Client Alert | Capital Markets

FAST ACT Amends JOBS ACT

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On December 4, 2015, President Obama signed into law the Fixing America's Surface Transportation Act, known as the "FAST Act." Continuing the theme of somewhat incongruous acronyms, the FAST Act amends aspects of the JOBS Act by including a number of provisions designed to further facilitate capital raising by emerging growth companies (EGCs) and secondary trading in privately-placed securities, and to modernize certain public company disclosure requirements. The key securities law provisions of the FAST Act are summarized below.

Provisions Related to Improving Access to Capital for Emerging Growth Companies

The Act provides additional flexibility to ECGs (a category of issuer created under the JOBS Act that is generally defined as an issuer with annual gross revenues of less than $1 billion during its most recent fiscal year) as follows:

Current Law/Practice	Changed Law/Practice	Commentary
An EGC undertaking an IPO may not commence a road show less than 21 days after publicly filing its confidentially submitted registration statement.	The 21-day period is reduced to 15 days.	By way of example, if an issuer files its registration statement publicly on EDGAR before 5:30 pm ET on January 5, it will be able to commence its roadshow on January 20 as opposed to January 26.
EGC status is lost by an issuer that has over $1 billion of revenues in the preceding fiscal year. This means that an EGC that starts an IPO process with that status and files confidentially with the SEC can lose ECG status on January 1 of the following year if it had more than $1 billion of revenues in that year.[1]	A company that qualified as an EGC at the time it submitted a draft registration statement to the SEC for review, but which subsequently loses its EGC status, will continue to be treated as an EGC until the earlier of (1) the consummation of its IPO, and (2) one year after losing EGC status.	Before this change, an incongruous outcome was created: • A company that lost EGC status while still in the confidential filing stage was forced to file its IPO registration statement publicly and would not be considered an EGC thereafter.

[1] An EGC can also lose EGC status before an IPO on the date on which it has issued US$1 billion or more of non-convertible debt during the previous three years.

		• A company that filed its IPO registration statement publicly before losing EGC status would be permitted to complete its IPO as an EGC.[2] The change in the law removes the false paradigm that previously forced EGCs to file their registration statement publicly prematurely in order to maintain EGC status.
The SEC will not review an IPO registration statement, whether confidentially submitted or publicly filed, unless the financial statements comply with SEC rules with respect to the age of financial statements at the date of the submission or filing.[3]	Commencing January 3, 2016, an EGC can omit historical financial information for an IPO if (a) the company reasonably believes that the omitted historical financial information will not be required at the time of offering, and (b) all required financial statement information is provided to investors at the time a preliminary prospectus is distributed.	Issuers frequently have to prepare historical financial statements for a fiscal year that will not ultimately be required by the time an IPO is completed. The change will permit such issuers to exclude that fiscal year from their registration statement if they do not reasonably expect it to be required for the roadshow. This will result in the outcome that the early versions of an IPO registration statement may contain only one year of audited financial statements.

The amendments to the JOBS Act implemented by the FAST Act continue to maintain a two tier system for IPOs in the United States based on the distinction of having less than $1 billion in annual revenues. Many of the benefits accorded EGCs, however, have no direct relationship to company size. For example, the ability to file a registration statement confidentially or to "test-the-waters" with potential investors appear to be fundamental points of principal that should apply to all companies if they are deemed suitable for some companies. This is distinct from scaled disclosure requirements for smaller companies that arguably have a more direct relationship to company size. It is hoped that Congress will ultimately adopt legislation treating all IPO companies equally with respect to the procedures that apply to them.

Reforming Access for Investments in Startup Enterprises

The SEC has sought over the years to facilitate secondary trading in privately placed securities. To this end, Rule 144 codifies the ability of a purchaser of securities issued by a private company to resell those securities freely – even absent a public trading market for those securities – more than one year after their purchase from the issuer (or an affiliate of the issuer) provided the purchaser is not an affiliate of the issuer (and has not been an affiliate within the previous 90 days). Rule 144 also addresses the ability of affiliates and non-affiliates to resell privately-placed securities issued by a public company. However, Rule 144 still leaves two groups of purchasers of privately-placed securities without a clear exemption to permit unlimited trades: (1) purchasers within the first year of their purchase (six months in the case of a public company), and (2) affiliates of the issuer (at any time). As a result, a *de facto* exemption, recognized by practitioners and referred to as the "Section 4(a)(1½) exemption," has sprung up to permit private resales of restricted securities following many of the same practices as have developed around private placements pursuant to Section 4(a)(2). The SEC has never provided specific guidance with respect to the "Section 4(a)(1½) exemption," which has in many ways provided flexibility to all parties. The FAST Act codifies a new exemption from registration in Section 4(a)(7) of the Securities Act for the resale of securities that meet the following specific requirements:

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2 Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, Question 3.

3 SEC Financial Reporting Manual, Section 1210.

- *Accredited Investor Status*. Each purchaser must be an "accredited investor" within the existing definition contained in Regulation D under the Securities Act.
- *No General Solicitation*. Neither the seller, nor anyone acting on the seller's behalf, may engage in general solicitation of buyers.
- *Information Requirements for Private Companies*. If the issuer is not a reporting company under the Exchange Act or a foreign private issuer exempt from reporting pursuant to Exchange Act Rule 12g3-2(b), the issuer must provide certain information, including financial statements, as set forth on Annex 1 hereto.
- *90-Day Waiting Period Following Initial Issuance*. The securities must be of a class of securities that have been outstanding for more than 90 days.
- *Not Available for Bad Actors*. Neither the seller nor any person receiving a commission in connection with the transaction would be disqualified as a bad actor under Regulation D.
- *Issuer Limitations*. The issuer is engaged in business and is not in the organizational stage or in bankruptcy, or a blank check, blind pool or shell company with no specific business plan or purpose.
- *Not a Disguised Primary Offering*. The transaction is not conducted by the issuer or a subsidiary of the issuer.

Securities sold under Section 4(a)(7) will be "covered securities" under the Securities Act and thus will be exempt from certain aspects of state "blue sky" regulation. Securities acquired in these transactions will be deemed "restricted securities" within the meaning of Rule 144. Finally, such transaction shall be deemed not to be a distribution for purposes of Section 2(a)(11) with the result that neither the seller nor a placement agent assisting with the transaction would need to have concern about potential underwriter liability.

The practical implications of the new exemption will develop over time, but our initial assessment is as follows:

- The world of sellers and purchasers for whom the new exemption provides meaningful benefits appears relatively small because the transferred securities remain restricted securities in the hands of the purchaser, the purchaser must be an accredited investor (e.g., this is not a public offering) and, in the case of a private company, the financial statement disclosure requirements will likely be unappetizing for many companies and/or unavailable to many sellers.
- The "Section 4(a)(1½) exemption" facilitates the same trades with the same outcomes as the new Section 4(a)(7) exemption, and the new Section 4(a)(7) exemption makes it clear that it is not an exclusive means of effecting a secondary sale of a restricted security.
- Increased use of Section 4(a)(7) may depend in part on the willingness of law firms to continue to give opinions that transactions are exempt from registration pursuant to the "Section 4(a)(1½) exemption." Such opinions are standard fare for many exempt transfers; however, a migration away from a willingness to give such opinions in favor of the certainty afforded by the more onerous Section 4(a)(7) exemption might result in its greater use.
- If Section 4(a)(7) is to become a more customary means of effecting secondary sales, we would expect to see investors seek contractual undertakings from private companies to make available to them and to potential purchasers the requisite financial and other information, subject to reasonable and customary confidentiality provisions.

Disclosure Modernization and Simplification

The Act aims to modernize and simplify certain disclosure requirements under the SEC disclosure rules and forms by:

- Requiring the SEC, before June 1, 2016 (within 180 days of enactment), to issue regulations permitting issuers to present a summary page in their annual reports on Form 10-K, so long as they include cross-references to more complete disclosure elsewhere in the Form 10-K;
- Requiring the SEC, before June 1, 2016 (within 180 days of enactment), to take action to scale or eliminate requirements of Regulation S-K to reduce the burden on EGCs, accelerated filers, smaller reporting companies and other smaller issuers, and to eliminate "duplicative, overlapping, outdated, or unnecessary" requirements for all issuers; and
- Requiring the SEC to conduct a study on Regulation S-K, and eventually to enact related rules, to "(1) determine how best to modernize and simplify such requirements in a manner that reduces the costs and burdens on issuers while still providing all material information; (2) emphasize a company-by-company approach that allows relevant and material information to be disseminated to investors without boilerplate language or static requirements…; [and] (3) evaluate methods of information delivery and presentation and explore methods for discouraging repetition and the disclosure of immaterial information". A report on this study is due to Congress before November 28, 2016 (within 360 days from enactment) and rules related to the study are to be issued within 360 days from the issuance of the report.

As a practical matter, the SEC Staff is already engaged in a disclosure simplification review process, and it is unclear how this study will impact that review.

Small Company Simple Registration:

Smaller reporting companies (SRCs) (entities that, as of the last business day of their second fiscal quarter have a public float of less than $75 million) will be permitted to utilize forward incorporation by reference in a Form S-1 registration statement. The SEC must make the necessary changes to Form S-1 by January 18, 2016 (within 45 days of enactment).

A Form S-1 can be used as a shelf registration statement for secondary sales of securities; however, Form S-1 cannot currently be updated by means of filing, and incorporating by reference, Exchange Act reports after initial effectiveness. Instead, each time an Exchange Act report is filed, a prospectus supplement must be filed to update the Form S-1 by incorporating by reference the Exchange Act report, so long as no "fundamental change" has occurred. A post-effective amendment – which is more burdensome and subject to SEC review – must be filed in order to reflect "fundamental changes" or to disclose material changes in the plan of distribution.

As a result of the change, SRCs will benefit from a more streamlined means of facilitating secondary sales pursuant to a shelf registration if they are required to do so on a Form S-1. This would generally be the case in the first year after an SRC completes an IPO or if the SRC is otherwise not eligible to use Form S-3 which does permit forward incorporation by reference.

Annex 1

Information required to be provided by an issuer to the seller and prospective purchasers of securities pursuant to Section 4(a)(7) of the Securities Act.

- The exact name of the issuer and the issuer's predecessor (if any).
- The address of the issuer's principal executive offices.
- The exact title and class of the security.
- The par or stated value of the security.
- 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 transfer agent, corporate secretary, or other 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, which shall be presumed reasonably current if the statement is as of 12 months before the transaction date.
- The names of the officers and directors of the issuer.
- The names of any persons registered as a broker, dealer, or agent that shall be paid or given, directly or indirectly, any commission or remuneration for such person's participation in the offer or sale of the securities.
- The issuer's most recent balance sheet and profit and loss statement and similar financial statements, which shall—
    - be for such part of the 2 preceding fiscal years as the issuer has been in operation;
    - be prepared in accordance with generally accepted accounting principles or, in the case of a foreign private issuer, be prepared in accordance with generally accepted accounting principles or the International Financial Reporting Standards issued by the International Accounting Standards Board;
    - be presumed reasonably current if—
        - with respect to the balance sheet, the balance sheet is as of a date less than 16 months before the transaction date; and
        - with respect to the profit and loss statement, such statement is for the 12 months preceding the date of the issuer's balance sheet; and
        - if the balance sheet is not as of a date less than 6 months before the transaction date, be accompanied by additional statements of profit and loss for the period from the date of such balance sheet to a date less than 6 months before the transaction date.
- 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 statement certified by such seller that they have no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.

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