FAST Act eases resale of unregistered securities and adds new accommodations for emerging growth companies: top points

Capital Markets Alert

Corporate Governance Alert

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President Barack Obama has signed into law the Fixing America's Surface Transportation Act (the FAST Act).

Although primarily focused on funding of the nation's transportation infrastructure, the FAST Act also includes some significant changes to the US federal securities laws that are aimed at streamlining capital formation.

Specifically, the FAST Act, signed into law on December 4, introduces a new exemption from the registration requirements of the Securities Act of 1933, as amended, for resales of securities acquired in unregistered offerings, with significant implications for the expanding market in private secondary transactions. In addition, the FAST Act amends the Jumpstart Our Business Startup Act of 2012 (the JOBS Act) by adding new accommodations for emerging growth companies (EGCs) undertaking initial public offerings.

NEW EXEMPTION FOR PRIVATE RESALE OF RESTRICTED AND CONTROL SECURITIES

Section 4(a)(7) of the Securities Act

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The FAST Act amends the Securities Act by adding a new Section 4(a)(7) exempting from the registration requirements of Section 5 the resale of "restricted securities" [1] and "control securities" [2] in transactions that meet specified requirements. Securities that are acquired in a transaction complying with Section 4(a)(7) shall be deemed to have been acquired in a transaction not involving any public offering, and such transaction shall be deemed not to be a distribution for purposes of the statutory underwriter definition in Section 2(a)(11) of the Securities Act.

To benefit from the new Section 4(a)(7) exemption, a resale transaction must satisfy the following requirements:

- Each purchaser must be an accredited investor.
- Neither the seller, nor any person acting on the seller's behalf, may use general solicitation or general advertising
- If the issuer is neither an SEC reporting company nor exempt from reporting pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"), the seller and a prospective purchaser must obtain from the issuer (and the seller must in all cases make available to a prospective purchaser) reasonably current information, including:
  - the capitalization of the issuer as of the end of the issuer's most recent fiscal year
  - a statement of the nature of the business of the issuer, which will be presumed reasonably current if it as of 12 months before the transaction date
  - a list of the issuer's officers and directors
  - information about any registered broker, dealer or other agent that will receive, directly or indirectly, any commission or other fees in connection with the sale of the securities
  - the issuer's most recent balance sheet and profit and loss statements for such part of the two preceding fiscal years as the issuer has been in operation, which shall be prepared in accordance with GAAP or (in the case of a foreign issuer) International Financial Reporting Standards as issued by the International Accounting Standards Board and
  - if the seller is an affiliate, a statement regarding the nature of the affiliation together with a certification by the seller that it has no reasonable grounds to believe that the issuer is in violation of the federal securities laws or regulations.
- Neither the seller, nor any person that receives remuneration or a commission for participating in the offer or sale of the securities, including solicitation of purchasers, is subject to a "bad actor" disqualification under Rule 506(d)(1) of Regulation D under the Securities Act or a statutory disqualification under Section 3(a)(39) of the Securities Exchange Act of 1934, as amended
- The issuer is engaged in business, is not in the organizational stage or in bankruptcy or receivership, and is not a blank-check, blind pool or shell company that has no specific business plan or purpose or has indicated that its primary business plan is to engage in a merger or combination of the business with an unidentified person and
- The transaction is not with respect to a security that constitutes an unsold allotment to, or subscription or participation by, a broker or dealer as an underwriter of the security or a redistribution.

Securities acquired in reliance on Section 4(a)(7) will be "restricted securities" subject to transfer restrictions and "covered securities" under Section 18(b)(4) of the Securities Act (by virtue of which securities sold in such transactions will be exempt from compliance with state "blue sky" laws).

Impact of Section 4(a)(7)

Section 4(a)(7) significantly eases the ability of investors to resell securities acquired in unregistered offerings, particularly in situations where other resale exemptions from the registration requirements of the Securities Act may be unavailable, burdensome to comply with or provide less certainty.

Section 4(a)(7) distinguished from Rule 144

Rule 144 is a safe harbor permitting resales by non-affiliates of restricted securities that have been held for a minimum of six months (if the issuer is an SEC registrant that is current in its periodic reporting obligations) or one year (in other cases). The Rule 144 safe harbor also permits resales of control securities by affiliates of the issuer, subject to compliance with requirements as to the amount sold, the manner of sale and notification to the SEC, whether or not such securities are also "restricted securities". Once sold in a Rule 144 transaction, the

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securities that were the subject of that transaction are no longer restricted securities in the hands of the acquiror.

The main distinctions between Section 4(a)(7) and Rule 144 are that Section 4(a)(7) will (i) permit non-affiliates to resell securities acquired in unregistered offerings sooner than six months after the date of acquisition and (ii) allow affiliates to resell such securities without regard to the volume, manner of sale and SEC notification requirements that apply under Rule 144. However, as noted above, securities resold in reliance on Section 4(a)(7) will be restricted securities in the hands of the buyer and therefore may not subsequently be resold absent registration or an exemption therefrom.[3] As such, Section 4(a)(7) transactions are likely to be executed at a discount as compared to resales under Rule 144 or in the public markets.

Section 4(a)(7) distinguished from Rule 144A

Rule 144A is a safe harbor for resales to investors reasonably believed by the seller to be "qualified institutional buyers," or QIBs, [4] of eligible securities issued in unregistered offerings. Because it is not available for securities that would, when issued, be "fungible" (as defined in Rule 144A) with securities listed on a national securities exchange (such as common stock), Rule 144A is relied on principally for offerings of fixed-income securities. In such transactions, the issuer offers and sells the securities to its placement agent pursuant to Section 4(a)(2), with the subsequent resale by the placement agents to QIBs exempted from registration pursuant to Rule 144A. Securities resold in reliance on Rule 144A are restricted securities in the hands of the buyer and therefore may not subsequently resold absent registration or an exemption therefrom.

Section 4(a)(7) allows resale to a broader universe of investors than Rule 144A, insofar as it is an exemption for resales to accredited investors, whereas Rule 144A is limited to QIBs. Moreover, unlike Rule 144A, Section 4(a)(7) is not limited by its terms to resales of securities that are not fungible with securities listed on a national securities exchange.

Section 4(a)(7) distinguished from "Section 4(a)(1½) exemption"

In situations where the resale safe harbors under Rule 144 and Rule 144A are not available, holders of restricted securities and control securities have relied on the so-called "Section 4(a)(1½) exemption" to conduct private resales of those securities. This is a resale procedure that has evolved, outside of the SEC's regulatory framework, through market practice. The "4(a)(1½)" resale procedure is relied on for, among others, placements to institutional accredited investors made on a side-by-side basis with Rule 144A offerings to QIBs.

The "4(a)(1½)" sale procedure replicates several key features of an issuer private placement under Section 4(a)(2). In particular:

- The overall number of buyers is limited
- The seller does not engage in any general advertising or general solicitation
- The buyer certifies in writing its sophistication, access to information, and non-distributive intent and acknowledges that the securities have not been registered with the SEC and may not be resold in the United States without registration or an exemption therefrom
- The buyers agrees to be subject to the same legending and stop-transfer restrictions as those by which the seller is bound
- The buyer agrees to deliver to the issuer a legal opinion that the transaction is not required to be registered with the SEC
- The seller provides the buyer with the type of information about the issuer and the securities resold that is provided in an issuer's initial private placement of the securities and
- There is a large minimum denomination with respect to the securities acquired.

Assuming compliance with these procedures, securities practitioners generally are comfortable concluding that the seller is not a statutory underwriter within the meaning of Section 2(a)(11) of the Securities Act.

A number of commenters have suggested that Section 4(a)(7) codifies the "Section 4(a)(1½) exemption." While Section 4(a)(7) and the "Section 4(a)(1½) exemption" may overlap to a certain extent, there are important differences. *Firs*t, in situations involving reporting companies or Rule 12g3-2(b) exempt foreign issuers, Section

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4(a)(7) makes clear that no current information needs to be provided by the seller to the prospective purchaser. *Second*, as long as neither the seller nor anyone acting on its behalf has engaged in general advertising or general solicitation, the seller may resell in reliance on Section 4(a)(7) without regard to whether the issuer or other sellers have engaged in such activity. *Third*, delivery of a legal opinion by the buyer should not be needed for a Section 4(a)(7) resale. Finally, Section 4(a)(7) pre-empts the registration and qualification requirements under state "blue sky" laws, whereas sellers undertaking "Section 4(a)(1½)" transactions must pay attention to those state rules.

ENHANCEMENTS TO JOBS ACT

The FAST ACT introduces a number of enhancements to the JOBS Act, as follows:

Public filings for EGCs in an IPO

The JOBS Act gave EGCs the flexibility to submit their IPO registration statements and any amendments for confidential review by the SEC as long as they publicly file the initial confidential submission and all related amendments with the SEC at least 21 days before any road show. The FAST Act amends Section 6(e)(1) of the Securities Act to reduce the 21-day requirement to 15 days.

Grace period for EGCs

The FAST Act amends Section 6(e)(1) of the Securities Act to permit an issuer that qualified as an EGC at the time it confidentially submitted or publicly filed a registration statement for review with the SEC, but ceases to be an EGC during the IPO process, to continue to be treated as an EGC until the earlier of the date on which the issuer consummates the IPO or the end of the one-year period beginning on the date the issuer ceases to be an EGC.

Omission of financial information for certain historical periods

The FAST Act amends Section 102 of the JOBS Act by requiring the SEC, by January 3, 2016, to revise the instructions to Forms S-1 and F-1 to permit, and effective January 3, 2016 permits, an EGC that filed or confidentially submitted a registration statement to omit financial information for historical periods that would otherwise be required by Regulation S-X at the time of filing or submission, provided that:

- The omitted financial information relates to a historical period that the issuer reasonably believes will not be required to be included in the Form S-1 or F-1 at the time of the contemplated offering and
- Prior to the issuer distributing a preliminary prospectus to investors, the registration statement is amended to include all financial information required by Regulation S-X as of that date.

This change to Forms S-1 and F-1 effectively permits EGCs to exclude historical financial statements that will be superseded by more recent financial statements during the SEC review process. It should significantly reduce IPO costs as EGCs will not have to devote resources to the preparation and audit of financial statements and accompanying disclosures if they reasonably believe that, during the SEC review process, those financial statements will be replaced in the registration statement by financial statements for more recent fiscal years.

OTHER FAST ACT AMENDMENTS TO THE SECURITIES LAWS

Simplified Regulation S-K disclosure requirements

The FAST Act requires the SEC, within 180 days of its enactment, to revise Regulation S-K to reduce, scale or eliminate the burden on EGCs, accelerated filers, smaller reporting companies and other smaller issuers and eliminate provisions of Regulation S-K that are duplicative, overlapping, outdated or otherwise unnecessary.

The FAST Act further requires the SEC to (i) undertake a study on Regulation S-K to determine how to modernize and simplify Regulation S-K in a manner that reduces all costs and burdens on issuers while still providing all material information, (iii) emphasize a company by company approach that eliminates boilerplate language and static requirements and (iii) evaluate methods of information delivery and presentation that discourage repetition and the disclosure of immaterial information. By November 28, 2016, the SEC shall submit a report to the Congress regarding its filings and detailing recommendations on modernizing and simplifying Regulation S-K and issue proposed rules to implement the recommendations included in the report.

The SEC staff has already been engaged in a process to simplify Regulation S-K disclosure requirements. The above-mentioned provisions of the FAST Act suggest that the Congress desires to step up (or at least maintain) the pressure on the SEC to complete that process.

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Form S-1 forward incorporation

The FAST Act requires the SEC, within 45 days of its enactment, to revise Form S-1 to permit smaller reporting companies to incorporate by reference in a registration statement on Form S-1 any SEC filings made after the effective date of the Form S-1. Forward incorporation will be primarily beneficial to smaller issuers that are required to use Form S-1 as a "resale shelf" as such issuers will no longer be required to file post-effective amendments to keep their registration statements current.

Summary page in Form 10-K

The FAST Act requires the SEC, within 180 days of its enactment, to issue regulations permitting issuers to include a summary page within Form 10-K, provided that each item on the summary page includes a cross-reference (by electronic link or otherwise) to the related material in Form 10-K.

Loosened Exchange Act thresholds for savings and loan holding companies

The FAST Act modifies the provisions of the JOBS Act, which had amended the threshold triggering Exchange Act registration under Section 12(g) for "banks and bank holding companies," by applying the same threshold to "savings and loan holding companies." The FAST Act expands the scope of Section 12(g)(1)(B) to include "savings and loan holding companies" (as defined in Section 10 of the Home Owners' Loan Act). As a result, savings and loan holding companies and banks will be treated the same, and will not be required to register under the Exchange Act unless they have, at the end of the fiscal year, at least $10 million in assets and a class of equity securities held of record by at least 2,000 persons.

Please also feel free to contact Christopher Paci or your DLA Piper lawyer with any questions about how these rule changes may impact your planned transactions.

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[1] Securities sold by an issuer in a transaction not involving a public offering are deemed to be "restricted securities."

[2] "Control securities" are securities held by an affiliate of the issuer; such securities may include securities of the issuer acquired in the open market.

[3] A buyer of securities in a Section 4(a)(7) transaction should, in any subsequent Rule 144 resale, be permitted to tack the holding period of the seller pursuant to Rule 144(d)(1). Presumably the SEC will confirm this through an amendment to Rule 144(a)(iii) or the issuance of a Compliance and Disclosure Interpretation. Tacking of holding periods is not permitted, however, where the seller has purchased from an affiliate of the issuer (which will trigger the commencement of a new holding period).

[4] The definition of QIB in Rule 144A(a)(1) identifies specific categories of investors that qualify as QIBs. In general terms, QIBs are institutions that own or invest on a discretionary basis at least $100 million of securities.

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