

SEC Proposes Several Significant Changes to Offering and Reporting Rules

May 24, 2007

At its public meeting on May 23, 2007, the Securities and Exchange Commission announced several far-reaching proposals that, if adopted, would simplify private placements and resales of unregistered securities, make short-form registration statements (i.e., Forms S-3 and F-3) more readily available, simplify reporting for smaller companies, and give guidance on compliance with Section 404 of the Sarbanes-Oxley Act of 2002 relating to internal controls.

Private Placements

The Commission's proposed amendments to Regulation D were designed to ease access to the private capital markets by smaller public companies, and include the proposal of a new exemption and a new category of permitted purchasers.

- New Item 507 would permit limited advertising in the nature of a tombstone advertisement if the only purchasers fall into a new category of investors, referred to as "Rule 507 Qualified Purchasers." Because the limited advertisement would be inconsistent with the prohibition under the 1940 Act on public offering by private investment funds, Rule 507 would not be available to hedge funds.
- "Rule 507 Qualified Purchasers" would include:
 - Individuals with \$2.5 million in investments
 - Individuals with \$400,000 in annual income (\$600,000 for a couple)
 - Institutions with \$10 million in investments
- The definition of "accredited investor" would be amended to add an investments-owned standard to the current total assets and net worth standards under which investors can qualify as "accredited" in other Regulation D offerings, and the thresholds would be adjusted to account for inflation, starting in five years.
- The safe harbor from the integration concepts for private offerings would be modified to shorten the minimum time period from 6 months to 90 days.
- The disqualification provisions of Regulation D would be updated.

- The electronic filing of a Form D in a more user-friendly format would be required.

Unregistered Resales of Securities

The Commission proposed amendments to Rule 144 to revise the holding period for the resale of restricted securities, simplify compliance for nonaffiliates, revise the Form 144 filing thresholds, and codify certain staff interpretations and proposed amendments to Rule 145. These changes would include:

- The Rule 144(d) holding period for resales of restricted securities would be reduced from one year to six months in the case of publicly reporting issuers; however, the running of this holding period would be tolled during any period when the holder has a short, or a put-equivalent, position with respect to the securities. This tolling would not result, in any event, in a total holding period in excess of one year.
- Upon the expiration of the six-month holding period, nonaffiliates would be able to resell restricted securities of a publicly reporting issuer freely, so long as there is adequate publicly available information about the issuer.
- For affiliates selling under Rule 144 after the six-month holding period, the manner of sale restrictions would no longer apply to the sale of debt securities.
- The Form 144 filing thresholds would be increased and the Form 144 filing requirements would be integrated with those of Form 4 under Section 16 of the Exchange Act.
- The “presumptive underwriter” concept set forth in Rule 145(d) (most commonly, directors and officers of a target company) would be eliminated except in the case of shell companies. In the case of shell companies, the Rule 145 resale provisions applicable to presumptive underwriters would be revised to match those of the revised Rule 144.

Wider Availability of Forms S-3 and F-3

In an effort to facilitate capital raising by smaller public companies (i.e., those with public floats of less than \$75 million), the Commission proposed that Forms S-3 and F-3 be made available for such companies to register primary offerings, including shelf offerings, as long as:

- The smaller public issuer satisfies the registrant requirements of General Instruction I.A. of Forms S-3 and F-3, the most notable of which are that the issuer have been a reporting company under the Exchange Act, and have made its filings on a timely basis thereunder, for the preceding 12 months.
- The smaller public issuer must not be a shell company, nor have been a shell company within the preceding 12 months.
- The smaller public issuer may not use Form S-3 or F-3 to sell, during any 12-month period, securities having an aggregate value of more than 20% of its public float. The SEC would

monitor compliance with the 20% limitation by reviewing the prospectuses filed pursuant to Rule 424(b) at the time of each shelf take-down.

Internal Controls

The Commission plans to issue significant releases on internal controls.

- A guidance release will contain more explicit “principles based” guidance for management of public companies as to the steps they should take in evaluating the adequacy of their companies’ internal controls. Compliance with these guidelines will satisfy management’s obligations under Section 404 of the Sarbanes-Oxley Act of 2002.
- Specific definitions of “material weakness” and “significant deficiency” have been proposed.
- Auditors will now be expected to issue one opinion on the adequacy of a public company’s internal controls, rather than a separate assessment of management’s evaluation of the adequacy of internal controls.
- The Commission does not intend to grant further extensions of time for issuers to comply with Section 404.

Streamlining of Disclosure for Smaller Public Companies

The Commission proposed amendments to its reporting requirements that would:

- Expand eligibility for scaled disclosure for smaller public companies, making scaled disclosure available to all companies with public floats of less than \$75 million.
- Simplify the Commission’s disclosure and reporting requirements by combining, for many purposes relating to disclosure, the categories of “small business issuers” and “nonaccelerated filers” into one category called “smaller reporting companies.”

Several other changes of varying significance were outlined and will be the subject of agency releases in the forthcoming weeks.

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