

SEC Clarifies Baby Shelf Rules

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The Securities and Exchange Commission (“SEC”) recently issued a new compliance and disclosure interpretation (the “New C&DI”) in Question 116.25 regarding the availability of Form S-3 for the registration and sale of shares by companies with public float less than \$75 million.

Instruction I.B.6(a) to Form S-3 states that if a registrant has a public float of less than \$75 million, the registrant may only register and sell securities via Form S-3 if the aggregate market value of the securities sold by or on behalf of the registrant during the 12-month period immediately prior to and including the date of the sale is no more than one-third of all common voting and nonvoting equity held by non-affiliates of the registrant. This instruction and accompanying rules and interpretive guidance are often referred to as the “Baby Shelf Rules.” The new C&DI puts a stop to certain practices that were being used by registrants to work around the Baby Shelf Rules.

Registrants subject to the Baby Shelf Rules have in the past done a shelf takedown off of Form S-3 while simultaneously selling additional securities through a private placement. The securities sold through the private placement would then be registered for sale on a re-sale registration statement on Form S-3. Such re-sale would not be subject to the Baby Shelf Rules because, as described in Instruction B.3 to Form S-3, the re-sale was by the new holder of the securities, not by or on behalf of the registrant. Using this structure enabled companies to sell more securities than the limitations of the Baby Shelf Rules allowed, while still having all shares ultimately registered for sale on Form S-3.

The New C&DI makes clear that the historical work-around transaction is no longer permissible, as the SEC will now count the securities registered on the re-sale registration statement on Form S-3 toward the cap in the Baby Shelf Rules. Despite this new guidance, it is important to note that, subject to compliance with applicable SEC guidance and the facts and circumstances of the issuance, a company subject to the Baby Shelf Rules may still issue securities using Form S-3 and concurrently sell securities in a private placement. The private placement securities can be registered for

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re-sale on Form S-1, or on Form S-3 if the registrant complies with the Baby Shelf Rules after including the re-sale securities in the calculation.