Client Alert

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Energy Capital Markets

Corporate & Securities Securities

August 2, 2011

The SEC Adopts Transaction Requirements that Preserve Form S-3 Eligibility for Most Issuers

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The Securities and Exchange Commission (SEC) has eliminated the use of investment grade credit ratings as a transaction requirement for short-form registration of securities, instead creating alternative transaction requirements that preserve the use of Form S-3 for most companies that previously relied on their investment grade credit ratings.

Last year's enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act required the SEC to remove references to credit ratings from its rules and forms under the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act). In February 2011, the SEC proposed amendments to eliminate these references, as well as solicited comments on their impact on public companies and other market participants and the availability of other alternatives that it should consider. On July 26, 2011, the SEC voted unanimously to adopt amendments to its rules to eliminate references to credit ratings under the 1933 Act and the 1934 Act, and to create new criteria for short-form registration of securities. The SEC expanded the number of alternative transaction requirements from what it had originally proposed based on the various comments it received. As a result, the current pool of issuers eligible to use Form S-3 should not change significantly.

The SEC Eliminates Credit Ratings Transaction Requirement for Use of Form S-3 and Adopts New Alternative Transaction Requirements

To be eligible to use Form S-3 (references in this alert to Form S-3 also refer to Form F-3) as a short form to register securities under the 1933 Act, a public company must meet the form's registrant requirements (which generally pertain to reporting history under the 1934 Act) and at least one of the transaction requirements of the form. Many seasoned debt issuers historically have relied on the transaction requirement that permitted public companies to register primary offerings of non-convertible securities if the securities were rated investment grade by at least one nationally recognized statistical rating organization. In lieu of investment grade credit ratings as a transaction requirement, the SEC has adopted the following new alternative transaction requirements for Form S-3 eligibility:

- 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 1933 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 1933 Act; or
- The issuer is a wholly-owned subsidiary of a well-known seasoned issuer as defined in Rule 405 under the 1933 Act (WKSI); or
- The issuer is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI; or
- The issuer discloses in the registration statement that it has a reasonable belief that it would have been eligible to use Form S-3 as of September 2011 because it is registering a primary offering of non-convertible investment grade securities, discloses the basis for such belief, and files a final prospectus for an offering pursuant to such registration statement on Form S-3 on or before September 2014.

Consistent with its initial proposal, with respect to the first two alternatives above, non-convertible securities issued in private placement transactions or in registered exchange offers would not count towards such thresholds.

Most Public Companies, Including Operating Subsidiaries of Many Utility Holding Companies, Will Be Able to Maintain Their Form S-3 Eligibility

The SEC's initial proposal sought to replace the investment grade credit rating transaction requirement with only the $1 billion issued threshold transaction requirement. Based on comments and other feedback that the SEC received from various issuers and other market participants, the SEC believed that its initial proposal would substantially alter the pool of issuers that would be eligible to register their securities offerings on Form S-3. Accordingly, the SEC expanded on its initial proposal to include the additional alternative transaction requirements listed above. The SEC believes that by adding these additional alternative transaction requirements, it will preserve eligibility for those seasoned debt issuers that have historically relied on the use of Form S-3. Many issuers will be able to easily satisfy one of these new transaction requirements, even though they would not have met the $1 billion issued threshold transaction requirement. More specifically, most wholly owned, state-regulated operating subsidiaries of utility holding companies will remain eligible to use Form S-3 so long as their utility holding companies are currently WKSIs. In this regard, the absence of the investment grade credit rating transaction requirement and the adoption of the alternative transaction requirements should provide more certainty as to continued use of Form S-3 for those issuers who may be subject to downgrades of their ratings below investment grade.

Alternatives Are Available for Issuers that Are Ineligible to Use Form S-3 under the New Amendments

In order to ease the transition to the new rules and allow companies affected by these amendments time to adjust, issuers that would not be able to satisfy the first four transaction requirements listed above may continue to use short-form registration under the amendments' temporary grandfather provision, which is the fifth transaction requirement listed above. This provision will allow an issuer to use Form S-3 for a period of 3 years from the effective date of the amendments so long as the issuer discloses its reasonable belief that it would have been eligible to use Form S-3 under the rules in existence prior to the amendments. Factors that indicate a reasonable belief of eligibility would include an investment grade issuer credit rating, a previous investment grade credit rating on a security issued in an offering similar to

the type the issuer seeks to register that has not been downgraded or put on a watch list since its issuance or a previous assignment of a preliminary investment grade rating.

Even with the inclusion of the grandfather provision, there may be some issuers that will become ineligible to use Form S-3 to register their securities offerings as a result of the amendments. As a result, these companies will need to consider and evaluate other methods for issuing their securities in compliance with the 1933 Act after the expiration of the grandfather provision. Public companies that are not eligible for Form S-3 may register their securities under the 1933 Act on Form S-1. Alternatively, a public company that would be ineligible to use Form S-3 could choose to forgo the 1933 Act registration process altogether and access the capital markets by conducting a private placement, either by way of a direct placement with investors pursuant to Section 4(2) of the 1933 Act or by way of a Rule 144A offering through an investment bank acting as initial purchaser.

Pillsbury's Energy Capital Markets team, which works routinely with a significant number of U.S. utility companies, believes that the amendments adopted by the SEC will allow most utility companies that historically have been eligible to use Form S-3 to continue to do so. We expect the amendments to take effect in September 2011.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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