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Alert Memo

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SEC Removes References to Credit Ratings from Securities Act and Certain Exchange Act Rules and Forms

The Securities and Exchange Commission ("SEC") voted unanimously today to remove references to credit ratings from its rules and forms under the Securities Act of 1933 (the "Securities Act") and certain rules under the Securities Exchange Act of 1934 (the "Exchange Act"). The new rules generally take effect 30 days after publication in the Federal Register.

Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") requires each Federal agency to review its regulations and "remove any reference to or requirement of reliance on credit ratings" and substitute alternative standards of credit-worthiness. The amendments adopted today implement Section 939A with respect to the SEC's rules and forms under the Securities Act, principally for eligibility to use Forms S-3 and F-3, and the proxy rules in Schedule 14A under the Exchange Act. In doing so, the SEC sought to preserve the availability of short-form registration and shelf registration for issuers that are widely followed in the market.

Affected Rules and Forms

The credit rating references that will be removed are found in the SEC rules and forms described below:

- Securities Act Forms S-3 and F-3, which contain various requirements that must be met for an issuer of securities to qualify to register its securities on those forms.
    - The principal benefits of registering securities on these forms are the ability to forward incorporate by reference into the registration statement information that the issuer will file with the SEC under the Exchange Act ("short-form registration") and the ability to offer securities on a delayed or continuous basis after the registration statement is declared effective ("shelf registration").
    - As currently in effect, Forms S-3 and F-3 can be used by an otherwise qualified issuer to make primary offerings of non-convertible securities that

are rated investment grade by at least one nationally recognized statistical rating organization ("NRSRO").[1]

- Securities Act Forms S-4 and F-4, which are used primarily to register securities issued in business combination and liability management transactions. As currently in effect, these forms permit incorporation by reference of information about an issuer that meets the registrant requirements of Form S-3 or F-3 and is registering non-convertible investment grade debt or preferred equity securities.

- Exchange Act Schedule 14A, which is the form used for proxy statements. As currently in effect, Schedule 14A similarly permits incorporation by reference if the proxy statement is being used to solicit action in respect of non-convertible investment grade debt or preferred equity securities.

- Securities Act Rule 134, which provides a "safe harbor" for certain communications that are made in connection with an offering of securities. As currently in effect, Rule 134 provides that a communication that includes only enumerated types of information will not be deemed a "prospectus" or "free writing prospectus" under the Securities Act. One of the currently permitted items is credit ratings assigned or expected to be assigned by an NRSRO to the applicable securities.

- Rules 138, 139 and 168 under the Securities Act, which currently provide that certain communications (by a broker or dealer in the case of Rules 138 and 139 and by an issuer in the case of Rule 168) are not deemed to constitute an offer to sell a security if the related security is a non-convertible investment grade security.

Replacing the "Investment Grade" Standard

Forms S-3 and F-3 currently refer to credit ratings in the transaction eligibility requirements for primary offerings of non-convertible debt or preferred equity securities. The SEC voted to replace this with a qualification that will be met if any of the four following tests is met:

- the issuer has issued for cash at least $1 billion of non-convertible, SEC-registered debt or preferred equity securities during the prior three years, as measured within 60 days of the date it files the registration statement (this was

[1] Forms S-3 and F-3 are also available to registrants that satisfy certain other criteria. For example, a registrant whose common equity held by non-affiliates (i.e., market float) has a market value of at least $75 million may use S-3 or F-3 for offerings of any security (including common equity and convertible securities) regardless of the investment grade rating test or its replacements adopted today.

the only substitute criterion in the version of this rule the SEC proposed for comment);

- the issuer has outstanding at least $750 million of non-convertible debt or preferred equity securities that were issued in SEC-registered offerings for cash, as measured within 60 days of the date it files the registration statement;

- the issuer is a wholly-owned subsidiary of a well-known seasoned issuer (as defined in Rule 405 under the Securities Act); or

- the issuer is a majority-owned operating partnership of a real estate investment trust (a "REIT") that is a well-known seasoned issuer.

The last three criteria were adopted in response to comments received on the proposed rules and reflect the SEC's effort not to alter the pool of issuers that are widely followed in the market and eligible to use Form S–3 (and similar forms).[2]

The qualifications in Forms S-4 and F-4, Rules 138, 139 and 168 and Schedule 14A that currently require investment grade ratings were also amended to refer to these new criteria instead of credit ratings.

The SEC voted to remove NRSRO credit ratings from the safe harbor provisions of Rule 134 under the Securities Act, but noted that the removal of this safe harbor will not necessarily result in a communication including such credit rating information being deemed a prospectus or free writing prospectus. As a result, communications that include credit rating information will be evaluated under what are necessarily more uncertain facts-and-circumstances criteria. Given the risks of such an exercise, especially in light of the relatively extensive and detailed offering-related information that a Rule 134 communication could otherwise contain, issuers and underwriters may well decide simply to exclude rating information from deal-related communications.

[2] The SEC noted in the proposing release (Release Nos. 33–9186; 34–63874 (Feb. 9, 2011)) that "the legislative history [of Dodd-Frank] does not indicate that Congress intended to change the types of issuers and offerings that could rely on the Commission's forms." However, one additional criterion we (and other commenters) proposed that the SEC declined to add would have permitted foreign private issuers to take into account non-convertible debt and preferred securities issued in offshore transactions under Regulation S. The SEC's failure to do so is likely to result in greater reliance by these issuers on Rule 144A for offerings into the United States.

Three-Year Temporary Grandfathering Provision

The final rules approved today include a temporary grandfathering provision that will be in effect for three years from the effective date of today's amendments. Under this provision, issuers that reasonably believe they would have been eligible to register a securities offering pursuant to the "investment grade rating" test under Form S–3 or F–3 as in effect prior to today's amendments will be allowed to continue to use Form S–3 or F–3 as long as they disclose in the registration statement the basis for that belief.[3]

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Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Capital Markets in the "Practices" section of our website (http://www.clearygottlieb.com) if you have any questions.

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[3] In light of the requirement that the reasonable belief be disclosed in the registration statement, it will be interesting to see whether the SEC believes this requirement can be satisfied by a general statement as to investment grade ratings, and if so, whether this reference to ratings would require a consent from a rating agency in light of the earlier removal pursuant to Dodd-Frank of the carve-out of rating agencies in former Rule 436(g) under the Securities Act. A general statement as to ratings could be interpreted as not implicating the consent requirement, but this issue was not addressed at today's meeting.

CLEARY GOTTLIEB

Office Locations

New York
One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

Washington
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

Paris
12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

Brussels
Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

London
City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

Moscow
Cleary Gottlieb Steen & Hamilton LLC*
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax
* an affiliate of Cleary Gottlieb Steen & Hamilton LLP

Frankfurt
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

Cologne
Theodor-Heuss-Ring 9
50688 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

Rome
Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

Milan
Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

Hong Kong
Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

Beijing
Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax

Buenos Aires
CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
54 11 5556 8900
54 11 5556 8999 Fax