

# Management Alert

## SEC Adopts Overhaul of Small Business Registration and Reporting Requirements

The Securities and Exchange Commission (SEC) has adopted a series of rule and form amendments that will extend the benefits of small business issuer regulations to a greater number of companies and simplify and consolidate existing scaled disclosure and reporting requirements. Specifically, the amendments will:

- Replace category of “small business issuers” with an expanded class of “smaller reporting companies;”
- Integrate Regulation S-B’s substantive disclosure requirements into new scaled disclosure provisions of Regulations S-K and S-X, as appropriate;
- Eliminate Regulation S-B and its related SB forms; and
- Permit smaller reporting companies to elect to comply with scaled disclosure and reporting requirements of revised Regulations S-K and S-X.

### *Smaller Reporting Companies Regulatory Structure*

The new rules replace the terms “small business issuer” and “non-accelerated filer” with a new “smaller reporting company” which is defined as an issuer with a public float of less than \$75 million measured as of the last business day of the issuer’s second fiscal quarter, or, if the issuer has no common equity public float or market price, annual revenues of less than \$50 million for its most recently completed fiscal year. The SEC declined to adopt a proposal that would have adjusted these public float and annual revenue thresholds for smaller reporting companies once every five years to account for inflation.

A company determining its eligibility in connection with the filing of its initial registration statement will have to choose a date within 30 days of filing to determine eligibility based on (1) a bona fide estimate of the offering price per share, (2) the number of shares of common stock outstanding that are held by non-affiliates before the offering, and (3) the number of shares to be sold at the estimated offering price. A company may elect to recalculate its public float at the time its initial public offering is completed. If a company determined that its public float was less than \$75 million at the time of filing its initial registration statement and its public float rose above \$75 million during the pre-effective stage, the company would continue to be an eligible smaller reporting company until its next annual determination date, the end of its second fiscal quarter.

If a smaller reporting company determines that it is no longer an eligible smaller reporting company as of the end of its second fiscal quarter in any given year, it will be required to transition to the larger public company disclosure requirements beginning with the quarterly report on Form 10-Q for the first fiscal quarter of the next fiscal year. If a larger reporting company determines it meets the criteria for a smaller reporting company as of the end of its most recently completed second fiscal quarter, it is permitted to immediately transition to the scaled disclosure requirements for smaller reporting companies in the Form 10-Q report corresponding to such second fiscal quarter.

If a smaller public company becomes a larger public company because its public float exceeds \$75 million as of the end of its second fiscal quarter or, if it has no public float, because its

annual revenue exceed \$50 million in any fiscal year, then it will not qualify to transition back to smaller company reporting status until its public float is less than \$50 million as of the end of its most recently completed second fiscal quarter or its annual revenues are less than \$40 million in its last fiscal year, as applicable.

In a departure from existing rules, a foreign private issuer may qualify as a smaller reporting company under the new rules if it otherwise meets the requisite criteria discussed above, it files a domestic form that permits disclosure based on the standards for smaller reporting companies, and provides financial statements prepared in accordance with U.S. GAAP. Investment companies and asset-backed issuers are ineligible to qualify as smaller reporting companies.

### *Scaled Disclosure System*

The new rules eliminate Regulation S-B and relocate the non-financial disclosure and reporting requirements of Regulation S-B to the comparable sections of Regulation S-K and the financial disclosure and reporting requirements of Regulation S-B to a new Article 8 of Regulation S-X. Where the current Regulation S-K and Regulation S-B disclosure standards differ significantly, the former Regulation S-B disclosure standards will, under the new rules, be preserved in the Regulation S-K items as optional disclosure for smaller reporting companies. Under the new rules, a smaller reporting company may choose, on an item-by-item, or “a la carte” basis, to comply with either the Regulation S-K disclosure requirements for smaller reporting companies or the comparable requirements for larger reporting companies. This optional, scaled disclosure model provides smaller reporting companies with the opportunity to take advantage of one, some, all, or none of the smaller reporting company disclosure requirements in any one filing, and permits such companies to switch back and forth among requirements from one filing to the next.

The integration of Regulation S-B reporting items into Regulation S-K will be accomplished as follows:

- Description of Business – The disclosures required by Item 101 of Regulation S-B will be moved to a new paragraph (h) of Item 101 of Regulation S-K. The smaller reporting company disclosure required under paragraph (h) is less detailed than the disclosure required from larger reporting companies and only requires disclosure of business development activities for three years rather than five.
- Description of Property – Item 102 of Regulation S-B directs issuers to information called for in certain SEC industry guides. The new rules amend Item 102 of Regulation S-K by adding references to the following SEC industry guides:
  - o Industry Guide 2 – Disclosure of oil and gas operations;
  - o Industry Guide 4 – Prospectus relation to interests in oil and gas programs;
  - o Industry Guide 5 – Preparing of registration statements relating to interest in real estate limited partnerships; and
  - o Industry Guide 7 – Description of property by issuers engaged or to be engaged in significant mining operations.
- Market and Dividend Information – The disclosure standards of Item 201 of Regulation S-B may be elected by smaller reporting companies pursuant to revised instruction 6 to paragraph (e) of Item 201 of Regulation S-K.
- Selected Financial Data and Supplementary Financial Information – The information required by Items 301 and 302 of Regulation S-K currently is not required under Regulation S-B. A new paragraph (c) will be added to each of Items 301 and 302 of Regulation S-K exempting smaller reporting companies from the disclosures required by those items.
- MD&A – The disclosures required by Item 303 of Regulation S-B will be moved to a new paragraph (d) of Item 303 of Regulation S-K. The smaller reporting company disclosure is more streamlined, only requires presentation of two years of financial statements, and does not require tabular disclosure of contractual obligations.
- Market Risk – The information required by Item 305 of Regulation S-K currently is not required under Regulation S-B. A new paragraph (e) will be added to Item 305 of

Regulation S-K exempting smaller reporting companies from the disclosures required by this item.

- Executive Compensation – The disclosures required by Item 402 of Regulation S-B will be added to new paragraphs (l) through (r) of Item 402 of Regulation S-K. Smaller reporting companies:
  - o Are permitted to provide executive compensation disclosure for three rather than five executive officers;
  - o Only need to present two years of compensation information in the Summary Compensation Table rather than three;
  - o Do not need to provide a Compensation Discussion and Analysis;
  - o Are only required to provide three of the seven compensation tables required of larger reporting companies; and
  - o Do not need to include footnote disclosure of grant date fair value in the Director Compensation Table.
- Related Person Transactions – The disclosures required by Item 404 of Regulation S-B will be reflected in amendments to paragraph (c)(1) and a new paragraph (d) of Item 404 of Regulation S-K. Whereas larger reporting companies only have to disclose related person transactions in excess of \$120,000, smaller reporting companies must disclose transactions that exceed the lesser of \$120,000 or 1% of its average total assets at year end for the last three completed fiscal years. In addition, smaller reporting companies:
  - o Are not required to disclose policies and procedures for approving related person transactions;
  - o Must provide additional disclosure about underwriting discounts and commissions and corporate parents; and
  - o Must provide disclosure regarding promoters and certain control persons.
- Corporate Governance – The disclosures required by Item 407 of Regulation S-B will be added to a new paragraph (g) of Item 407 of Regulation S-K. Smaller reporting companies are not required to provide disclosure on compensation committee interlocks and insider participation

or a compensation committee report. In addition, a smaller reporting company will not be required to provide an audit committee report until the first annual report after its initial registration statement is filed with the SEC.

- Prospectus Summary, Risk Factors and Earnings Ratios – The disclosures required by Item 503 of Regulation S-B will be added to a new paragraph (e) of Item 503 of Regulation S-K. Smaller reporting companies are not required to provide earnings ratios when issuing debt or preferred equity securities.
- Use of Proceeds – The substantive disclosures required by Item 504 of Regulation S-B are already identical to Item 504 of Regulation S-K. The instructions will be revised to clarify that new Article 8 of Regulation S-X will govern whether financial statements of businesses proposed to be acquired are to be included in the filings of smaller reporting companies.
- Exhibits – The disclosure required by Item 601 of Regulation S-B will be added to a new paragraph (c) to Item 601 of Regulation S-K. A smaller reporting company is not required to provide the exhibits required by Item 601(b) (12) relating to the computation of earnings ratios unless the company elects to include the ratios voluntarily under Item 503 of Regulation S-K.

The SEC declined to adopt the proposed new paragraph (m) to Item 512 of Regulation S-K that would have exempted smaller reporting companies from making the undertakings relating to asset-back securities, foreign private issuers and trust indenture offerings required of larger reporting companies. In addition, while disclosure of personal bankruptcy proceedings of a director or officer is not required under Item 401 of Regulation S-B, smaller reporting companies will now be required to disclose personal bankruptcy petitions filed by or against directors or officers pursuant to Item 401 of Regulation S-K.

The smaller reporting company financial statement requirements under new Article 8 of Regulation S-X may be used by smaller reporting companies in lieu of the more rigorous requirements of Regulation S-X. Whereas Regulation S-B only requires an audited balance sheet for the most recently completed fiscal

year, the new Article 8 of Regulation S-X will require two years of comparative, audited balance sheets for smaller reporting companies. In addition, pursuant to current Rule 3-05(b)(2)(iv) of Regulation S-X, if a target business acquired by a small business issuer had less than \$25 million in revenues for its latest fiscal year, the three-year financial statements of the target business that a small business issuer must file under Rule 3-05 may omit the earliest of the three fiscal years. The rules amend Rule 3-05(b)(2)(iv) to increase the exemption threshold from \$25 million to \$50 million.

Unlike the more flexible scaled disclosure options available to smaller reporting companies under the amendments to Regulation S-K as described above, a smaller reporting company must comply with either the financial statement requirements of Item 310 of Regulation S-K or new Article 8 of Regulation S-X for an entire fiscal year and would not be permitted to switch back and forth during a single fiscal year.

### *Transition Rules*

The new rules will become effective February 4, 2008. SB registration statements will continue to be available until August 4, 2008 provided that the registration statement is declared effective on or prior to that date. Thereafter, any post-effective amendment to a previously effective SB registration statement must be on another form (e.g. Form S-1).

A company that currently qualifies as a small business issuer under Regulation S-B may continue to file its quarterly reports on Form 10-QSB using the current Regulation S-B disclosure requirements and will have the option to file its next annual report for a fiscal year ending on or after December 15, 2007 on either Form 10-KSB using the current Regulation S-B disclosure requirements or on Form 10-K using the new scaled disclosure requirements of Regulation S-K. After a smaller reporting company files its first annual report under the new rules, all subsequent periodic reports would then be required to be on Form 10-Q or Form 10-K, as applicable, using the new scaled disclosure requirements of Regulation S-K. Companies newly qualifying as smaller reporting companies after the effective

date of the new rules will have the option to file periodic reports on Form 10-Q or Form 10-K using the new scaled disclosure requirements under Regulation S-K.

### *Elimination of SB Forms*

The new rules eliminate existing SB registration statements (e.g. Form SB-2) after August 4, 2008, eliminate Form 10-QSB after October 31, 2008 and eliminate Regulation S-B and Form 10-KSB after March 15, 2009. To identify smaller reporting companies, a “check-the-box” line item would be added to the cover page of filings eligible to be used by smaller reporting companies to indicate a registrant’s status as such. The elimination of the SB filing forms would result in most smaller reporting companies using Form S-1 for public offerings, thereby giving them the opportunity to incorporate by reference their previously filed periodic reports.

*If you have any questions regarding this Management Alert or if you want to learn more about the smaller reporting company disclosure and reporting requirements, please contact the Seyfarth Shaw attorney with whom you work, or any Corporate attorney on our website, [www.seyfarth.com](http://www.seyfarth.com).*

**ATLANTA**

One Peachtree Pointe  
 1545 Peachtree Street, N.E.  
 Suite 700  
 Atlanta, GA 30309-2401  
 404-885-1500  
 404-892-7056 fax

**BOSTON**

World Trade Center East  
 Two Seaport Lane  
 Suite 300  
 Boston, MA 02210-2028  
 617-946-4800  
 617-946-4801 fax

**CHICAGO**

131 South Dearborn Street  
 Suite 2400  
 Chicago, IL 60603-5577  
 312-460-5000  
 312-460-7000 fax

**HOUSTON**

700 Louisiana Street  
 Suite 3700  
 Houston, TX 77002-2797  
 713-225-2300  
 713-225-2340 fax

**LOS ANGELES**

One Century Plaza, Suite 3300  
 2029 Century Park East  
 Los Angeles, CA 90067-3063  
 310-277-7200  
 310-201-5219 fax

**NEW YORK**

620 8th Avenue  
 32nd Floor  
 New York, NY 10018  
 212-218-5500  
 212-218-5526 fax

**SACRAMENTO**

400 Capitol Mall  
 Suite 2350  
 Sacramento, CA 95814-4428  
 916-448-0159  
 916-558-4839 fax

**SAN FRANCISCO**

560 Mission Street  
 Suite 3100  
 San Francisco, CA 94105-2930  
 415-397-2823  
 415-397-8549 fax

**WASHINGTON, D.C.**

815 Connecticut Avenue, N.W.  
 Suite 500  
 Washington, D.C. 20006-4004  
 202-463-2400  
 202-828-5393 fax

**BRUSSELS**

Boulevard du Souverain 280  
 1160 Brussels, Belgium  
 (32) (2) 647 60 25  
 (32) (2) 640 70 71 fax



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