

# Client Alert

A report  
for clients  
and friends  
of the firm August 2005

## New SEC Rules Regarding Shell Companies Affect All Reporting Companies

The SEC recently adopted rules relating to filings by reporting shell companies. These rules are intended to protect investors by deterring fraud and abuse in public securities markets involving shell companies. The new rules are designed to provide greater transparency to investors in legitimate shell companies and deter the use of shell companies for fraudulent methods and schemes. Because the new rules change the cover pages of Forms 10-Q, 10-QSB, 10-K, 10-KSB and 20-F, they affect all reporting companies.

Under the new rules, the SEC defines a "shell company" as a registrant (other than an asset-backed issuer) with no or nominal operations and either no or nominal assets, assets consisting solely of cash and cash equivalents or assets consisting of any amount of cash and cash equivalents and nominal other assets.

In the new rules, the SEC addressed two variations of abusive shell company transactions. The first type of transaction involves the use of Form S-8 registration statements by reporting shell companies to circumvent the registration and prospectus delivery requirements of the Securities Act of 1933 (the "Securities Act"). The second type of transaction addressed involves the use of Form 8-K to report "reverse merger" and other transactions in which a reporting shell company combines with a formerly private operating business, with the surviving entity becoming a reporting company in the business formerly conducted by the private business.

The new rules, subject to certain limited exceptions:

- prohibit the use of Form S-8 by shell companies;

- require a shell company, when reporting an event that causes it to cease being a shell company, to file a Form 8-K with the SEC containing the same type of information that it would be required to file to register a class of securities under the Securities Exchange Act of 1934 (the "Exchange Act");
- require foreign private issuer shell companies to file a "shell company report" on Form 20-F to report a transaction that causes them to cease being shell companies; and
- add check boxes to the cover pages of Form 10-Q, Form 10-QSB, Form 10-K, Form 10-KSB and Form 20-F for a registrant to identify itself as a shell company.

**Amendments to Form S-8.** Form S-8 is used only to register securities for offer and sale in connection with employee benefit plans. Under the amended rules, the SEC prohibits shell companies from using Form S-8. The SEC indicated that because shell companies do not operate businesses and, as a result, rarely have employees, they see little legitimate basis for shell companies to use Form S-8. The prohibitions on the use of Form S-8 adopted by the SEC will not prevent a shell company from registering offers and sales of securities pursuant to employee benefit plans under the Securities Act, but instead require the shell company to register those transactions on a less streamlined registration statement form, such as Form S-1, Form SB-2 or Form F-1.

A reporting company will be eligible to file a Form S-8 registration statement 60 days after it ceases to be a shell company and files information equivalent to the information that it would be required to file if the company were registering a class of securities under the Exchange Act through the use of Form 10 or Form 10-SB. A shell company that is a foreign private issuer is subject to the new rules regarding the use of Form S-8, except that foreign private issuers will file such information through the use of Form 20-F.

**Amendments to Form 8-K.** Form 8-K prescribes information about important corporate events that a company must disclose on a current basis. The amendments adopted by the SEC address the use of Form 8-K to report "reverse merger" and other transactions in which a reporting shell company ceases being a shell company, generally by combining with a formerly private operating business. Through such a de facto IPO transaction, the private operating business, in effect, becomes a public reporting company. This type of transaction generally involves a "reverse merger," whereby the private operating business merges into the shell company, with the shell company surviving and the former shareholders of the private business controlling the surviving entity.

The SEC amended Form 8-K to require the surviving entity in a transaction where a shell company ceases being a shell company to file a Form 8-K:

- that contains the information that would be required in an initial registration statement on Form 10 or Form 10-SB to register a class of securities under the Exchange Act, and
- that reports the material terms of the transaction.

Shell companies are required to file the Form 8-K within four business days after the closing of the transaction, which is consistent with the timeframe for most Form 8-K filings. This amendment eliminates the 71-day window during which a shell company previously could delay filing required financial information.

The SEC believes that requiring prompt and detailed disclosure in a Form 8-K filing will provide investors in operating businesses newly merged with shell companies with a level of information that is equivalent to the information provided by reporting companies that did not originate as shell companies.

**Amendment to Form 20-F.** The amendments to Form 20-F require a foreign private issuer that is a shell company to file a report on Form 20-F after completion of a transaction that causes it to cease being a shell company. The report must contain the same information that would be required in a registration statement on Form 20-F used to register the classes of the foreign private issuer's securities that are subject to the reporting requirements of the Exchange Act and must be filed within four business days of the completion of the transaction being reported.

**Shell Company Check Box on Exchange Act Reports.** In order to facilitate better identification of shell companies, the SEC's new rules add a check box to the cover page for Form 10-Q, Form 10-QSB, Form 10-K and Form 10-KSB for domestic issuers, and Form 20-F for foreign private issuers.

The check box will indicate whether or not the filer is a shell company as defined in Rule 12b-2 under the Exchange Act.

**Exception for "Business Combination Related Shell Companies."** In connection with its promulgation of the new rules, the SEC indicated that the new delay in use of Form S-8, as well as the reporting requirements under Form 8-K and Form 20-K, are not necessary for a subset of shell companies referred to as "business combination related shell companies," which are used solely for the purpose of effecting certain changes in domicile and business combination transactions. Accordingly, the amendments to Form S-8, Form 8-K and Form 20-F do not apply to this limited subset of shell companies.

The new SEC rules became effective August 22, 2005, except for the filing of a report on Form 8-K reporting the material terms of a shell company transaction, which will become effective on November 7, 2005.

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**Julie M. Allen**  
212.969.3155 – jallen@proskauer.com

**Richard H. Rowe**  
202.416.6820 – rrowe@proskauer.com

**Allan R. Williams**  
212.969.3220 – awilliams@proskauer.com

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