MAYER·BROWN

Legal Update
December 16, 2015

US Capital Markets Implications of the FAST Act

The Fixing America's Surface Transportation Act (FAST Act) was signed into law on December 4, 2015, and contains several securities law-related provisions, the most notable of which are those that:

- Give more flexibility to emerging growth companies (EGCs);
- Provide a new private resale exemption along the lines of the court-created "Section 4(1½) exemption";
- Provide for the inclusion of summary disclosure in Form 10-K reports;
- Allow forward incorporation by reference in Form S-1 of filed documents by smaller reporting companies;
- Clarify the Securities Exchange Act of 1934 registration thresholds for savings and loan companies; and
- Require that the Securities and Exchange Commission (SEC) assess and make recommendations on the modernization and simplification of disclosure requirements in Regulation S-K.

The changes are primarily enhancements to the Jumpstart Our Business Startups Act (JOBS Act). Some provisions take effect immediately or in the near future, while others will require SEC rulemaking before they can be implemented. In addition, the requirement for the SEC to assess and make recommendations to modernize and simplify Regulation S-K is a long-term project with deadlines over the next two years.

Immediate and Near-Term Impact of the FAST Act

CHANGES AFFECTING EMERGING GROWTH COMPANIES

- Under the JOBS Act, an EGC could not commence a road show until any registration statement and related amendments submitted for confidential review with the SEC had been publicly filed with the SEC for 21 days.[1] The FAST Act reduces this period to 15 days, effective as of December 4, 2015.[2] The staff of the SEC's Division of Corporation Finance (the Staff) has taken the position that EGCs with initial public offerings (IPOs) pending before the FAST Act became law may take advantage of this provision, and if an EGC does not conduct a road show, the confidential submissions must be filed at least 15 days before the effectiveness of the registration statement.[3]
- Under the FAST Act, an issuer that ceases to be an EGC after the time it submits a confidential registration statement (or publicly files a registration statement) will continue to have EGC status through the earlier of the date it consummates the IPO or one year after it ceases to be an EGC.[4] This provision is effective as of December 4, 2015, and the Staff has taken the position that EGCs with registration statements pending at that time may rely on this provision.[5]
- Starting 30 days after enactment of the FAST Act (i.e., January 3, 2016), an EGC using

Forms S-1 or F-1 may omit from the filing (or confidential submission) historical financial information required by Regulation S-X if the omitted financial information relates to a period the EGC reasonably believes will not be required in the filing at the time of the contemplated offering, and so long as the issuer amends the registration statement prior to distributing a preliminary prospectus to include all financial information required at the time of the amendment. The SEC has been directed to revise the general instructions to Form S-1 and F-1 to conform to this change.[6] The Staff has announced that it will not object if EGCs rely on this provision before the 30-day effectiveness period has expired.[7]

For example, a calendar year-end EGC that submits or files a registration statement in December 2015 with the reasonable expectation that it would commence its offering in April 2016 (at which time annual financial statements for 2015 and 2014 would be required) may omit its 2013 annual financial statements from the December filing.

Interim financial statements. In a compliance and disclosure interpretation (C&DI) issued on December 10, 2015,[8] the Staff confirmed that for purposes of this provision of the FAST Act, interim financial information "relates" to both the interim period and any longer period (either interim or annual) into which it has been, or will be, included. Accordingly, an EGC may not omit interim financial statements for a period that will be included within required financial statements covering a longer interim or annual period at the time of the offering, even though the interim financial statements for the shorter period will not be presented separately at that time. With respect to the example above, the Staff stated that although such an issuer may omit its 2013 annual financial statements from the December filing, the issuer "may not omit its nine-month 2014 and 2015 interim financial statements because those statements include financial information that relates to annual financial statements that will be required at the time of the offering in April 2016."

Financial statements of other entities. In another C&DI issued on December 10, 2015,[9] the Staff indicated that an EGC issuer may omit financial statements of other entities from its filing or submission if it reasonably believes that those financial statements will not be required at the time of the offering. The Staff explained that the issuer:

> [C]ould omit financial statements of, for example, an acquired business required by Rule 3-05 of Regulation S-X if the issuer reasonably believes those financial statements will not be required at the time of the offering. This situation could occur when an issuer updates its registration statement to include its 2015 annual financial statements prior to the offering and, after that update, the acquired business has been part of the issuer's financial statements for a sufficient amount of time to obviate the need for separate financial statements.

The Staff included a reference to Section 2030.4 of the Division of Corporation Finance's Financial Reporting Manual at the end of this C&DI.

Practical considerations for EGC securities offerings. The changes to the financial information requirements should result in cost savings for EGCs because they will no longer need to pay for an audit for a fiscal year that would have been required at the time of the initial filing if that fiscal year will not have to be included in the audited financial statements at the time the registration statement is expected to become effective. Similarly, the EGC may not have to prepare unaudited financial statements for a quarterly period that will not appear in the

final prospectus and that does not otherwise relate to the financial statements for the periods presented in the final prospectus.

The shortening of the gap between the confidential SEC filing and the road show potentially could allow an EGC to bring its offering to market before conditions change. To take advantage of the shortened timing, some EGCs might need to accelerate their process for obtaining information and agreements from securityholders who are not directly involved in the offering process.

Finally, because of the ability to remain an EGC for up to one year after otherwise losing EGC status, a company that is currently an EGC can be confident it is not wasting time and money preparing a registration statement using the EGC disclosure rules and confidential filing procedures even if there is a possibility it will exceed the EGC thresholds before its public offering is completed.

PRIVATE RESALE EXEMPTION

The FAST Act adds Section 4(a)(7) to the Securities Act. This new section exempts from registration the private resale of restricted securities to accredited investors (as defined under Rule 501(a) of Regulation D), subject to the following limitations:[10]

- The seller can be neither the issuer nor a direct or indirect subsidiary of the issuer;
- Neither the seller nor anyone acting on the seller's behalf may offer or sell the securities using any form of general solicitation or general advertising;
- Neither the seller nor any person that has been or will be paid (directly or indirectly) for their participation in the offer or sale is subject to events described under the "bad actor" disqualification provisions of Rule 506(d)(1) of Regulation D or "statutory disqualification" under Section 3(a)(39) of the Exchange Act;
- The issuer must be engaged in business, must not be at the organizational stage or in bankruptcy, and must not be a blank check, blind pool or shell company that has no specific business plan or that has as its primary business plan the intention to be an acquisition company;
- The securities may not be part of a broker-dealer's unsold allotment or subscription as an underwriter of the securities; and
- The securities must be of a class that has been authorized and outstanding for at least 90 days before the transaction date.

In addition, if the issuer is not a reporting company, is not exempt from reporting under Rule 12g3-2(b) or is not a foreign government eligible to register securities under Schedule B, the seller must obtain for the purchaser by request to the issuer the following information, which must be reasonably current:

- Certain information about the issuer, including its name (and any predecessor's name), the address of principal executive offices, the names of officers and directors, the name and address of the transfer agent, a statement of the nature of the issuer's business (which is deemed to be reasonably current if made within 12 months of the transaction date) and the names of any brokers, dealers or agents to be paid a commission in connection with the transaction;
- The title and class of the securities, their par or stated value, and the total number or amount outstanding as of the issuer's most recent fiscal year;
- The issuer's most recent balance sheet and profit and loss statement and similar financial statements for the two preceding fiscal years (or such part of which the issuer has been in operation) prepared in accordance with GAAP or IFRS (for foreign private issuers). Such financial statements are presumed to be reasonably current if (i) in the case of the

balance sheet, it is as of a date less than 16 months before the transaction date and (ii) in the case of the profit and loss statement, it is for the 12 months preceding the date of the issuer's balance sheet. If the balance sheet is not as of a date less than six months before the transaction date, it must be accompanied by additional statements of profit and loss for the period from the date of such balance sheet to a date not less than six months before the transaction date; and

- If the seller is a control person with respect to the issuer, a brief statement regarding the nature of the affiliation and a certificate that the seller has no reasonable grounds to believe that the issuer is in violation of securities laws or regulations.

The securities sold in compliance with these requirements are deemed to be acquired in a transaction not involving a public offering and remain restricted securities. A compliant transaction is deemed not to be a distribution for purposes of determining whether the seller is an underwriter under Section 2(a)(11). The securities are "covered securities" for blue sky law purposes.[11]

Practical considerations of the new private resale exemption. Before the FAST Act, holders of restricted or control securities typically had limited options to divest of such securities. Among their options were the following:

- Await an IPO or other offering in which the securities would be registered;
- Sell under Rule 144 after applicable holding periods and other requirements have been met;
- Rely on the so-called "Section 4(1½) exemption"—the exemption recognized in judicial precedent but never formally codified, by which transactions are thought to be exempt from registration if the seller is not deemed an "underwriter" for purposes of Section 4(a)(1) and the sale does not involve a public offering along the lines of Section 4(a)(2) and its case law (Section (4)(a)(2) is an exemption only available to issuers—and not other holders—for transactions not involving any public offering, which is defined as sales to a limited number of investors who must be sophisticated and have access to information equivalent to a registration statement); or
- Sell to qualified institutional buyers (QIBs) under Rule 144A, if certain requirements are met.

The FAST Act amendments make clear that Section 4(a)(7) is not meant to be an exclusive exemption or to override other exemptions, including Rule 144, Rule 144A and the Section 4(1½) exemption. Like these other exemptions, Section 4(a)(7) likely offers few advantages when the issuer is not a reporting company because any seller would need the cooperation of the issuer to provide the required information to purchasers.

Accordingly, Section 4(a)(7) is likely to be used when the issuer is a reporting company and:

- A seller holding restricted or control securities desires to sell before the Rule 144 waiting period or other requirements have been satisfied;
- The seller does not want to limit sales to QIBs under Rule 144A or a limited number of sophisticated investors under the Section 4(1½) exemption; and
- Affiliates that want to sell in excess of Rule 144 volume limitations (assuming the SEC does not revise or interpret Rule 144 to apply Section 4(a)(7) resales to the Rule 144 volume limitation).

Because Section 4(a)(7) requires less information be provided to purchasers than is required for resales relying on the Section 4(1½) exemption or Rule 144, it may still offer advantages when a non-reporting issuer is willing to cooperate with the resale by providing

limited information. The Section 4(a)(7) information requirements align with those of Rule 144A, and this alignment could make Section 4(a)(7) useful in "side-by-side" offerings to both QIBs under Rule 144A and accredited investors under Section 4(a)(7), particularly if Section 4(1½) would not be available or would be too restrictive.

Purchasers in private placements should consider whether the purchase agreements and any restrictions on transfer (including legend language) should reflect the availability of Section 4(a)(7) resales and whether the issuer should agree to cooperate with such resales by providing the required information.

SUMMARY DISCLOSURE FOR FORM 10-K

No later than 180 days after enactment of the FAST Act (i.e., on or before June 1, 2016), the SEC must issue regulations allowing issuers to submit a summary page on Form 10-K so long as each item includes a cross-reference by electronic link or otherwise to the related material in the Form 10-K.[12]

Practical considerations of the Form 10-K summary requirements. The Staff has noted that issuers currently are "not prohibited from including a summary in an annual report on Form 10-K provided the summary fairly represents the material information in the report. The FAST Act imposes an additional requirement that each item in the summary must include a cross-reference to material contained in the Form 10-K."[13]

FORWARD INCORPORATION BY REFERENCE FOR SMALLER REPORTING COMPANIES

Prior to the FAST Act, a smaller reporting company using a Form S-1 as a shelf registration statement would be required to keep the Form S-1 current by filing supplements and amendments to incorporate its Exchange Act filings. The FAST Act directs the SEC to revise Form S-1 to permit a smaller reporting company to incorporate by reference documents that the issuer files with the SEC after the effective date of the registration statement, which would eliminate the need to file continuous updates to the Form S-1 filing, essentially giving it some of the functionality of a Form S-3.[14] The SEC is directed to revise Form S-1 within 45 days after the enactment of the FAST Act (January 18, 2016).

Practical considerations of allowing forward incorporation. This provision will enable smaller reporting companies to maintain resale registration statements on Form S-1 without the need to incur the time and cost of preparing prospectus supplements and post-effective amendments. However, it is unlikely that the SEC will be able to propose and adopt the necessary changes to Form S-1 in this time frame. Interested issuers should closely monitor developments in this area to determine when they are able to take advantage of this provision.

REGISTRATION THRESHOLD FOR SAVINGS AND LOAN COMPANIES

The FAST Act makes clear that savings and loan companies will be afforded the same treatment as banks in determining thresholds for registration and the termination of registration under Section 12(g) of the Exchange Act. A savings and loan company is subject to registration once it has total assets of more than $10 million and a class of equity securities held of record by at least 2,000 persons (rather than 500 non-accredited investors), and registration terminates for any class of security once the record holders of such class of security is reduced to fewer than 1,200 persons (rather than 300).[15]

Practical considerations of the registration threshold. The statutory provision was effective upon enactment. In addition, the Staff has indicated that the Division of Corporation Finance "is evaluating the effect of this provision on the Commission's proposal, *Changes to Exchange Act Registration Requirements to Implement Title V and Title VI*

of the JOBS Act, Release No. 33-9693 where the SEC proposed making similar changes to its rules."[16]

Future Developments: Disclosure Modernization and Simplification of Regulation S-K

The FAST Act directs the SEC to revise Regulation S-K (i) "to further scale or eliminate requirements of Regulation S-K, in order to reduce the burden on EGCs, accelerated filers, smaller reporting companies, and other smaller issuers, while still providing material information to investors"; (ii) "to eliminate provisions of Regulation S-K, required for all issuers, that are duplicative, overlapping, outdated or unnecessary"; and (iii) to make other changes not requiring further study under the review described below.[17] The SEC must complete this work no later than 180 days after enactment of the FAST Act (i.e., on or before June 1, 2016).

The SEC must also carry out a study of Regulation S-K in consultation with the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies to, among other things, modernize and simplify the regulation, emphasize a company-by-company approach and discourage repetition and disclosure of immaterial information.[18] Within 360 days after enactment of the FAST Act (i.e., on or before November 28, 2016), the SEC must issue a report of its findings and recommendations to Congress. The SEC must issue proposed rules implementing its recommendations within 360 days after the delivery of the report.

Practical considerations of the disclosure modernization and simplification. It appears that some, if not most, of the work contemplated by these changes is already under way. The SEC delivered a similar report regarding Regulation S-K to Congress in December 2013 as required by the JOBS Act and is currently reviewing the disclosure requirements of Regulations S-K and S-X under its Disclosure Effectiveness Project.

Because some of the directives to the SEC apply to all issuers, public companies should monitor the SEC's progress in this area. Even before it has proposed changes in this regard, the SEC is currently receiving comments from interested persons on possible revisions to Regulations S-K and S-X. However, it is unclear whether the SEC will act on the timetable proposed in the FAST Act. Interested issuers should closely monitor developments in this area to determine whether they are able to take advantage of any changes adopted by the SEC to its existing requirements.

For more information about the topics raised in this Legal Update, please contact the author of this Legal Update, Andrew J. Stanger, at +1 713 238 2702, or any of the following lawyers:

Andrew J. Stanger
+1 713 238 2702
ajstanger@mayerbrown.com

David S. Bakst
+1 212 506 2551
dbakst@mayerbrown.com

John P. Berkery
+1 212 506 2552
jberkery@mayerbrown.com

Robert F. Gray, Jr.
+1 713 238 2600
rgray@mayerbrown.com

Michael L. Hermsen
+1 312 701 7960
mhermsen@mayerbrown.com

Laura D. Richman
+1 312 701 7304
lrichman@mayerbrown.com

Endnotes

[1] Section 6(e)(1) of the Securities Act.

[2] Section 71001.

[3] SEC Announcement, "Recently Enacted Transportation Law Includes a Number of Changes to the Federal Securities Laws," December 10, 2015, available at http://www.sec.gov/corpfin/announcement/cf-announcement---fast-act.html (referred to as the SEC Announcement).

[4] Section 71002, amending Section 6(e)(1) of the Securities Act.

[5] See the SEC Announcement.

[6] Section 71003.

[7] See the SEC Announcement.

[8] Available at http://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm.

[9] Id.

[10] Section 76001.

[11] Section 76001(b), amending Section 18(b)(4) of the Securities Act.

[12] Section 72001.

[13] The SEC Announcement.

[14] Section 84001.

[15] Section 85001, amending Sections 12(g)(1)(B) and (4) of the Exchange Act.

[16] The SEC Announcement.

[17] Section 72002.

[18] Section 72003.