

M E M O R A N D U M

TO: Our Clients and Colleagues

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SUBJECT: **SEC Revisions to Eligibility Requirements for Form S-3**

In December 2007, the SEC adopted revisions to the eligibility requirements for primary securities offerings on Forms S-3 and F-3. The adopting release is available at <http://sec.gov/rules/final/2007/33-8878.pdf>. The new rule will be effective January 28, 2008.

In contrast to its initial proposal, the adopted rule limits the utilization of Form S-3 to issuers listed on national securities exchanges (including the NASDAQ tiers, but excluding Over-The-Counter Bulletin Board and Pink Sheet issuers), but increases the eligible amount of the float that can be sold pursuant to a new General Instruction I.B.6 of Form S-3 (the "Instruction") to 33 $\frac{1}{3}$ % of an eligible issuer's public float.

Form S-3 continues to remain available without a percentage limitation for issuers having a public float - i.e., fair market value shares held by non-affiliates - exceeding \$75 million. Additionally, issuers initially eligible only under General Instruction I.B.6 who subsequently increase their non-affiliate market capitalization to in excess of \$75,000,000 will not be subject to the 33 $\frac{1}{3}$ % limitation.

To ascertain the amount of securities that may be sold pursuant to the Instruction requires a two step process: (1) determination of the registrant's public float immediately prior to the intended sale, and (2) calculation of all sales of registrant's securities pursuant to primary offerings under the Instruction for the previous twelve month period (including the intended sale). The public float is computed by reference to the price at which equity was last sold as of the date within 60 days prior to the date of sale. Accordingly, the new rule, as applied with respect to convertible securities and warrants which are listed on the Form S-3, will require each issuer to keep accurate records of the actual exercise price and conversion price during the prior twelve months. Furthermore, with respect to the common stock underlying the warrants registered on Form S-3, valuation as to unexercised warrants will be calculated at the market price of the common stock underlying the warrants, rather than the exercise price of the warrants. An example is provided in paragraph 4 under "Practice Pointers" at the end of this memorandum.

Issuers will be required to be “timely” filers for the twelve months prior to filing Form S-3. Additionally, since revised General Instruction I.B.6 is only available to issuers listed on national securities exchange, these issuers will be subject to corporate governance requirements (e.g. audit committee, director independence). The national securities exchanges also impose listing fees on listing of additional shares, and have different requirements as to advance notice and approval of proposed equity raising transactions (including “20% rule” discussed below).

Shell companies as defined under Rule 405 are not eligible to use Form S-3 until they have not been a shell company for at least twelve calendar months, have filed “Form10 type” information (generally accomplished by filing of a “Super” Form 8-K) and have been timely reporting for twelve calendar months.

PRACTICE POINTERS:

1. Every eligible issuer should consider filing an undesignated shelf registration statement. A Rule 424(b) prospectus can be filed with each take-down amending the cover page, type of security, selling shareholders and other relevant provisions of the Form S-3. The Rule 424(b) prospectus is generally filed within one day after the closing.
2. Every issuer 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.
3. Issuers listed on a national securities exchange are subject to certain qualitative requirements. Among those are the so-called 20% rule, which require issuers selling securities that are issuable or which would be issuable in an amount in excess of 20% of the outstanding common stock at a price below book or market, to obtain shareholder approvals (see e.g. NASDAQ Market Place Rule 4350). In the event the 20% rule will apply, the issuer would be required to file a Proxy Statement or an Information Statement, which will delay the benefits of the new rules. Issuers 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 - especially offerings that occur within six months of each other.
4. The SEC has provided several examples of the calculation of public float, including the following:

A registrant has 12 million shares of voting common equity outstanding held by nonaffiliates. The market price of this stock is \$5 per share, so the registrant has a public float of \$60 million. The registrant has an effective Form S-3 shelf registration statement filed in reliance on new General Instruction I.B.6. of Form S-3, pursuant to which the registrant wants to issue \$10 million of convertible debt securities which will be convertible into common stock at a 10% discount to the market price of the common stock. Pursuant to Instruction 2 to new General Instruction I.B.6., the amount of securities issued is measured by reference to the value of the underlying common stock rather than the amount for which the debt securities will be sold. At the 10% discount, the conversion

price is \$4.50 and, as a result, 2,222,222 shares currently underlie the \$10 million of convertible debt. Because the current market price of those underlying shares is \$5 per share, for purposes of General Instruction I.B.6. the value of the securities being offered is \$11,111,110 (2,222,222 shares at \$5 per share), which is less than the \$20 million allowed by the one-third cap (one-third of \$60 million).

After the convertible debt securities are sold and are outstanding, the registrant contemplates an additional takedown. To determine the amount of securities that the registrant may sell under General Instruction I.B.6. in the anticipated offering, the registrant must know its current public float and must calculate the aggregate market value of all securities sold in the last year on Form S-3 pursuant to General Instruction I.B.6. Instruction 2 to new General Instruction I.B.6. requires that the registrant compute the market value of convertible debt securities sold under I.B.6. by reference to the value of the underlying common stock rather than the amount for which the debt securities were sold. With respect to the notes that were sold and have been converted, the aggregate market value of the underlying common stock is calculated by multiplying the number of common shares into which the outstanding convertible securities were converted times the market price on the day of conversion. With respect to the notes that were sold but have not yet been converted, the aggregate market value of the underlying common stock is calculated by multiplying the maximum number of common shares into which the notes are convertible as of a date within 60 days prior to the anticipated sale by the per share market price of the registrant's equity used for purposes of determining its current float. (The date chosen by the registrant for determination of the maximum number of shares underlying the convertible notes must be the same date that the registrant chooses for determining its market price in connection with the calculation of public float pursuant to new General Instruction I.B.6. Sec Instruction 5 to new General Instruction I.11.6.)

In this example, assume that the registrant has a current per share stock price of \$5.55. If half of the notes converted into common stock while the per share market price was \$5.00 (\$4.50 discount), then, for purposes of Instruction 2 to new General Instruction I.B.6., the value of that prior issuance is \$5,555,555 (half of the notes divided by the discounted conversion price of \$4.50 and then multiplied by \$5, the market price on the day of conversion).

As for the notes that have not yet been converted, the aggregate market value of the underlying common stock is determined by calculating the number of shares that may be received upon conversion and multiplying that by the current market value of \$5.55. Therefore, the outstanding note amount (\$5 million) is divided by the discount conversion price (\$5), resulting in 1,000,000 shares and this amount is then multiplied by the current market value of \$5.55. Thus, for purposes of Instruction 2 to new General Instruction I.B.6., \$5,550,000 is the value of the outstanding notes that have not yet been converted. Adding this to the value of the notes that have already been converted results in a total value of \$11,105,555 having been issued under this Form S-3.

To determine the amount of additional securities that the registrant may sell under General Instruction I.B.6., the registrant should add the value of the notes issued (\$11,105,555) plus the value of all other securities sold by the registrant pursuant to Instruction I.B.6. during the preceding 12 calendar months. If this amount is less than one-third of the registrant's current public float, it may sell additional securities with a value up to, but not greater than, the difference between one-third of its current public float and the value of all securities sold by it pursuant to Instruction I.B.6. during the preceding 12 calendar months.

Please feel free to contact us if you require further information.