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SEC Proposes to Eliminate "Investment Grade" Eligibility for Short Form Registration

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On February 9, 2011, the Securities and Exchange Commission ("SEC") proposed to amend the eligibility requirements for issuers to use the "short form" registration on Form S-3.[1] The proposal would condition the eligibility to make "off the shelf" primary offerings of non-convertible securities on Form S-3 on whether an issuer has issued $1 billion of non-convertible securities in transactions registered under the Securities Act of 1933 ("Securities Act"), other than equity securities, for cash during the past three years. This would replace the current condition that allows an issuer to use Form S-3 for primary offerings of non-convertible securities that are rated investment grade by at least one Nationally Recognized Statistical Rating Organization ("NRSRO").

Although the SEC had proposed substantially similar amendments to Form S-3 in 2008, Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 mandated that the SEC review its regulations, rules and forms that reference credit-worthiness and credit ratings and "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness" as the agency deems appropriate. The proposed new minimum registered debt issuance threshold seeks to reduce reliance on credit ratings while preserving the use of Form S-3 for issuers that are widely followed in the market. In the first of what the SEC promises will be a series of proposals designed to reduce the current degree of regulatory reliance on ratings issued by NRSROs, the Commissioners voted unanimously to adopt a standard it believes will serve as a better indication than credit ratings of the degree of market attention that an issuer attracts. Under the proposal, the $1 billion threshold would be calculated as the aggregate principal amount of non-convertible securities that have been issued in any registered primary offering for cash, on any form other than Form S-4 or Form F-4.

The SEC also proposed conforming amendments under the Securities Act to Rules 134, 138, 139 and 168, Forms S-4 and F-4 and, under the Exchange Act of 1934 ("Exchange Act"), to Schedule 14A. The conforming amendments would remove the specific reference to the investment grade rating criterion on each of these rules and forms and substitute the minimum registered debt issuance threshold. In addition, the SEC proposed to rescind a form specific to Canadian issuers, Form F-9, because Canadian regulatory developments and lack of use have made the form unnecessary. [2]

The Proposing Release will remain open for public comment until March 28, 2011.

Substitution of Standards

Form S-3 and Form F-3 (for foreign issuers) are "short forms" because they allow eligible issuers to rely on reports they have filed under the Exchange Act to satisfy many disclosure requirements. Issuers eligible to use Form S-3 are able to conduct delayed offerings "off the shelf" and as such benefit from "considerable flexibility in accessing the public securities markets in response to changes in the market and other factors." [3] Eligible issuers are able to register offerings before planning any specific offering and, once the shelf registration is effective, such issuers may offer securities in one or more tranches without waiting for further SEC action. To be eligible, the offering generally must satisfy a two part test. First, issuers must meet "issuer eligibility requirements" that require the issuer to have been a reporting company for at least 12 months, have filed its reports in a timely manner and have not defaulted on any debt or failed to pay a dividend on preferred stock since the end of the last fiscal year. Second, the offering must satisfy one of the "transactional requirements"; under General Instruction I.B.2 to Forms S-3 and F-3, the investment grade rating criterion constitutes one such transactional requirement. In the Proposing Release, the SEC advances the minimum registered debt issuance threshold as a substitute standard to satisfy this transactional requirement.

The minimum registered debt issuance threshold is the same threshold used to define a well-known seasoned issuer ("WKSI") of non-convertible securities that does not meet the public float test set forth in Securities Act Rule 405. The incorporation of WKSI standards reflects the SEC's attempt to ensure that issuers that fail to attract sufficient market attention do not have access to short form registration whereby they could take advantage of off the shelf registration to stem the flow of important information to the public. In the Proposing Release, the SEC states that "we preliminarily believe that [the minimum registered debt issuance threshold] is the most workable alternative for determining whether an issuer is widely followed in the marketplace so that Form S-3 and Form F-3 eligibility and access to the shelf offering process is appropriate." [4] In determining compliance with the $1 billion threshold proposed by the SEC:

- Issuers may aggregate the amount of non-convertible securities (whether or not investment grade), other than common equity, issued in registered primary offerings during the prior three years (as measured from a date within 60 days of the filing of the registration statement);
- Issuers may include only such non-convertible securities that were issued in registered primary offerings for cash—they may not include registered exchange offers on Forms S-4 or F-4;
- Parent company issuers only may include in their calculation the principal amount of their full and unconditional guarantees, within the meaning of Rule 3-10 of Regulation S-X, of non-convertible securities of their majority-owned subsidiaries issued in registered primary offerings for cash during the three-year period; and
- Issuers generally would be permitted to include in the calculation of the $1 billion threshold, the principal amount of any debt and the greater of liquidation preference or par value of any non-convertible preferred stock that was issued in primary registered offerings for cash.

The SEC underscored its awareness that the proposal would allow for some offerings by issuers of lower credit quality and solicits public comment accordingly. In addition, the SEC recognized that the proposal would have a significant impact on the ability of utility companies, issuers of insurance contracts and real estate investment trusts ("REITs") to conduct offerings on Form S-3. For example, in general, wholly-owned operating partnerships of exchange-listed REITs that currently rely on the

investment grade standard of Form S-3 would no longer be eligible to use Form S-3 if the proposals are adopted because they would not be able to satisfy the $1 billion threshold. The SEC seeks comment on whether they should condition the eligibility of such an operating partnership subsidiary on the eligibility of the issuer's parent, the REIT.

In inviting the public to propose alternatives not yet considered by the SEC, the Commissioners took note of the SEC's findings that the substitute standard would have precluded 45 issuers from using Form S-3 to offer non-convertible securities during the period between January 1, 2006 and August 15, 2008.

Endnotes

[1] *See* Securities Act Release No. 33-9186 (February 9, 2011) [hereinafter "Proposing Release"].

[2] Form F-9 is available to Canadian issuers as an alternative to Form F-10 for the registration of non-convertible investment grade debt. The principal advantage of Form F-9 over Form F-10 to Canadian issuers is that the form does not require a reconciliation to United States' GAAP. However, Canada has changed its regulations to require that Canadian issuers use International Financial Reporting Standards such that Form F-9 no longer provides any advantage over Form F-10. Form F-9's rare use is an additional consideration; only 21 issuers have filed Form F-9 for fewer than 40 registration statements since 2007. As the utility of Form F-9 has greatly diminished, the SEC proposes to eliminate the form.

[3] Proposing Release, at 6.

[4] Proposing Release, at 12.

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