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SEC Adopts Final Rules Simplifying Reporting for Smaller Public Companies and Expanding Access to Form S-3 for Primary Securities Offerings

On December 19, 2007, the Securities and Exchange Commission (SEC) issued final amendments to significantly ease the reporting and capital raising process for smaller public companies. First, the SEC adopted amendments to simplify reporting for smaller reporting companies, a new category that replaces the small business issuer category and generally includes companies with a public equity float of less than $75 million. The biggest effect of this change will be to allow more smaller public companies to take advantage of the SEC's scaled disclosure requirements. Second, the SEC adopted amendments to the eligibility requirements of Form S-3, its short-form registration statement, to allow certain issuers to conduct primary securities offerings on the form without regard to the size of their public float or the rating of debt they are offering.

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Reporting for Smaller Reporting Companies

New Smaller Reporting Company Category. The simplified reporting will apply to a new category called smaller reporting companies. This category will replace the existing category of small business issuers who currently are eligible to report under Regulation S-B and its related forms rather than Regulation S-K and its related forms. The smaller company reporting category should significantly expand the number of companies eligible for scaled disclosure requirements in SEC filings. Scaled disclosure in general reduces the amount of disclosure required.

Under the new rules, the definition of a "smaller reporting company" requires the company to have a public float of less than $75 million. When a company is unable to calculate public float (such as where a company has no common equity outstanding or no market price for its outstanding common equity exists at the time of determination), smaller reporting company status requires the company to have less than $50 million in revenue in the last fiscal year. By contrast, small business issuer status currently requires both revenues of less than $25 million and public float of less than $25 million.

For current reporting companies, the public float test is determined at the same

time and in the same manner as the determination of accelerated filer status in Rule 12b-2 under the Exchange Act. Public float will be calculated as of the last business day of a company's second fiscal quarter using the price at which the shares of its common equity were last sold or the average of the bid and asked prices of such shares in the principal market for the shares, multiplied by the number of shares held by non-affiliates. As a result, companies that are not accelerated filers should also qualify as smaller reporting companies.

For non-reporting companies filing an initial registration statement, public float will be calculated based on the estimated offering price per share at the time of filing of the registration statement, the number of shares of common equity outstanding that are held by non-affiliates before the offering and the number of shares of common equity to be sold at the estimated offering price. To the extent that the final offering price and number of shares sold changes the calculation, initial public offering registrants have the option to recalculate the public float at the time the offering is completed for purposes of filing the next periodic report. In addition, a company will not lose smaller company status for the filing if its public float rises above $75 million during the pre-effective stage of the filing as long as the company made a bona fide eligibility determination at the time of the initial filing.

A larger reporting company that determines it is a smaller reporting company as of the last business day of its more recently completed second fiscal quarter is permitted to transition to the scaled disclosure requirements for a smaller reporting company in the Form 10-Q for that quarter. A smaller reporting company required to transition to the larger reporting company disclosure requirements will not be required to do so until the Form 10-Q for the first quarter after the fiscal year in which the determination of larger company status is made.

Currently, small business issuer status is limited to U.S. and Canadian issuers. Under the new rules, the SEC is expanding eligibility for smaller company reporting status to all non-U.S. issuers who file using domestic company forms and provide financial statements prepared in accordance with U.S. GAAP.

Movement of Non-Financial Scaled Disclosure Requirements to Regulation S-K. The new rules move the following non-financial scaled disclosure item requirements from Regulation S-B to Regulation S-K:

- Item 101 (Description of Business): paragraph (h) of Item 101 will permit a

smaller reporting company to provide a somewhat less detailed description of the company's business;

- Item 201 (Market Price of and Dividends on Registrant's Common Equity and Related Stockholder Matters): a smaller reporting company does not need to provide a performance graph;
- Item 301 (Selected Financial Data) and Item 302 (Supplementary Financial Information): a smaller reporting company does not need to provide selected financial data or quarterly financial data;
- Item 303 (Management's Discuss and Analysis): a smaller reporting company only needs to provide two years of analysis if the company is presenting two years of financial statements and does not need to provide a tabular disclosure of contractual obligations;
- Item 305 (Quantitative and Qualitative Disclosures about Market Risk): a smaller reporting company is not required to disclose Item 305 information;
- Item 402 (Executive Compensation): a smaller reporting company is required to disclose significantly less executive compensation information as follows:
  - generally only requires three named executive officers (including principal executive officer and principal financial officer), rather than five;
  - the Summary Compensation Table only needs to cover two years rather than three;
  - not required to provide a Compensation Discussion and Analysis (although some alternative narrative disclosures are required);
  - provide only three of the seven tables required of larger companies (the Summary Compensation Table, the Outstanding Equity Awards at Fiscal-year End Table and the Director Compensation Table); and
  - not be required to provide footnote disclosure of the grant date fair value of equity awards in the Director Compensation Table;
- Item 404 (Transactions with Related Persons): a smaller reporting company is not required to disclose policies and procedures for reviewing related person transactions, but it does have a potentially lower disclosure threshold of the lesser of 1% of average total assets at year end for the last three completed fiscal years or $120,000;
- Item 407 (Corporate Governance): a smaller reporting company is not required to provide Compensation Committee Interlock and Insider Participation disclosure or a Compensation Committee Report and is not required to provide an Audit Committee report until the first annual report after its initial registration statement is filed with the SEC and becomes effective;
- Item 503 (Prospectus Summary, Risk Factors and Ratio of Earnings to Fixed Charges): a smaller reporting company is not required to provide information

regarding the ratio of earnings to fixed charges where applicable and does not need to include risk factors disclosure in Form 10-K or Form 10-Q reports;
- Item 504 (Use of Proceeds): clarify that new Article 8 of Regulation S-X will govern whether financial statements of businesses proposed to be acquired must be included in the filings of smaller reporting companies; and
- Item 601 (Exhibits): a smaller reporting company need not provide Exhibit 12 (Statements re: Computation of Ratios).

The SEC concluded that the remaining requirements of Regulation S-B are identical or substantially the same as the corresponding requirements of Regulation S-K.

Movement of Financial Scaled Disclosure Requirements to Regulation S-X. The new rules move the scaled financial statement requirements in Item 310 of Regulation S-B to new Article 8 of Regulation S-X. Article 8 of Regulation S-X will require two years of audited balance sheets for smaller reporting companies, unlike the one year now permitted for small business issuers. Smaller reporting companies are allowed to provide only two years of audited statements of income, stockholders' equity and cash flows, unlike the three years that apply to larger companies.

Electing Scaled Disclosure on an "A La Carte" Basis. Smaller reporting companies may elect to comply with scaled financial and non-financial disclosure on an a la carte basis. For example, a smaller reporting company may elect to disclose executive compensation based on the scaled disclosure requirements, but opt to follow the larger company requirements for the balance of the disclosure. In any event, the disclosures must be consistent with the legal requirements under the federal securities laws, including Securities Act Rule 408 and Exchange Act Rule 12b-20 which require that, in addition to any information required by a form, there must be included any additional material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.

The final rules clarify that to the extent a smaller reporting company disclosure requirement is more rigorous than the comparable larger company requirement, a smaller reporting company must comply with the more rigorous smaller reporting company requirement. The main instance where this applies relates to related party transactions under Item 404 where smaller reporting companies may have a lower disclosure threshold as describe above. Elimination of S-B Forms After a Phase-Out Period. All of the S-B forms will be eliminated, including

Form 10-SB for registration under the Exchange Act, Form 10-KSB and Form 10-QSB for annual and quarterly reports under the Exchange Act and Form SB-2 for registration statements under the Securities Act.

Companies that currently are small business issuers and who will be smaller reporting companies under the new rules can begin to use Form 10-K, Form 10-Q and other non-S-B forms immediately when the new rules are effective, but can also elect to continue to use the S-B forms for a phase-out period. A current small business issuer can file its next annual report for a fiscal year ending on or after December 15, 2007 on either Form 10-KSB or Form 10-K, and may continue to file periodic reports using Regulation S-B and the S-B forms until its next annual report is filed. For example, a small business issuer with a fiscal year ending on December 31 may continue to use the S-B forms until it files its Form 10-KSB for its fiscal year ending December 31, 2008.

Another benefit of the new rules is that a smaller reporting company may use scaled disclosure in a Form S-1 registration statement under which a company is permitted to incorporate by reference its previously filed Exchange Act reports, whereas Form SB-2 does not permit incorporation by reference.

Effective Date for New Rules. Most of the amendments are effective on February 4, 2008. A company that qualifies as a smaller reporting company, whether or not it currently is a small business issuer, will have the option to comply with the scaled disclosure requirements in any registration statement or periodic report filed after the effective date.

Revisions to Eligibility Requirements for Primary Securities Offerings on Form S-3

Form S-3 is the "short-form" used by eligible domestic companies to register securities offerings under the Securities Act. The form allows abbreviated disclosure by allowing companies to rely on their reports filed under the Exchange Act to satisfy the form's disclosure requirements. Incorporation by reference of required information from a company's disclosure in its Exchange Act filings includes not only reports that were previously filed but also those that will be filed in the future. This enables companies to use Form S-3 to conduct offerings "off the shelf" under Rule 415 of the Securities Act.

The General Instructions to Form S-3 contain the eligibility requirements for use of the form. The basic requirements include being a company that has been subject to the reporting requirements of Section 12 or 15(d) of the Exchange Act for at least 12 months prior to filing and having filed in a timely manner all reports

required be filed during the 12 months prior to the filing (excluding certain Form 8-K filings). Prior to the amendments, use of Form S-3 for a primary offering of securities (i.e., securities offered by or on behalf of the registrant for its own account) required that the registrant had a public float of equity securities of at least $75 million, measured as of a date within 60 days of the filing. Form S-3 can also be used for transactions involving primary offerings of non-convertible investment grade securities, certain rights offerings, dividend reinvestment plans and conversions, and offerings by selling shareholders of securities listed on a national securities exchange.

The new rules allow a company with less than $75 million of public float to use Form S-3 to register primary offerings of its securities provided the company:

- meets the other eligibility requirements for the use of Form S-3 such as timely filing of required reports with the SEC for the preceding 12 months;
- has a class of common equity securities that is listed and registered on a national securities exchange (such as the New York Stock Exchange, the American Stock Exchange or the NASDAQ Stock Market)
- does not sell more than the equivalent of one-third of its public float in primary offerings registered on Form S-3 in reliance on the new rules during any 12-month period; and • is not a shell company and has not been a shell company for at least 12 months before filing the Form S-3.

The SEC had originally proposed a limit of 20% of public float, but changed it to one-third of public float in the final rules. The SEC's objective for the cap is to allow an offering that is large enough to help an issuer efficiently obtain financing, yet small enough to take into account the effect such new issuance may have on the market for a thinly traded security. The SEC's original rule proposal had also suggested that any company with a public trading market may be allowed to use amended Form S-3 for primary offerings, including securities traded on the OTC Bulletin Board and the Pink Sheets, but the final rule limits eligibility to companies with a class of common equity securities listed on a national securities exchange. The SEC concluded that the exchanges' listing rules, procedures and requirements provide an important additional measure of protection for investors.

For purposes of determining the limit of one-third of public float, a registrant must first determine its public float immediately prior to an intended sale under the Form S-3 based on the last sale price, or the average of the bid and asked prices, of its common equity as of a date within 60 days prior to the date of sale.

Then, the registrant must aggregate all sales of its securities pursuant to primary offerings under Form S-3 under the new rule in the 12 months prior to the date of sale to determine whether the one-third cap would be exceeded. This calculation includes sales of debt as well as equity, so that eligible registrants will also be able to offer non-investment grade debt on Form S-3 (as noted above, investment grade debt is already covered by Form S-3 without regard to the public float test).

Since the test is applied each time a sale is made under the new eligibility rule for Form S-3, it is possible for changes in public float to later increase or decrease the one-third cap for a specific sale under a Form S-3 registration statement. The revised instructions require registrants relying on the new eligibility rule to disclose in each prospectus their updated calculation of public float and the amount of securities offered pursuant to the new rule during the 12 month period ending on the date of the prospectus. A company relying on the new eligibility rule may initially register more than the one-third limit as a shelf Form S-3 may last up to three years. The one-third cap is lifted in the event that a registrant's public float increases to $75 million or more subsequent to the effective date of the registration statement.

These amendments to Form S-3 take effect on January 28, 2008.