



# Securities Briefing Vol. 7, No. 2

March 1, 2008

## **TOPICS IN THIS SECURITIES BRIEFING:**

This Securities Briefing provides an overview of the SEC's final rules amending the disclosure and reporting requirements for smaller companies under the Federal securities laws, including expanding the group of companies eligible for the smaller company requirements and integrating Regulation S-B with Regulation S-K.

This Securities Briefing is intended only as a summary of the SEC's final rules discussed and you are encouraged to review the full text of the final rules.

## **FINAL SEC RULES TO AMEND DISCLOSURE AND REPORTING REQUIREMENTS FOR SMALLER REPORTING COMPANIES**

### **OVERVIEW**

The SEC has adopted rules to amend the disclosure and reporting requirements for a greater number of smaller companies under the Federal securities laws. As proposed, the final rules create a new term - "smaller reporting company" - to replace the current term "small business issuer." The final rules permit most companies with a public float of less than \$75 million to qualify for the simpler or "scaled" disclosure and reporting requirements currently available to small business issuers. The final rules provide a revenue test for issuers that do not have a public float or are unable to calculate it. As proposed, the final rules also eliminate the stand-alone Regulation S-B by integrating its requirements into Regulation S-K.

The final rules are intended to implement various recommendations of the Advisory Committee on Smaller Public Companies that the SEC established to assess the current regulatory system for smaller public companies. The SEC's primary objectives for the final rules include:

- Expanding the eligibility for compliance with the SEC's "scaled disclosure and reporting requirements" for smaller companies by making those requirements available to most companies with a public float of less than \$75 million.
- Simplifying the SEC's rules for smaller companies by combining the two categories of small business issuers and non-accelerated filers into one category called "smaller reporting companies."
- Simplifying and improving the SEC's disclosure and reporting rules by integrating Regulation S-B disclosure requirements into Regulation S-K.



## **EFFECTIVE DATE**

The final rules are effective as of February 4, 2008 except as follows:

- The elimination of Item 308(b) of Regulations S-B and Form 10-QSB are effective as of October 31, 2008; and
- The elimination of Item 310(b) of Regulation S-B and Form 10-KSB are effective as of March 15, 2009.

## **EXPANDED ELIGIBILITY FOR SMALLER REPORTING COMPANY STATUS**

Prior to adoption of the final rules, there were two categories of smaller companies: "small business issuers" with both a public float and revenues of less than \$25 million and "non-accelerated filers" that did not qualify as "large accelerated filers" or "accelerated filers." In general, non-accelerated filers were companies with a public float of less than \$75 million. As proposed, the final rules create a new company category called "smaller reporting company" to replace the current "small business issuer" category plus capture non-accelerated filers. A smaller reporting company is defined as a company that:

- Had a public float of less than \$75 million as of the last business day of its most recently completed second quarter, or
- In the case of an initial registration statement filed under the Securities Act of 1933, had a public float of less than \$75 million as of a date within 30 days of the registration statement filing date, or
- Had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available if the public float is zero.

A company's public float is calculated by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity in the principal market for the common equity. In the case of an IPO, the public float is computed by multiplying the aggregate worldwide number of shares held by non-affiliates before the registration plus the number of shares included in the registration statement by the estimated public offering price of the shares.

The definition of small business issuer under the old rules excluded companies that were not organized in the United States or Canada, investment companies and asset-backed issuers. The final rules continue to exclude investment companies and asset-backed issuers from eligibility to qualify as a smaller reporting company. Foreign companies that meet the smaller reporting company criteria and make their filings on domestic company forms are eligible to qualify as smaller reporting companies under the final rules.

## **INTEGRATING REGULATION S-B INTO REGULATION S-K**

The SEC decided to eliminate the dual disclosure scheme of Regulations S-B and S-K because it was overly complex and a possible deterrent for smaller public companies to take advantage of the scaled

disclosure and reporting requirements. The final rules integrate Regulation S-B requirements into Regulation S-K largely as proposed by adding new subsections to the relevant items of Regulation S-K which contain the applicable provisions of Regulations S-B. Each new subsection has a heading of "Smaller reporting companies" to make it easier to find the disclosure requirements applicable to smaller reporting companies in each item. The SEC has also added an index of scaled disclosure requirements in new Item 10(f) of Regulation S-K to highlight the items with scaled disclosure requirements for smaller reporting companies.

The final rules do not make any major substantive changes to the Regulation S-B items moved into Regulation S-K. When the disclosure standards of identically numbered items in Regulations S-B and S-K are substantially the same for smaller reporting companies and other companies, there are no changes made to the existing Regulation S-K item. The final rules make the following integration changes, among others:

- Add a new subsection (h) to Item 101 (Description of Business) to require the alternative disclosure standards for smaller companies that now exist in Item 101 of Regulation S-B.
- Amend the instructions to Item 102 (Description of Property) to include references to the industry guides referred to in Item 102 of Regulation S-B.
- Make a minor wording change to Item 201 (Market Price of and Dividends on Registrant's Common Equity and Related Stockholder Matters) to replace the reference to "small business issuer" to "smaller reporting company" as existing Item 201 of Regulation S-K currently permits an alternative disclosure standard for smaller companies.
- Add a new subsection (c) to each of Items 301 (Selected Financial Data) and 302 (Supplementary Financial Information) providing that smaller reporting companies are not required to provide this information.
- Add a new subsection (d) to Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations) to include the alternative disclosure standards for smaller companies under current Item 303 of Regulation S-B.
- Add a new subsection (e) to Item 305 (Quantitative and Qualitative Disclosures about Market Risk) providing that smaller reporting companies are not required to provide this information.
- Add new subsections (l) - (r) to Item 402 (Executive Compensation) to add the alternative disclosure standards on executive compensation for smaller companies currently in Item 402 of Regulation S-B.
- Add a new subsection (d) to Item 404 (Transactions with Related Persons, Promoters and Certain Control Persons) to add the alternative disclosure standards for related party transactions that are currently in Item 404 of Regulation S-B. However, the final rules did change the Regulation S-B standard for related party disclosures. Under new Item 404(d)(1), smaller reporting companies now need to provide related party disclosures for any transaction in which the amount involved exceeds the lesser of \$120,000 or one percent of the average of the smaller reporting company's total assets for the last two completed fiscal years (Regulation S-B used total assets for the last three completed fiscal years).

- Add a new subsection (g) to Item 407 (Corporate Governance) to add the alternative disclosure standards that are currently in Item 407 of Regulation S-B.
- Add a new subsection (e) to Item 503 (Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges) to include the alternative disclosure requirements that are currently in Item 503 of Regulation S-B. The final rules also amend the instructions to Forms 10, 10-K and 10-Q to indicate that smaller reporting companies do not need to provide Item 503 risk factor disclosures in those filings.
- Make a minor change to the instructions of Item 504 (Use of Proceeds) to clarify that new Article 8 of Regulation S-X, rather than the other articles 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.
- Add a new subsection (c) to Item 601 (Exhibits) to include the standards currently in Item 601 of Regulation S-B for smaller companies and modify the wording of Item 601 to eliminate all references to "SB" forms and Regulation S-B.

Note that the SEC decided against amending Item 401 (Directors, executive officers, promoters and control persons) to include the Regulation S-B standard for disclosing involvement in Federal bankruptcy or state insolvency proceedings. As a result, smaller reporting companies now need to comply with the slightly different disclosure requirements of Item 401 of Regulation S-K for such matters (i.e., disclosure must be provided for any petitions filed under the Federal bankruptcy laws or any state insolvency laws by or against a director or officer during the past five years).

### **SMALLER REPORTING COMPANY FINANCIAL STATEMENT REQUIREMENTS**

In response to comments, the final rules move the financial statement requirements for smaller reporting companies into a new Article 8 of Regulation S-X (the proposed release had suggested adding them as a new Item 310 to Regulation S-K). In addition, Article 8 now requires two years of comparative audited balance sheet data (rather than the one year required by Regulation S-B). The final rules also adopt a technical amendment to Regulation S-X Rule 3-05(b)(2)(iv) (Financial Statements of Businesses Acquired or to be Acquired) to replace the \$25 million small business issuer revenue standard with the \$50 million revenue standard for a smaller reporting company unable to calculate public float.

### **SMALLER REPORTING COMPANIES GIVEN AN "A LA CARTE" DISCLOSURE APPROACH**

As proposed, the final rules allow a smaller reporting company to choose, on an item-by-item basis, to comply with the financial and non-financial disclosure standards applicable to smaller reporting companies or the financial and non-financial disclosure standards applicable to larger companies. In this way, a smaller reporting company has, in the SEC's words, the "option to take advantage of the smaller reporting company requirements for one, some, all or none of the items, at its election, in any one filing." Note, however, the following inconsistency with the "a la carte" approach. New Item 10(f) of Regulation S-K provides that a smaller reporting company may comply with either the requirements applicable to smaller reporting

companies or the requirements applicable to other companies for each item unless the requirements for smaller reporting companies specify that smaller reporting companies must comply with the smaller reporting company requirements. It appears that Item 404(d) (Transactions with related persons, promoters and certain control persons) is the only place in Regulation S-K, as amended, to specify that a smaller reporting company must comply with the smaller reporting company disclosure standard. All the other smaller reporting company standards in Regulation S-K appear to be permissive.

In addition, the SEC provided the following guidance in the adopting release on use of the "a la carte" disclosure approach:

- It is important for smaller reporting companies to provide disclosure "that permits investors to make period-to-period comparisons, whether quarterly or annually."
- If a smaller reporting company scaled item requirement is more rigorous than the same larger company item requirement, smaller reporting companies must comply with the more rigorous smaller reporting company item requirement. Currently, the smaller reporting company requirements for Item 404 present the only instance where the smaller reporting company requirement can be more rigorous than the larger company standard.
- It will not be appropriate for a smaller reporting company to comply with the larger company Regulation S-K item requirement "if that requirement sets a higher threshold obviating the need for the smaller reporting company to provide disclosure." The SEC cited compliance with Item 404 as an example of such a situation.
- It is expected that the SEC staff will continue to "evaluate item-by-item compliance by smaller reporting companies with only the Regulation S-K requirements applicable to smaller reporting companies, and not with the requirements applicable to larger companies" even if the smaller reporting company being reviewed has elected to comply with the larger company requirements in the filing.

Finally, as proposed, a new check box appears on the cover page of Securities Act and Exchange Act filings for smaller reporting companies to check in order to indicate that they are eligible for smaller reporting company status. The SEC intends this approach to balance the interests of investors who wish to determine if a filer is eligible for smaller reporting company status with the need for transparency while not "unduly stigmatizing smaller companies."

#### **ELIMINATION OF "SB" FORMS**

In response to comments, the final rules eliminate some of the forms associated with Regulation S-B on a transitional basis rather than eliminating all of them immediately as proposed. The final rules rescind the registration statements on Forms SB-1, SB-2 and 10-SB effective February 4, 2008. A small business issuer may file its annual report for a fiscal year ending on or after December 15, 2007 on either Form 10-KSB or Form 10-K. A small business issuer may also continue to file its periodic reports using Regulation S-B and the related "SB" forms until its next annual report is filed. Once that annual report is filed, the small



business issuer may no longer file periodic reports on "SB" forms. As a result of the optional transition rules, Form 10-QSB will not be removed until October 31, 2008 and Form 10-KSB will not be removed until March 15, 2009.

#### **DETERMINATION OF SMALLER REPORTING COMPANY STATUS**

Under the final rules, whether or not a company is a smaller reporting company is determined on an annual basis. The final rules provide that a smaller reporting company will lose eligibility for smaller reporting company status in the first quarter after the year its public float is greater than \$75 million as of the last business day of the second fiscal quarter. A company that does not file reports as a smaller reporting company will be required to transition to that status no later than the first quarter of the next fiscal year if its public float falls below \$50 million as of the last business day of the second fiscal quarter. Unlike the proposed rules, the final rules permit a company newly eligible to be a smaller reporting company to choose to reflect this determination and comply with the scaled disclosure requirements in the first Form 10-Q filed after the determination.

If a company does not have a public float or no public market for its common equity securities exists and its annual revenues are less than \$50 million, it will retain smaller reporting company status until its annual revenues exceed \$50 million. If an issuer does not qualify for smaller reporting company status under the revenue test, it remains unqualified as a smaller reporting company until its annual revenues are less than \$40 million during the previous fiscal year.

#### **COPY OF FINAL SEC RULES AMENDING DISCLOSURE AND REPORTING REQUIREMENTS FOR SMALLER REPORTING COMPANIES**

A copy of the final SEC rules amending the disclosure and reporting requirements for smaller reporting companies is available on the SEC's website at [www.sec.gov](http://www.sec.gov) by selecting Final Rule: Smaller Reporting Company Regulatory Relief and Simplification or by going to <http://www.sec.gov/rules/final/2007/33-8876.pdf>

#### **MEMBERS OF GRAY PLANT MOOTY SECURITIES PRACTICE TEAM**

##### **Attorneys on the Securities Team include:**

J.C. Anderson (612) 632-3002

Lindley S. Branson (612) 632-3024

Maxwell J. Bremer (612) 632-3056

Christopher A. Carlisle (612) 632-3033



Barry F. Clegg (612) 632-3220

Gene H. Hennig (612) 632-3202

Alyssa J. Hirschfeld (612) 632-3316

Inchan Hwang (612) 632-3310

Julia S. Offenhauser (612) 632-3067

Douglas M. Ramler (612) 632-3324

Michael P. Sullivan, Jr. (612) 632-3350

Daniel R. Tenenbaum (612) 632-3050

Mark D. Williamson (612) 632-3379

Note on Distribution of Securities Briefing: If you have friends or business associates who would like to receive the Gray Plant Mooty Securities Briefing, please forward this to them by e-mail. This newsletter will also be available on the Gray Plant Mooty Web site ([www.gpmlaw.com](http://www.gpmlaw.com)) under "Publications."

To be added to the distribution list or to update your e-mail address, you may send your name, e-mail address, and company name by e-mail to: [Shirley.Johnson@lathropgpm.com](mailto:Shirley.Johnson@lathropgpm.com) or contact Shirley Johnson at (612) 343-3206. If you would like to be removed from our distribution list altogether, please reply to that effect or contact: [Shirley.Johnson@lathropgpm.com](mailto:Shirley.Johnson@lathropgpm.com).

*This newsletter is a periodic publication of Gray, Plant, Mooty, Mooty & Bennett, P.A. that should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult legal counsel concerning your situation and any specific legal questions you may have.*

**Copyright. 2008. All rights reserved.  
Gray, Plant, Mooty, Mooty & Bennett, P.A.**

*This article is provided for general informational purposes only and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult a lawyer concerning any specific legal questions you may have.*