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New Legislation Extends JOBS Act Relief and Creates Resale Exemption, Among Other Changes to the Federal Securities Laws

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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.[1] The FAST Act made several important changes to the federal securities laws, including (i) extending the scope of certain rule changes made under the JOBS Act, particularly for initial public offerings by emerging growth companies; (ii) codifying a long-used method for exempt resale transactions; (iii) easing the disclosure requirements for "smaller reporting companies" using Form S-1; and (iv) more generally, streamlining disclosure for filings with the Securities and Exchange Commission. In this client alert, we summarize and discuss the potential impact of these changes.[2]

Extending the JOBS Act: IPOs by EGCs

Prior to the FAST Act, an emerging growth company, or EGC, that had confidentially submitted its registration statement in draft form was required to publicly file the registration statement at least 21 days prior to the date on which it commenced its road show. The FAST Act shortens this period from 21 days to 15 days.[3]

The FAST Act also implements a grace period for a company that loses its status as an EGC after its initial confidential submission (or public filing of the registration statement) but before the completion of its IPO. Going forward, a company in such circumstances will continue to be treated as an EGC until the earlier of (i) the completion of the IPO or (ii) the one-year anniversary of the date on which the company lost its EGC status.[4]

Even more significantly, the FAST Act permits an EGC to omit from its confidential submission or filed registration statement any financial statements otherwise required if the EGC reasonably believes that the omitted financial statements will not be required to be included in the registration statement "at the time of the contemplated offering," which we believe refers to the time of effectiveness, as long as the red herring prospectus used by the EGC on its road show contains all financial information required by Regulation S-X.[5] This relief is limited to filings (or confidential submissions) for initial public offerings on Form S-1 or F-1,[6] although it extends not only to the issuer's financial statements but also to those of an acquired business.[7] While the relief provided by the FAST Act is specific to financial statements required by Regulation S-X, we believe that an EGC should also be able to exclude selected financial data for any period for which the EGC omitted financial statements in reliance on this FAST Act provision.[8] Similarly, we do not believe that an MD&A section should be required for any period for which financial statements are excluded based on the FAST Act amendment.[9]

Overall, these changes should result in a more efficient IPO process. We expect the greatest impact will result from the ability to exclude financial statements, and potentially corresponding MD&A disclosure, that are not ultimately required in the red herring prospectus. For example, previously, a calendar-year EGC making its initial confidential submission on January 4, 2016 would have been required to include audited financial statements for 2013 and 2014. However, if the EGC reasonably believes that it will not conduct its road show until after February 16, 2016, it may now exclude the audited 2013 financial statements, as long as it includes audited 2014 and 2015 financial statements in its red herring prospectus and in the registration statement at the time of effectiveness. Note that in this scenario, the EGC would be required to include, both before and after the FAST Act, interim financial statements for the nine months ended September 30, 2014 and 2015.[10] Particularly where the earlier year audit is not already available, this relief will provide meaningful cost and time savings for the issuer.

The changes regarding the shortening of the public filing period to 15 days and the grace period for status as an EGC became effective on December 4, 2015 with the enactment of the FAST Act. An EGC's ability to exclude certain financial statements from its IPO registration statement, as described above, formally commenced with a Form S-1 or F-1 filed (or confidentially submitted) on or after January 3, 2016.[11] However, the SEC staff did not object if an EGC availed itself of this relief prior to such date.[12]

New Exemption for Resale Transactions

Prior to the enactment of the FAST Act, if a seller of securities could not use the resale safe harbor under Rule 144, it typically had little choice but to rely on so-called "Section 4(1½)." There is no actual Section 4(1½) statutory exemption. Rather, it is assembled from principles that apply under two actual Securities Act exemptions, Sections 4(a)(1) and 4(a)(2), and sanctioned in some degree by the courts and by industry practice.[13] The so-called Section 4(1 ½) exemption may be available, for example, when the purchaser of the securities is financially sophisticated, has access to or receives information about the issuer and would have been able to purchase the securities directly from the issuer in an exempt transaction (i.e., pursuant to the private placement exemption).[14] The FAST Act codifies a form of the Section 4(1 ½) exemption by adding Section 4(a)(7) to the Securities Act as a new exemption for resale transactions.[15] To rely on the new exemption, the transaction must meet the following criteria:

- the purchaser must be an accredited investor;
- the seller and any person acting on the seller's behalf may not engage in general solicitation or general advertising;
- in the case of a company that is not required to file reports under the Securities Exchange Act of 1934, the purchaser must receive information about the issuer, including, among other things, (i) the nature of its business; (ii) the names of its directors and officers; (iii) financial statements for the past two years (which do not need to be audited); and (iv) the nature of any affiliation between the issuer and the seller;
- the seller and any broker that it uses may not be disqualified pursuant to the bad actor provision in Rule 506 under the Securities Act or the disqualifications contained in Section 3(a)(39) of the Exchange Act;
- the issuer may not be in the organizational stage nor in bankruptcy, and it may not be a blank check company, a blind pool, or a shell company;

- ???the securities subject to the transaction may not be not part of an underwriter's unsold allotment; and
- ???the securities subject to the transaction must be part of a class that has been authorized and outstanding for at least 90 days.

The securities transferred in reliance on Section 4(a)(7) will remain "restricted securities," as defined in Rule 144(a)(3). However, the FAST Act preempts the application of state blue sky registration requirements to resale transactions under the new exemption. In addition, because the FAST Act added a provision to clarify that Section 4(a)(7) will not be the exclusive means for establishing an exemption from registration for a resale transaction,[16] the Section 4(1 ½) exemption, as it has developed and been used over the years, should continue to be available to sellers in resale transactions.

The addition of Section 4(a)(7) became effective on December 4, 2015 with the enactment of the FAST Act.

Smaller Reporting Companies: Forward Incorporation by Reference for Form S-1

Prior to adoption of the FAST Act, all companies conducting a continuous offering on Form S-1 were required to supplement their prospectus upon material events, or file a post-effective amendment for certain significant updates (including updating the financial statements included in the prospectus).[17] The reason for these additional filings was that Form S-1 did not permit the issuer to incorporate by reference into the prospectus reports and other documents filed by the issuer under the Exchange Act after the Form S-1's effective date, referred to as forward incorporation by reference.

The FAST Act directs the SEC to revise Form S-1 by January 18, 2016 to permit forward incorporation by reference, but only for smaller reporting companies.[18] This provision is derived from a recommendation by the SEC's 2012 Government-Business Forum on Small Business Capital Formation, known as the Small Business Forum.[19] In making its recommendation, the Small Business Forum noted that investors could now easily access a company's Exchange Act filings that would be incorporated by reference into the Form S-1 through the SEC's EDGAR system or the Internet.[20]

The ability of a smaller reporting company to forward incorporate by reference in Form S-1 requires the SEC to revise the form to permit such action. Although the FAST Act directs the SEC to make the revision by January 18, 2016, companies should not automatically rely on the provision until the SEC has actually made the revision. It is possible that, in revising Form S-1 to implement the FAST Act, the SEC will permit forward incorporation by reference for all companies (including non-smaller reporting companies),[21] subject to typical exclusions for blank check companies, shell companies and issuers of penny stock.

Streamlining Disclosure: Form 10-K Summary Page

Currently, a company may, but is not required to, include in its Form 10-K a summary of the entire report. However, many companies do not provide this voluntary summary. The FAST Act directs the SEC to issue rules by June 1, 2016 that will permit a company to include in its Form 10-K a summary page but only to the extent the summary cross-references, via electronic link or otherwise, to the disclosure required by each item of Form 10-K and contained elsewhere in the document.[22] This provision is likely intended to encourage the use of an executive summary to the Form 10-K, although its usefulness will likely depend on the details in the final rules promulgated by the SEC and on how market practice develops. Ultimately, this Form 10-K summary page could become akin to the "box summary" used in a prospectus for an IPO.

Although not clear, Congress might have intended for the 10-K summary page to be "furnished," instead of "filed," under the Exchange Act and thereby not subject to liability under Section 18 of the Exchange Act, nor Section 11 of the Securities Act (as furnished information would not be incorporated by reference into a Securities Act registration statement). The text of the FAST Act uses the word "submit" (instead of "file") when referring to the summary page and the legislative history of the provision suggests that companies would not be exposed to liability for using a summary page.[23] We expect the SEC to address this issue in the final rules that it adopts.

Streamlining Disclosure: Regulation S-K Revisions and Study

The FAST Act directs the SEC to revise Regulation S-K by June 1, 2016 (i) to scale disclosure applicable to EGCs, accelerated filers, smaller reporting companies and other smaller issues and (ii) to eliminate duplicative, outdated or unnecessary provisions.[24]

Independent of the above-described requirement, the FAST Act also directs the SEC, in consultation with its Investor Advisory Committee and its Advisory Committee on Small and Emerging Companies, to conduct a study on ways to modernize Regulation S-K and ways to require disclosure of material information without the inclusion of boilerplate or repetitive language.[25] By November 28, 2016, the SEC must issue a report to Congress on its study's findings and make recommendations on revisions to Regulation S-K.[26] Within 360 days of its report, the SEC must propose rules to implement its recommendations.[27]

The JOBS Act had previously directed the SEC to review Regulation S-K,[28] and the SEC issued its report to Congress in December 2013.[29] However, in requiring another study on the subject, Congress criticized the SEC for not proposing substantive reform and failing to move more quickly to modernize the regulation.[30] The SEC staff is currently undertaking a "disclosure effectiveness" project to study possible changes to Regulation S-K,[31] and we expect that the FAST Act's directives on Regulation S-K will become part of this "disclosure effectiveness" project and perhaps quicken its pace.

Extending the JOBS Act: Exchange Act Registration and Reporting for Savings and Loan Holding Companies

Section 601 of the JOBS Act changed the thresholds for a bank or a bank holding company to register or de-register a class of equity securities under Section 12(g) of the Exchange Act and to suspend reporting under Section 15(d) of the Exchange Act. Following enactment of the JOBS Act, a bank or bank holding company with total assets exceeding $10 million at the end of its fiscal year is required to register a class of equity securities if there are at least 2,000 record holders of that class.[32] To de-register a class or to suspend reporting with respect to a class, a bank or bank holding company must have less than 1,200 record holders for that class.[33]

The FAST Act extends these thresholds to "savings and loan holding companies" (as defined in Section 10 of the Home Owners' Loan Act).[34] According to Representatives Robert Hurt and Steve Womack, this change to the thresholds is merely a technical correction to Section 601 of the JOBS Act, as Congress did not intend to treat savings and loan holding companies differently from banks and bank holding companies.[35] The SEC had proposed similar changes to the thresholds (which have not yet been adopted), citing this Congressional intent.[36] According to the SEC, as of June 30, 2014, 72% of savings and loan holding companies that are Exchange Act reporting companies would become eligible terminate registration under these thresholds.[37]

These changes for savings and loan holding companies became effective on December 4, 2015 with the enactment of the FAST Act.

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We expect these new changes to the federal securities laws to facilitate the public offering process for many companies, and to accelerate the SEC's project for streamlining public disclosure. Because the new legislation requires the SEC to propose new rules and to initiate new studies, we expect that the agency's ability to address some of its other initiatives may be slowed as a result.

[1] The full text of the FAST Act is available here: https://www.congress.gov/114/bills/hr22/BILLS-114hr22enr.pdf.

[2] On December 10, 2015, the SEC staff issued its summary of the FAST Act, which is available here: http://www.sec.gov/corpfin/announcement/cf-announcement---fast-act.html. The SEC staff has also published a few interpretations of the FAST Act, and they are available here: http://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm.

[3] Section 71001 of the FAST Act.

[4] Section 71002 of the FAST Act. Previously, pursuant to Rule 401(a) under the Securities Act of 1933, a company that lost its status as an EGC prior to publicly filing its registration statement was not permitted to avail itself to the scaled disclosure and exemptions available to EGCs in the publicly filed registration statement.

[5] Section 71003 of the FAST Act.

[6] *Id*.

[7] *See* Question 2 in Compliance and Disclosure Interpretations (Fixing America's Surface Transportation (FAST) Act). Not infrequently, audited financial statements of an acquired business are unavailable, so the new relief will likely decrease the requests for waivers from the SEC staff to the extent that such financials statements are for periods that will be unnecessary at the time of the road show.

[8] Section 10220.2 of the Financial Reporting Manual permits an EGC to omit selected financial data required by Item 301 of Regulation S-K for any period prior to the earliest audited period for which financial statements are presented in its IPO registration statement.

[9] *See* Instruction 1 to Item 303(a) of Regulation S-K (stating "[g]enerally, the [MD&A] shall cover the…period covered by the financial statements"); *see also* Section 102(c) of the JOBS Act (requiring an EGC to provide MD&A disclosure for the two year period included in its IPO registration statement). However, one purpose of MD&A is to disclose trends and compare financial periods. To the extent an EGC relies on Section 71003 and includes only one fiscal year in its initial confidential submission, the MD&A may not disclose a trend or show a comparison. When the EGC files financial statements and a corresponding MD&A for a second fiscal year, the SEC staff may take slightly longer to review the MD&A for trend and comparative disclosure, and the EGC may receive additional substantive comments that will need to be resolved quickly prior to its road show.

[10] *See* Question 1 in Compliance and Disclosure Interpretations (Fixing America's Surface Transportation (FAST) Act).

[11] Section 71003 of the FAST Act also directed the SEC to revise, by January 3, 2016, the general instructions to Forms S-1 and F-1 to provide for an EGC's ability to omit financial statements, as described above. However, an EGC's ability to take advantage of the relief is not dependent on the SEC's revisions to the forms.

[12] The SEC staff stated this position in the summary it published on December 10, 2015.

[13] *See*, *generally*, J. William Hicks, Resales of Restricted Securities (2014 Edition), Chapter 6.

[14] *Id*.

[15] Section 76001 of the FAST Act. *See* 161 Cong. Rec. H6806-6807 (2015) (Statements of Scott Garrett, Carolyn Maloney & Patrick McHenry).

[16] *See* new Section 4(e)(2) of the Securities Act.

[17] *See*, *generally*, Question 212.11 in Compliance and Disclosure Interpretations (Securities Act Rules).

[18] Section 84001 of the FAST Act.

[19] *See* H.R. Rep. No. 114-201, at 2 (2015); *see also* Thirty First Annual SEC Government-Business Forum on Small Business Capital Formation Final Report, Nov. 15, 2012, at 26 and 31.

[20] *Id*.

[21] Section 84001 likely limited forward incorporation by reference on Form S-1 to smaller reporting companies because the recommendation on which the provision was based was limited to small businesses. Generally, a non-smaller reporting company can conduct continuous offerings on Form S-3, which already permits forward incorporation by reference. However, a non-smaller reporting company might become ineligible to use Form S-3 (e.g., if it untimely filed its Form 10-K or a Form 10-Q in the past twelve months). These untimely filings would not, by themselves, cause the company to become a smaller reporting company. In this situation, the company must use Form S-1 for any continuous offering until it regains its Form S-3 eligibility, but because it is not a smaller reporting company, it would be ineligible to forward incorporate by reference in its Form S-1 under Section 84001.

[22] Section 72001 of the FAST Act.

[23] *See* H.R. Rep. No. 114-279, at 2 (2015) ("Permitting issuers to submit a summary page would enable companies to concisely disclose pertinent information to investors without exposing them to liability.")

[24] Section 72002 of the FAST Act. However, the SEC is not required to revise any item for which it determines that further study is required to determine its efficacy. *Id*.

[25] Section 72003(a), (e) of the FAST Act.

[26] Section 72003(c) of the FAST Act.

[27] Section 72003(d) of the FAST Act.

[28] Section 108 of the JOBS Act.

[29] A copy of the report is available here: https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

[30] *See* H.R. Rep. No. 114-279, at 2 (2015).

[31] *See*, *generally*, Keith F. Higgins, Disclosure Effectiveness: Remarks before the American Bar Association Business Law Section Spring Meeting (April 11, 2014), available here: http://www.sec.gov/News/Speech/Detail/Speech/1370541479332.

[32] In contrast, companies with total assets exceeding $10 million and that are not banks or bank holding companies are required to register a class of equity securities if that class has 2,000 record holders or 500 record holders that are not accredited investors. See Section 12(g)(1)(A) of the Exchange Act.

[33] In contrast, a company that is not a bank or bank holding company can de-register a class or suspend reporting with respect to a class only if (i) the class has less than 300 record holders or (ii) the class has less than 500 record holders and the company does not have more than $10 million in total assets. See Sections 12(g)(4) and 15(d) of the Exchange Act and Rules 12g-4 and 12h-3 under the Exchange Act.

[34] Section 85001 of the FAST Act.

[35] *See* 161 Cong. Rec. H5142-5143 (2015) (Statements of Robert Hurt and Steve Womack); *see also* H.R. Rep. No. 114-200, at 2 (2015).

[36] *See* Section II.B of Release 33-9693 (December 18, 2014).

[37] *Id*.

Related Professionals

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