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Steps to Avoid Losing Form S-3 Eligibility & Incurring Other Penalties after a Late Exchange Act Filing, Part 1

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This is the first of a two-part series on how issuers can avoid losing Form S-3 eligibility. In this installment, the author details the implications of the loss of Form S-3 registration statement eligibility. The second part, dealing with remedial actions to "correct" missed filing deadlines, will be published in our November issue.

Missing a deadline for filing a Securities Exchange Act of 1934 (Exchange Act) report can result in a number of adverse consequences for an issuer and its stockholders. However, in some cases issuers have a limited opportunity to make a late filing timely or otherwise avoid one of the most significant penalties ensuing from a late filing for a number of public issuers—the loss of Form S-3 registration statement eligibility—by seeking a filing date adjustment or an eligibility waiver from the Securities and Exchange Commission (SEC).

Implications of a Late Exchange Act Filing

Inability to Use Form S-3 for Future Registrations

Absent corrective action, missing the deadline to file an annual report on Form 10-K or a quarterly report on Form 10-Q would cause an otherwise eligible issuer to lose Form S-3 eligibility for primary and secondary offerings for at least 12 months following the date the filing is first delinquent.[1] The deadlines for these reports

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depend on the issuer's filing status as determined under Rule 12b-2 of the Exchange Act—either large accelerated filer, accelerated filer, smaller reporting company or non-accelerated filer.[2] If an issuer cannot timely file its Form 10-K or Form 10-Q "without unreasonable effort or expense," Rule 12b-25 of the Exchange Act permits issuers to seek a one-time filing deadline extension of up to 15 additional calendar days for a Form 10-K and up to five additional calendar days for a Form 10-Q by filing a Form 12b-25 with the SEC within one business day after the periodic report's initial due date.[3] If the issuer submits a Form 12b-25 by this deadline and subsequently files its Form 10-K or Form 10-Q within the applicable extension period, the periodic report is considered to have been timely filed for purposes of the Exchange Act and Form S-3.

Excluding current reports on Form 8-K to report items designated under General Instruction I.A.3(b) of Form S-3, missing a Form 8-K deadline would also cause an otherwise eligible issuer to lose its Form S-3 eligibility for at least 12 months.[4] A Form 8-K is generally due within four business days after the event that triggers the filing requirement.[5] Unlike Form 10-Ks and Form 10-Qs,[6] however, issuers do not have the opportunity to extend a Form 8-K deadline under Rule 12b-25 or otherwise.

Regardless of the issuer's filing status, without Form S-3 eligibility, issuers have only one option for conducting registered offerings to obtain capital: the Form S-1 registration statement, which is the SEC's basic long-form registration statement. A Form S-3 registration statement is shorter and generally less expensive to prepare than a Form S-1 registration statement because it allows an issuer to incorporate by reference information included in the issuer's periodic and current reports previously filed under the Exchange Act, as well as information included in the issuer's Exchange Act reports filed *after* the registration statement is declared effective by the SEC. Although certain issuers that are current in their filings under the Exchange Act may be permitted to incorporate by reference their previously filed Exchange Act reports into a Form S-1 registration statement (i.e., "historical incorporation by reference"), these issuers are not permitted to incorporate by reference any Exchange Act report filed after the Form S-1 is declared effective (i.e., no "forward incorporation by reference"). As a result, a Form S-1 issuer must prepare and file post-effective amendments or prospectus supplements to update its Form S-1 registration statement, which involves additional time, effort and expense and in the case of a post-effective amendment, may require the issuer to file a new auditor's consent.

In addition, only a Form S-3 registration statement may be used by an issuer to conduct a primary offering (i.e., an offering on behalf of the issuer) on a delayed or continuous basis under Rule 415 of the Securities Act of 1933 (Securities Act). Rule 415 permits "shelf" registrations whereby an issuer can register a number of different types of securities (e.g., common stock, preferred stock, debt instruments, warrants and units) for sale in advance and elect to the sell some or all of the securities in the market over time in one or more transactions at varying (i.e., "market") prices. The shelf registration process allows issuers to capitalize on favorable market conditions by offering securities through one or more installments (known as "shelf takedowns") without requiring further SEC review or approval for any sale. Because Rule 415 does not permit an issuer to conduct a primary offering on a shelf basis using a Form S-1 registration statement, all securities in an offering conducted on Form S-1 (i.e., issuers who are not Form S-3 eligible) must be sold under the Form S-1 registration statement at the same price and at a single point in time,[7] which gives an issuer far less opportunity to take advantage of favorable market conditions. It also requires that the issuer file and have declared effective a new registration statement each time it wishes to conduct an offering of additional or different securities. As a result, a number of issuers who are not eligible to use Form S-3 decide to seek financing through private placements, including PIPE (private investment in public equity) transactions, in which they may need to sell securities at significant discounts to their trading prices to compensate investors for the loss of immediate resale liquidity they may have otherwise received by acquiring securities in a registered offering.

Potential Loss of Current Form S-3 Registration Statements

A delinquent Exchange Act filing may also impact an issuer's ability to continue to use any *then*-effective Form S-3 registration statements for primary and secondary offerings. Rule 401 of the Securities Act sets forth the registration statement form eligibility requirements under the Securities Act. To use Form S-3, Rule 401 requires that an issuer meet the registration statement eligibility requirements at the time the Form S-3 is initially filed with the SEC[8] *and* each time the issuer files an update to the registration statement for the purpose of meeting the requirements under Section 10(a)(3) of the Securities Act.[9] Section 10(a) sets forth the information required to be included in a statutory prospectus for the offer and sale of securities. Section 10(a)(3) generally provides that the information in a prospectus forming part of a registration statement that is used more than nine months after the effective date of the registration statement cannot be more than 16 months old. The prospectus is deemed "stale" after this time. To prevent a Form S-3 prospectus from going stale, it must be continuously updated. As discussed above, a primary benefit to an issuer of the Form S-3 registration statement over the Form S-1 registration statement is that a Form S-3 is automatically updated after it becomes effective (i.e., kept current without filing a Form S-3 post-effective amendment) through many of the issuer's other Exchange Act filings, including its Form 10-Ks, Form 10-Qs, definitive proxy statements and certain Form 8-Ks. For purposes of Rule 401(b), updating a Form S-3 through the incorporation by reference of a Form 10-K containing the issuer's audited financial statements for its most recent fiscal year is the equivalent of filing a post-effective amendment to the Form S-3 pursuant to Section 10(a)(3).[10] Accordingly, if an issuer does not meet the Form S-3 eligibility requirements at the time it files its Form 10-K, including the requirement that the issuer have timely filed its Exchange Act reports during the prior 12 months, it would automatically lose Form S-3 eligibility at the time the Form 10-K is filed. In that event, each Form S-3 registration statement in effect prior to the filing of the Form 10-K would either need to be deregistered or, if the issuer is eligible to use Form S-1, converted into a registration statement on Form S-1 by means of a post-effective amendment to the Form S-3.[11]

Preparing and filing a Form S-1 registration statement for a new offering or a post-effective amendment to a previously effective Form S-3 imposes additional costs to the issuer in legal, accounting and registration fees, as well as management time and distraction. In addition, any Form S-1, including a post-effective amendment to a Form S-3 on Form S-1, would be subject to full SEC review and comment and must be declared effective by the SEC before it may be used to offer and sell securities.[12]

Additional Implications

The failure to timely file an Exchange Act report also constitutes a violation of Section 13(a) or 15(d) of the Exchange Act, and corresponding Rule 13a-1 or 15d-1, which impose the reporting requirements on public company issuers. In some cases, these violations may subject the issuer to an enforcement action by the SEC.

A late Exchange Act filing would also result in at least a temporary loss of eligibility to use Form S-8 for securities offered under an issuer's employee benefit plans (or interests in those plans), as well as deny the issuer's stockholders the option to use Rule 144 of the Securities Act for resales of the issuer's securities. To use Form S-8, an issuer must have filed all reports with the SEC required to be filed during the preceding 12 months. Rule 144 similarly requires that a publicly-reporting issuer have filed all Form 10-Ks, Form 10-Qs and Form 8-Ks required to be filed during the 12 months prior to the applicable resale.[13] Unlike Form S-3, however, Form S-8 and Rule 144 only require that these filings have been filed, not that they have been *timely* filed. As a result, assuming the other applicable requirements are met, an issuer will regain eligibility to use Form S-8, and its stockholders will become re-eligible to use Rule 144 for resales, as soon as the issuer's delinquent Exchange Act filing is made with the SEC.

For issuers with securities listed on a national exchange, failure to timely file an Exchange Act

report may violate applicable securities exchange regulations and subject the issuer and its securities to penalties. Regulations of The New York Stock Exchange (NYSE), The Nasdaq Stock Market, LLC (Nasdaq) and The American Stock Exchange (AMEX) require issuers to file some or all of their Exchange Act reports by the deadline set forth under the SEC's regulations.[14] In nearly all circumstances, a late Exchange Act filing would trigger a notice from Nasdaq or AMEX discussing the delinquency (only a late Form 10-K would trigger a notice from the NYSE), which the issuer would be required to report on a Form 8-K.[15] Issuers that do not meet a deadline are also at risk of having their securities suspended from trading or delisted from the exchange.[16]

Finally, issuers with an outstanding debt obligation may be in violation of one or more restrictive covenants following a failure to timely file their Exchange Act reports. Indentures governing debt may require issuers to timely file periodic reports and certain current reports by the deadlines prescribed by the SEC. Under these indentures, a failure to timely file may constitute an event of default and trigger, for example, an acceleration of repayment or liquidated damages penalties under the debt agreements.[17] In some cases, an event of default for a late filing could force an issuer into insolvency or bankruptcy proceedings.

Next: *Dealing with remedial actions to "correct" missed filing deadlines*

NOTES

1. General Instruction I.A.3(b) to Form S-3 requires that the issuer have "filed in a timely manner all reports required to be filed during the 12 calendar months and any portion of a month immediately preceding the filing of the registration statement." For example, if an issuer files a Form S-3 registration statement on August 15, 2008, it must have timely filed all Exchange Act reports during the period from September 1, 2007 through the filing date (excluding any Form 8-K filed to report one or more items designated under note 4 below). Delinquent reports that may be "furnished" rather than filed under the Exchange Act do not result in an issuer's loss of Form S-3 eligibility. (See SEC Compliance and Disclosure Interpretations Question 106.05; April 2, 2008 available at http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm.)
2. Large accelerated filers generally include issuers who had a worldwide market value of outstanding voting and non-voting common equity held by non-affiliates of $700 million or more as of the last business day of their most recently completed second fiscal quarter. Accelerated filers generally include issuers who had a worldwide market value of outstanding voting and non-voting common equity held by non-affiliates of $75 million or more, but less than $700 million, as of the last business day of their most recently completed second fiscal quarter. Smaller reporting companies generally include issuers who had a worldwide market value of outstanding voting and non-voting common equity held by non-affiliates of less than $75 million as of the last business day of their most recently completed second fiscal quarter or, if it had no common equity public float as of the last business day of its most recently completed second fiscal quarter, the issuer had annual revenues of less than $50 million for its most recently completed fiscal year. Non-accelerated filers are issuers, including smaller reporting companies, who do not qualify as large accelerated filers or accelerated filers.
3. A Form 12b-25 for an annual report on Form 10-K and a quarterly report on Form 10-Q is designated as an "NT 10-K" or "NT 10-Q," respectively.
4. Under General Instruction I.A.3(b) to Form S-3, a delinquent Form 8-K covering solely one or more of the following items will not by itself result in a loss of Form S-3 eligibility: Item 1.01 Entry into a Material Definitive Agreement; Item 1.02 Termination of a Material Definitive Agreement; Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant; Item 2.04 Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement; Item 2.05 Costs Associated with Exit or Disposal Activities; Item 2.06 Material Impairments; Item 4.02(a) Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review (specifically relating to non-reliance of previously issued financial statements); and Item 5.02(e) Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers (specifically relating to compensatory arrangements of certain officers). The SEC has exempted these items because it believes

they "may require management to make rapid materiality and similar judgments within the compressed Form 8-K filing timeframe [and that] [t]he potential significant burden that could result from a company's sudden loss of eligibility to use Form S-2 or S-3 under these circumstances could be a disproportionately large negative consequence of an untimely Form 8-K filing." (Securities Act Release No. 8400. Exchange Act Release No. 49424. (March 16, 2004.),)

5. The exceptions to this requirement are reports filed under Item 7.01 (Regulation FD Disclosure) and Item 8.01 (Other Events) if filed solely to satisfy the issuer's obligations under Regulation FD of the Exchange Act.
6. If an issuer omits any Part III information from its Form 10-K on the expectation that the information will be incorporated by reference from the issuer's definitive proxy statement or information statement, the issuer must file the proxy statement or information statement, or an amendment to the Form 10-K, that includes the omitted information by the 120th day after the issuer's fiscal year-end (usually April 30th for calendar reporting companies). An issuer that fails to meet this deadline will be deemed to not have timely filed its Form 10-K and, accordingly, will lose Form S-3 eligibility for at least 12 full months following the first date the report was delinquent.
7. However, after the initial closing of the offering, the issuer may sell additional securities for a limited period of time pursuant to an over-allotment option (i.e., a "green shoe") granted by the issuer to the underwriters pursuant to an underwriting agreement.
8. Rule 401(a).
9. Rule 401(b) and SEC Telephone Interpretation B.53 (July 1997).
10. SEC Telephone Interpretation B.55 (July 1997).
11. SEC rules and regulations do not per se prohibit the use of an effective Form S-3 registration statement from the period following the delinquency until the issuer files its Form 10-K provided the issuer is within the 16-month window under Section 10(a)(3). However, issuers must decide, based on the type of late filing and the information it is required to include, whether the prospectus included in the effective Form S-3 continues to comply with Section 10(a)(1) of the Securities Act.
12. Investors in PIPE transactions usually receive a right to have some or all of the securities acquired in the transaction (or the underlying common stock in the case of convertible securities) registered for resale by the issuer. Frequently, issuers are contractually required to keep the "resale" registration statement continuously effective for a minimum period of time and must pay "liquidated" damages (in the form of cash and/or the issuance of securities) to the PIPE investors for any failure to do so, subject to limited exceptions.
13. Rule 144(c).
14. Section 802.01E of The New York Stock Exchange Listed Company Manual provides that an issuer that fails to timely file its Form 10-K will be subject to monitoring by the exchange and potential delisting procedures. Nasdaq Marketplace Rule 4310(c)(14) and Section 1101 of The AMEX Company Guide state that all required reports shall be filed with the exchange on or before the date they are required to be filed with the SEC or appropriate regulatory authority.
15. See Item 3.01 of Form 8-K: "Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing."
16. Section 1003(d) of the AMEX Company Guide provides that the securities of an issuer who fails to comply with its SEC reporting requirements in any material respect "are subject to suspension from dealings and, unless prompt corrective action is taken, removal from listing."
17. The Trust Indenture Act of 1939 does not specify any deadline for when Exchange Act reports must be filed with the SEC or the indenture trustee. Therefore, an event of default would generally only be triggered for a delinquent filing if expressly provided in the indenture or otherwise agreed to by the parties.