

Committee Highlights

The Committee has discussed many of the issues raised in Greg's article for the past two years, as our subcommittee, which conceived of "Reg D" has been involved in these considerations from the beginning. If you are interested in becoming involved in our securities related activities, please contact Greg. Our committee provides many opportunities to engage directly with SEC staff on matters such as these.

— Editors

Our Subcommittees

The Committee maintains four substantive subcommittees focusing on Closely Held Business Entities, Emerging Companies, International Transactions and Securities Regulation.

The Committee has long been an advocate before the Securities and Exchange Commission, the Internal Revenue Service and other regulatory agencies of reforms to address the special problems in capital formation confronted by small businesses, including smaller public companies. The annual Government-Business Forum on Small Business Capital Formation, sponsored by the SEC, is one result of past Committee initiatives and was a leading force in the SEC's adoption of Regulation D. A present Committee initiative, through the Private Placement Broker Dealer Task Force, advocates a simplified registration system for finders of financing for early stage companies.

DOORS OPEN IN 2008: NEW SEC RULES IMPROVE REGULATION AND ACCESS TO CAPITAL FOR SMALLER BUSINESSES

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Perhaps at no time in recent history has the Securities and Exchange Commission (the "Commission") focused so much attention on smaller companies and the impact of securities regulation on their ability to raise capital and maintain public reporting status in the modern era. These efforts began in earnest in December 2004, when Commission Chairman William H. Donaldson appointed an Advisory Committee on Smaller Public Companies (the "Advisory Committee") to examine the impact of the Sarbanes-Oxley Act of 2002 and other aspects of the federal securities laws on smaller public companies. The Advisory Committee's mission was to provide guidance on modernizing and improving the Commission's capital-raising, reporting and disclosure requirements for smaller companies with the twin goals of ensuring the U.S. public capital markets are accessible to small business and assuring protection of investors.

The Advisory Committee issued its comprehensive Final Report on April 23, 2006; see <http://www.sec.gov/info/smallbus/acspc.shtml>.

After an intensive 13 months period of study and analysis, on May 23, 2007, the Commission unveiled a series of rule proposals addressing the recommendations contained in the Advisory Committee's Final Report. Press Release 2007-102; <http://www.sec.gov/news/press/2007-102.htm>. Over the summer of 2007, seven releases were issued by the Commission proposing new regulations with an emphasis on modernizing and improving capital raising and reporting requirements, particularly for smaller companies. The Commission worked with the Public Company Accounting Oversight Board to develop better regulation and guidance on the matter of internal control over financial reporting, one of the centerpieces of the Sarbanes-Oxley Act of 2002 (SOX[®]). Cognizant of the financial impact of the legislation's internal control reporting provisions, particularly on smaller companies, the Commission's Office of Economic Analysis is studying the costs and benefits of SOX Section 404. In conjunction with that study, which is expected to be completed by June 2008, the Commission further delayed the effectiveness of the auditor attestation requirements for the smallest public companies one additional year. The Commission's efforts and activities regarding the internal control reporting and the accounting provisions of SOX are not addressed in this article.

On November 15, 2007, the first series of new rules under the Securities Act of 1993, as amended (the "Securities Act") emanating from the Advisory Committee's Final Report were unanimously adopted by the Commission. With the exception of the electronic filing of Form D, they all are currently or shortly will become effective.

II. REVISIONS TO RULES 144 AND 145

Of the five series of new rules changes, the Commission's amendments to Rules 144 and 145 under the Securities Act have the most immediate impact on the greatest number of companies. Release No. 33-8869; File No. S7-11-07, December 6, 2007. The amendments will provide enhanced liquidity and should permit companies more easily to access the vast pools of available private equity capital. The amendments will become effective on February 15, 2008.

A. Rule 144. The amendments to Rule 144 provide the following relief:

- shorten the holding period for restricted securities of reporting companies to six months;
- substantially simplify Rule 144 compliance for non-affiliates by allowing non-affiliates of reporting companies:
 - to freely resell restricted securities after satisfying a six-month holding period (subject only to the Rule 144(c) public information requirement until the securities have been held for one year), and
 - to freely resell restricted securities after satisfying a 12-month holding period;
- for affiliates' sales, revise the manner of sale requirements for equity securities;
- eliminate the manner of sale requirements and relax the volume limitations for affiliates' sales of debt securities;

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are not subject to Focused Assessments (Audits), will encounter less frequent cargo examinations, and, in certain situations, may enjoy waiver of certain filing requirements.

CONCLUSION

Companies are truly "going global" in an international environment wrought with security concerns. Counsel will be likely encounter Customs and International Trade issues sooner rather than later.

For more information regarding issues concerning Customs Law and International Trade, contact

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DOORS OPEN IN 2008, cont.

- for affiliates' sales, raise the thresholds that trigger Form 144 filing requirements from 500 shares or \$10,000 to 5,000 shares or \$50,000;

The elimination of the Form 144 notice requirement for non-affiliates and the increase of the filing thresholds will significantly decrease the number of required Form 144 filings. The new rules also simplify and streamline the Preliminary Note to Rule 144 and other parts of the regulation; and codify certain staff interpretations relating to Rule 144.

In its proposing release for the Rule 144 revisions, the Commission set forth its intention to reintroduce a tolling provision that would suspend the rule's holding period for the length of time that a security holder owning restricted securities of a reporting company engaged in hedging activities. However, as a result of substantial public comment that the tolling provision would unduly complicate Rule 144 and impose unnecessary costs on security holders and intermediaries to monitor hedging activities, the tolling provision was not included in the final rule amendments. The staff announced that it will continue to monitor the hedging activities of holders of restricted securities and revisit the issue if it appears that hedging activity is resulting in abuses in the context of Rule 144.

For debt securities, the Commission eliminated the manner of sale requirements, although not as originally proposed, and relaxed the volume limitations for debt securities by adding a new alternative test to Rule 144 (e) that will permit the resale of up to 10% of a tranche in any three-months period.

B. Rule 145. The amendments to Rule 145 accomplish the following:

- eliminate the presumptive underwriter provision except with respect to transactions involving blank check or shell companies; and
- revise the resale provisions of Rule 145(d).

The effect of the elimination of the presumptive underwriter provision in Rule 145, except with regard to transactions involving shell

companies, is that only a party to a Rule 145(a) transaction involving shell companies, other than business combination related shell companies, or an affiliate of the party, will be deemed a presumed underwriter of the transaction. Those deemed underwriters may resell their securities under the revised provisions of Rule 145(d).

III. EXEMPTION FROM EXCHANGE ACT REGISTRATION FOR OPTIONS

Two new amendments to Rule 12h-1 under the Securities Exchange Act of 1994, as amended (the "Exchange Act") provide exemptions from registration under Section 12(g) of the Exchange Act for compensatory employee stock options. Release No. 34-56887; File No. S7-14-07, December 3, 2007. The new exemptions, which apply only to an issuer's compensatory employee stock options and not to the class of securities underlying those options, accomplish the following:

- provide an exemption for private non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans; and

provide an exemption from Section 12(g) registration for compensatory employee stock options for issuers that are required to file reports under the Exchange Act pursuant to Exchange Act Section 13 or Section 15(d).

For rapidly growing companies particularly, these rules changes will help them in continuing to attract the energetic and ambitious, intellectually and creatively gifted human capital that fueled much of the economic growth of the last two decades of the 20th century. These amendments became effective on December 7, 2007.

The Commission's rationale for the separate exemptions from Exchange Act registration for compensatory employee stock options was based on the differences with regard to, among other things, the nature of the trading markets and the amount of publicly available information between issuers that are required to file reports under the Exchange Act and those issuers that do not have such an obligation. Since option holders of issuers that are required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act would have access to the issuer's publicly filed Exchange Act reports, the separate exemption for compensatory employee stock options granted by those issuers contains fewer substantive provisions.

The exemption from Exchange Act Section 12(g) registration for compensatory employee stock options issued by a private, non-reporting issuer under written compensatory stock option plans is available if:

- Eligible option holders are limited to employees, directors, consultants, and advisors (to the extent permitted under Rule 701) of an issuer, its parents, and majority-owned subsidiaries of the issuer or its parents and certain transferees;
- Transferability by option holders of compensatory employee stock options, and prior to exercise, shares to be received on exercise of those options is restricted; and

Risk and financial information is provided to option holders that is of the type that would be required under Rule 701 if securities sold in reliance on Rule 701 exceed \$5 million in a 12 months period.

IV. SMALLER REPORTING COMPANY REGULATORY SIMPLIFICATION

With much fanfare, the Commission has heralded its disclosure regulations for smaller public companies as a watershed event. Release No. 33-8876; File No. S7-15-07, December 19, 2007. While the new rules will make scaled disclosure regulations available to approximately 1,500 additional smaller companies, they will not necessarily make their compliance burden easier. The final rules abolishing Regulation S-B and integrating all basic non-financial disclosure requirements in Regulation S-K contain their own complexity that comes with the cafeteria approach to specific disclosure provisions. These amendments, which became effective on February 4, 2008, accomplish the following:

- replace the current "small business issuer" category with a new expanded category of "smaller reporting companies" having less than \$75 million in public equity float or, if a company (cont. page 9)

does not have a calculable public equity float, having revenues of less than \$50 million in the last fiscal year;

- expand eligibility for the Commission's scaled disclosure and reporting requirements for smaller companies by allowing the newly defined category of smaller reporting companies to use the scaled disclosure requirements;
- move 12 non-financial scaled disclosure item requirements from Regulation S-B into Regulation S-K (the scaled disclosure requirements will only be available to smaller reporting companies);
- move the scaled financial statement requirements in Item 310 of Regulation S-B into new Article 8 of Regulation S-X, and amend these requirements to provide a scaled disclosure option for smaller reporting companies, requiring two years of balance sheet data instead of one year;

permit smaller reporting companies to elect to comply with scaled financial disclosure and non-financial disclosure on an item-by-item or "a la carte" basis;

- eliminate the current "SB" forms and allow a phase-out period for current small business issuers transitioning to smaller reporting company status; and

permit all foreign companies to qualify as "smaller reporting companies" if they choose to file on domestic company forms and provide financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles.

By moving all of the disclosure provisions to one location, and attempting to streamline and simplify the requirements, the Commission has essentially replaced the stand-alone regulatory scheme for small businesses established in 1992 with the adoption of Regulation S-B. The new scaled disclosure requirements are intended to make the burdens of regulation commensurate with the benefits. In the words of Chairman Christopher Cox, the Commission wanted to ensure that investors in smaller companies "are paying for important investor protections and not red tape." For most purposes, under the revised rules, the new category of "smaller reporting companies" replaces the old categories of "small business issuer" under Regulation S-B and "non-accelerated reporting companies" created by the Sarbanes-Oxley Act.

V. **EXPANSION OF FORM S-3 AND FORM F-3 ELIGIBILITY**

On December 11, 2007, the Commission adopted amendments to the eligibility requirements of Form S-3 and Form F-3 which will expand the ability of more companies to conduct primary offerings of securities using those "short forms" regardless of the size of their public float or the rating of the offering debt. Release No. 33-8878; File No. S7-10-07, December 19, 2007. The flexibility provided by the ability to incorporate information by reference to the issuer's Exchange Act filings, including those to be filed in the future, provided by Forms S-3 and F-3 should allow many smaller companies to access the capital markets more quickly and efficiently. The new rules, which became effective on January 28, 2008, feature the following:

- issuers are eligible to use Forms S-3 and F-3 if they have a class of common equity securities listed and registered on a national securities exchange and have timely filed Exchange Act reports for a period of 12 months prior to filing the registration statement;
- no more than the equivalent of one-third of the issuer's public float may be sold in primary offerings over any period of 12 calendar months; and

shell companies are not eligible to use Form S-3 or Form F-3 until they have ceased being a shell company for at least 12 months.

In adopting the new regulations, the Commission acknowledged the great advances in electronic dissemination and accessibility of public company disclosure available over the Internet. It also expressed its belief that a "moderate" expansion of the class of transactions to be

permitted on Form S-3 for primary securities offerings will not compromise investor protection. The Commission, however, was not prepared to eliminate completely the eligibility requirements for use of the short form registration statements.

Believing that public float continues to be an approximate measure of a stock's market following and, therefore, the degree of efficiency with which the market absorbs information and reflects it in the price of a security, the new regulations require a certain level of public float in order to sell an unlimited amount of securities using Forms S-3 and F-3. In its May 2007 rule change notification, the Commission proposed to limit the amount of securities the issuer that could be sold in primary offerings using the short forms to a maximum of 20% of the issuer's public float. In response to public comment that the 20% ceiling would severely limit the utility of the rule revisions, the higher one-third limitation was adopted. To emphasize the importance of complying with the maximum permitted offering amount, the Commission adopted an amendment to Securities Act Rule 401(g) to make clear that violation of the one-third restriction will also violate the requirements as to proper registration form, even though the registration statement previously had been declared effective.

Some commentators were hopeful that all companies with a public trading market, including those traded over the counter in the Pink Sheets, would be authorized to use Form S-3. However, the Commission expressed its belief that limiting the universe of eligible issuers to those with at least one class of equity securities registered on a national securities exchange, would enhance investor protection due to the exchanges' listing requirements, strong corporate governance standards and real-time reporting of quotation and transaction information. Since most securities offered under the new eligibility rules will be "covered securities" as defined by Section 18(b) of the Securities Act, they will be largely exempt from state Blue Sky regulation.

The calculation of the amount of securities that may be sold in any period of 12 calendar months for convertible securities will be based on the aggregate market value of the underlying equity shares, not the market value of the convertible securities. This is intended to make it less likely that convertible securities will be structured in a manner designed to avoid the effectiveness of the cap. The one-third cap will be calculated by reference to the issuer's public float immediately prior to a contemplated sale, not the time of the filing of the registration statement. Therefore, as the issuer's public float increases, the amount of securities it can sell will continue to grow. Also, once the issuer's public float increases to \$75 million or more, the one-third cap automatically is lifted. The eligibility for use of Form S-3 must be recomputed each time the registration statement is amended to update the information contained therein pursuant to Section 10(a)(3) of the Securities Act, typically when the annual Form 10-K is filed. If the public float at that date is less than \$75 million, the one-third cap is reimposed.

VI. **ELECTRONIC FILING OF FORM D**

On December 11, 2007, the Commission voted unanimously to adopt provisions to mandate electronic filing of Form D information after a phase-in period beginning on September 15, 2008, during which electronic filing will be voluntary. Press Release 2007-259; <http://www.sec.gov/news/press/2007-259.htm>. Electronic filing of Form D will become mandatory on March 16, 2009. At the same time, the Commission revised the information requirements of Form D as follows:

- requiring filers to identify all issuers in a multiple-issuer offering;
- deleting the current requirement to identify as "related persons" owners of 10 percent or more of a class of equity securities;
- replacing the current requirement to provide a business description with a requirement to provide industry group information from a pre-established list;
- requiring revenue range information for operating companies and net asset value information for hedge funds (subject to an option to decline to disclose);

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- requiring reporting the date of first sale;
- specifying that material mistakes of fact or errors in a previously filed Form D require an amendment and when changes in a previously filed Form D or the passage of time require amendments;
- requiring that amendments contain current information in response to all information requirements;
- revising the minimum investment amount disclosure requirement to specify that it relates to outside investors only;
- replacing the current requirement to disclose information on a wide variety of expense and use of proceeds items with a requirement to disclose expenses only as to amounts paid for sales commissions and, separately stated, finders' fees, and to disclose use of proceeds only as to the amount of gross proceeds used or proposed to be used for payments to related persons; and
- permitting a limited amount of free writing to the extent necessary to clarify responses.

The revised information requirements will become effective on September 15, 2008, the same date as the beginning of the electronic filing phase-in period. John White, Director of the Division of Corporation Finance, expressed the Commission's hope that the new online filing of Form D "will eventually facilitate one-stop filing of both federal and state Form D notices and substantially reduce filing burdens of smaller companies."

The Commission's press release announcing the Form D rule changes states that information contained in Form D will be filed through an online filing system that will be accessible from any computer with Internet access, will capture and tag data items and will make the filed information available on the Commission's website in a format that can be viewed in an easy-to-read format.

VII. CONCLUSION

The Commission has made great strides in addressing the capital raising needs of smaller businesses and reducing the burdens of a regulatory scheme that has become unnecessarily complex and expensive for companies of modest size, complexity and scope of operations. There is still a great deal of work to do, primarily in the area of exempt offerings. The Commission's proposals to modify Regulation D under the Securities Act have generated much debate and, in the opinion of many, do not go far enough or address squarely the issues of "offers" and the prohibition on general solicitation. If the Regulation D proposals are adopted as proposed, continued attention and further reform will be warranted in the future. After making such significant changes to benefit smaller companies, it would be disappointing if the Commission were not to continue to evaluate for future proposal the additional changes recommended by the Advisory Committee on Smaller Public Companies.

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