



SEC PROPOSES REGULATORY RELIEF FOR SMALLER REPORTING COMPANIES

By: [Ryan B. Opel](#)

July 18, 2007

The SEC recently proposed a series of amendments intended to provide regulatory relief for smaller reporting companies under the Securities Act of 1933 and the Securities Exchange Act of 1934.¹ These proposals would significantly expand the number of companies eligible to benefit from the SEC's scaled-down disclosure and reporting requirements and simplify such requirements for these companies by integrating Regulation S-B into Regulation S-K. The proposed amendments are subject to comment and final rulemaking action by the SEC. Comments are due by September 17, 2007.

Background

The SEC currently maintains a separate registration and reporting system for small business issuers, the centerpiece of which is Regulation S-B. This system, however, has been criticized for its complexity and underutilization. Under the current regulatory regime, there are concerns that too few small companies are eligible to benefit from Regulation S-B's scaled reporting standards and that such small companies may fear a stigma or lack of market acceptance associated with Regulation S-B reporting. The SEC proposals described in this client alert attempt to remedy these deficiencies and protect smaller companies and their investors from unduly burdensome federal securities regulation.

Expanding Eligibility for Smaller Reporting Company Scaled Regulation

The SEC proposes to extend its existing scaled disclosure and reporting benefits to a new category of "smaller reporting companies" by combining the current categories of "small business issuers" and "non-accelerated filers." The proposed definition of "smaller reporting company" generally includes any company with a public float² of less than \$75 million as of the last business day of the company's most recently concluded second fiscal quarter. Companies that do not have a public float or are unable to calculate it would be eligible for scaled treatment if their revenues are below \$50 million annually. The \$75 million and \$50 million thresholds would automatically be adjusted for inflation every five years.

Smaller reporting companies would receive all of the reduced disclosure and reporting benefits currently made available to small business issuers and non-accelerated filers. These benefits include the following: (1) eligibility to use reduced disclosure and reporting standards currently provided to small business issuers under Regulation S-B, which, among other things, permit less detailed financial statements and simplified disclosure requirements regarding executive compensation, related person transactions and

¹ Smaller Reporting Company Regulatory Relief and Simplification, Securities Act Release No. 33-8819, Exchange Act Release No. 34-56013 (July 5, 2007), available at <http://www.sec.gov/rules/proposed/2007/33-8819.pdf>.

² As proposed, public float would be calculated in the same manner as is currently used to determine accelerated filer status: the price at which the shares of the company's common equity were last sold (or the average of the bid and asked prices of such shares) in the principal market for the shares as of the last business day of the company's most recently completed second fiscal quarter, multiplied by the number of outstanding shares held by non-affiliates.

management’s discussion and analysis of financial condition and results of operations; and (2) additional time for filing annual and quarterly reports.³

Integrating Regulation S-B into Regulation S-K

The proposed amendments are intended to simplify and improve the disclosure and reporting rules for smaller domestic companies by integrating the substantive provisions of Regulation S-B into Regulation S-K without making any major substantive changes to the items being moved from Regulation S-B. As a general rule, this integration would be accomplished by adding a new paragraph under the heading “smaller reporting companies” to each relevant item of Regulation S-K, which new paragraph would contain the disclosure standards from Regulation S-B. Where disclosure standards of identically numbered items in Regulation S-B and Regulation S-K are substantially the same, the SEC proposes no change to the existing Regulation S-K disclosure item. Regulation S-B and all related “SB” forms would be eliminated, requiring smaller reporting companies to use regular Forms S-1, S-3, S-4, 10-Q, and 10-K. Regulation S-B’s “small business issuer” designation would be eliminated entirely in favor of the new “smaller reporting company” designation.

The result of this integration would be an expanded Regulation S-K that would allow smaller reporting companies to adopt an “a la carte” approach and choose, on an item-by-item basis, whether to comply with Regulation S-K’s more detailed disclosure requirements or the scaled disclosure requirements formerly contained in Regulation S-B. To take advantage of the scaled disclosure requirements, smaller reporting companies need only check a box on the cover page of a filing. In any one filing, smaller reporting companies would then have the option to use the scaled disclosure requirements for one, some, all or none of the items at its election. With respect to financial statements, however, smaller reporting companies must present financial statements that comply with either full or scaled Regulation S-K for an entire fiscal year – in other words, smaller reporting companies would not be permitted to switch back and forth between such requirements in different filings within a single fiscal year. The SEC staff would evaluate item-by-item compliance with the requirements that apply to only smaller reporting companies.

Transitioning to and from Smaller Reporting Company Status

The proposed amendments also would simplify the rules governing transitions to and from smaller reporting company status using the transition model currently used with respect to accelerated filer status. Under the proposed rules, a smaller reporting company would lose eligibility to claim smaller reporting company status in the first fiscal year following a fiscal year in which the company’s public float rises above \$75 million as of the last day of the company’s second fiscal quarter. A company not claiming smaller reporting company status would be required to transition to that status in the next fiscal year if its public float falls below \$50 million as of the last day of the company’s second fiscal quarter.⁴

Eliminating Transitional Small Business Issuer Format

The SEC proposes eliminating the transitional disclosure format because it is not commonly understood and is infrequently used. Accordingly, smaller reporting companies would no longer have the option to use Form SB-1 and the transitional “question-and-answer” format of Form 10-KSB.

³ Just like non-accelerated filers, smaller reporting companies would have 90 days to file their annual reports on Form 10-K (compared to 60 and 75 days for large accelerated filers and accelerated filers, respectively) and 45 days to file their quarterly reports on Form 10-Q (compared to 40 days for all other filers).

⁴ With respect to issuers that do not have or cannot calculate a public float, issuers with less than \$50 million in annual revenues would be able to use the scaled disclosure requirements until annual revenues exceed \$50 million. Issuers with revenues in excess of \$50 million would not be eligible for smaller reporting company status unless annual revenues fall below \$40 million during the previous fiscal year.

Conclusion; Additional Information

If adopted, the proposed amendments would lessen the regulatory burden faced by many smaller public companies that have a small public float, but nevertheless historically have been unable or unwilling to be deemed a small business issuer. The integration of Regulation S-B into Regulation S-K and the elimination of the S-B forms would allow these smaller companies to benefit from scaled regulation – and likely reductions in legal and accounting costs – without subjecting themselves to the taint that some market observers associate with Regulation S-B filers.

If you have any questions regarding the proposed amendments, please contact either the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com./default.asp?id=1099&objId=10>.

Womble Carlyle client alerts are intended to provide general information about significant legal developments and should not be construed as legal advice regarding any specific facts and circumstances, nor should they be construed as advertisements for legal services.

IRS CIRCULAR 230 NOTICE: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (or in any attachment) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed in this communication (or in any attachment).