internet, the SEC has significantly expanded the use of Form S-3 and Form F-3 for specified public offerings by companies that do not meet the existing common equity public float requirement of \$75 million. These so-called "short form" registration statements allow for significant simplification of offering documents compared to the documents required when using a Form S-1 or F-1. The proposals will also enable smaller public companies to be in a better position to take advantage of market windows by having registered securities available on a "shelf" registration statement.

According to the proposal, a company with a public float (shares held by non-affiliates) of less than \$75 million could register a primary offering on Form S-3 and Form F-3 (including a "shelf" registration), provided that the company:

- does not sell more than 20% of its public float in primary offerings on those forms in any one-year period;
- has timely filed all SEC reports for the past year; and
- is not at the time of filing, and has not been at any time in the last year before filing, a "shell company" (as defined under Rule 405 of the Securities Act).

Notably, the SEC's proposal specifically states that these broadened eligibility requirements would allow companies not traded on national securities exchanges, including those companies trading on the Over-the-Counter Bulletin Board and Pink Sheets quotation service, potentially to avail themselves of the benefits of registering their securities on one of these short forms.

In order to determine the amount of securities it could sell pursuant to Form S-3 or Form F-3, a company would 1) determine its public float immediately prior to the intended sale and 2) compare that number to the aggregate amount of all sales of the company's securities in primary offerings under Form S-3 or Form F-3 over the previous 12-month period. If that resulting number did not already exceed the 20% public float cap, the company would be permitted to sell securities until aggregate sales reach the 20% cap. Since the company's public float limitation would be calculated immediately prior to the contemplated sale (as opposed to at the time of the initial filing of the registration statement), the amount of securities that a company would be permitted to sell could grow or decrease over time as the company's public float increases or decreases. Furthermore, the 20% public float limitation on sales would disappear if a company crossed the \$75 million public float threshold. Explaining the adoption of this proposed requirement, the SEC said that it intended for the 20% limitation to be large enough to enable issuers to meet their financial needs when marketing opportunities arise but small enough to take into account the effect such issuances could have on the market for thinly traded securities.

### **Next Steps**

The SEC has provided a 60 day period for the public to comment on the proposed rules. Once the comment period concludes and the submitted comments are processed by the Staff, the SEC will publish final rules. We will in the interim provide updates as events warrant.

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### **Footnotes:**

[1] The full text of the SEC's proposed rule can be found at <http://www.sec.gov/rules/proposed/2007/33-8813.pdf>.

[2] The full text of the SEC's proposed rule can be found at <http://www.sec.gov/rules/proposed/2007/33-8812.pdf>.