Congress Poised to Pass Legislation to Facilitate Capital Formation

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Yesterday, conference committee members for the House and Senate agreed on a five-year transportation bill. While this type of legislation is rarely of interest to participants in the capital markets, the bill includes several provisions that will improve upon the JOBS Act and facilitate capital formation transactions. The legislation is expected to be voted on by the House and Senate this week as lawmakers prepare to send a final bill to President Obama for signature before December 4.

The capital formation legislation was attached to the House version of the transportation bill in early November and was preserved without further modification by a conference committee tasked with reconciling the House and Senate proposals. The capital formation measures (which appear in the last section of the proposed bill, under Division G—Financial Services) include the following:

Title LXXI—Improving Access to Capital for Emerging Growth Companies

This provision would makes changes to the treatment of emerging growth companies (EGCs), as defined by the JOBS Act. Specifically, it would:

- Reduce from 21 to 15 the number of days before a road show that an EGC must publicly file its confidential submissions with the SEC;
- Provide a grace period for an issuer that filed for its IPO as an EGC but then subsequently lost EGC status before the IPO is completed: the issuer will continue to be treated as an EGC for one year or, if earlier, until consummation of its IPO; and
- Permit EGCs that file a registration statement (or submit the statement for confidential review) on Form S-1 or Form F-1 to omit Regulation S-X financial information for historical periods otherwise required as of the time of filing (or confidential submission) provided that (1) the omitted financial information relates to a historical period the EGC reasonably believes will not be required in the Form S-1 or F-1 at the time of the offering and (2) prior to the distribution of a preliminary prospectus to investors, the registration statement is amended to include all financial information required by S-X at the date of such amendment. *By way of example, an EGC currently planning an IPO that expects to price in the spring with 2015 audited financial statements could omit 2013 audited financial statements in its registration statement so long as the registration statement is amended to include the 2015 audited financials before a preliminary IPO prospectus is distributed to investors.*

Title LXXVI—Reforming Access for Investments in Startup Enterprises

This provision would establish a legal framework for private resales of restricted securities by codifying as new Section 4(a)(7) of the Securities Act the so-called “Section 4(1½) exemption,” an informal resale exemption that has developed over time based on case law and industry practice. Specifically, it would exempt from registration any resale transaction subject to the following conditions:

- Each purchaser is an accredited investor;
- No general solicitation is utilized;
- In the case of transactions involving the securities of non-reporting issuers, such issuers (upon request of the seller) must make available to both the seller and prospective purchaser certain

additional information, including general information about the issuer (name, address, nature of business, officers and directors, and transfer agent) and the securities (title, class, par value and amount outstanding), and certain financial information of the issuer;

- The securities may not be offered by the issuer or a direct or indirect subsidiary of the issuer;
- The securities must not be part of an unsold allotment to, or a subscription or participation by, an underwriter of the securities;
- The securities must be of a class that has been outstanding for at least 90 days prior to the date of the transaction; and
- The issuer must be "engaged in business" and not be in the organizational stage or in bankruptcy, or a blank check or shell company. Although the title of the provision refers to "startup enterprises," the exemption would apply to resales of securities of all issuers, public and private, irrespective of size.

Certain bad actor disqualification requirements for sellers and intermediaries would apply, and such offerings would be exempt from state "blue sky" registration.

The effect of this provision would be to further facilitate the creation of a secondary market in securities of private companies, as the rules for secondary trades will be clearly spelled out for market participants. That is consistent with the theme of the JOBS Act, which sought to improve access to public markets for companies while also making it easier for companies to stay private longer.

Title LXXXIV—Small Company Simple Registration

This provision would permit smaller reporting companies to automatically update information in a Form S-1 prospectus by forward incorporation of reports filed with the SEC after the registration statement is declared effective. Under current law, only S-3 filers can utilize forward incorporation by reference, and a Form S-1 used as a shelf must be manually updated through supplements or post-effective amendments. This change will enhance the ability of smaller reporting companies to use Form S-1 as a "shelf" registration statement. It should be noted that Form S-1 is only available as a shelf for secondary resales and not primary offerings by an issuer.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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