

FAST Act Codifies “Section 4(1½)” Resale Exemption and Modifies JOBS Act

In December 2015, President Obama signed into law the Fixing America’s Surface Transportation Act (“FAST Act”).¹ Though the FAST Act is designed primarily to provide for long-term highway and transit project funding, several provisions implicate the federal securities laws and modify the Securities Act of 1933 (the “Securities Act”). Among other things, Section 76001 of the FAST Act codifies the so-called “Section 4(1½)” exemption for private resales of restricted securities. Other capital markets-related provisions include amendments to the Jumpstart Our Business Startups Act (“JOBS Act”) and provisions relating to the Securities and Exchange Commission’s (“SEC”) modernization and simplification of public disclosures program.²

I. Background: The “4(1½)” Exemption

Section 4(a)(2) of the Securities Act exempts from registration offers and sales of securities *by an issuer* not involving any public offering. Section 4(a)(1) of the Securities Act exempts from registration offers and sales of securities by any person *other than an issuer, underwriter, or dealer*. SEC Rule 144 and Rule 144A provide two regulatory safe harbors from registration for certain resales of securities.³ In addition to these two bright line safe harbors, there evolved over the years a practice in which a holder of securities acquired from an issuer in a transaction not involving a public offering can resell them privately, i.e., without registering the resale transaction under the Securities Act, in a transaction that is sufficiently “private”, to a buyer that is deemed to be sufficiently “sophisticated” so as to not require the protections of registration under the Securities Act. Typically, the selling holder obtains a legal opinion to provide comfort to parties to the transaction, and to the issuer of the securities, that the private sale can appropriately be effected without Securities Act registration. This practice, which has become known as a “4(a)(1½)” transaction (or simply a “4(1½)”), is based on a combination of case law, SEC guidance and general practices. In issuing a legal opinion covering such a transaction, counsel generally rely on representations by the holder, the issuer and the buyer of the securities as to the relevant facts and circumstance as well as on relevant case law and interpretations.

II. FAST Act Section 76001

Section 76001 of the FAST Act adds a new Section 4(a)(7) to the Securities Act which essentially codifies the 4(1½) approach.⁴ Under the new Section 4(a)(7), resale transactions are exempt from Securities Act registration if they satisfy the following conditions:

1. Each purchaser is an accredited investor, as defined in Regulation D;
2. Neither the seller, nor any person acting on the seller’s behalf, offers or sells the securities by any form of general solicitation or general advertising;

¹ Fixing America’s Surface Transportation Act, H.R. 22, 114th Cong. (2015), available at <https://www.gpo.gov/fdsys/pkg/BILLS-114hr22enr/pdf/BILLS-114hr22enr.pdf>.

² See, SEC Recently Enacted Transportation Law Includes a Number of Changes to the Federal Securities Law (December 10, 2015), available at <http://www.sec.gov/corpfin/announcement/cf-announcement---fast-act.html>.

³ Rule 144 covers the resale of securities purchased from an issuer or held by an affiliate of an issuer in a transaction not involving a public offering provided certain requirements are met. Rule 144A covers the resale of securities purchased from an issuer in a transaction not involving a public offering provided such resales are made only to “qualified institutional buyers”, as such term is defined in Rule 144A, and certain other conditions are met.

⁴ This new exemption became effective upon enactment and does not require SEC rulemaking. The securities received by the purchaser will continue to be “restricted securities” within the meaning of Rule 144.

3. In the case of a non-reporting issuer, the issuer must provide to the seller and the prospective purchaser, at the seller's request, certain general and financial information about the issuer and the securities;⁵
4. The seller is not an issuer or a subsidiary directly or indirectly of the issuer;
5. The seller and any person who receives remuneration or a commission in connection with the transfer of securities must not be disqualified under the Regulation D Rule 506(d) bad actor provisions;
6. The issuer must be engaged in business, and must not be (i) in the organizational stage, (ii) in bankruptcy or receivership, (iii) a blank check, blind pool, or shell company that has no specific business plan or (iv) a special purpose acquisition vehicle;
7. The securities must not be part of an unsold allotment to, or a subscription or participation by, a broker or dealer as an underwriter of the securities or a redistribution; and
8. The securities must be part of a class that has been authorized and outstanding for at least 90 days prior to the date of the transaction.

Section 76001 further provides that securities sold under the exemption are "covered securities" under Section 18 of the Securities Act, therefore federal preemption applies and no "blue sky" qualifications will be required under state securities laws.

These amended provisions to create a nonexclusive safe harbor are intended to remove the uncertainty inherent in resales utilizing the practice known as the 4(1½) exemption and should reduce costs associated with obtaining legal opinions in relation to such sales. The preemption of state blue sky laws and added certainty provided by new Section 4(a)(7) is expected to be a useful addition to those desiring to sell securities in private transaction under circumstances not covered by other safe harbors from Securities Act registration.

III. Other FAST Act Provisions

The FAST Act also contains provisions that may benefit investment banks acting as underwriters in Emerging Growth Company ("EGC") initial public offerings ("IPOs"). Under the JOBS Act, companies with less than \$1 billion total annual gross revenues generally qualify as EGCs and benefit from scaled disclosure requirements, such as the ability to submit a draft registration statement for confidential, non-public review by SEC staff.⁶ Sections 71001 through 71003 of the FAST Act each expand upon or modify the JOBS Act provisions relating to the IPO process for EGCs.⁷

- Section 71001 reduces the time period for public filing of the registration statement from no later than 21 days prior to the commencement of the roadshow to no later than 15 days prior to the commencement of the roadshow. This should allow EGCs to better coordinate their marketing efforts with the public filing of the IPO.

⁵ The information required to be delivered by a non-reporting issuer to the seller and the prospective purchasers is listed on Annex A hereto.

⁶ Jumpstart Our Business Startups Act, H.R. 3606, 112th Cong. (2012), available at <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf>. For a more comprehensive overview of the JOBS Act, see our Firm Memorandum *The Jumpstart Our Business Startups Act* (the "JOBS Act"), (Apr. 3, 2012), available at <http://www.cahill.com/news/memoranda/1012952>, *SEC Staff Issues Guidance of the JOBS Act*, (Apr. 19, 2012), available at <http://www.cahill.com/news/memoranda/1012954>; and *SEC Staff Issues Additional Guidance on the JOBS Act*, (June 28, 2012), available at <http://www.cahill.com/publications/firm-memoranda/1012961>.

⁷ Sections 71001 through 71003 are currently effective.

- Section 71002 establishes a grace period for a change in EGC status following public filing of a registration statement. Namely, an issuer that was an EGC at the time it submitted a confidential or publicly filed registration statement, but ceases to be an EGC thereafter, may continue to be treated as an EGC until the earlier of (a) the date the company “consummates its initial public offering” or (b) one year after the date the company ceases to be an EGC. This should provide added certainty and flexibility to EGC’s who wish to rely on the JOBS Act accommodations during the IPO process.
- Section 71003 eases requirements relating to disclosure of historical financial information. Specifically, the FAST Act amends Section 102 of the JOBS Act to allow an EGC issuer to 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) the omitted information relates to a historical period that the issuer reasonably believes will not be required to be included in the Form S-1 or Form F-1 filing at the time of the contemplated offering and (b) the issuer amends the registration statement prior to distributing a preliminary prospectus to include all financial information required by Regulation S-X at the date of the amendment. Interim financial statements are deemed to “relate” to both the interim period and to any longer period into which it has been or will be included.⁸ An EGC issuer may omit financial statements of other entities such as acquired businesses from its filing or submission if it reasonably believes that those financial statements will not be required at the time of the offering.⁹ These amended disclosure requirements have the potential to reduce financial audit costs for issuers and accelerate the timeframe for completing the initial registration statement in an IPO.

Other FAST Act provisions aim, in other ways, to modernize and simplify routine disclosure requirements for public companies, EGCs, and smaller reporting companies. Most require implementing regulations, such as Section 84001, which directs the SEC to revise Form S-1 within 45 days to allow smaller reporting companies to incorporate by reference any documents filed with the SEC after the effective date of the registration statement, termed “forward incorporation”.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com, John Schuster at 212.701.3323 or jschuster@cahill.com.

⁸A Compliance and Disclosure Interpretation by the SEC’s Division of Corporation Finance clarifies by way of the following example: “[C]onsider a calendar year-end EGC that submits or files a registration statement in December 2015 and reasonably expects to commence its offering in April 2016 when annual financial statements for 2015 and 2014 will be required. This issuer may omit its 2013 annual financial statements from the December filing. However, 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.” See, *SEC Fixing America’s Surface Transportation (FAST) Act* (December 21, 2015), available at <https://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm>.

⁹The SEC’s Division of Corporation Finance clarifies by way of the following example: “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.” *Id.*

ANNEX A

The following information is to be delivered to the seller and prospective purchasers by non-reporting issuers:

1. The name of the issuer (and any predecessor);
2. The address of the issuer's principal executive offices;
3. The exact title and class of security, its par or stated value, and the number of shares or total amount of securities outstanding as of the end of the issuer's most recent fiscal year;
4. The name and address of the transfer agent, corporate secretary, or other person responsible for stock transfers;
5. A statement of the nature of the issuer's business and the products and services it offers as of 12 months before the transaction date;
6. The names of the officers and directors of the issuer;
7. The names of the broker, dealer, or agent to be paid any commission or compensation in connection with the transaction;
8. The issuer's most recent balance sheet and statement of profit and loss, and similar financial statements for the two preceding fiscal years during which the issuer has been in operation, prepared in accordance with generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS); and
9. If the seller is a control person of the issuer, a brief statement regarding the nature of the affiliation and a certification that the seller has no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.