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Securities Alert

JOBS Act Eases IPO Process and Public Reporting Requirements for Emerging Growth Companies

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On April 5, 2012, the JOBS Act was signed into law, culminating a bipartisan effort by Congress to ease restrictions on capital raising that have affected and guided companies and investors for decades. The JOBS Act is intended to help small businesses and startups grow and create jobs by, among other things, creating a new class of issuer, the "Emerging Growth Company," and treating this class favorably compared to other pre-Act companies that have similar characteristics. As noted in our April 6, 2012 alert summarizing the major features of the JOBS Act, the JOBS Act changes the ways for new companies to go public.

This alert focuses on the "IPO On-Ramp" features of the JOBS Act, which are designed to make the IPO process easier for Emerging Growth Companies and to reduce disclosure and other public company obligations for these companies following an IPO. The information provided in this alert reflects additional guidance issued by the SEC on April 10 and April 16, 2012.

What is an Emerging Growth Company?

The JOBS Act establishes a new type of issuer, the "Emerging Growth Company" or EGC, which receives new and favorable treatment under the federal securities laws. A company (including a foreign company) will qualify as an EGC if:

- It has less than $1 billion of total revenues (as presented on the company's income statement under U.S. GAAP) during its most recently completed fiscal year.

However, a company will not qualify as an EGC if its initial public offering of common stock (or certain other first sales of registered common equity securities) occurred on or before December 8, 2011, even if it has total revenues of less than $1 billion during its most recently completed fiscal year.

A company that qualifies as an EGC will maintain this status until the earliest of:

- The last day of the first fiscal year of the company during which it has at least $1 billion of total revenues;
- The last day of the fiscal year of the company following the fifth anniversary of its IPO;
- The date on which the company meets the SEC's test for "large accelerated filer" status (meaning, a company with an unaffiliated public float in excess of $700 million as of the end of its most recent second fiscal quarter, that has been public for a year and has filed at least one annual report with the SEC); or
- The date on which the company has issued more than $1 billion in registered or unregistered non-convertible debt over the previous rolling three-year period.

Advantages for EGCs in the IPO Process

The JOBS Act makes it easier for EGCs to "go public" by creating significant advantages in the IPO process that apply only to EGCs.

Testing the Waters

EGCs and persons authorized to act on their behalf may test the waters, both before and after the filing of a registration statement with the SEC, by communicating orally or in writing with "qualified institutional buyers" (QIBs) and "accredited investors" (AIs). This will allow EGCs and their underwriters to determine investor interest in a contemplated securities offering, even before a registration statement is filed. Significantly, these communications will not have to be filed with the SEC as free writing prospectuses. Before the JOBS Act, these communications were prohibited unless a company had already filed a registration statement, and required the filing of free writing prospectuses with the SEC after a registration statement had been filed. In addition, the SEC has recently indicated that test-the-waters communications need not be treated as an IPO "roadshow," which has positive implications for the process for confidential submissions of IPO registration statements described below.

Reduced Financial Disclosure

In an IPO registration statement, EGCs are allowed to present only two years of audited financial statements and related Management's Discussion and Analysis (MD&A) disclosure, instead of the traditional three years of audited financial statements and related MD&A disclosure. In addition, EGCs are permitted to omit "selected financial data" in an IPO registration statement for any period prior to the earliest audited period presented in the registration statement, meaning that an EGC need only provide two (instead of the traditional five) years of "selected financial data." However, it remains to be seen whether companies and/or their underwriters will be comfortable, from a marketing perspective, presenting only two years of audited financial statements and selected financial data in IPO registration statements. The IPO registration statement of an EGC may also utilize so-called "scaled disclosure," including reduced executive compensation disclosure and audit disclosure, as more fully described under the heading "*Reduced Public Reporting Requirements Following IPO*" below.

Confidential IPO Submissions to the SEC

Prior to the JOBS Act, domestic companies (and most foreign companies) desiring to go public were required to publicly file their registration statement and preliminary prospectus with the SEC. Now, under the JOBS Act, both domestic and foreign EGCs may submit draft versions of these documents to the SEC on a confidential, non-public basis. This means that the investment community will not know the contents of an EGC's submissions (or perhaps even that they exist) while they are under review by the SEC, allowing the EGC to protect sensitive or confidential information until it has more certainty regarding the likelihood of completing its IPO. A draft registration statement is not required to be signed by the EGC or to include the consent of the EGC's auditor, although the draft does need to be substantially complete and include the required exhibits as well as a signed audit report covering the fiscal years presented. An EGC is required to publicly file its registration statement and prospectus (including the initial confidential submission and all amendments thereto) at least 21 days before commencing its IPO roadshow (or at least 21 days before the anticipated date of effectiveness of the registration statement if there is no roadshow). In addition, an EGC is not required to pay the associated SEC filing fee until the registration statement is first publicly filed.

Ending Certain Restrictions on Analysts

In a significant departure from long-standing protections, the JOBS Act allows for research analysts, including analysts from the investment banking firm(s) underwriting an EGC's IPO, to publish and distribute research reports on the EGC both before and after the filing of the registration statement, as well as after the IPO itself. In addition, research analysts are now permitted to participate in meetings (such as pitch meetings for underwritten IPOs) with management of an EGC at which investment bankers are present. These changes have raised concerns that the analysts' research reports may be influenced by their investment banking colleagues seeking to win lucrative business from potentially high-flying companies. Another potential conflict of interest is that investment bankers may use such research reports to generate interest in the stock of an EGC, which is often resold to retail investors following an IPO.

Reduced Public Reporting Requirements Following IPO

An EGC will continue to be subject to the significantly reduced "scaled disclosure" referred to above after it goes public, which should lower the cost and burden of operating as a public company.

Financial Disclosure

An EGC is not required to present audited financial statements or "selected financial data" for any period prior to the earliest audited period presented in the EGCs IPO registration statement.

Audit Standards

EGCs are not required to comply with any new or revised financial accounting principles until they apply to all private companies. In addition, if any future rules are adopted that call for mandatory audit firm rotation or an "auditor discussion & analysis" (as proposed in a concept release by the Public Company Accounting Oversight Board), EGCs will not be required to comply with such rules. Perhaps most significantly, EGCs are exempt from the Sarbanes-Oxley Act requirement that a public company's auditor attest to and report on management's assessment of the effectiveness of the company's internal controls for financial reporting.

Executive Compensation Disclosure and Governance

EGCs are not required to present a "Compensation Discussion & Analysis" section in their disclosure materials and are permitted to present only two (instead of three) years of executive compensation information for only three (instead of five) executive officers. Also, EGCs will not be required to disclose the relationship between executive compensation and company performance, or the ratio of CEO pay to median company pay, when these disclosure requirements under the Dodd-Frank Act are implemented via SEC rules. In addition to these reduced executive compensation disclosure requirements, EGCs are not required to hold the shareholder advisory votes on "say-on-pay," "say-on-frequency" and "say-on-golden parachute" recently enacted under the Dodd-Frank Act. With respect to other disclosures regarding executive compensation, public EGCs may comply with the reduced reporting requirements applicable to so-called "smaller reporting companies."

Review of Regulation S-K

Under the JOBS Act, the SEC must review and analyze Regulation S-K, which sets forth required disclosures for all public companies as well as companies in the IPO registration process, to determine how to streamline the registration process in order to make it more efficient and less burdensome for EGCs. The SEC is required to provide Congress with a report of its review no later than 180 days following enactment of the JOBS Act.

Conclusion

The JOBS Act effectively creates a new class of public company issuer that will receive more favorable treatment under U.S. securities laws than older, smaller companies that are nevertheless good corporate citizens. As noted in our April 6, 2012 alert summarizing the JOBS Act's major features, this disparity will likely result in pressure from companies that do not qualify as EGCs (due to the date of their IPOs) for similarly relaxed standards to be applicable to them.

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