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Changes to the JOBS Act and SEC Disclosure Requirements

Last Friday, President Obama signed into law the Highway Transportation Bill, otherwise known as the FAST Act. Among its many provisions, the Act includes changes to the JOBS Act, changes to SEC disclosure requirements and a new statutory exemption for private resales of securities.

The text of the legislation is available **here** (under Division G—Financial Services).

Summary

The main features of the new legislation are:

- **JOBS Act Changes for Emerging Growth Company ("EGC") Initial Public Offerings**: EGCs can now commence roadshows within 15 calendar days of publicly filing the registration statement with the SEC as opposed to the previous 21-calendar day waiting period and can rely on continued treatment as an EGC for certain purposes during a grace period if they lose their EGC status during the SEC review process. Further, EGCs can start the SEC review process without having to include financial information for periods that will not be required to be included at the time the IPO is expected to go on the road.
- **Form 10-K and Regulation S-K Disclosure Changes**: All issuers will be allowed to submit a summary page on Form 10-K. The legislation further directs the SEC to simplify—for all filers—Regulation S-K and eliminate duplicative, overlapping or otherwise unnecessary requirements.
- **New Section 4(a)(7) Exemption for Private Resales**: A new statutory exemption for private resales of restricted and control securities is now established under Section 4(a)(7) of the Securities Act.
- **Incorporation by Reference for Smaller Reporting Companies**: Smaller reporting companies will be allowed to automatically update information in a Form S-1 resale prospectus using forward incorporation of SEC reports—something only S-3 filers could utilize before.

JOBS Act Changes for EGC Initial Public Offerings

This provision:

- **Reduces the number of days that an EGC must have a registration statement publicly on file with the SEC before it may conduct a "road show" from 21 to 15 calendar days**. This change is self-executing and, accordingly, is effective immediately. For example, previously an EGC had to wait three weeks after filing publicly to commence its roadshow. Now, it need only wait two weeks and a day.
- **Permits EGCs to omit financial information for earlier periods**. EGC registration statements on Forms S-1 or F-1 may omit financial information for historical periods otherwise required by Regulation S-X that relate to a

historical period that the EGC reasonably believes will not be required to be included at the time of the contemplated offering. Before the EGC distributes the preliminary prospectus to investors, the registration statement must be amended to include all financial information required by Regulation S-X at the date of such amendment. For example, under the new legislation an issuer that expects to market its IPO during 2016 on the basis of audited financial statements for 2015 could commence the SEC review process in 2015 or early 2016 without ever having to prepare audited financial statements for 2013. The SEC has 30 days from the date of enactment of the Act to promulgate rules effecting this change. However, issuers may omit such financial information starting on the 31st day from enactment of the Act.

- **Adds a grace period if EGC status is lost during IPO process**. Under current law and SEC staff guidance, an issuer that loses its EGC status during the confidential review process will immediately lose its ability to submit amendments to its registration statement on a confidential basis. This could be the case, for example where, since the issuer's initial confidential submission, the issuer has completed a fiscal year with revenues over $1 billion and thus ceased to be an EGC. Under the new legislation, an issuer that was an EGC at the time it commenced the SEC review process for its registration statement (whether through confidential submission or public filing) but subsequently loses its EGC status will, during a grace period, still be treated as an EGC. The change is added to Section 6(e)(1) of the Securities Act relating to confidential submission and is limited to that subsection, which may affect the scope of application of the grace period. The grace period ends on the earlier of (i) the consummation of the issuer's IPO under the relevant registration statement or (ii) one year after the issuer ceased to be an EGC. This change is self-executing and, accordingly, is effective immediately.

Form 10-K and Regulation S-K Disclosure Changes

All issuers will be allowed to submit a summary page on Form 10-K but only if each item on the summary page includes a cross reference to the material in the 10-K. Such cross reference can be in the form of a hyperlink. As a matter of market practice, issuers have not generally provided "summaries" in their 10-Ks. Given that most 10-Ks are lengthy, this provision is an attempt to enable issuers to concisely disclose pertinent information in summary form and provide investors quicker access to such information. Further, this legislation also requires the SEC to eliminate redundant, outdated or otherwise unnecessary requirements of Regulation S-K for all issuers. The SEC is further directed to study the requirements of Regulation S-K and report to Congress ways to provide material information to investors but reduce costs on issuers. One such measure, as the legislation points out, is to emphasize a "company by company approach" and minimize boilerplate languages for investors. The SEC has 180 days from enactment of the Act to issue these regulations and 360 days to submit the study's findings and suggestions to Congress.

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

Private placements by issuers are exempt under Section 4(a)(2) of the Securities Act. This includes private placements to accredited investors under the SEC's Regulation D. Private placement resales by persons other than the issuer, such as holders of restricted securities or affiliates of the issuer, were not eligible for Section 4(a)(2) or Regulation D. Those resale transactions instead had to rely on the so-called Section 4(1½) exemption, a concept developed based on case law and policy considerations. It effectively permits the use of private placements for those resale transactions, subject to certain conditions. The absence of an express statutory basis created some

uncertainty regarding the precise scope of the exemption. This uncertainty affected primarily secondary trading in stock of private companies. A new Section 4(a)(7) of the Securities Act now provides legal certainty. To qualify for the new exemption, the transaction must meet the following requirements:

- Each purchaser must be an accredited investor as defined under Rule 501 of Regulation D;
- No general solicitation or general advertising is allowed from the seller or any person acting on the seller's behalf;
- For transactions by a non-reporting issuer, upon request by the seller, such issuer must provide the seller and prospective purchaser (and the seller must always provide the prospective purchaser) certain general information (e.g., name of the issuer, address of the issuer's principal executive offices, title and class of the security, par or stated value of the security, number of shares or total amount of the securities outstanding as of the most recent fiscal year end, etc.) and updated balance sheet and income statement financial information covering the last two fiscal years and any applicable interim periods; and
    - To the extent that the seller is a control person with respect to the issuer, a brief statement regarding the nature of the affiliation and a certification by such seller that it has no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations;
- The seller in the transaction must not be the issuer or a subsidiary (either direct or indirect) of the issuer;
- The seller or any person that has been or will be paid remuneration or commissions for participating in the offer must not be subject to an event that would disqualify an issuer or other covered person as a "bad actor" (e.g., criminal conviction) under Rule 506(d)(1) of Regulation D or subject to a statutory disqualification described under Section 3(a)(39) of the Securities Act;
- The issuer must be "engaged in business" and must not be in the organizational stage or in bankruptcy or receivership and must not be a blank check, blind pool or shell company;
- The transaction must not be part of an unsold allotment to, subscription or participation by a broker or dealer as an underwriter of the security or a redistribution; and
- The transaction must relate to a security of a class that has been authorized and outstanding for at least 90 days.

Further, the securities acquired through Section 4(a)(7) are deemed to be from a private placement, not a "distribution" for purposes of Section 2(a)(11), and are restricted under Rule 144.

As the exemption would become clearly delineated, this legislation may facilitate the development of a secondary market for private companies among accredited investors. The legislation expressly provides that Section 4(a)(7) "shall not be the exclusive means for establishing an exemption" from SEC registration. This should give market participants some comfort that the traditional Section 4(1½) exemption continues to be available, and that it is not necessary to comply with all of the requirements of Section 4(a)(7) in every resale that relies on a private placement exemption.

Incorporation by Reference for Smaller Reporting Companies

Smaller reporting companies (entities that, as of the last business day of their second fiscal quarter, have a public float of less than $75 million) will be able to automatically update information in a Form S-1 resale prospectus using forward incorporation by reference documents filed with the SEC after the S-1 registration statement becomes effective. This method of updating information was previously available only to S-3 filers. Hence, to the extent the S-1 is updated by an incorporated document instead, this new provision may not only eliminate the need for smaller reporting companies to use supplements or post-effective amendments but also allow those companies to use S-1 as an equivalent to a shelf registration statement.

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