Being Prepared to Access the Capital Markets

Despite periods of recovery, in today’s volatile markets companies may face capital constraints not of their own making. The market instability surrounding the European sovereign debt crisis, as well as the related volatility of the debt and equity markets, may limit access to capital. In an unpredictable economic environment, it is important that companies be prepared to access the capital markets opportunistically and quickly. This memorandum highlights key matters that companies should consider and address in order to make sure that they are ready to access the public capital markets when market windows open. For the technical reasons discussed below, the coming months may be critical for many issuers to reassess the status of their shelf registration statements.

Effective Shelf Registration Statements

The quickest way to access the public capital markets is to have an effective shelf registration statement. Companies should make sure that their current shelf registration statements are effective. Companies also must understand when their current effective shelf registration statements are due to be refiled pursuant to Rule 415 under the Securities Act in order to preserve their availability.

Requirement for Refiling Existing Effective Shelf Registration Statements Every Three Years

Pursuant to Rule 415 under the Securities Act, shelf registration statements for most primary offerings of securities by issuers and all automatic shelf registration statements expire three years from the date of their effectiveness. Therefore, to keep a shelf registration in place, issuers must refile their shelf registration statements every three years.1 A significant number of issuers filed shelf registration statements following December 1, 2005, the effective date of the SEC’s Securities Offering Reform, and many of these issuers refiled their shelf registration statements every three years. As we recently marked the six-year anniversary of the Securities Offering Reform, these issuers should once again consider refileing their shelf registration statements to preserve capital raising flexibility. Accordingly, we recommend that companies review the status of existing shelf registration statements to determine whether they have a shelf registration statement that is due to expire within the next several months.

180-Day Grace Period

If an issuer files a new registration statement that is not an automatic shelf, it can continue to offer securities off the prior shelf, even if the prior shelf is more than three years old, as long as the issuer has filed a new shelf registration statement before the

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1 Note that the three-year refile requirement does not apply to all registration statements. For example, it does not apply to nonautomatic resale shelf registration statements covering offerings by selling security holders or registration statements on Form S-8.
expiration of the prior registration statement. This grace period extends until the earlier of the effective date of the new shelf registration statement or 180 days after the third anniversary of the effective date of the prior registration statement. The grace period will enable an issuer to utilize the unused portion of the prior shelf registration statement (or, in the case of an issuer who previously had a well-known seasoned issuer (WKSI) shelf but is now filing a nonautomatic shelf, up to the amount to be registered in the new registration statement) for up to 180 days, even in cases where the SEC decides to review the new filing.

**S-3 Eligibility**

*General*

In general, the eligibility requirements for use of Form S-3 for primary offerings by an issuer require that the aggregate market value of common equity held by nonaffiliates, or public float, be at least $75 million. The $75 million public float requirement is based on a price within 60 days prior to the date of filing.

When a company’s public float falls below $75 million, however, it may still be able to use Form S-3 for primary offerings subject to a cap on the amount of securities being sold. In 2007, the SEC expanded S-3 eligibility to include smaller reporting companies. Issuers with a public float of less than $75 million are now eligible to file a shelf registration statement for primary offerings provided the issuer (a) is not a shell company, (b) has a class of common equity securities listed and registered on a national exchange and (c) does not sell more than one-third of its public float in any 12-month period. If the issuer’s public float equals or exceeds $75 million at any time after the effective date of the new registration statement, this cap will no longer apply. If, however, the public float falls below $75 million at the time an issuer’s next annual report is filed, the cap will be reimposed. Note, too, that an issuer whose float has fallen below $75 million could also file the new shelf registration statement before the old shelf expires and continue to use the old shelf during the 180-day grace period discussed above.

Companies whose future S-3 eligibility may be in jeopardy should consider filing an S-3 shelf registration statement while they remain eligible. This will enable issuers to continue to use their S-3 registration statement, at least until the filing of their next annual report. Companies also should be aware that if they have failed to timely file any report required to be filed under the Exchange Act in the prior 12 months, they may lose S-3 eligibility at the time of the filing of their next annual report.

**S-3 Eligibility for Offerings of Nonconvertible Securities Other Than Common Equity**

In July 2011, the SEC adopted new rules that replaced prior criteria utilizing credit ratings as a basis of the eligibility requirement for issuers seeking to use Form S-3 when registering the public sale of nonconvertible securities other than common equity, such as debt securities. These rules were adopted to implement the requirements of Section 939A of the Dodd-Frank Act — a provision that requires regulators to reduce reliance on credit ratings. The new rules became effective on September 2, 2011. Prior to their adoption, one of the ways that an issuer could qualify to use Form S-3 for the registration of nonconvertible securities other than common equity was if those securities had received an investment grade rating by at least one nationally recognized statistical rating organization (NRSRO). The new rules eliminated this eligibility test, and instead a company now may use Form S-3 when issuing nonconvertible securities other than common equity if the company satisfies one of the following four tests:
• the issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least $1 billion in nonconvertible securities other than common equity, in primary offerings for cash (not pursuant to an exchange offer) registered under the Securities Act, over the prior three years;

• the issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of nonconvertible securities other than common equity, issued in primary offerings for cash (not pursuant to an exchange offer) registered under the Securities Act;

• the issuer is a wholly owned subsidiary of a WKSI; or

• the issuer is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI.

In order to ease transition to the new rules, the SEC adopted a temporary grandfather provision that allows an issuer to use Form S-3 for a period of three years from September 2, 2011, if it has a reasonable belief that it would have been eligible to register the securities offerings under the old requirements.

WKSI Status

Companies that qualify as WKSIs are permitted to file shelf registration statements that are not subject to SEC review but instead become effective automatically upon filing, are unlimited in amount and allow for pay-as-you-go registration fees. To determine WKSI status, either (a) an issuer’s public float must be at least $700 million or (b) an issuer must have issued in the last three years at least $1 billion aggregate principal amount of nonconvertible securities other than common equity (which criteria only permits the issuer to utilize WKSI status for the purpose of registering nonconvertible securities other than common equity), in each case within 60 days of the later of (a) the time of filing the shelf registration statement or (b) the time of the most recent filing to update financial statements in a prospectus pursuant to Section 10(a)(3) of the Securities Act. Ordinarily, the required Section 10(a)(3) update of financial statements occurs at the time an issuer’s annual report on Form 10-K or 20-F is filed. As a result, issuers that no longer meet the criteria for WKSI status at the time such status must be reassessed may lose the benefits of the automatic shelf available to WKSI filers and, upon refiling a shelf registration statement, be subject to SEC review of their refiled shelf registration statement. These issuers would also lose other flexibilities available to WKSI filers, such as the flexibility to offer additional securities of the classes covered by the registration statement without filing a new registration statement, to register additional classes of securities not covered by the registration statement by filing a post-effective amendment, the ability to omit certain information from the prospectus and the pay-as-you-go registration fees.

If an issuer does not satisfy WKSI status at the time of filing the new registration statement, the issuer may still file a nonautomatic shelf and get the benefit of the 180-day grace period discussed above for the old WKSI shelf registration statement. If its stock price has not recovered by that time, such issuer must file a nonautomatic shelf to stay in the market, at least until the annual report providing the updated financials for purposes of Section 10(a)(3) is filed, at which time its WKSI status must be re-evaluated. If an issuer has filed a nonautomatic shelf and its stock price recovers during the 180-day grace period, it could file a new automatic shelf and rely on Rule 457(p) to carry forward unused filing fees.
Other Important Considerations in Preparing to Access the Capital Markets — Legal Due Diligence and Auditor Preparedness

In addition to having an effective shelf registration statement, issuers should be prepared on all fronts for an offering as soon as a market opportunity presents itself. In particular, issuers should think about the time-consuming diligence efforts performed by company and underwriters’ counsel. Issuers who want to be prepared for an offering as quickly as possible should have their outside counsel not only update their diligence on an ongoing basis but also assist in drafting updated disclosure in Exchange Act reports about the effects of macroeconomic conditions on their companies, if applicable. A company’s need to access capital in an especially volatile economic environment and a company’s exposure to sovereign debt and to financial institutions that are exposed to sovereign debt or are otherwise in financial difficulty are particular areas of current concern. For issuers who have designated underwriters’ counsel for their shelf offerings, such counsel also should be apprised of developments and stay updated in their diligence. Issuers that do not presently have designated underwriters’ counsel may wish to consider selecting such counsel to facilitate future transactions. Issuers also should keep their auditors closely involved and ready to act quickly to provide comfort letters and other advice when a market opportunity arises.

Conclusions

Macroeconomic uncertainty and market volatility may restrict companies’ access to the capital markets. As a result, it is important for companies to make sure they are ready to access the markets as soon as a market window opens. The most efficient way to access the public markets is to make sure a company is prepared for an immediate shelf takedown. Issuers must pay close attention to their existing shelf registration statements and the timing of required refilings of new registration statements. In addition, issuers must look closely at their current circumstances to see how the market and pricing of their stock may affect their registration options.