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and Other Recent Developments Affecting the IPO Market

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On December 4, 2015, President Obama signed into law the Fixing America's Surface Transportation Act, known as the FAST Act. Although aimed principally at authorizing spending on highway and transit projects, the FAST Act includes several amendments to the Jumpstart Our Business Startups Act (JOBS Act) and other securities law provisions. The aspects of the FAST Act applicable to IPOs are already in effect, while other provisions are subject to future SEC rulemaking. The changes made by the FAST Act, together with other recent developments, will help shape the IPO landscape in the coming year and beyond. A summary of the FAST Act's changes and other recent developments, and some of their implications, is set forth below. (The cross-references in the discussion below are to the sections of *Initial Public Offerings: A Practical Guide to Going Public* that discuss related topics.)

Public Filing Prior to Road Show

Under the JOBS Act, an emerging growth company (EGC) was required to publicly file its IPO registration statement on Form S-1 (for domestic U.S. issuers) or Form F-1 (for foreign private issuers) no later than twenty-one days before commencing the road show (or twenty-one days before effectiveness of the registration statement, if there is no road show). Effective immediately upon enactment, the FAST Act reduces this time

period from twenty-one days to fifteen days. (*See* §§ 10:5.2[B] and 16:5.4[A] for further discussion of the public filing requirement.)

This reduction may prompt EGCs to reevaluate the timing of activities that are commonly conducted in the period of time between the initial public disclosure of a proposed IPO (resulting from either the initial public filing of an IPO registration statement, or a voluntary public announcement pursuant to Rule 134 or Rule 135 under the Securities Act) and the launch of the IPO roadshow, such as attending to registration rights notices and waivers and obtaining lockup agreements and questionnaires from stockholders who had not been privy to the company's IPO plans. (*See* §§ 11:2.2[D] and 11:2.2[C] for discussion of Rule 134 and Rule 135, and §§ 13:5.3[C], 14:4.1, 14:4.2, and 18:12.2 for discussion of common practices with respect to the timing of registration rights notices and waivers, lockup agreements, and questionnaires.)

EGC Grace Period

Under the JOBS Act, an issuer must qualify as an EGC in order to elect confidential review of a draft registration statement, and eligibility as an EGC is re-determined at the time of the initial public filing of the registration statement. Effective immediately upon enactment, the FAST Act provides a grace period for an issuer that is an EGC at the time it confidentially submits or publicly files a registration statement on Form S-1 or Form F-1 for an IPO, but ceases to be an EGC prior to completion of the IPO. In this limited circumstance, the issuer will continue to be treated as an EGC through the earlier of:

- the date on which the issuer consummates its IPO pursuant to such registration statement; or
- the end of the one-year period beginning on the date the issuer ceases to be an EGC.

The SEC staff had previously interpreted the JOBS Act such that if an issuer publicly filed a registration statement at a time when it qualified as an EGC, the disclosure provisions for EGCs would continue to apply through effectiveness of the registration statement even if the issuer lost its EGC status during registration. The FAST Act extends this relief to circumstances where an issuer qualifies as an EGC at the time of confidential submission of the registration statement. Absent this change, if an issuer ceased to qualify as an EGC while undergoing confidential review, it would be required to publicly file a registration statement that complied with the disclosure rules and regulations applicable to companies that are not EGCs in order to continue the review process. (*See* § 10:5.2[B] for discussion of the IPO relief available to EGCs, and § 16:5.4[A] for discussion of confidential submission.)

Omission of Certain Financial Statements

Effective January 3, 2016 (thirty days after enactment of the FAST Act), the FAST Act amends the JOBS Act to permit an EGC that files (or submits for confidential review) a registration statement on Form S-1 or Form F-1 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:

- the omitted financial information relates to a historical period that the issuer reasonably believes will not be required to be included in the registration statement at the time of the contemplated offering; and
- prior to the issuer distributing a preliminary prospectus to investors, such registration statement is amended to include all financial information required by Regulation S-X at the date of such amendment.

Shortly after enactment of the FAST Act, the SEC staff issued several interpretations of this amendment.[1] In an interpretation that narrows the usefulness of the amendment for many EGC issuers, the staff concluded that an issuer 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 shorter period will not be presented separately at that time.[2] In another interpretation, the staff concluded that an EGC issuer may omit financial statements of other entities—such as financial statements of an acquired business required by Rule 3-05 of Regulation S-X—if the issuer reasonably believes that those financial statements will not be required at the time of the offering.

As a result of this amendment, EGC issuers can avoid devoting time and resources to preparing financial statements and related disclosures solely to comply with Form S-1 or Form F-1 requirements at the time of filing (or confidential submission) but that would not otherwise be required at the time of the offering. This amendment may also enable EGC issuers to avoid

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1. U.S. Sec. & Exch. Comm'n, Compliance and Disclosure Interpretations, Fixing America's Surface Transportation (FAST) Act (Dec. 21, 2015), www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm.
2. In its interpretation, the staff provided 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."

the expense of having the omitted financial statements audited by an independent auditor, although some auditor involvement with the omitted financial statements will still be required if financial information contained in such financial statements is included in the registration statement, such as in the section setting forth selected financial data (particularly if the auditor is expected to provide "comfort" on such financial information). (*See* § 4:4 for discussion of the financial statements required to be included in a registration statement, and § 12:10.2[I] for discussion of comfort letters.)

New Resale Exemption

Effective immediately upon enactment, the FAST Act adds a new statutory exemption to the Securities Act for certain resales of restricted securities. New section 4(a)(7) provides a non-exclusive exemption from registration for any resale transaction, regardless of whether the issuer is publicly or privately held, where:

- each purchaser is an accredited investor;
- neither the seller nor any person acting on the seller's behalf engages in any form of general solicitation or general advertising;
- the seller is not the issuer or a direct or indirect subsidiary of the issuer;
- neither the seller nor any person that has been or will be paid remuneration or a commission for their participation in connection with the transaction would be disqualified as a bad actor under Rule 506(d)(1) of Regulation D or is subject to a statutory disqualification described under section 3(a)(39) of the Exchange Act;
- the issuer is not in bankruptcy or receivership and is not a blank check, blind pool, or shell company that has no specific business plan or purpose or has indicated that its primary business plan is to engage in an acquisition of an unidentified person;
- the transaction does not relate to an unsold allotment to, or a subscription or participation by, a broker or dealer as an underwriter of the security or a redistribution;
- the transaction involves securities of a class that has been authorized and outstanding for at least ninety days prior the transaction date; and
- perhaps most importantly, in the case of an issuer that is not a reporting company under the Exchange Act, is not exempt from the reporting requirements pursuant to Rule 12g3-2(b) of the Exchange Act, or is not a foreign government eligible to register securities on Schedule B, the issuer provides to the seller and the prospective purchaser the information specified below.

In order for the section 4(a)(7) exemption to be available, a non-reporting issuer must provide to the seller and the prospective purchaser the following information, which must be reasonably current in relation to the date of the resale transaction (if the issuer is unwilling or unable to provide this information, the exemption will not be available):

- the issuer's exact name (as well as the name of any predecessor);
- the address of the issuer's principal executive offices;
- the exact title and class of the security, its par or stated value, and the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year;
- the name and address of the transfer agent, corporate secretary, or other person responsible for stock transfers;
- a statement of the nature of the issuer's business and the products and services it offers, which will be presumed reasonably current if the statement is as of twelve months before the transaction date;
- the names of the issuer's officers and directors;
- the names of the broker, dealer, or agent that will be paid any commission or remuneration in connection with the transaction;
- the issuer's most recent balance sheet and profit and loss statement and similar financial statements for the two preceding fiscal years during which the issuer has been in operation,[3] prepared in accordance with GAAP, or in the case of a foreign private issuer, in accordance with IFRS; and
- if the seller is an affiliate of the issuer, a brief statement regarding the nature of the affiliation, and a certification by such seller that it has no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.

The securities sold in an exempted transaction under section 4(a)(7) will be deemed to be "restricted securities" within the meaning of Rule 144 and "covered securities" under the Securities Act for purposes of preemption of state "blue sky" regulations.

The section 4(a)(7) exemption may have a significant impact on private resale transactions in the securities of both privately held and publicly held

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3. The balance sheet will be presumed reasonably current if it is as of a date less than sixteen months before the transaction, and the profit and loss statement will be presumed reasonably current if it is for the twelve months preceding the date of the 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 less than six months before the transaction date.

issuers. For privately held issuers that are willing to provide the required information, the new exemption provides clarity for private resales in circumstances in which Rule 144(b)(1) is unavailable (such as sales by affiliates, or sales by non-affiliates who do not satisfy the holding period requirement) and can eliminate the need to rely on the so-called section 4(a)(1½) exemption, and could facilitate the development of a private resale market. For publicly held issuers, the new exemption provides similar benefits. (*See* § 2:6.4 for discussion of the section 4(a)(1½) exemption, and § 24:3.3 for discussion of Rule 144(b)(1).)

Forward Incorporation by Reference for Form S-1 by Smaller Reporting Companies

A "short-form" Form S-3 registration statement permits the issuer to incorporate by reference information from its prior Exchange Act filings (rather than repeat that information in the Form S-3) and to incorporate by reference information from its future Exchange Act filings (rather than amend the Form S-3 to add that information). Form S-3 is available only to issuers satisfying specified issuer and transaction standards, which a "smaller reporting company"[4] often cannot satisfy. Smaller reporting companies that are ineligible to use Form S-3 must use a Form S-1 registration statement. Prior to the enactment of the FAST Act, a Form S-1 registration statement did not permit forward incorporation by reference. (*See* § 21:3.2 for discussion of smaller reporting companies, and § 24:6 for discussion of Form S-3.)

The FAST Act requires the SEC, by January 18, 2016 (forty-five days after enactment of the act), to revise Form S-1 to permit a smaller reporting company to incorporate by reference in a Form S-1 registration statement any documents that it files with the SEC after the effective date of the Form S-1. This will allow smaller reporting companies (including foreign private issuers that elect to be treated as smaller reporting companies and file on domestic U.S. issuer forms) that are not eligible to register shares for resale using Form S-3 to avoid having to file post-effective amendments solely for the purpose of keeping a resale Form S-1 current.

Disclosure Modernization and Simplification

The FAST Act includes several provisions that are intended to modernize and simplify disclosure requirements:

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4. A smaller reporting company is defined as a public company that, as of the last business day of its most recently completed second fiscal quarter, had a public float of less than $75 million.

- **Summary page for Form 10-K:** The FAST Act requires the SEC, by June 1, 2016 (180 days after enactment of the act), to issue regulations to permit issuers to submit a summary page in their Form 10-K, but only if each item on the summary page includes a cross-reference (by electronic link or otherwise) to the related information in the Form 10-K. Current SEC rules do not prohibit issuers from including a summary in an annual report on Form 10-K, provided the summary fairly represents the material information in the report. It remains to be seen whether the practice will gain traction following adoption of the regulations called for by the FAST Act.
- **Improvement of Regulation S-K:** The FAST Act also requires the SEC, by June 1, 2016, to revise Regulation S-K to:
  - further adjust ("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 all material information; and
  - eliminate provisions of Regulation S-K required for all issuers that are duplicative, overlapping, outdated, or unnecessary.
- **Study on modernization and simplification of Regulation S-K:** The FAST Act requires the SEC to conduct another study on Regulation S-K, this time in consultation with two committees previously established by the SEC (the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies), to:
  - determine how best to modernize and simplify Regulation S-K requirements in a manner that reduces the costs and burdens on issuers, while still providing all material information to investors;
  - emphasize a company-by-company disclosure approach that allows relevant and material information to be disseminated to investors without boilerplate language or static requirements; and
  - evaluate alternative methods of information delivery and presentation and explore methods for discouraging repetition and the disclosure of immaterial information.

A report on the Regulation S-K study required under the FAST Act is due to Congress by November 28, 2016 (360 days after enactment of the act), and rules to implement the recommendation of the report are to be issued within 360 days from the issuance of the report.

In December 2013, the SEC staff completed the study of Regulation S-K required under the JOBS Act. The SEC staff has since taken steps to begin to implement reforms through its ongoing "disclosure effectiveness" project.

(*See* § 10:5.5[A] for discussion of the December 2013 Regulation S-K study and disclosure effectiveness.)

Implementation of the Regulation S-K study mandated by the FAST Act is likely to be a large undertaking and a long-term project. In the meantime, the Director of the Division of Corporation Finance, as part of the division's ongoing disclosure effectiveness project, has publicly exhorted public companies to improve their disclosure documents in the absence of rule changes by reducing repetition, focusing disclosure, and eliminating outdated information.

Timing of SEC Rulemaking

The FAST Act prescribes deadlines for SEC rulemaking that may not be achievable in light of the time required to draft new rules, prepare the accompanying economic analyses, permit proper review by the SEC, and afford opportunity for public input, as well as the backlog of uncompleted rulemaking mandated by prior legislation. Legal challenges to the upcoming rules are also possible, although the FAST Act rules are very unlikely to be as controversial as some prior SEC rules—such as those addressing proxy access and resource extraction—that have been overturned by federal courts. As a result, the timing of SEC rulemaking under the FAST Act is uncertain.

Other Recent Developments

IPO companies may also be affected by the following recent developments, some of which apply to pre-IPO companies and others of which apply only to public companies.

- **Adoption of final crowdfunding rules:** On October 30, 2015, the SEC adopted final crowdfunding rules, which will become effective on May 16, 2016. The final rules are essentially the same as those originally proposed in October 2013. The most notable change from the proposed rules to the final rules is that financial statements only need to be reviewed (instead of audited) by an independent public accounting firm for offerings of more than $500,000 but less than the $1 million overall cap. There appears to be substantial interest among small companies in raising capital through crowdfunding, although the growth of this market may be constrained by the ongoing SEC reporting obligations (applicable to all crowdfunding transactions) and the requirement to provide financial statements reviewed by an independent public accounting firm (applicable to crowdfunding transactions raising more than $500,000). (*See* § 2:8.2[E] for discussion of crowdfunding.)

- **Proposed amendments to Rule 504 and Rule 147:** In conjunction with the adoption of final crowdfunding rules, the SEC proposed to amend two existing Securities Act exemptions from registration to assist smaller companies with capital formation consistent with investor protection. The proposed amendments to Rule 504 would increase the aggregate dollar amount of securities that may be offered and sold pursuant to the rule from $1 million to $5 million and apply "bad actor" disqualifications to Rule 504 offerings to provide additional investor protection. The proposed amendments to Rule 147 would modernize the exemption for intrastate offerings to further facilitate capital formation, including through intrastate crowdfunding provisions. (*See* § 2:8.2[B][1] for discussion of Rule 504.)
- **New IRS guidance on application of section 162(m):** Under section 162(m) of the Internal Revenue Code, a public company generally may not claim a federal income tax deduction for annual compensation (including base salary, bonuses, and income recognized with respect to stock options and other equity awards) in excess of $1 million paid to its CEO and its three other highest-paid executive officers. Since 2007, because of a quirk of cross-referencing between the Internal Revenue Code and SEC rules, practitioners have understood that a CFO is not an executive officer for this purpose. However, in a Chief Counsel Advice (CCA) legal memorandum issued on August 24, 2015 (and made publicly available in late October), the IRS concluded that the compensation paid to the CFO of a smaller reporting company that is eligible to take advantage of the relaxed disclosure requirements under Regulation S-K is subject to the deduction limitation of section 162(m) if he or she is one of the two most highly compensated executive officers other than the CEO of the smaller reporting company. A CCA memorandum is not precedential authority, and this CCA memorandum leaves open several important questions. Nevertheless a smaller reporting company (and an emerging growth company, based on the logic of the CCA memorandum), should now consider carefully whether or not compensation paid to its CFO after the end of the company's applicable section 162(m) transition period will be subject to section 162(m). (*See* § 22:8 for discussion of section 162(m), and § 21:3.2 for discussion of smaller reporting companies.)
- **ISS voting policy changes:** The governance practices of newly public companies may come under challenge from the application of ISS voting policies sooner than in the past due to revised ISS voting policies that are likely to result in negative vote recommendations on directors where, prior to an IPO, the company adopts charter or bylaw provisions considered by ISS to be adverse to stockholder rights, such as classified boards or supermajority vote requirements to

amend the company's bylaws or charter. Under the new policy, which is effective for stockholder meetings on or after February 1, 2016, ISS will consider the following factors in making its voting recommendations:

- the level of impairment of stockholder rights caused by the provision;
- the company's or the board's rationale for adopting the provision;
- the provision's impact on the ability of stockholders to change the company's governance structure in the future (such as limitations on the stockholders' right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- the ability of stockholders to hold directors accountable through annual director elections, or whether the company has a classified board structure; and
- a public commitment to put the provision to a stockholder vote within three years after the date of the company's IPO.

ISS will consider making a negative vote recommendation on directors at all future stockholder meetings until the adverse provision is either reversed by the board or submitted to a vote of public stockholders. (*See* § 5:8 for discussion of classified boards, supermajority vote requirements, and other takeover defenses.)