



August 23, 2007

Via Electronic Mail

The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission
Attn: Nancy M. Morris, Secretary
100 F Street, NE
Washington, DC 20549
Electronic Address: rule-comments@sec.gov

Re: SEC File Number S-7-10-07; Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3

Dear Chairman Cox:

The Office of Advocacy (Advocacy) of the Small Business Administration (SBA) respectfully submits this comment letter on the U.S. Securities and Exchange Commission's (SEC) proposed rule, *Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3*.¹ Advocacy supports this proposal to allow qualified smaller public companies to utilize shelf registrations, because it will provide efficiency and flexibility for these small entities in accessing the public markets. Advocacy is pleased that the SEC is considering this proposal and five other small business initiatives that were recommended by the SEC's Advisory Committee on Smaller Public Companies (Advisory Committee).²

While these proposals will be helpful, Advocacy is concerned that smaller public companies still face the large and disproportionate costs of internal controls reporting requirements under Section 404 of the Sarbanes-Oxley Act of 2002. Even with the availability of shelf registrations, excessive costs of Section 404 compliance will restrict the ability of a new generation of small, innovative companies from seeking capital in the U.S. capital markets. Advocacy recommends that the SEC reconsider the Advisory Committee's central recommendation, to provide an extension for smaller public

¹ *Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3*, 72 Fed. Reg. 35118 (June 26, 2007).

² *Revisions to Rule 144 and Rule 145*, 72 Fed. Reg. 36822 (July 5, 2007); *Electronic Filing of Form D*, 72 Fed. Reg. 37376 (July 9, 2007); *Exemption of Compensatory Employee Stock Options From Registration*, 72 Fed. Reg. 37608 (July 10, 2007); *Smaller Reporting Company Regulatory Relief*, 72 Fed. Reg. 39670 (July 19, 2007); *Revisions in Regulation D*, 72 Fed. Reg. 45116 (Aug. 10, 2007).

companies to comply with Section 404.³

I. The Office of Advocacy

Congress established the Office of Advocacy in 1976 by Pub. L. 94-305 to represent the views and the interests of small business within the federal government. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),⁴ as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),⁵ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.⁶

II. Background

Form S-3 (for domestic companies) and Form F-3 (for foreign companies) are short forms used by companies to register securities offerings under the Securities Act of 1933, instead of traditional registration forms such as S-1, SB-2 (for small businesses) and F-1.⁷ These short forms are more efficient because they allow companies to incorporate by reference a company's prior Exchange Act filings, as well as those filed in the future.⁸

Current SEC rules allow issuers with over \$75 million in public float to use Form S-3 and F-3 to conduct primary offerings (securities offered by or on behalf of the registrant/company for its own account) called shelf registrations.⁹ Ordinarily, an entire allotment of securities covered by a registered offering will be made available for purchase on the effective date for a limited time. Shelf registrations allow companies to register securities offerings prior to any specific offering, and release delayed or continuous offerings without waiting for additional SEC action.¹⁰ This type of registration is advantageous because it allows companies to exercise considerable flexibility in accessing the public securities market, to respond to changes in the market and other factors.¹¹ Additionally, Form S-3 can be utilized for secondary offerings (securities for the account of any person other than the issuer) if the securities of the same

³ SEC Advisory Committee on Smaller Public Companies, Final Report of the SEC Advisory Committee on Smaller Public Companies 32 (Apr. 23, 2006) (*Advisory Committee Report*), available at: <http://www.sec.gov/info/smallbus/acspc.shtml>.

⁴ *Regulatory Flexibility Act of 1980*, Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. § 601 et seq.).

⁵ *Small Business Regulatory Enforcement Fairness Act*, Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

⁶ 5 U.S.C. § 603.

⁷ 72 *Fed. Reg.* at 35118.

⁸ 72 *Fed. Reg.* at 35119.

⁹ 72 *Fed. Reg.* at 35118. Public float is the number of a company's outstanding shares in the hands of public investors, as opposed to the company. It is defined in Form S-3 as "the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant."

¹⁰ Thomas Lee Hazen, *Principles of Securities Regulation* 86 (Thomas West 2005).

¹¹ 72 *Fed. Reg.* at 35119.

class are listed and registered on a national securities exchange or are quoted on NASDAQ.¹²

In its April 2006 report, the Advisory Committee on Smaller Public Companies recommended that the SEC allow all reporting companies listed on a national exchange, NASDAQ or the OTCBB to eligible to use Form S-3. The Advisory Committee Report stated that, “many smaller public companies are not eligible to use Form S-3 in primary offerings because their public float is below \$75 million; they cannot use Form S-3 in secondary offerings because their securities are not listed on a national securities exchange or quoted on NASDAQ.”¹³

This proposal would allow companies with less than \$75 million in public float to register primary offerings of their securities on Form S-3, provided: (1) they meet the other registrant requirements (subject to Exchange Act rules for 12 months, timely filings and reports, etc.); (2) they are not shell companies and have not been shell companies for at least 12 calendar months before filing their registration statement; and (3) they do not sell more than the equivalent of 20 percent of their public float in primary offerings over any period of 12 months. This proposal would also extend the use of these forms for primary offerings of qualified companies quoted on the Over-the Counter-Bulletin Board and Pink Sheets quotation services.¹⁴ The SEC provided an Initial Regulatory Flexibility Analysis for this rule.

IV. Advocacy Supports the Proposed Extension of Form S-3 and F-3 Eligibility

Advocacy supports this SEC proposal based on an Advisory Committee recommendation to extend the eligibility of shelf registrations, because this regulatory alternative will provide efficiency and flexibility for these small public companies in accessing the public markets.

Small public companies and their representatives expressed their overall support for this proposal to Advocacy. These representatives believe that the Commission has taken a step in advancing the microcap and nano-cap company competitiveness in a market. The proposed allowance of shelf registrations will allow easier access to capital to develop the next generation of public companies. These companies also stated that these forms require less work and costs than standard registration forms.

¹² *Advisory Committee Report*, at 68.

¹³ *Advisory Committee Report*, at 69. According to this report, “The OTCBB is a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter (OTC) equity securities. An OTC equity security generally is any equity security that is not listed or traded on NASDAQ or a national security exchange.”

¹⁴ 72 *Fed. Reg.* at 35120, 35121.

V. Small Public Companies Suggest Refinements to S-3 and F-3 Eligibility

Although small public companies and their representatives were supportive of this rulemaking, they also voiced their recommendations for refinements in these key areas: 1) the 20 percent public float limitation and 2) allowing S-3 for certain secondary offerings.

1) *20 Percent Public Float Limitation*

Several small business representatives were concerned that this proposal limits these small entities with public float of less than \$75 million from selling more than 20 percent of their public float in offerings over any period of 12 calendar months.¹⁵ One commenter stated that this 20 percent limitation based on public float was arbitrary, and not as a function of the needs of the business itself. This commenter stated, “businesses, large and small, run on business plans, whether that is to increase a sales force, pay for research and development, or build a new assembly line.”¹⁶ This letter suggested that rather than an the 20 percent float limitation, it would be more useful if the company was required to provide a more detailed statement than required by Regulation S-K, identifying what the proceeds of the shelf registration would be used for.¹⁷

Advocacy spoke to a chief financial officer of a micro-cap technology company with a market capitalization of \$12-\$15 million dollars, who stated that the 20 percent limit would stop his company from utilizing this short form because they need more funding in a given 12 month period. This CFO also stated that micro-cap companies will have problems calculating this public float limitation due to the fluctuation in their stock price. “I still fear that the smaller micro and nano-cap companies may fall short of realizing capital that will allow real and substantive improvements,” said one securities attorney, “small companies in research and development for intellectual property, such as medical devices, have a very long term burn rate [negative cash flow] before their products hit the market.”¹⁸

Advocacy recommends that the SEC consider raising this public float limit in a 12-month calendar year for smaller public companies utilizing these short forms. Advocacy also recommends that the SEC publish a Small Business Compliance Guide for this rule, as small public companies need further explanation on how to calculate this 20 percent public float limitation.¹⁹

¹⁵ 72 *Fed. Reg.* at 35118.

¹⁶ Comment letter from Feldman Weinstein and Smith LLP to the SEC (July 16, 2007).

¹⁷ *Id.*

¹⁸ Telephone interview with Marshall Shichtman, Marshal Shichtman & Associates, P.C., Carle Place, NY (Aug. 16, 2007).

¹⁹ 72 *Fed. Reg.* at 35121. To calculate the amount of securities that may be sold under Form S-3 and F-3 by registrants with a public float below \$75 million, the proposal lists a two-step process: 1) determination of the registrants’ public float 60 days prior to the sale and 2) aggregation of all sales in the previous 12-month period to determine whether the 20% limitation would be exceeded.

2) *Allowing S-3 for Certain Secondary Offerings*

This proposal follows part of the Advisory Committee's recommendations, by allowing all qualified reporting companies listed on a national exchange, NASDAQ or the Over the Counter Bulletin Board (OTCBB) and Pink Sheets quotation services to utilize Form S-3 and F-3 for primary offerings.²⁰

Small business representatives have also suggested that the SEC take this opportunity to extend the use of Form S-3 for transactions involving secondary offerings (securities for the account of any person other than the issuer), pursuant to another recommendation of the Advisory Committee. Currently, the general instructions limit the use of Form S-3 and F-3 for secondary offerings to securities "listed and registered on a national securities exchange...or quoted on the automated quotation system of a national securities association."²¹ This rule excludes the securities of OTCBB and Pink Sheets users. The Advisory Committee noted that "as a consequence OTCBB issuers that undertake private placements with association registration rights, or that are required to register affiliate or Rule 145 shares, are required to file a registration statement on Form S-1 or Form SB-2 and incur the substantial burden and expense that the continuous updating of those forms require."²² The SEC has not provided a reason they are not following this recommendation, and the Advocacy recommends that the SEC reconsider this recommendation.

VI. Conclusion

The SEC's Advisory Committee on Smaller Public Companies was created "to assess the impact of the current regulatory system for smaller companies under the securities laws of the United States and make recommendations for changes."²³ Advocacy supports this proposal and the five other small business initiatives that were recommended by the Advisory Committee, because they represent positive steps that will help small public companies.

However, Advocacy believes that the current regulatory environment after the imposition of Section 404 internal control reporting requirements has made it prohibitively expensive for any smaller public company to access the public markets. Although Advocacy supports the recent proposals by the SEC and the Public Company Accounting Oversight Board (PCAOB) to revise the implementing rules of Section 404, Advocacy believes that Section 404 will still impose large and disproportionate costs on small public companies.²⁴ Advocacy recommends that the SEC reconsider the Advisory Committee's central recommendation, to provide an extension for small public

²⁰ *Advisory Committee Report*, at 68

²¹ *Id.* at 71.

²² *Id.*

²³ *Advisory Committee on Smaller Public Companies, Notice of Establishment*, 69 *Fed. Reg.* 76498 (Dec. 21, 2004).

²⁴ Comment letter from Thomas Sullivan and Janis Reyes to the Securities and Exchange Commission (Feb. 21, 2007), *available at*: http://www.sba.gov/advo/laws/comments/sec07_0221.html.

companies to comply with Section 404.²⁵ This step will make the SEC's other small business initiatives that much more meaningful.

Advocacy is pleased to forward the comments and concerns of small businesses. Please feel free to contact me or Janis Reyes at (202) 619-0312 (Janis.Reyes@sba.gov) if you have any questions or require additional information.

Sincerely,

//signed//

Thomas M. Sullivan
Chief Counsel of Advocacy

//signed//

Janis C. Reyes
Assistant Chief Counsel

cc:

The Honorable Susan E. Dudley, Administrator, Office of Information and Regulatory Affairs
The Honorable Paul S. Atkins, Commissioner, U.S. Securities and Exchange Commission
The Honorable Roel C. Campos, Commissioner, U.S. Securities and Exchange Commission
The Honorable Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission
The Honorable Annette L. Nazareth, Commissioner, U.S. Securities and Exchange Commission
Gerald J. Laporte, Chief, Office of Small Business Policy, U.S. Securities and Exchange Commission

²⁵ *Advisory Committee Report*, at 6.