

SMALLER COMPANY PUBLIC OFFERING REMINDERS

The SEC has taken steps over the past few years to address the effects the market downturn has had on smaller companies. As year end approaches, smaller public companies need to evaluate their eligibility to use Form S-3 to register securities for public sale and whether their existing registration statements will remain viable after they have filed their annual reports on Form 10-K.

THE BENEFITS OF SHORT FORM S-3

Two primary advantages of being able to register the sale of securities on Form S-3:

- Form S-3 allows incorporation by reference of a company's Exchange Act disclosures that will be filed in the future. Such "forward incorporation" allows the prospectus filed as part of a Form S-3 to remain current for an extended period of time and avoids the expense, time and delay of filing post-effective amendments.
- Form S-3 allows companies to conduct primary "off the shelf" offerings pursuant to Rule 415 under the Securities Act. Pursuant to Rule 415, an issuer may register for sale any type of securities in any amount the issuer reasonably believes it will sell and, for three years after effectiveness of the filing (the life of the shelf), sell securities "off the shelf" by filing a prospectus supplement in connection with the sale. This allows a company to take advantage of market conditions by being able to issue securities in registered sales without having to face delays from the SEC's registration and review process.

GENERAL ELIGIBILITY REQUIREMENTS

Domestic companies must:

- have a class of securities registered under Section 12 of the Exchange Act or be subject to the Exchange Act's periodic reporting requirements pursuant to Section 15(d) thereof,



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- have a public float equal in value to at least \$75 million,
- have been subject to the periodic reporting requirements of the Exchange Act and filed all such required reports for at least 12 months, and
- have timely filed all such required reports in the 12 months and any portion of a month prior to filing the registration statement, with the exception of certain Current Reports on Form 8-K.

LIMITED OFFERING BY SMALLER COMPANIES: GENERAL INSTRUCTION I.B.6.

The Form S-3 eligibility requirements permit a company with a public float of less than \$75 million to use Form S-3 to conduct limited public offerings of securities in an amount that does not exceed one-third of the company's public float. A company with less than \$75 million in public float may register primary offerings of its securities on Form S-3, provided the company:

- has filed its Exchange Act reports on a timely basis for at least one year prior to the filing of the registration statement,
- has a class of common equity securities that is listed on a national securities exchange (The New York Stock Exchange, the American Stock Exchange, the Nasdaq Global Select Market, the Nasdaq Global Market, and the Nasdaq Capital Market—but not the Over-the-Counter Bulletin Board or the Pink Sheets.)
- is not a “shell company” and has not been a shell company for at least one year before filing the registration statement.

GENERAL INSTRUCTION I.B.6. LIMITED OFFERINGS—HOW MUCH CAN YOU SELL?

In order to conduct a limited offering, a company must measure:

- the value of its public float at the time of the intended sale and
- the aggregate market value of all debt and equity securities sold in primary offerings under Form S-3 General Instruction I.B.6. during the prior 12 months (including the intended sale) in order to ensure that the one-third public float limit will not be exceeded.

A company's **public float** is calculated using (i) the price at which the company's common stock was last sold prior to the intended sale, or (ii) the average of the bid and asked prices of the company's common stock as of a date within 60 days prior to the date of sale, multiplied by the shares held by non-affiliates outstanding at the time of the offering.



A company's **aggregate market value of securities sold** is calculated by adding the gross sale price for all primary offerings of securities (both debt and equity) under General Instruction I.B.6. in the prior 12 months. (For securities that are convertible into or exercisable for equity shares, such as convertible debt or warrants, issuers must calculate the amount of securities they may sell in any 12-month period, based on the aggregate market value of the underlying equity shares, not the market value of the convertible securities.)

- Each proposed offering requires reevaluation of a company's public float and aggregate value of securities sold. Because the one-third public float limitation on sales is calculated within 60 days prior to a proposed sale, the amount of securities a company may sell pursuant to general Instruction I.B.6. will continue to fluctuate over time as the price of its common stock increases or decreases. 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 company's public float falls.
- If a company's public float increases to \$75 million or more subsequent to the effective date of a limited offering Form S-3 registration statement, the one-third cap will cease to apply to the issuer until such time as the company files its next annual report on Form 10-K or files a post-effective amendment to the registration statement.

CAN A COMPANY OFFER THE FULL SHELF AMOUNT IF ITS PUBLIC FLOAT DROPS BELOW \$75 MILLION?

Yes. If a company is planning to make an offering pursuant to an effective registration statement that was filed when the company's float was above \$75 million, that company may be able to offer the full amount of the shelf even though its public float at the time of the offering does not meet the \$75 million threshold. The registration statement remains available for the full amount registered and available thereon to the company through the earlier of the filing of the next post-effective amendment to the registration statement or the company's next Form 10-K. Each such filing acts as a "determination date" for purposes of eligibility. If a company has a public float below \$75 million and is subject to General Instruction I.B.6. for the first time upon filing its Form 10-K, the company must include disclosure of the offering limitation in that 10-K. After such determination date, the company is not required to file a post-effective amendment to amend the Form S-3. Instead the company would simply disclose in each subsequent 424(b) prospectus supplement filed for offerings under such Form S-3, that the company is subject to General Instruction I.B.6. and include additional required disclosure setting forth the company's (i) public float and (ii) the aggregate amount of all securities offered pursuant to General Instruction I.B.6. during the prior 12 months.

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CAN A COMPANY MAKE A LIMITED OFFERING IF PUBLIC FLOAT FALLS BELOW \$75 MILLION AND IT HAS BEEN DELISTED?

Yes. The SEC has informally advised that when a company has a registration statement on Form S-3 effective and it is delisted from a national securities exchange after filing its Form 10-K or other post-effective amendment, such company, assuming it meets the other eligibility requirements, may continue to utilize the one-third limited offering. For purposes of illustration:

At the time of filing its annual report on Form 10-K in April, the company has an effective registration statement on Form S-3 but does not have a public float in excess of \$75 million. The company's common stock is delisted from the NASDAQ Capital Market and traded on the OTCBB the following June. In August, the company may still utilize its effective registration statement on Form S-3, by making a limited offering pursuant to General Instruction I.B.6. Because there has been no determination date since the time of the delisting, the registration statement, albeit on a limited offering basis, remains available to the company.

NATIONAL SECURITIES EXCHANGES LIMITATIONS TO CONSIDER

Companies must consider exchange-related implications when preparing to offer securities under General Instruction I.B.6. For example, NASDAQ Marketplace Rule 5635(d)(2) (the 20% rule) requires shareholder approval prior to the issuance of securities in connection with a transaction other than a public offering, involving the sale of common stock (or securities convertible into common stock) equal to 20% or more of the common stock (or voting power) outstanding before the issuance for less than the greater of book or market value. NASDAQ generally does not consider a registered direct shelf offering to be a public offering. Such a requirement would further restrict the amount of the offering made by the company.

In the event the 20% rule is triggered, the company must file a Proxy Statement or an Information Statement and obtain shareholder approval, which will delay the benefits Form S-3 provides. Companies should be aware that national securities exchanges may determine that one or more offerings, even if there are differing offerees and different securities, may be deemed "integrated" for purposes of determining the need to comply with the 20% rule.

WHEN FORM S-3 IS NO LONGER AVAILABLE

If a company's stock has been delisted or its sales have exceeded the one-third public float limitation under General Instruction I.B.6. or it becomes ineligible to offer securities on Form S-3 for any other reason, the company must file post-effective amendments to convert each of its existing registration statements on Form S-3



to Form S-1. When an company's offerings under General Instruction I.B.6. exceed the one-third cap, a violation of the form requirements of Form S-3 would occur. Rule 401(g) under the Securities Act provides that violations of the one-third limited offering cap violate the requirements as to proper form under Rule 401 even if the SEC has previously declared the registration statement effective. A company with a public float below \$75 million that would exceed the one-third cap under Form S-3 could still use the more lengthy/cumbersome Form S-1 to register additional primary offerings under the Securities Act. As (hopefully) markets continue to stabilize and companies seek to raise capital, companies will need to evaluate their eligibility and amounts available under existing registration statements on Form S-3.

- Companies should be always aware of possible impending expiration dates of their shelf registration statements and / or changes to their status which will effect form eligibility. Companies should plan to file new registration statements or convert existing registration statements on Form S-3 into long Form S-1s, in both cases allowing sufficient time to incorporate scheduling the company's independent accountants, selling security holders and other potential offering participants, as well as for the possibility of SEC staff review and other events that may delay effectiveness of the new registration statement.

PRACTICAL STEPS:

- Every eligible company should consider filing an undesignated shelf registration statement. A Rule 424(b) prospectus must be filed with each take-down amending the cover page, type of security, selling shareholders and other relevant provisions of the Form S-3. If the issuer is subject to General Instruction I.B.6. at the time of the shelf take down, the 424(b) prospectus must disclose such information.
- Every company with effective registration statements on Form S-3 that has a public float below \$75 million and that is not currently in compliance with the listing requirements of the national securities exchange it is currently listed on should begin to evaluate the likelihood of delisting and whether:
 - if delisted prior to the filing of the next Form 10-K, the existing Form S-3s will need to be amended to Form S-1s. Such amendments should be filed prior to the dequalifying 10-K so as to ensure no lapse in the registration of any currently registered shares. Such lapse could trigger a default or breach under existing contracts of the company; or
 - if delisted after the filing of the next Form 10-K (while still below \$75 million in public float) the company should consider an offering under the limited offering cap prior to next year's Form 10-K.

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- Every company listed on the OTC Bulletin Board or Pink Sheets should attempt to remain a timely filer so that if it subsequently determines to list on a national securities exchange, it will become immediately eligible for use of Form S-3.

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