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FAST Act's Hidden Securities Law Benefits

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The so-called "Fixing America's Surface Transportation Act" or "FAST Act" was signed into law on December 4, 2015. Buried in the legislation are changes to the JOBS Act and the Securities Act of 1933 that add a statutory exemption for private resales of restricted and control securities, loosen initial public offering requirements for emerging growth companies and mandate a streamlining of SEC disclosure requirements.

The FAST Act, a copy of which can be found here, is a major piece of legislation with the principal aim of providing long-term funding for surface transportation. However, among the dozens of unrelated provisions, the FAST Act slips several important changes to the Jumpstart Our Business Startups Act (the JOBS Act) and the Securities Act of 1933 (the Securities Act) affecting emerging growth companies (EGCs), smaller reporting companies and other issuers. Most notably, the FAST Act establishes a new exemption under Section 4(a)(7) of the Securities Act for private resales of securities intended to facilitate the development of secondary markets in private securities.

Summary

- **Statutory Exemption for Resales of Restricted and Control Securities.** Title LXXVI of the FAST Act—*Reforming Access for Investments in Startup Enterprises*—adds Section 4(a)(7) to the Securities Act as a new exemption from registration to facilitate the private resale of securities, which codifies the so-called "Section 4(a)(1½)" exemption but in a more limited scope. This exemption is effective immediately. See below for a more detailed description of this aspect of the FAST Act.

- **Requirements for EGCs under the JOBS Act.** Title LXXI of the FAST Act—*Improving Access to Capital for Emerging Growth Companies*—amends Section 6(e)(1) of the Securities Act to shorten the waiting period, from 21 days to 15 days, during which an EGC must have its registration statement on public file with the Securities and Exchange Commission (the SEC) before it may commence its "road show." In addition, EGCs that have submitted a registration statement and thereafter lose their EGC status will have a one-year grace period from the date they lose their EGC status during which they will continue to be treated as an EGC—until the end of the one-year grace period or, if earlier, the date on which the EGC completes its IPO. Previously, if a company lost its EGC status during the confidential

review process, it would be required to publicly file its registration statement pursuant to SEC rules applicable to non-EGCs. These changes are effective immediately.

Title LXXI of the FAST Act also amends Section 102 of the JOBS Act to allow EGCs to submit a registration statement to the SEC that omits financial information for historical periods required by Regulation S-X as of the time a registration statement is filed or confidentially submitted if (i) the issuer reasonably believes the information relates to a historical period that will not be required to be included at the time of the contemplated offering and (ii) prior to the distribution of the preliminary prospectus to investors, the registration statement is amended to include all financial information required by Regulation S-X at the date of such amendment. The SEC has until January 3, 2016 to effect these changes to the JOBS Act; however, issuers may omit this financial information commencing on January 3, 2016. This provision will likely result in significant cost-savings for companies engaged in an IPO, where the preparation of financial statements is a costly and lengthy affair. Moreover, issuers often struggle to prepare financial statements and related disclosures for periods required solely to comply with Regulation S-X requirements that are subsequently updated by more current information required to be included in the final offering document. As an example, currently, if a calendar year EGC files its IPO registration statement in January 2016, it would be required to include audited financial statements for 2013 and 2014, as well as interim financial statements for the nine-month period ended September 30, 2015, even if the company then completes its IPO later in 2016, at which point only audited financial statements for 2014 and 2015 would be required. Under the new rules, this EGC would be able to omit the financial statements for 2013 on its initial filing if it includes the audited financial statements for 2015 before the preliminary IPO prospectus is distributed to investors. The SEC issued Compliance and Disclosure Interpretations on December 10, 2015 to clarify that an issuer nonetheless must include interim unaudited financial statements in its initial filing if annual financial statements covering such interim periods would ultimately be required at the time of the offering, even if the shorter interim periods would not be presented at that time. The SEC also stated in those interpretations that an EGC may omit financial statements of other entities if the issuer reasonably believes that those financial statements will not be required at the time of the offering.

- **Disclosure Simplification**. Title LXXII of the FAST Act—*Disclosure Modernization and Simplification*—directs the SEC to issue by June 1, 2016 new regulations allowing issuers to submit a summary page on Annual Reports on Form 10-K as long as the summary cross-references the material in the Form 10-K. The cross-reference may be by electronic hyperlink or otherwise. Title LXXII of the FAST Act also directs the SEC by June 1, 2016 to scale back or eliminate requirements of Regulation S-K in order to reduce the burden on EGCs, accelerated filers, smaller reporting companies and other smaller issuers and to eliminate duplicative, overlapping, outdated or unnecessary Regulation S-K requirements for all issuers. Finally, Title LXXII of the FAST Act directs the SEC to further study Regulation S-K disclosure and issue a report and proposed rules by November 28, 2016.

- **Small Company Simple Registration.** Title LXXXIV of the FAST Act—*Small Company Simple Registration*—directs the SEC to revise Form S-1 by January 18, 2016 so as to allow smaller reporting companies to incorporate by reference in a registration statement any documents they have filed with the SEC after the effective date of the registration statement. This new provision will eliminate the need for smaller reporting companies to file post-effective amendments and supplements. Additionally, it may allow smaller companies to use Form S-1, in effect, as a shelf registration statement.

- **Exchange Act Registration for Savings and Loan Holding Companies**. Title LXXXV of the FAST Act—*Holding Company Registration Threshold Equalization*—amends Section 12(g)(1)(B) of the Securities Exchange Act of 1934 (the Exchange Act), effective immediately, to include “savings and loan

holding companies (as defined in section 10 of the Home Owners' Loan Act). Section 12(g)(1)(B) requires banks and bank holding companies with total assets exceeding $10 million and a class of equity securities (other than an exempted security) held of record by at least 2,000 persons to register that class of securities under the Exchange Act. Prior to the amendment, savings and loan holding companies were subject to Section 12(g)(1)(A), which provides that an issuer will become subject to Exchange Act registration requirements within 120 days after the last day of its first fiscal year ended on which the issuer has total assets in excess of $10 million and a class of equity securities (other than exempted securities) held of record by either (i) 2,000 persons or (ii) 500 persons who are not accredited investors.

New Statutory Exemption for Private Resales – Section 4(a)(7)

The FAST Act adds Section 4(a)(7) to the Securities Act, granting a statutory exemption for resale transactions of restricted and control securities subject to certain conditions. Up until now, affiliates of the issuer have lacked a clear exemption to permit unlimited resale transactions. By design, Section 4(a)(1) exempts resale transactions by "any person other than an issuer, underwriter, or dealer." Section 4(a)(2) exempts transactions by "an issuer not involving any public offering." Because of the broad definition of underwriter, affiliates are often not covered by Section 4(a)(1), and they are excluded from Section 4(a)(2). Currently, Rule 144 under the Securities Act allows limited resales by affiliates (and non-affiliates) of the issuer subject to holding periods and other limitations. Over the years, an approach referred to as the "Section 4(a)(1½) exemption" has developed among securities professionals, which is not codified in the securities laws, but which has been accepted as allowing for limited resales of restricted securities in private transactions without the holding period requirement of Rule 144. This exemption rests on the theory that the resale of privately placed securities to an investor that could have been made under Section 4(a)(2) in the original private sale by the issuer should not be deemed a new distribution and should be exempt from registration if the new investor, who is purchasing the same securities from the original purchaser in a private transaction, will be subject to the same restrictions imposed on the original purchaser. The new statutory exemption under the new Section 4(a)(7) will bring certainty to the resale transactions that up until now have been exempted under Section 4(a)(1½). The Section 4(a)(7) exemption applies so long as the following requirements are met:

- Each purchaser must be an accredited investor (as defined in Rule 501(a) under the Securities Act);
- Neither the seller nor any agent of the seller can make any general solicitation or general advertising in order to offer or sell the securities;
- If the securities being sold are those of a non-reporting issuer (with limited exceptions, e.g. foreign governments), the seller must obtain, upon request to the issuer, and provide to the prospective purchaser, certain information, including:
    - the name of the issuer (and any predecessor);
    - the address of the issuer's principal executive offices;
    - the title and class of the securities;
    - the par or stated value of the securities;
    - the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year;
    - the name and address of the person responsible for transferring shares and stock certificates;

  - a statement of the nature of the business of the issuer, and the products and services it offers, made within 12 months before the transaction;
  - the names of the officers and directors of the issuer;
  - the names of any person acting as a broker, dealer or agent that will be paid any commission or remuneration for such person's participation in the offer or sale of the securities;
  - certain financial statements of the issuer, including the issuer's most recent balance sheet and profit and loss statement for the two preceding fiscal years; and
  - if the seller is a control person with respect to the issuer, a statement regarding the nature of the affiliation and a statement certified by the seller that it has no reasonable grounds to believe that the issuer is in violation of securities laws;
- The sale cannot involve securities for which the seller is the issuer or a subsidiary, either directly or indirectly, of the issuer;
- The seller or any person that has been or will be paid any commission or remuneration for their participation in the offer or sale of the securities must not be subject to disqualification as a bad actor under Rule 506(d)(1) of Regulation D under the Securities Act or subject to disqualification under Section 3(a)(39) of the Exchange Act;
- The issuer must be engaged in business, must not be in the organizational stage, in bankruptcy or receivership, and cannot be a blank check, blind pool or shell company that is only to be used for a merger or an acquisition;
- The transaction does not involve a security that constitutes all or part of an unsold allotment to or subscription by a broker or dealer acting as an underwriter of the security or a redistribution; and
- The class of securities being sold has been authorized and outstanding for at least 90 days before the date of the transaction.

Securities sold under Section 4(a)(7) will be "covered securities" under the Securities Act and accordingly will generally be exempt from state "blue sky" regulation. Additionally, securities acquired under the Section 4(a)(7) exemption will be deemed to have been acquired in a transaction not involving a public offering and the transaction will be deemed not to be a distribution for purposes of Section 2(a)(11) of the Securities Act. This is particularly important for sellers or placement agents, who can now avoid concerns about potential underwriter liability. Finally, the securities sold pursuant to Section 4(a)(7) will be deemed restricted securities under Rule 144 under the Securities Act.

Section 4(a)(7) also makes clear that it is not the exclusive means of effecting a resale of a restricted security. Accordingly, resale transactions may continue to be undertaken under the Section 4(a)(1½) exemption set forth above, which may continue to be particularly useful in the case of resales of securities of private companies that lack sufficient financial information.

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