SEC CLARIFIES INTEGRATION UNDER RULE 152 AND PROPOSES TO LIBERALIZE REGULATION D AND FORMS S-3 AND F-3

EASED REPORTING FOR SMALLER ISSUERS ALSO PROPOSED

The Securities and Exchange Commission recently clarified Rule 152 to permit private placements near the time of a public offering, and has proposed several significant changes to Regulation D and Forms S-3 and F-3, as well as an easing of reporting requirements for smaller companies.[1]

PROPOSED EXPANSION OF REGULATION D

Summary

Regulation D is proposed to be amended to:

- Create a new category of "large accredited investors," to whom offers and sales may be made without registration, and permit publication of a tombstone-type announcement of the offering that includes a brief business description;
- Expand somewhat the definition of "accredited investor" to include a $750,000 "investments-owned" threshold;
- Shorten the length of the integration safe harbor of Reg. D from six months to 90 days; and
- Provide uniform disqualification provisions throughout Reg. D.

The SEC also made it clear that, consistent with Rule 152, the filing of a registration statement does not per se eliminate an issuer's ability to conduct a concurrent private offering.

Background

Large Accredited Investors

Regulation D was adopted in 1982 to clarify and expand the private placement exemption from the registration requirements of the Securities Act of 1933.

Rule 506 provides an exemption without regard to the amount offered, so long as offers are made without general solicitation or advertising, and sales are made only to "accredited investors" and

[1] See Securities Act Release No. 33-8828, File No. S7-18-07 (August 3, 2007), Securities Act Release No. 33-8812, File No. S7-10-07 (June 20, 2007), and Securities Act Release No. 33-8819, File No. S7-15-07 (July 5, 2007), available at www.sec.gov/rules/proposed.shtml.

up to 35 non-accredited investors. In 1982, approximately 1.87% of U.S. households qualified for accredited investor status, while today, due to inflation, demographic factors and economic growth, 8.47% of U.S. households so qualify. While the current proposals would not limit any of the exemptions currently available to accredited investors, the new "large accredited investor" category would, in a sense, represent a return to the original concept since approximately 1.64% of U.S. households would qualify for this status.

The SEC believes that limited advertising of unregistered offerings solely to large accredited investors would not compromise investor protection due to the increased sophistication and financial literacy of investors and the advantages of modern communication technologies.

Integration and Rule 152

The General Conditions to Reg. D provide guidance as to when a would-be private offering is deemed "integrated" with a public offering and therefore subject to registration. Currently, Reg. D private placements conducted within six months of the filing of a registration statement may be integrated with the public offering. The SEC considers the following five factors in determining whether such private offerings should be integrated with public offerings:

- Whether the sales are part of a single plan of financing;
- Whether the sales involve issuance of the same class of securities;
- Whether the sales have been made at or about the same time;
- Whether the same type of consideration is received; and
- Whether the sales are made for the same general purpose.[2]

In addition, Rule 152 provides that "The phrase 'transactions by an issuer not involving any public offering' in Section 4(2) shall be deemed to apply to transactions not involving any public offering at the time of said transactions although subsequently thereto the issuer decides to make a public offering and/or files a registration statement."

Other key elements of the current framework include the SEC staff's *Black Box Incorporated* no-action letter[3] and its progeny (on which the PIPES market is based) and Rule 502(a) under Reg. D, which provides a safe harbor from integration for offerings conducted six months or more apart.

Recognizing that "capital raising around the time of a public offering, in particular an initial public offering, often is critical if companies are to have sufficient funds to continue to operate while the public offering process is ongoing," the SEC has offered guidance that endorses and

[2] See 17 CFR § 230.502.

[3] June 26, 1990.

expands upon *Black Box* and adopts a liberal view of integration consistent with Rule 152 by proposing a shortening of the integration safe harbor to 90 days.

Proposed Regulation D Changes

Limited Advertising Available for Offerings to Large Accredited Investors

The new category of "large accredited investors" is based on the definition of "accredited investor" adopted in 1982, but accounts for inflation by raising the dollar-amount thresholds. The following table summarizes the changes proposed:

	Current Standard for Accredited Investor Status	**Proposed Standard for Large Accredited Investor Status**
Entities	$5 million in assets	$10 million in investments
Individuals (net worth/investments)	$1 million in net worth	$2.5 million in investments
Individuals (annual income)	$200,000 ($300,000 with one's spouse)	$400,000 ($600,000 with one's spouse)

In offerings solely to the newly defined "large accredited investors," issuers would be permitted to publish tombstone-type announcements of the offering, similar to those prescribed under Rule 135c, but which may also include a description of the issuer's business up to 25 words in length.[4] The announcements can only be in written form, including written mediums such as newspapers and the Internet. Television or radio advertisements or infomercials would remain prohibited.

The following table compares offerings under current Rule 506 to accredited investors and offerings pursuant to proposed Rule 507 to large accredited investors:

	Current Rule 506 Offerings to Accredited Investors	**Proposed Rule 507 Offerings to Large Accredited Investors**
Number of permitted non-accredited investors	35	0
Limited advertising permitted	No	Yes
Exempt from state securities regulation	Yes	Yes

[4] The issuer is required to state in the announcement that (i) sales will be made to large accredited investors only, (ii) no money or other consideration is being solicited or will be accepted through the announcement, and (iii) the securities have not been registered with or approved by the SEC and are being offered and sold pursuant to an exemption.

Proposed Changes to the Definition of Accredited Investors

The SEC proposes to expand, somewhat, the current definition of "accredited investor." The current definition looks to a net worth, including personal residences, of at least $1 million. The proposed rules add an alternative "investments-owned" standard of $750,000 that excludes non-investment assets such as personal residences. The SEC is also proposing to adjust all the dollar-amount thresholds in the definition of accredited investor for inflation on a going-forward basis, starting on July 1, 2012 and every five years thereafter.

The SEC proposed adding several categories of permitted entities to the list of potentially accredited investors, including any corporation, partnership, limited liability company or other legal entity with similar legal attributes, and proposed that $5,000,000 in "investments" along with the current $5,000,000 in assets, qualify an entity for accredited investor status.

Integration Guidance under Rule 152

The SEC release states that, consistent with Rule 152, the staff of the Division of Corporation Finance will not take the view that a completed private placement exempt from registration under Securities Act Section 4(2) should be integrated with a public offering of securities that is registered on a subsequently filed registration statement, noting that a company's contemplation of filing a registration statement for a public offering at the same time it is conducting a Section 4(2)-exempt private placement would not cause the exemption to be unavailable.

Moreover, recognizing that a company's financing needs do not end with the filing of a registration statement, the release goes on to state that, despite an earlier view that the filing of a registration statement is deemed to be a general solicitation of investors, "the filing of a registration statement does not per se eliminate a company's ability to conduct a private offering." Rather, the determination "should be based on a consideration of whether the investors in the private placement were solicited by the registration statement or through some other means that would otherwise not foreclose the availability of the Section 4(2) exemption," such as through a pre-existing relationship or a direct contact by the company or its agent outside the public offering effort.

Shortening of Integration Safe Harbor to 90 Days

The SEC has proposed to shorten the length of the integration safe harbor of Reg. D from six months to 90 days.

Under the proposed rule, companies would be able to conduct private placements only 90 days before or after the filing of a registration statement without concern that the two offerings may be integrated. Issuers could rely on the safe harbor once every fiscal quarter.

Other Amendments and Request for Comments

The SEC also proposed to apply uniform bad-actor disqualification provisions to all offerings seeking to rely on Reg. D. Issuers would be barred from relying on Reg. D exemptions if relevant violations of laws and regulations were committed by:

- The issuer, any predecessor of the issuer, or any affiliated issuer;
- Any director, executive officer, general partner, or managing member of the issuer;
- Any beneficial owner of 20% or more of any class of the issuer's equity securities; or
- Any promoter connected with the issuer.

The length of the disqualification from reliance on Reg. D in the proposal is generally five years.

In addition to the proposed rules, the SEC is seeking comments on possible revisions to Rule 504 and on the definition of "accredited natural person" for certain pooled investment vehicles in Securities Act Rules 216 and 509 that were proposed in December 2006.

The comment period for the Reg. D proposal ends on September 13, 2007.

PROPOSED ELIMINATION OF PUBLIC FLOAT AND DEBT RATING REQUIREMENTS FOR PRIMARY OFFERINGS ON FORMS S-3 AND F-3

Summary

The proposed revisions to Forms S-3 and F-3 include:

- Eliminating public float and debt rating requirements for the use of Forms S-3 and F-3;
- Creating a cap of 20% of public float for offerings registered under the proposed rules; and
- Allowing former shell companies to register offerings on Forms S-3 and F-3 if they meet certain requirements.

Background

Domestic companies may register primary securities offerings on Form S-3 if the company meets the Form's registrant requirements, which generally involve compliance with Exchange Act reporting requirements, and transaction requirements, including a public float threshold of $75 million. Currently, transactions involving primary offerings of non-convertible investment grade debt may be registered on Form S-3 without regard to public float.

Companies that are eligible to conduct primary offerings on Form S-3 benefit from the ability to incorporate subsequently filed Exchange Act reports into the Form S-3, thus automatically updating the registration statement. In addition, Form S-3 enables companies to conduct primary offerings "off the shelf" pursuant to Rule 415 of the Securities Act.

In order to allow smaller public companies to take advantage of the benefits of Form S-3 and to increase the ability of such companies to raise capital quickly, the SEC has proposed amendments to Forms S-3 and F-3.

Changes to Forms S-3 and F-3

Elimination of Public Float and Debt Rating Requirements

The SEC proposed amendments to allow companies with less than $75 million in public float to register primary offerings on Forms S-3 and F-3, even if their securities were not traded on a national securities exchange, provided that the issuer satisfies the other eligibility conditions of the respective forms[5] and is not a shell company (and has not been a shell company for the 12 months preceding the filing of the registration statement on Form S-3).[6] The amendment would eliminate the current debt rating requirements for use of Form S-3 by allowing offerings of convertible and non-investment grade debt to be registered on Form S-3 as well.

Sales Limited to 20% of Public Float

A company that registers pursuant to the proposed rules would not be permitted to sell more than the equivalent of 20% of its public float in primary offerings pursuant to the new instructions on these forms over any period of 12 calendar months.[7] The 20% limit includes the sale of equity as well as debt offerings.

The SEC believes the 20% cap is large enough for the issuers to meet their financing needs, but also small enough to take into account any effect the issuance of securities may have on the market for a thinly traded security. Registrants that meet the $75 million threshold at the time the registration statement is filed are not subject to restrictions on the amount of securities sold on the registration statement and may rely on the current eligibility requirements of Forms S-3 and F-3.

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[5] These eligibility requirements require the company to, among other things: (1) have a class of securities registered pursuant to Section 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 requirements of Section 12 or 15(d) of the Exchange Act and have filed in a timely manner all material required to be filed pursuant to Section 13, 14 or 15(d) of the Exchange Act for at least 12 calendar months immediately preceding the filing of the registration statement on Form S-3.

[6] A shell company is defined as a registrant, other than an asset-backed issuer, that has: (1) no or nominal operations; and (2) either (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets.

[7] This 20% limit includes both equity and debt securities.

Former Shell Companies May Become Eligible to Use Forms S-3 and F-3

Under the proposed rule, a former shell company may become eligible to use Forms S-3 and F-3 to register primary offerings of its securities, but only if:

- It satisfies the registrant requirements of Form S-3 or F-3;
- It has not been a shell company for the previous 12 months;
- It has filed information that would be required in a registration statement on Form 10, Form 10-SB or Form 20-F, as applicable, to register a class of securities under Section 12 of the Exchange Act; and
- It has been timely reporting for 12 months.

Comments with respect to this proposed rule release must be received on or before August 27, 2007.

SMALLER REPORTING COMPANY REGULATORY RELIEF AND SIMPLIFICATION

The SEC has proposed amendments to the rules relating to the disclosure and reporting requirements for smaller companies under the Securities Act and the Exchange Act. Most notably, the SEC proposes to extend the benefits of the current optional disclosure and reporting requirements for smaller companies[8] to a much larger group of companies by allowing companies with a public float of less than $75 million to qualify for the smaller company requirements, up from $25 million for most companies today. Other companies, including those that do not have a public float as defined or are unable to calculate it, would be eligible for the lessened disclosure and reporting requirements for smaller companies if their revenues fall below $50 million annually. In addition, under the proposed amendments, foreign issuers that meet the criteria would also be able to qualify as smaller reporting companies.[9]

The proposals would maintain the current disclosure requirements for smaller companies contained in Regulation S-B, but would integrate them into Regulation S-K by adding a new paragraph to each item of Regulation S-K that contains separate disclosure standards for smaller reporting companies. The SEC proposed adoption of an *à la carte* approach that would allow smaller reporting companies to take advantage of the adjusted disclosure requirements available to them on an item-by-item basis. The proposals would also eliminate all "SB" forms associated with Regulation S-B in order to mainstream smaller reporting company filers into the Regulation S-K framework.

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[8] The disclosure requirements for smaller companies under Regulation S-B are less detailed than the requirements in Regulation S-X, the regulation that governs the financial statements of most companies that do not rely on Regulation S-B. Regulation S-B also contains a number of disclosure requirements that are scaled to the characteristics of smaller companies, including requirements on executive compensation, related person transactions, and management's discussion and analysis of financial condition and results or plan of operation.

[9] The proposed amendments would continue to exclude investment companies and asset-backed issuers from eligibility for scaled reporting and disclosure requirements.

Comments relating to the smaller reporting company proposed amendments must be received on or before September 17, 2007.

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If you have any questions regarding this memorandum, please contact Bruce Kraus (212-728-8237, bkraus@willkie.com) or the attorney with whom you regularly work.

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