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Milbank

Global Securities Group Client Alert

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SEC AMENDS FORMS S-3 AND F-3 ELIGIBILITY CRITERIA TO REMOVE REFERENCES TO CREDIT RATINGS

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was enacted. This client alert is part of a series of client alerts Milbank is releasing on particular aspects of the Dodd-Frank Act that are important to our clients.

Section 939A of the Dodd-Frank Act requires each Federal agency, including the Securities and Exchange Commission (the "SEC"), to review any of its regulations that require the use of an assessment of the credit-worthiness of a security or money market instrument, modify its regulations to remove references to or requirements of reliance on credit ratings and provide an appropriate substitute for such ratings.

On July 26, 2011, the SEC adopted amendments to remove references to credit ratings in rules and forms promulgated under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act") in light of Section 939A of the Dodd-Frank Act.¹ Many of the amendments will become effective on September 2, 2011.

Revisions to Forms S-3 and F-3 Eligibility to Register Primary Offerings of Non-Convertible Securities

For securities issuers, the most important of these amendments will be the changes to the transaction eligibility criteria for registering primary offerings of non-convertible securities on Form S-3 and F-3.

Forms S-3 and F-3 are "short form" registration statements that may be used by eligible issuers to register certain securities offerings under the Securities Act. Issuers benefit from short-form registration particularly because the registration forms allow an issuer to incorporate by reference its annual, quarterly and current reports filed with the SEC (including future filings) as an efficient means to bring its public disclosure into the prospectus. Also, these forms are often used for shelf registrations and registered offerings of securities of various types (or "takedowns") on a delayed or continuous basis after the registration statement is declared effective. Among other things, shelf registration allows an issuer great flexibility to quickly access the capital markets when market conditions are most advantageous.

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¹ See SEC Release No. 33-9245; 34-64975; File No. S7-18-08.

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An issuer's eligibility to use these forms depends on satisfying both registrant requirements and one of several alternative transaction requirements. Currently, one of the transaction requirements is that a registrant can use Forms S-3 or F-3 to register a primary offering of non-convertible securities if the securities are rated investment grade by at least one nationally recognized statistical rating organization. Issuers often rely on the investment grade requirement to determine their eligibility for short-form registration, particularly if they cannot meet the alternate public float requirement of having \$75 million or more in common equity held by non-affiliates.

The investment grade requirement for eligibility is now being replaced with four alternative requirements, subject to a grandfathering provision. Once the amendments are effective, an offering of non-convertible securities, other than common equity, will be eligible to be registered on Form S-3 or F-3 if:

- the issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least \$1 billion in non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Securities Act, over the prior three years; or
- the issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least \$750 million of non-convertible securities, other than common equity, issued in primary offerings for cash, not exchange, registered under the Securities Act; or
- the issuer is a wholly-owned subsidiary of a well-known seasoned issuer ("WKSI") as defined in Rule 405 under the Securities Act; or
- the issuer is a majority-owned operating partnership of a real estate investment trust ("REIT") that qualifies as a WKSI.

Assuming one of these conditions is met, the issuer would also need to meet the registrant requirements.²

The SEC also adopted a grandfathering provision, which permits an issuer to use Form S-3 or F-3 during the next three years if it would have met the investment grade securities test. To rely on this grandfathering provision, the issuer must: (1) disclose in the registration statement that it has a reasonable belief that it would have been eligible to use Form S-3 or F-3 as of September 1, 2011, because it is registering a primary offering of non-convertible investment grade securities, (2) disclose the basis for such belief and (3) file a final prospectus for any such offering on or before September 2, 2014 (three years from the effective date of these amendments).

Impact

For widely followed high yield issuers that do not have a \$75 million or more public float, an immediate benefit of the amendments is that they will gain access to short-form registration and the shelf offering process thereunder. In addition, according to SEC estimates the number of issuers eligible to use Forms S-3 or F-3 will likely increase.

The SEC and various commentators have expressed concern that the amendments might cause some issuers to become ineligible to use short-form registration.³ Given the additional cost and time associated with long-form registration, an issuer that becomes ineligible for short-form registration may opt to seek financing privately

² Generally, Form S-3 requires that registrants be organized under the laws of the United States, or any State or Territory or the District of Columbia, and have their principal business operations in the United States or its territories. In addition, in order to be S-3 eligible, registrants must be subject to the reporting requirements of the Exchange Act pursuant to either Section 13(a) or Section 15(d) of the Exchange Act. Form S-3 also requires that registrants be subject to the reporting requirements under the Exchange Act for at least twelve calendar months, have timely filed all required reports under the Exchange Act during the twelve calendar months immediately preceding the filing of a Form S-3 registration statement, with the exception of certain specified item requirements under Form 8-K, and have not defaulted on any installment debt or leases, or failed to pay any dividends or sinking fund payments on any preferred stock since the end of the last fiscal year for which financial statements were filed under the Exchange Act by such registrants. Form F-3, which relates to foreign registrants, contains substantially similar eligibility requirements to Form S-3, with the exception of the Form S-3 requirements relating to a registrant's place of incorporation and location of principal business operations.

³ See SEC Release No. 33-9186; 34-63874; File No. S7-18-08 and related comment letters.

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or offshore rather than register with the SEC. Any such result would work against the SEC's policy objective of encouraging registration.

By providing four alternative eligibility requirements and including a grandfathering provision, the SEC has sought to address commentators' concerns about the initial proposed rules and to minimize the likelihood of rendering eligible issuers ineligible. Nevertheless, it appears likely that at least a few issuers that previously qualified for short-form registration will no longer be eligible after the grandfathering period ends.

Other Amendments to Rules and Forms

The SEC's other related amendments include:

- revisions to Forms S-4 and F-4 under the Securities Act and Schedule 14A under the Exchange Act so that they refer to the new eligibility criteria set out in Forms S-3 and F-3;
- conforming revisions to Rules 138, 139 and 168⁴ under the Securities Act for consistency with the revisions to Forms S-3 and F-3; and
- eliminating the reference to security ratings in Rule 134(a)(17).

Securities offering participants should be aware that the amendment of Rule 134 means that the disclosure of credit ratings information is no longer covered by the Rule 134 safe harbor (which deems certain communications not to be a prospectus or a free writing prospectus). This does not mean that a communication that includes a credit rating will automatically be considered a prospectus. As the safe harbor may not be available, however, issuers and underwriters will need to consider whether such a communication is a prospectus under a facts and circumstances analysis. The absence of the safe harbor may lead issuers and underwriters to avoid including credit ratings information from offering-related communications, including Bloomberg screen communications and announcements during the waiting period under certain circumstances.

Again, these amendments to Rules 134, 138, 139 and 168, Forms S-3, F-3, S-4 and F4 and Schedule 14A will become effective on September 2, 2011.

⁴ Securities Act Rules 138, 139 and 168 provide safe harbors for certain communications made during the offering process, deeming those communications not to be an offer to sell a security under the Securities Act. Rules 138 and 139 relate to the publication of research by brokers and dealers. Rule 168 provides a safe harbor for factual business information and forward-looking information released or disseminated in the ordinary course. Currently, these rules extend the safe harbor to communications relating to certain offerings of non-convertible securities that meet the investment grade test.

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