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FAST Act Creates a New Exemption for the Resale of Securities and Eases Certain Regulations for Emerging Growth Companies and Smaller Issuers

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January 7, 2016

The Fixing America's Surface Transportation Act (FAST Act) was signed into law by President Obama on December 4, 2015. Though the bulk of the FAST Act relates to infrastructure funding, it includes a number of significant amendments to federal securities laws, most notably the creation of a new exemption for the resale of restricted securities as well as easing certain regulations and reporting requirements for emerging growth companies and smaller issuers.

Resale Exemption Under Section 4(a)(7) of the Securities Act

The FAST Act adds a new Section 4(a)(7) to the Securities Act of 1933, as amended (the "Securities Act"), creating an additional exemption for the resale of restricted securities. In some respects, Section 4(a)(7) is a codification of the so-called "4(a)(1½)" exemption, which is not formally established in federal securities laws or regulations, but is generally accepted by securities law practitioners and has been recognized by the Securities and Exchange Commission (the "SEC") and various federal courts.

Under Section 4(a)(7), the exemption from registration for resale will apply if:

- Each purchaser is an "accredited investor" under Section 501(a) of the Securities Act (for individuals, this requires, generally, annual income of greater than $200,000 per year individually or $300,000 with the investor's spouse, or a net worth exceeding $1 million not including the investor's primary residence);
- Neither the seller nor any person acting on the seller's behalf engages in any form of general solicitation;
- If the issuer of the securities is not an SEC reporting company or entitled to certain exemptions as a foreign issuer or government, the seller must make certain information regarding the issuer and the securities available to the purchaser, including the issuer's name and address, information about the security offered and the capitalization of the issuer, information about the issuer's transfer agent, the nature of the issuer's business, the issuer's officers and directors,

information about any broker or dealer involved, the issuer's balance sheet and profit and loss statements for the two preceding years and certain other financial information, and if the seller is a control person of the issuer, a statement regarding the nature of the seller's affiliation and a certification that it has no reasonable grounds to believe that the issuer is in violation of securities laws.

- The seller is not the issuer or a direct or indirect subsidiary of the issuer;
- The "bad actor" disqualifications under Rule 506 of the Securities Act or Section 3(a)(39) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), do not apply to the seller or any person that will be compensated in connection with the transaction;
- The issuer is not a blank check, blind pool or shell company or a special purpose acquisition company, or in bankruptcy or receivership;
- The transaction does not relate to a broker-dealer's or underwriter's unsold allotment; and
- The security involved is part of a class that has been authorized and outstanding for at least 90 days.

After restricted securities are sold pursuant to Section 4(a)(7), they will still deemed to be "restricted" and therefore restrictive legends may not be removed as typically would be the case under a sale pursuant to Rule 144 of the Securities Act. However, Section 4(a)(7) is not subject to many of the restrictions under Rule 144, such as a required holding period, or a volume limitation on sales by affiliates of the issuer.

Securities sold pursuant to Section 4(a)(7) will be deemed to be "covered securities" under Section 18(b)(4)(D) of the Securities Act, regardless of whether the issuer is a public or private company, and therefore any state "blue sky" registration requirements are preempted. Accordingly, such securities will not need to be qualified or registered under state securities laws to use this exemption.

Codification of "4(a)(1½)" Exemption

The "4(a)(1½)" exemption is a sort of combination of the concepts of Sections 4(a)(1) and 4(a)(2) of the Securities Act that has developed over time to permit the resale of restricted securities that is not specifically permitted under other laws or regulations, such as Rule 144 of the Securities Act. Section 4(a)(1) of the Securities Act provides an exemption from registration for "transactions by a person other than an issuer, underwriter, or dealer." However, under Section 2(a)(11) of the Securities Act, any person that has a view to "distribution" of securities is deemed to be an underwriter, and affiliates of the issuer are also generally deemed to be underwriters for this purpose, so such persons are not entitled to use Section 4(a)(1) to resell securities. Section 4(a)(2) provides an exemption for transactions "by an issuer not involving any public offering." The logic behind the "4(a)(1½)" exemption is that if a sale is not a "public offering" (thus would be permissible if the seller was the issuer under 4(a)(2)), then such a sale should not be deemed to be a distribution that would be cause the seller to be an "underwriter," and therefore the resale is permissible under 4(a)(1). Accordingly, securities law practitioners have generally taken the position that a resale of securities by a person other than the issuer is permissible if it is not in connection with a public offering of such securities.

Over time, certain standards have been recognized by practitioners for when a sale is not deemed to be a "public offering" and thereby permissible under the 4(a)(1½) exemption, though there has

always been an element of uncertainty as this rule was not formally recognized under law and there was no “safe harbor” (such as under Rule 144 or Rule 506) providing a “bright line” rule for when such sales are permitted. The new Section 4(a)(7) helps remove this uncertainty and generally codifies the standards under the 4(a)(1½) exemption that have been followed by practitioners. Furthermore, Section 4(a)(7) has the added benefit of stating that securities resold under this rule are “covered securities,” thereby avoiding the requirement of registering or otherwise qualifying such securities under state blue sky laws.

Changes for Emerging Growth Companies

A new category of “Emerging Growth Companies” (“ECGs”) was created under the JOBS Act in 2012. The FAST Act modifies the reporting requirements for ECGs in certain circumstances, including the following:

- *Shortening Timing Requirement for Initial Public Filing of S-1.* Under the JOBS Act, ECGs are permitted to confidentially file an initial public offering (“IPO”) registration statement, which does not need to be publicly disclosed until 21 days before the road show. The FAST Act shortened this time period to 15 days.

- *Grace Period for ECG Status.* The FAST Act provides a grace period for issuers who are ECGs at the time they file IPO registration statements, but cease to meet the ECG requirements during the review process. Such issuers may continue to be treated as ECGs until the earlier of (a) the date on which it consummates the IPO, or (b) the end of the one year period on which it ceased to meet the ECG requirements.

- *Omission of Certain Historical Financial Statements*. When filing IPO registration statements, ECGs will be able to omit historical financial information that would otherwise be required to be filed under Regulation S-X as long as (a) the issuer does not reasonably believe that such financial information will be required at the time of the completed offering, and (b) prior to distributing the preliminary prospectus, the registration statement includes all financial information required under Regulation S-X as of the date of the latest amendment to the registration statement. As the SEC review process can take months for an IPO, this change could help ECGs reduce offering costs as they will not be required to prepare and audit such financial statements for earlier versions of the registration statement if they are unlikely to be required when the preliminary prospectus is ultimately distributed.

The first two amendments above became effective on December 4, 2015 and the third became effective on January 3, 2016.

Modifications to Regulation S-K Disclosure and Form 10-K

By June 1, 2016, the SEC is required to revise Regulation S-K to reduce the burden on ECGs, smaller reporting companies, accelerated filers, and other small issuers, and to eliminate duplicative, overlapping, outdated, or unnecessary provisions in the rules. The SEC must conduct a study of Regulation S-K to determine how to best modernize and simplify the disclosure in Regulation S-K and reduce the costs and burdens to issues, eliminate boilerplate language and static requirements, and discourage repetition and disclosure of immaterial information. Furthermore, the SEC must submit a report to Congress with the findings of such study along with recommendations on how to modernize and simplify Regulation S-K and to improve the disclosure documents, along with proposed rules to implement such recommendations.

The SEC is also required to issue regulations by June 1, 2016 permitting issuers to include a summary report with their annual reports on Form 10-K, so long as such summary pages include cross references to the applicable material in the report.

Forward Incorporation in Form S-1 by Smaller Reporting Companies

By January 18, 2016, the SEC is required to revise Form S-1 so that smaller reporting companies (generally, issuers with a public float less than $75 million) will be able to incorporate by reference Exchange Act reports filed after the effective date of the Registration Statement on Form S-1. Previously, Form S-1 did not permit any issuers to incorporate future filings by reference, which is permitted on other registration statements, such as Registration Statements on Form S-3, for which the issuer must meet certain eligibility requirements. Accordingly, to keep an S-1 “current” (as would be required for a resale shelf registration statement), the issuer would have to file post-effective amendments subject to SEC review, which can be costly and time consuming.

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