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Securities Law Advisory: SEC Expands Eligibility for Use of Forms S-3 and F-3

New rules permit use of Forms S-3 and F-3 for primary offerings by issuers with less than $75 million in public float, subject to the limitation that no more than one-third of public float in 12 months may be issued in such offerings.

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In an effort to enable more domestic issuers and foreign private issuers to conduct primary securities offerings using Forms S-3 and F-3, respectively, and thereby facilitate the capital-raising activities of smaller public companies, the Securities and Exchange Commission (SEC) has recently expanded the eligibility conditions for the use of Forms S-3 and F-3 to register primary offerings. Prior to the SEC's amendments, companies were able to register primary offerings of their securities on Forms S-3 and F-3 only if the value of their equity held by non-affiliates, or "public float," was $75 million or more (calculated within 60 days prior to the date on which the registration statement or a post-effective amendment to the registration statement, such as an annual report on Form 10-K or 20-F, was filed). The revisions that have been adopted by the SEC now allow companies with less than $75 million in public float to register primary offerings of their securities on Forms S-3 and F-3, provided that certain other conditions are met, including that such issuers do not sell securities valued in excess of one-third of their public float in primary offerings using Forms S-3 or F-3 over any period of 12 calendar months.

In the Adopting Release for these rules, the SEC noted that "[t]hese amendments are intended to allow a larger number of public companies to benefit from the greater flexibility and efficiency in accessing the public securities markets afforded by Form S-3 and Form F-3 in a manner that is consistent with investor protection."[1] The "greater flexibility and efficiency" referred to by the SEC stems from the following factors:

- The Form S-3 contains significantly fewer disclosure requirements than does the Registration Statement on Form S-1, which form is available to all registrants, regardless of the size of their public floats. This makes the Form S-3 generally less expensive to prepare and update.
- The Form S-3 permits updating of the disclosure in the registration statement following its effectiveness through the incorporation by reference of a company's disclosures made in filings made under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), filed after effectiveness (so-called "forward incorporation by reference"). Forward incorporation by reference is not permitted in a Form S-1 registration statement, which means that a Form S-1 filing must continue to be updated after effectiveness either by means of supplements or post-effective amendments to the Form S-1, creating additional cost and potential delays.
- Use of the Form S-3 also allows companies to take advantage of primary "shelf" offerings pursuant to Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"). As the SEC noted in the Adopting Release, Rule 415 "provides [issuers with] considerable flexibility in accessing the public securities markets from time to time in response to changes in the markets and other factors," in that a certain number or dollar amount of securities can be registered on a Form S-3 prior to an actual offering and then kept "on the shelf" until market and other conditions for conducting an offering are favorable. Companies that are eligible to use Form S-3 for a primary securities offering thus have "more control over the timing of their offerings [and] can take advantage of desirable market conditions, allowing them to raise capital on more favorable terms (such as pricing)…." The Form S-1, by contrast, may not be used to register a primary shelf offering.

For all of these reasons, therefore, the ability to use a Form S-3 to conduct a primary offering is highly desirable.

In describing its rationale for capping smaller issuers' ability to use Form S-3 for a primary offering of securities at one-third of their public float during any 12-month period, the SEC noted that "[a]t the current time, we believe that securities transactions exceeding one-third of the value of an issuer's public float are generally of such significance to the issuer that the opportunity for specific staff review of the transaction and a greater window for underwriter due diligence are advisable."

What Are the Revised Eligibility Requirements for Use of Form S-3 or Form F-3 in a Primary Offering?

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

- they meet the other issuer eligibility conditions for the use of Form S-3[2];
- they have at least one class of common equity securities listed and registered on a national securities exchange[3];
- they do not sell securities with a value of more than one-third of their public float in primary offerings using Form S-3 in any rolling 12-month period; and
- they are not shell companies and have not been shell companies for at least 12 calendar months before filing a registration statement on Form S-3 for a primary offering.[4]

The SEC also adopted new General Instruction I.B.5. to Form F-3 to allow foreign private issuers with less than $75 million in worldwide public float to register primary offerings of their securities on Form F-3, provided that they satisfy the same criteria set forth in the bullets immediately above (substituting references to the Form F-3 for the Form S-3).

How does an Issuer Calculate the One-Third of Public Float Limitation on the Amount of Securities Issuable in 12 Months?

The aspect of expanded Form S-3 eligibility that will require the most analysis by issuers at the time of any offering relates to the requirement that an issuer with less than $75 million in public float may not issue securities having a value of more than one-third of its public float in primary offerings using Form S-3 in any rolling 12-month period. Note that private placements that are followed by a registration statement on Form S-3 to register the resale of the privately placed shares, or offerings that are registered using a Form S-1 registration statement, are not subject to these limitations.[5]

In order to determine the value of securities that may be sold pursuant to the New Instruction in a primary offering by issuers with a public float below $75 million, the new rule requires two steps:

. determination of the public float **within 60 days prior to the intended sale**; and
. aggregation of the **gross sales price** of any and all sales of the issuer's securities that have been made pursuant to primary offerings under the New Instruction in the previous 12-month period, *including* the intended sale, to determine whether the one-third cap would be exceeded.

Issuers will calculate their public float using 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 intended date of sale of the securities in the proposed offering. Then, in calculating the aggregate market value of securities sold during the preceding 12 months, issuers must add together the *gross sales price* for all primary offerings made pursuant to the New Instruction during the preceding 12 months. Based on that calculation, issuers may 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 the New Instruction in the preceding 12 months (including the proposed sale).

How Are Convertible Securities, Such As Warrants, Treated under These Rules?

If an issuer sells securities that are convertible into or exercisable for equity shares, such as convertible debt or warrants, the issuer must take into account the aggregate market value of the shares underlying the convertible securities, instead of using the market value of the convertible securities themselves, in calculating the value of securities sold during the preceding 12 months. In addition, this aggregate market value of the underlying equity must be calculated using the maximum number of shares into which such convertible securities are convertible as of a date within 60 days prior to the proposed date of sale, multiplied by the same per share market price that is used for purposes of calculating the issuer's public float pursuant to the New Instruction.

Can the One-Third Cap Change During a 12-Month Period?

Yes. Because the one-third cap is tied to the public float as calculated within 60 days prior to a proposed sale, the amount of securities that an issuer may sell under the New Instruction will fluctuate over time as the issuer's public float changes. Thus, if the float rises, the one-third cap will be higher. Of course, this provision also means that the amount of securities that may be sold can decrease, if the issuer's public float contracts.[6] Moreover, if an issuer's public float increases to $75 million or more subsequent to the effective date of a Form S-3 registration statement filed by that issuer, the one-third cap will cease to apply to the issuer until such time as the issuer files its next annual report on Form 10-K or files another post-effective amendment to the registration statement.[7] If the issuer's public float as of the date of filing of the annual report or the post-effective amendment is less than $75 million, the one-third cap will be reimposed for all subsequent sales made pursuant to the New Instruction, and it will remain in place until the issuer's float again equals or exceeds $75 million.

Is There Prospectus Disclosure Required by Issuers Relying on the New Instruction?

An issuer with a public float of less than $75 million that elects to rely on the New Instruction in making a primary offering of securities under Form S-3 must include (on the outside front cover of the prospectus to be used in making the offering) a calculation of the aggregate market value of the issuer's outstanding voting and nonvoting common equity and the amount of all securities offered pursuant to the New Instruction during the prior 12-month period that ends on, and includes, the date of the prospectus. Any offering that is made by an issuer above the one-third cap would violate the requirements of Form S-3. The SEC has adopted an amendment to Rule 401(g) under the Securities Act to provide that violations of the one-third cap would also violate the requirements as to proper form under Rule 401, even though the registration statement under which the offering is to be made has already been declared effective.

Can Shell Companies Rely on the New Instruction?

A former shell company that cannot meet the $75 million float test but otherwise satisfies the issuer requirements of Form S-3 will become eligible to use Form S-3 to register primary offerings of its securities, provided that:

- it has not been a shell company for at least 12 calendar months;
- it has filed information that would be required in a registration statement on Form 10 or Form 20-F, as applicable, to register a class of securities under Section 12 of the Exchange Act; and
- it has been timely in its reporting under the Exchange Act for 12 calendar months.

Endnotes

[1] The Adopting Release is available at http://www.sec.gov/rules/final/2007/33-8878.pdf.

[2] These conditions include that the issuer:

- is organized under the laws of the United States or any state or territory, and has its principal business operations in the United States;
- has a class of securities registered pursuant to Sections 12(b) or 12(g) of the Exchange Act or is required to file reports pursuant to Section 15(d) of the Exchange Act; and
- has been subject to the requirements of Sections 12 or 15(d) of the Exchange Act and has filed in a timely manner all the material required to be filed pursuant to Sections 13, 14, or 15(d) of the Exchange Act for a period of at least 12 calendar months immediately preceding the filing of the Form S-3 registration statement.

[3] The New York Stock Exchange, the American Stock Exchange, the Nasdaq Global Select Market, the Nasdaq Global Market, and the Nasdaq Capital Market all qualify as "national securities exchanges," while the Over-the-Counter Bulletin Board and the Pink Sheets do not.

[4] A "shell company" as defined by Rule 405 under the Securities Act is an issuer, other than an asset-backed issuer, that has: "(A) no or nominal operations; and (B) either: (1) no or nominal assets; (2) assets consisting solely of cash and cash equivalents; or (3) assets consisting of any amount of cash and cash equivalents and nominal other assets…."

[5] It is also, however, worth noting that the SEC has recently taken the position in several instances that the filing of a resale registration statement on behalf of a large (typically 20% or greater) selling stockholder or group of affiliated stockholders may actually constitute a primary offering by the issuer, to which the one-third of public float limitation would apply. This position has created issues for large stockholders of smaller issuers who may also not be able to resell their privately placed shares using Rule 144 under the Securities Act without volume limitations, if they are deemed to be affiliates of the issuer pursuant to Rule 144.

[6] The SEC points out in the Adopting Release that if a particular sale of securities, together with all securities sold in the preceding period of 12 calendar months in reliance on the New Instruction, does not exceed one-third of the issuer's public float as calculated within 60 days of the sale, then the transaction would not violate the New Instruction even if the issuer's public float subsequently drops to a level such that the prior sale now accounts for over one-third of the new, lower public float.

[7] Pursuant to Rule 401 under the Securities Act, issuers are required to recompute their public float each time the Form S-3 is updated in accordance with Section 10(a)(3) of the Securities Act, which occurs each year upon the filing of an annual report on Form 10-K and upon the filing of other post-effective amendments.

If you have any questions on these new developments, please contact the Mintz Levin attorney who handles your corporate and securities law matters.

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