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While You Were Sleeping…New Highway Act Improves the Capital Raising On-Ramp

On Dec. 4, 2015, President Obama signed into law the Fixing America's Surface Transportation Act, referred to as the "Fast Act," a highway and transit project funding bill. Tucked into the last 45 pages of this 1,300 plus page bill are several significant modifications to the federal securities laws that should prove beneficial to companies seeking to go public, already public Emerging Growth Companies[1] (EGCs), as well as holders of restricted securities. Following is a summary of the key provisions of the Fast Act that relate to federal securities laws.

Greater Flexibility for Initial Public Offerings by Emerging Growth Companies

The Fast Act contains several provisions that amend the 2012 Jumpstart Our Business Startups Act, or JOBS Act, in ways that will provide additional benefits for a company that desires to undertake an initial public offering (IPO) and that qualifies as an EGC under the JOBS Act.

- *Faster On-Ramp to the Road Show*. Effective immediately, the Fast Act reduces the number of days that an EGC's registration statement must be publicly filed before the company may commence a road show for its IPO. The JOBS Act provides an EGC the opportunity to submit to the Securities and Exchange Commission (SEC) a draft registration statement (DRS) for its IPO on a confidential basis. Although the JOBS act also allows an EGC to engage

[1] The JOBS Act defines an EGC as any issuer that had total annual gross revenues of less than $1 billion (adjusted for inflation every five years) during its most recently completed fiscal year, other than an issuer that completed an IPO on or before Dec. 8, 2011. An EGC on the first day of its fiscal year will no longer qualify as an EGC upon the earliest of:

- the last day of its fiscal year following the fifth anniversary of the first sale of its common equity securities in a public offering;
- the last day of a fiscal year during which it had total annual gross revenues of $1 billion (adjusted for inflation every five years);
- the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or
- the date on which it is deemed to be a "large accelerated filer" (a company that has been public for at least twelve months, has filed one Form 10-K, and has a public float of at least $700 million).

in limited "test the waters" communications before filing its registration statement on a publicly-available basis, ECGs had to wait at least 21 days after the public filing before commencing the "road show" for the offering. The Fast Act reduces the minimum number of days to 15, providing EGCs with greater flexibility in deciding when to file publicly. This should further encourage the use of the DRS, which permits an EGC to clear SEC comments before publicly exposing its otherwise confidential financial and operational information to the public (and its competitors) and also further facilitates the increasingly common "dual track" strategy to achieve a liquidity event for a privately held company in which an IPO is pursued contemporaneously with a sale of the company.

- *Smoother Exit Ramp From the EGC Lane*. The Fast Act also provides a grace period for companies that lose their status as an EGC after filing a registration statement for an IPO but before completing the offering. Previously, if an EGC lost its status as such during the SEC review process for its IPO, it immediately lost a variety of JOBS Act benefits otherwise applicable to an EGC, including the opportunity to continue to file draft registration statements on a confidential basis and the right to include two rather than three years of audited financial statements and reduced executive compensation disclosure in its registration statement. Now, such a company is permitted to continue to take advantage of those provisions until the completion of its IPO (or until one year after ceasing to qualify as an EGC, if sooner). This change became effective upon adoption of the Fast Act.

- *Old Roads Can Be Avoided.* The FAST Act requires the SEC to amend Forms S-1 and F-1 to provide that financial information for periods otherwise required to be presented may be omitted from the filing if an EGC reasonably believes that it will not be required to include the omitted financials for such periods at the time of the planned offering. In other words, if by the time of the actual offering a fiscal period would become too old to be required in the prospectus, it need not be included in the initial registration statement. Prior to distributing a preliminary prospectus to any investors, however, the EGC would be required to amend the registration statement to include any financial information required at that time. The Fast Act gives the SEC 30 days to amend Forms S-1 and F-1 to make this change, and allows issuers to omit financial information in accordance with the new law effective 30 days after enactment of the Fast Act. The SEC has already provided guidance on this provision that makes clear that interim periods may not be omitted; rather the relief only applies to the oldest fiscal periods that will become stale during the registration process.

A Shorter Road to Current Information

The Fast Act directs the SEC to revise Form S-1 within 45 days after the date of the bill to permit a smaller reporting company (generally, public companies with a public float of less than $75 million) to incorporate by reference in a Form S-1 registration statement any documents that the registrant files with the SEC after the effective date of the registration statement. This "forward incorporation by reference" will provide smaller reporting companies that are not eligible to file short-form registration statements on Form S-3 the ability to automatically update an effective Form S-1 through the filing of a Form 10-K, 10-Q, or 8-K under the Securities Exchange Act of 1934, as amended (Exchange Act). This benefit, currently only available to Form S-3 registration statements, will allow smaller reporting companies to use a Form S-1 for certain continuous offerings. This change should facilitate public offerings of convertible securities, warrants and other options, as well as market sales by selling shareholders, without the need to file a prospectus supplement or a post-effective amendment to the Form S-1 each time that the issuer files a report under the Exchange Act.

Removing Road Blocks For SEC Reports

The Fast Act requires the SEC to issue regulations to permit Exchange Act reporting companies to include a summary page in their annual reports on Form 10-K, provided that the summary page includes a cross-reference to the related information in the body of the report. The Fast Act also requires the SEC to take all actions to further scale or eliminate the requirements of Regulation S-K, which contain most of the disclosure rules applicable to registration statements under the Securities Act of 1933, as amended (Securities Act), and periodic reports under the Exchange Act, in order to reduce the burden on all categories of filers, while still providing all material information to investors, and to eliminate duplicative, outdated, or otherwise unnecessary provisions. The SEC has 180 days from the enactment of the Fast Act to implement each of these requirements. The SEC is also required to undertake a study of Regulation S-K and to determine how to best modernize and simplify its requirements, and to issue a report of its findings to Congress within 360 days from the enactment of the Fast Act.

A Clear Road for Private Resales

The Fast Act also includes a statutory exemption from SEC registration requirements for resales of securities by persons other than the issuer or any of its subsidiaries. U.S. federal securities laws require the registration of securities before they can be offered or sold except as permitted by one or more of a limited number of existing exemptions. The new exemption, adopted as a new Section 4(a)(7) of the Securities Act, removes uncertainty that has surrounded private resales of securities that were issued in private placements. Heretofore, such resales were exempted under a practice developed by securities lawyers informally known as the "Section 4(1-1/2) exemption." Under this approach, which relied upon interpretations of the Securities Act and case law guidance rather than an express exemption in the law itself, private resales were viewed as exempt if the securities were resold in a transaction that resembled a private placement by an issuer under Section 4(a)(2) of the Securities Act.

The new exemption covers a private resale of outstanding securities by a person other than an issuer or any of its subsidiaries. It is conditioned on several requirements:

- Each purchaser must be an "accredited investor" (a term defined in Regulation D under the Securities Act encompassing financially sophisticated or wealthy investors with a reduced need for the protections offered by the registration process).

- Neither the *seller nor anyone acting for the seller* may engage in general solicitation or advertising to offer or sell the securities.

- The seller and a prospective purchaser designated by it must obtain from the issuer (which is required to provide such information) certain minimum information regarding the issuer and the securities, including two years of GAAP-compliant financial statements. This information requirement does not apply, however, to an issuer that is either a reporting company under the Exchange Act or exempt from such reporting requirements under Rule 12g3-2(b) under the Exchange Act. Under that rule, an issuer is exempt from SEC reporting requirements if it is a foreign private issuer with securities listed for trading on a non-US exchange and that is already required to provide in English, either on its website or through an electronic information delivery system, information generally available in its primary trading market.

    - In addition, if the seller is a control person with respect to the issuer, it must explain the nature of its affiliation and certify that it believes that it has "no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations."

- Neither the seller nor any person remunerated for participating in the offer triggers a "bad actor" disqualification (for example, having a criminal conviction and a link to the issuer) under Regulation D under the Securities Act or is subject to disqualification under Section 3(a)(39) of the Exchange Act.

- The security has been authorized and outstanding for at least 90 days.

Securities resold under the new exemption continue to be restricted securities and may not be resold by the new holder without registration or an available exemption. On the brighter side, resales under new Section 4(a)(7) are not subject to state securities laws (Blue Sky laws) which are now pre-empted by the U.S. federal exemption.

In essence, the new statutory exemption means that holders of privately placed securities may sell them to accredited investors without having to comply with SEC registration requirements provided that all conditions of the exemption are satisfied, including avoiding any general solicitation or advertising regarding the proposed sale and satisfying the informational requirements.

The new 4(a)(7) exemption for private resales is expected to encourage continued development of secondary markets (including some Web enabled trading platforms) for trading privately placed securities among accredited investors. This should increase liquidity for private and early stage investors and facilitate capital raising by private companies. Although similar transactions have been executed on the basis of the 4(1-1/2) exemption for years, the reasoned approach required substantial fact-specific legal analysis and involved an inherent level of uncertainty that may have prevented the establishment of a wider market among accredited investors.

On balance, the new Fast Act securities provisions should immediately smooth the capital raising road for many companies accessing the capital markets. In the longer term, the SEC's mandate to streamline its disclosure requirements may have even broader effects on a broad spectrum of public companies.

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