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The Fast Act (Fixing American's Surface Transportation Act)

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

On December 4, 2015, President Obama signed the Fixing American's Surface Transportation Act (the "FAST Act") into law, which included many capital markets/securities-related bills. The FAST Act is being dubbed the JOBS Act 2.0 by many industry insiders. The FAST Act has an aggressive rulemaking timetable and some of its provisions became effective immediately upon signing the bill into law on December 4, 2015.

In July 2015, the Improving Access to Capital for Emerging Growth Companies Act (the "Improving EGC Act") was approved by the House and referred to the Senate for further action. Since that time, this Act was bundled with several other securities-related bills into a transportation bill (really!) – i.e., the FAST Act.

In addition to the Improving EGC Act, the FAST Act incorporated the following securities-related acts: (i) the Disclosure Modernization and Simplifications Act (see my blog HERE); (ii) the SBIC Advisers Relief Act; (iii) the Reforming Access for Investments in Startup Enterprises Act; (iv) the Small Business Freedom and Growth Act; and (v) the Holding Company Registration Threshold Equalization Act.

A number of the provisions in the FAST Act that were not self-executing and effective immediately require SEC rulemaking within 30-45 days. This timeline is not realistic for many reasons, including that it would be impossible to comply with the provisions of the Administrative Procedures Act and its requirements related to proposing rules and receiving comments, in that short period of time, not to mention the realities of the holiday season schedule. However, I do expect a quick turnaround from the SEC on drafting, publishing and enacting final rules.

On December 10, 2015, the SEC Division of Corporate Finance addressed the FAST Act by making an announcement with guidance and issuing two new Compliance & Disclosure Interpretations (C&DI). As the FAST Act is a transportation bill that rolled in securities law matters relatively quickly and then was signed into law even quicker, this is the first SEC acknowledgement and guidance on the subject. I suspect more in the near future.

Summary of Securities Law Related Matters Included in the FAST Act

The Improving Access to Capital for Emerging Growth Companies Act

The Improving the EGC Act became Sections 71001-71003 and Section 85001 of the FAST Act. The Improving the EGC Act is a very short bill with specific provisions designed to help smooth the IPO and follow-on offering process for companies qualifying as an EGC, which is most companies completing an IPO in today's market. The short provisions carry a big impact.

Effective immediately, the Improving EGC Act allows a company to exclude certain historical financial statements from its initial confidential S-1 filing as long as all required financial statements are included in the S-1 filing that will be distributed or available to potential investors. In particular, the Improving EGC Act specifically provides that a confidential registration statement may "omit financial information for historical periods otherwise required by regulation S-X as of the time of filing (or confidential submission of such registration statement, provided that: (A) prior to the issuer distributing a preliminary prospectus to investors, such registration statement is amended to include all relevant periods required at the date of such amendment; and (B) the issuer reasonably believes such financial disclosure will no longer be required to be included in the Form S–1 at the time of the contemplated offering."

This provision will greatly assist issuers that are timing and planning IPO's late in their fiscal year. For example, under today's rules an issuer with a FYE of December 31 that begins to plan an IPO after September 30, 2015, must decide whether to audit the two prior fiscal years (i.e., December 31, 2013 and 2014) and review September 30, 2015, for the filing or wait until the first quarter of 2016 and only audit December 31, 2014 and 2015. In addition to the excess cost of auditing 2013 in this scenario, the issuer must consider that the September 30 financials go stale after 135 days (mid-February), and that taking into account the 3-4 month S-1 review process, it will likely need to update for the 2015 audit prior to going effective in any event. Adding to the considerations is that most issuers do not close out their books until approximately 30 days post FYE (in this case, the end of January to close out books) and an audit takes at least 4 weeks.

Under the new FAST Act in this fact scenario the issuer could file its registration statement with just the 2013 audit and September 30, 2015 reviewed stub period. The stub period would still need to be included even though at the time of effectiveness it is contemplated that this stub period would be replaced with the full 2015 audit.

This timing creates a difficult dilemma on the timing of filing an S-1 for a first or early second quarter IPO. In my office, I feel like we are "doing the timing math" every week for new or contemplated IPO's. The amendment proposed in the Improving EGC Act will provide real-world assistance to EGC's and their deal team in preparing for and launching an IPO. Again, this provision became effective immediately on December 4, 2015.

Both of the two issued C&DI's is on this subject. In particular, the SEC clarifies that you cannot omit stub period financial statements even if that stub period will ultimately be included in a longer stub period or year-end audit before the registration statement goes effective. The SEC clarified that the FAST Act only allows the exclusion of historical information that will no longer be included in the final effective offering. The C&DI clarifies that "Interim financial information "relates" to both the interim period and to any longer period (either interim or annual) into which it has been or will be included."

The second C&DI clarifies the allowable exclusion of financial statements for other entities if the issuer reasonably believes that those financial statements will not be required in the final registration. The SEC confirms that: "Section 71003 of the FAST Act is not by its terms limited to financial statements of the issuer. Thus, the issuer could 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 Improving EGC Act also reduces the number of days prior to the road show or effectiveness of an S-1 that confidentially submitted S-1 filings must be made public from 21 days to 15 days. The change shortens the time that a company has to wait launch the road show. In particular, An EGC that has used a confidential submission process must publicly file its registration statement and all previously submitted drafts no later than 15 days (rather than 21 days) before conducting a road show. In offerings that do not involve a road show, the public filing must occur at least 15 days before the registration statement goes effective. This provision became effective immediately upon signing of the FAST Act on December 4, 2015. EGCs with initial public offerings pending before the FAST Act became law or at any time thereafter may take advantage of the provision.

Also effective immediately, the Improving EGC Act also allows an issuer that has filed a confidential S-1 as an EGC, but thereafter ceases to be an EGC, to continue to be treated as an EGC until the earlier of: (i) the completion of its initial public offering for which the confidential S-1 was filed; or (ii) one year from the date it ceased being an EGC.

The Improving EGC Act has an equally short and potentially helpful provision effecting follow-on offerings for an EGC. In particular, the Improving EGC Act provides

“FOLLOW-ON OFFERINGS.—An emerging growth company may, within 1 year of the company’s initial public offering, confidentially submit to the Commission a draft registration statement for any securities to be issued subsequent to its initial public offering, for confidential nonpublic review by the staff of the Commission prior to publicly filing a registration statement, provided that the initial confidential submission and all amendments thereto shall be publicly filed with the Commission not later than 2 days before the date on which the emerging growth company issues such securities.”

Although I can think of benefits for all market levels, in the small cap market space in particular, follow-on offerings often include an uplisting to a national exchange or higher tier of such exchange. Allowing confidential submission and review will ease the pressure on the follow-on offering deal team as it works through exchange applications such as NASDAQ or NYSE MKT. On the other hand, a one-year time frame for a follow-on is very short and only high-growth companies will be in a position to take advantage of this new benefit if passed.

As a reminder, the Jumpstart our Business Startups Act (JOBS Act) enacted in April 2012 created a new category of company: an "Emerging Growth Company" (EGC). An EGC is defined as a company with annual gross revenues of less than $1 billion that first sells equity in a registered offering after December 8, 2011. In addition, an EGC loses its EGC status on the earlier of (i) the last day of the fiscal year in which it exceeds $1 billion in revenues; (ii) the last day of the fiscal year following the fifth year after its IPO; (iii) the date on which it has issued more than $1 billion in non-convertible debt during the prior three-year period; or (iv) the date it becomes a large accelerated filer (i.e., its non-affiliated public float is valued at $700 million or more).

EGC status is not available to asset-backed securities issuers ("ABS") reporting under Regulation AB or investment companies registered under the Investment Company Act of 1940, as amended. However, business development companies (BDCs) do qualify.

The Disclosure Modernization and Simplifications Act

In early December 2014, the House passed the Disclosure Modernization and Simplification Act of 2014, following which it was bundled into the FAST Act and now passed into law. I previously wrote on this Act HERE). The Disclosure Modernization and Simplification Act of 2014 became Sections 72001-72003 of the FAST Act.

The Disclosure Modernization and Simplification Act of 2014 requires the SEC to adopt or amend rules to: (i) allow issuers to include a summary page to Form 10-K (Section 72001); and (ii) scale or eliminate duplicative, antiquated or unnecessary requirements for EGCs, accelerated filers, smaller reporting companies and other smaller issuers in Regulation S-K (Section 72002). In addition, the SEC is required to conduct yet another study on all Regulation S-K disclosure requirements to determine how best to amend and modernize the rules to reduce costs and burdens while still providing all material information (Section 72003).

In particular, Section 72001 of the FAST Act requires the SEC to issue regulations within 180 days permitting issuers to submit a summary page on Form 10-K if each item identified in the summary includes a cross-reference to the relevant information. Section 72002 related to amendments to Regulation S-K has the same 180-day deadline.

Section 72003 requires that the SEC conduct a study of Regulation S-K and provide a detailed report within 360 days.

The bill requests that the SEC emphasize a "company by company approach that allows relevant and material information to be disseminated to investors without boilerplate language or static requirements while preserving completeness and comparability of information across registrants" and "evaluate methods of information delivery and presentation and explore methods for discouraging repetition and the disclosure of immaterial information."

The Reforming Access for Investments in Startup Enterprises Act

The FAST Act incorporates the new Reforming Access for Investments in Startup Enterprises Act (the "RAISE Act"). The Raise Act is included in Section 76001 of the FAST Act. The RAISE Act is meant to codify the so-called Section 4(a)(1 ½) exemption. See my blog on the Section 4(a)(1 ½) exemption and the SEC Advisory Committee on Small and Emerging Companies recommendation for codification HERE.

The RAISE Act, through the FAST Act, creates a new Section 4(a)(7) of the Securities Act. The new Section 4(a)(7) exemption allows for the resale of securities by shareholders for transactions that meet the following requirements:

- Each purchaser is an accredited investor as defined in the Securities Act;
- Neither the seller nor any persons acting on the seller's behalf engages in any form of general solicitation or advertising;
- In the case of a non-reporting issuer or an issuer exempt from the reporting requirements pursuant to Rule 12g3-2(b), at the request of the seller, the issuer must provide reasonably current information to the seller and a prospective purchaser;
- Current information includes: (i) The issuer's exact name (as well as the name of any predecessor); (ii) The address of the issuer's principal place of business; (iii) The exact title and class of the offered security, its par or stated value, and the current capitalization of the issuer; (iv) Details for the transfer agent or other person responsible for stock transfers; (v) A statement of the nature of the issuer's business that is dated as of 12 months before the transaction date; (vi) The issuer's officers and directors; (vii) Information about any broker, dealer or other person being paid a commission or fee in connection with the

sale of the securities; (viii) The issuer's most recent balance sheet and profit and loss statement and similar financial statement for the two preceding fiscal years during which the issuer has been in business, prepared in accordance with GAAP or, in the case of a foreign issuer, IFRS. The balance sheet will be reasonably current if it is as of a date not less than 16 months before the transaction date, and the profit and loss statement shall be reasonably current if it is as of a date not less than 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 dates of such balance sheet to a date less than six months before the transaction date; and (ix) If the seller is an affiliate, a statement regarding the nature of the affiliation accompanied by a certification from the seller that it has no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.

The new Section 4(a)(7) exemption is not available in the following circumstances:

- In a transaction where the seller is a direct or indirect subsidiary of the issuer;
- If the seller or any person that will be compensated as part of the transaction, including a broker-dealer, is subject to the bad actor disqualifications in Rule 506 of Regulation D or under Section 3(a)(39) of the Exchange Act;
- If the issuer is a blank check, blind pool, shell company, SPAC or in bankruptcy or receivership;
- Where the transaction relates to a broker-dealer or underwriter's unsold allotment; or
- Where the security being sold is part of a class of securities that has not been authorized and outstanding for at least 90 days prior to the transaction date.

The securities sold in a Section 4(a)(7) resale transaction will be considered "restricted securities" for purposes of Rule 144. Securities sold will be "covered securities" under the NSMIA and therefore will pre-empt state law. A transaction pursuant to this exemption will not be deemed to be a "distribution" under the Securities Act.

Incorporation by Reference in Form S-1 by Smaller Companies

A significant change included in the FAST Act is in Section 84001 that requires the SEC to revise Form S-1 to allow smaller reporting companies to incorporate by reference to both prior and future Exchange Act filings. This is significant as currently smaller reporting companies are specifically prohibited from incorporating by reference and must prepare and file a post-effective amendment to keep a resale "shelf" registration current, which can be expensive. A shelf registration is one that allows continuous sales over a period of time.

Section 12(g) Correction

Section 85001 of the FAST Act amends Section 12(g) of the Securities Exchange Act to add savings and loans to the class of entities subject to the higher threshold registration requirements. Now, both savings and loan companies and banks are not required to register under the Exchange Act unless they have, at the end of the most recent fiscal year, at least $10 million in assets and a class of equity securities held of record by at least 2,000 shareholders. The prior omission of saving and loans was thought to be an inadvertent error in the JOBS Act.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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