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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Getting The Markets Back Into The Fast Lane

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Kristopher D. Brown   Thomas J. Friedmann   Martin Nussbaum

On Dec. 4, 2015, President Barack Obama signed into law the Fixing America's Surface Transportation Act, dubbed the FAST Act. Embedded in this 1,300 page new law aimed principally at authorizing spending on new highways and transit projects is language that modifies Section 4 of the Securities Act of 1933, as amended (the "Securities Act"), through a new Section 4(a)(7) that codifies and clarifies a securities offering exemption that has informally existed for some time, the so-called Section 4(a)(1-½) exemption. This new law is anticipated to significantly enhance the ability for affiliates of companies to sell their securities, thus increasing general market liquidity for many companies.

As background to this new law, it is important to remember that Section 5 of the Securities Act requires that all sales of securities be registered with the U.S. Securities and Exchange Commission unless, for example, there is an exemption for the transaction, pursuant to Section 4 of the Securities Act. Some of the more common exemptions available historically under Section 4 of the Securities Act are:

- Section 4(a)(1) — which permits sales of securities in transactions by any person other than an issuer, underwriter or dealer, which is invoked to cover most secondary market trading activity.

- Section 4(a)(2) — which permits sales of securities in transactions by an issuer not involving any public offering, which is invoked as the basis for many private placements and other exempt offerings.

The SEC has further clarified certain transactional exemptions under Section 4 of the Securities Act by providing "safe harbors" for transactions meeting specified requirements. A person relying on any "safe

harbor” to sell securities need only meet the specified requirements of the “safe harbor” to qualify the transaction for exemption. Some of the most used “safe harbors” include:

- Regulation D — which exempts private placements made to certain sophisticated investors (known as “accredited investors”).
- Regulation S — which is available for certain securities offered to specified defined classes of non-U.S. persons.
- Rule 144A — which exempts private placements to certain large institutional investors known as “qualified institutional buyers,” or QIBs (see below for further discussion of Rule 144A).

Additionally, the SEC and securities practitioners had over the years generally accepted an exemption known as the “Section 4(a)(1-½) exemption,” which permitted resales of securities initially sold in private placements (i.e., sales of securities that were not registered under the Securities Act). The Section 4(a)(1-½) exemption had been interpreted by practitioners to permit nonissuers to make private-placement transactions by imposing certain limitations and requirements, including limitations and requirements on (1) the number and level of sophistication of purchasers of the subject securities (2) public advertising and/or general solicitation relating to the transaction, (3) holding period requirements, and (4) the prior need to ascertain the purchaser’s intent in acquiring the securities (i.e., for investment or resale). Because of the lack of official sanction, sellers seeking to rely on the 4(a)(1-½) exemption have historically faced uncertainty in determining whether the transaction will be exempt under the Securities Act.

By adding a new Section 4(a)(7) to the Securities Act, the FAST Act now clarifies (and in some respects both broadens and narrows) the exemption available under the Section 4(a)(1-½), requiring that in connection with each private resale of securities:

- each purchaser be an accredited investor;
- neither the seller nor any person acting on the seller's behalf offers or sells such securities by general solicitation or advertising;
- the seller and prospective purchaser obtain certain reasonably current specified information (if the issuer does not make periodic filings with the SEC);
- neither the seller nor any person receiving remuneration for participating in the offer or sale of such security is subject to certain legal disqualification (i.e., a bad actor);
- the issuer is engaged in business, is not in an organizational stage or in bankruptcy or receivership, and is not a blank check, blind pool or shell company with no specific business plan or purpose;
- the transaction does not involve a security that constitutes the whole or part of an unsold allotment to, or a subscription or participation by, a broker or dealer as an underwriter of the security or a redistribution; and
- the transaction involves a security of a class authorized and outstanding for at least 90 days before the transaction.

Securities acquired in such exempt transactions are deemed to (1) have been acquired in a transaction not involving any public offering and (2) not be part of a distribution involving an underwriter.

While the SEC and practitioners have long accepted the 4(a)(1-½) exemption, the uncertainty faced by sellers was that the exemption available under Section 4(a)(1-½) required them to ensure that the purchasers of securities, and any intermediaries, are not acting as "underwriters" of such securities within the meaning of the Securities Act. The SEC in 1990 adopted Rule 144A, which permits resales of privately issued securities to large institutional investors known as "qualified institutional buyers," or QIBs — this also codified a "safe harbor" (previously only informally available under the 4(a)(1-½) exemption) for sales to QIBs. The FAST Act effectively does the same thing (in the form of codified law as opposed to a safe harbor) by permitting resales to investors other than QIBs.

The FAST Act now provides affiliates of an issuer (i.e., an executive officer, director or larger shareholder) a less onerous means to sell securities than was previously available under the prior regime pursuant to Rule 144 of the Securities Act. Rule 144 allows affiliated persons of an issuer to sell securities of such issuer only if the sale meets certain requirements, including trading volume limitations of such securities. Because the FAST Act does not include such a limitation, new Section 4(a)(7) will now likely afford greater liquidity to affiliates of an issuer seeking to sell their securities.

Similar to the manner in which Rule 144A provided guidance for resales to QIBs, the new Section 4(a)(7) exemption will clarify and eliminate what was an issue of real concern around underwriter status that had plagued sellers of securities (outside the QIB arena) previously seeking to rely on the 4(a)(1-½) exemption. At the same time, the new Section 4(a)(7) exemption is likely to foster an increase in the purchaser base for securities offerings by facilitating larger transactions (because sellers will no longer be required to ascertain intent of the purchaser or be concerned that a large transaction could be viewed as a distribution). The FAST Act also provides certain sellers, especially affiliates who may be deemed as such because of the size of their investment, through board representations they may possess or contractual rights they may have with an issuer, an alternative to Rule 144 for sales of their securities, thereby enhancing overall liquidity for sellers and, as a result, hopefully making it easier and cheaper for companies to raise capital.

—By Kristopher D. Brown, Thomas J. Friedmann, Martin Nussbaum and Shashi Khiani, Dechert LLP

Kristopher Brown and Martin Nussbaum are partners in Dechert's New York office.

Thomas Friedmann is a partner in Dechert's Boston office and co-chairman of the firm's Global Corporate Finance and Capital Markets practice.

Shashi Khiani is an associate in the firm's Washington, D.C., office.

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