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SEC Amends S-3 and F-3 Eligibility Requirements to Allow Primary Offerings Without Regard to Size of Issuer's Public Float or Debt Rating

On December 19, 2007, the Securities and Exchange Commission ("SEC") adopted amendments to the eligibility requirements of Form S-3 and Form F-3 to allow domestic and foreign private issuers to conduct primary securities offerings on these forms without regard to the size of their public float or the rating of debt they are offering, so long as they (1) satisfy the other eligibility conditions of the respective form, (2) have a class of common equity securities listed and registered on a national securities exchange, and (3) do not sell more than the equivalent of one-third of their public float in primary offerings pursuant to the new instructions on these forms over any period of 12 calendar months.[1] The amendments will take effect January 28, 2008. The change is intended to allow more companies to benefit from the greater flexibility and efficiency in accessing the public securities markets afforded by Form S-3 and Form F-3 without compromising investor protection. The amendments do not extend to shell companies, however, which would be prohibited from using Form S-3 and Form F-3 for primary offerings until 12 calendar months after they cease being shell companies. A brief discussion of the background of the amendments and a summary of their provisions follows.

I. Current Rules for Registering Securities Offerings using Forms S-3 and F-3

Form S-3 is the short form used by eligible domestic companies to register securities offerings under the Securities Act of 1933, as amended (the "Securities Act"). The form allows companies to rely on their reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act") to satisfy the form's disclosure requirements. Prior to the amendments, to use Form S-3, a company must have met the form's registrant requirements, which generally pertain to reporting history under the Exchange Act, and must have had a public float of at least $75 million.

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[1] *Revisions to the Eligibility Requirements for Primary Securities Offerings on Form S-3 and F-3*, SEC Release No. 33-8878; File No. S7-10-07 (December 19, 2007) available at http://www.sec.gov/rules/final/2007/33-8878.pdf (the "Adopting Release").

The ability to conduct primary offerings on Form S-3 confers significant advantages on eligible companies. Form S-3 permits the incorporation of required information by reference to a company's disclosure in its Exchange Act filings, including reports that were previously filed as well as those that will be filed in the future. This forward incorporation allows for automatic updating of the registration statement. By contrast, a registrant without the ability to forward incorporate must file a new registration statement or post-effective amendment to its registration statement to prevent information in the registration statement from becoming outdated and to update for fundamental changes to the information set forth in the registration statement. Form S-3 eligibility for primary offerings also enables companies to conduct primary offerings using a so-called "shelf registration."

The SEC's Advisory Committee on Smaller Public Companies (the "Advisory Committee"), an advisory committee chartered by the SEC in 2005 to assess the current regulatory system for smaller companies under U.S. securities laws, recommended that the SEC allow all reporting companies listed on a national securities exchange, Nasdaq[2] or trading on the Over-the-Counter Bulletin Board to be eligible to use Form S-3 if they have been reporting under the Exchange Act for at least one year and are current in their reporting at the time of filing. The Advisory Committee noted that many smaller public companies currently are not eligible to use Form S-3 to register primary offerings because they do not meet the minimum public float requirement and are, therefore, not able to take advantage of the efficiencies associated with the use of the form. As a consequence, the Advisory Committee argued that this restriction placed limits on the ability of such companies to raise capital.[3]

II. Highlights of the Amendments

The SEC adopted new General Instruction I.B.6. to Form S-3 (and a parallel instruction to Form F-3) to allow companies with less than $75 million in public float to register primary offerings of their securities on Form S-3, provided:

- they meet the other registrant eligibility conditions for the use of Form S-3 [4]
- they are not shell companies[5] and have not been shell companies for at least 12 calendar months before filing the registration statement;
- they do not sell more than the equivalent of one-third of their public float in primary offerings under General Instruction I.B.6. of Form S-3 over any period of 12 calendar months; and
- they have a class of common equity securities that is listed and registered on a national securities exchange.

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2 Nasdaq is now classified as a national securities exchange, but was not so classified at the time the recommendations were made.

3 Recommendation IV.P.3. of the Final Report of the Advisory Committee on Smaller Public Companies (Apr. 23, 2006) available at http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf.

4 In all cases, pursuant to General Instruction I.A., to use Form S-3, the registrant must: (1) have a class of securities registered pursuant to Sections 12(b) or 12(g) of the Exchange Act or be required to file reports pursuant to Section 15(d) of the Exchange Act; and (2) have been subject to the reporting requirements and have filed in a timely manner all the material required to be filed for a period of at least twelve calendar months immediately preceding the filing of the Form S-3.

5 The term "shell company" is generally defined in Securities Act Rule 405 as a company with no or nominal operations, and no or nominal assets or assets consisting of cash and cash equivalents.

To ascertain the amount of securities that may be sold pursuant to Form S-3 by registrants with a public float below $75 million, the new rule requires a two-step process:

- determination of the registrant's public float immediately prior to the intended sale; and
- aggregation of all sales of the registrant's securities (both debt and equity)[6] pursuant to primary offerings under the General Instruction I.B.6. in the previous 12-month period (including the intended sale) to determine whether the one-third cap would be exceeded.

The new rule requires registrants to compute their public float by reference to the price at which their common equity was last sold, or the average of the bid and asked prices of their common equity, in the principal market for the common equity as of a date within 60 days prior to the date of sale. To calculate the aggregate market value of securities sold during the preceding period of 12 calendar months, the rule requires that registrants add together the gross sales price for all primary offerings pursuant to General Instruction I.B.6. during the preceding period of 12 calendar months. Based on that calculation, registrants would be permitted to sell securities with a value up to, but not greater than, the difference between one-third of their public float and the value of securities sold in primary offerings on Form S-3 under General Instruction I.B.6. in the prior period of 12 calendar months.

The aggregate gross sales price includes the sales of equity as well as debt offerings. Thus, registrants would be eligible to offer non-investment grade debt on Form S-3.[7] In the case of securities that are convertible into or exercisable for equity shares, such as convertible debt or warrants, however, the new rule requires that registrants calculate the amount of securities they may sell in any period of 12 calendar months by reference to the aggregate market value of the underlying equity shares rather than the market value of the convertible securities. The aggregate market value of the underlying equity would be based on the maximum number of shares into which the securities sold in the prior period of 12 calendar months are convertible as of a date within 60 days prior to the date of sale, multiplied by the per share market price of the registrant's equity used for purposes of calculating its public float.

The one-third cap is designed to allow issuers flexibility. Because the restriction on the amount of securities that can be sold over a period of 12 calendar months is calculated by reference to a registrant's public float immediately prior to a contemplated sale, as opposed to the time of the initial filing of the registration statement, the amount of securities that an issuer is permitted to sell can continue to grow over time if the issuer's public float increases. Therefore, the value of one-third of a registrant's float during the period that a shelf registration statement is effective may, at any given time, be greater than at the time the registration statement was initially filed. Registrants may therefore benefit from increases in the size of their public float during the time the registration statement is effective. Conversely, the amount of securities that an issuer is permitted to sell at any given time may also decrease if the issuer's public float contracts. It is important to note, however, that a contraction in a registrant's float, such that the value of one-third of the float decreases from the time the registration statement was initially filed, would not retroactively invalidate any prior sale of securities because the relevant point in time for determining whether a registrant has exceeded the cap is the date of sale. If the sale of securities, together with all securities sold in the preceding period of 12 calendar months, does not exceed one-third of the registrant's

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6 As adopted, the method of calculating the one-third cap on sales is the same whether the registrant is selling equity or debt securities, or a combination of both. Adopting Release at 24, note 64.

7 The provisions of Form S-3 in effect today allow registrants to offer non-convertible investment grade debt securities on Form S-3 regardless of the size of their public float. General Instruction I.B.2. to Form S-3.

float calculated as of a date within 60 days prior to the date of the sale, then the transaction would not violate the new rule.

Further, the amendments include an instruction that removes the one-third cap on additional sales in the event that the registrant's float increases to $75 million or more subsequent to the effective date. Since Form S-3 and F-3 registrants who meet the $75 million float threshold at the time their registration statement is filed are not subject to restrictions on the amount of securities they may sell under the registration statement even if their float falls below $75 million subsequent to the effective date of the Form S-3 or F-3, the SEC offers the same flexibility to issuers if their float increases to a level that equals or exceeds $75 million subsequent to the effective date of their Form S-3 or F-3 without requiring the additional burden of filing a new Form S-3 or F-3 registration statement. However, pursuant to Rule 401 under the Securities Act, registrants are still required to recompute their public float each time an amendment to the Form S-3 is filed for the purpose of updating the registration statement in accordance with Section 10(a)(3) of the Securities Act — typically when an annual report on Form 10-K is filed. If, at the time of filing the annual report, the registrant's public float has dropped below $75 million, all subsequent sales will be subject to the one-third cap.

Finally, with regard to any violations of the one-third cap, the SEC has adopted an amendment to Rule 401(g) of the Securities Act. This amendment is intended to make clear that any violation of the one-third cap will also violate the requirements as to proper form under Rule 401, even though the registration statement had previously been declared effective.

The SEC believes that the amendments will allow more companies to benefit from the greater flexibility and efficiency in accessing the public securities markets afforded by Form S-3 and Form F-3 without compromising investor protection, and that the one-third cap will be sufficient to accommodate the capital raising needs of the large majority of smaller public companies.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jon Mark at (212) 701-3100 or jmark@cahill.com; or John Schuster at (212) 701-3323 or jschuster@cahill.com; R. Banks Bruce at (212) 701-3052 or rbruce@cahill.com.