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Masterman Culbert & Tully

Corporate Law Bulletin

JOBS Act – Title I:Emerging Growth Companies and the IPO On-Ramp

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EXECUTIVE SUMMARY

Earlier this year, Congress overwhelmingly passed the Jumpstart Our Business Startups Act ("JOBS Act"), which was subsequently signed by the President. The JOBS Act eases the regulatory burden on a newly-designated kind of issuer of securities called the "Emerging Growth Company" in two principal ways:

1. Providing an "on-ramp" to the IPO process; and
2. Relaxing disclosure and audit requirements.

The JOBS Act is designed to increase the number of IPOs in the U.S. equity market by reducing regulatory hurdles for start-ups and small businesses to access larger capital pools and by giving ordinary Americans the ability to go online and invest in entrepreneurs they believe in. Although all provisions discussed herein are effective immediately, with the exception of Regulation S-K discussed on the last page, SEC guidance is necessary to help implement some benefits, such as the confidential review of draft IPO registration statements.

This Bulletin is the first in a series discussing the JOBS Act, and addresses the key points of an Emerging Growth Company's new opportunities in the IPO on-ramp.

I: WHAT IS AN EMERGING GROWTH COMPANY?

Simply, an emerging growth company ("EGC") is any issuer that had less than $1 billion of total annual gross revenue during its last fiscal year.[1] An issuer shall remain an EGC until the earliest of:

(A) the last day of the issuer's fiscal year during which it had total annual gross revenue of $1 billion or more;
(B) the last day of the issuer's fiscal year following the fifth anniversary of the issuer's IPO;
(C) the date on which the issuer has, during the previous three year period, issued more than $1 billion in non-convertible debt; or
(D) the date on which the issuer is deemed to be a 'large accelerated filer' under the Exchange Act.[2]

Being classified as an EGC allows many smaller companies going public a maximum of five years in which they can ease into the full-blown disclosure and reporting requirements of being a public company. During this so called "IPO on-ramp" period, the typical burdens of an issuer in the IPO process are potentially significantly reduced because an EGC can communicate easier with potential investors, can have the SEC review its draft IPO registration statement before filing, and does not have to make as many disclosures or be subject to typically strict audit requirements.

II: HOW CAN MY COMPANY EASE INTO THE IPO PROCESS?

Testing the Waters

A significant new permissible communication that EGCs can engage in during the IPO on-ramp period is known as testing the waters. EGCs are now permitted to engage in oral and written communications with potential investors to determine whether they are interested in purchasing securities from the EGC, both prior to and following the filing of the company's IPO registration statement. This allows EGCs to test the waters without making full-blown public disclosures of sensitive company information. The only two requirements are that: (1) such potential investors be institutional accredited investors or qualified institutional buyers, and (2) if they end up purchasing securities, they be provided with a prospectus.

[1] If an issuer already sold common equity securities in an IPO on or before December 8, 2011, it cannot be an EGC.

[2] This means, generally, that the issuer has more than $700 million in public float.

An EGC that is contemplating an IPO can also now engage brokers and dealers to publish or distribute a research report about the EGC without such report being considered an offer for sale or offer to sell a security, even if the broker or dealer is participating or will participate in such EGC's IPO. A research report includes any written, electronic or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security of an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision.

Finally, brokers, dealers or members of a national association are exempt from any post-IPO "quiet period" rules restricting publishing or distributing a research report or making a public appearance with respect to the IPO of an EGC, either: (1) within any prescribed period following the IPO, or (2) within any prescribed period prior to the expiration of any agreement between the broker, dealer or member of a national securities association and the company or its stockholders that restricts or prohibits the sale of the company's securities after the IPO.

Draft IPO Registration Statement Review by the SEC

In addition to testing the waters to gauge interest in its IPO, EGCs can submit, in confidence, a draft IPO registration statement to the SEC for confidential, non-public review by the SEC staff of it prior to actual public filing.[3] However, there's a catch: such initial confidential submission and all amendments thereto must be publicly filed not later than 21 days before the EGC conducts a pre-IPO "road show" for potential investors.

Be careful, however, as a "road show" is broadly defined to mean an offer (other than a prospectus or a portion of a statutory prospectus filed as part of a registration statement) that contains a presentation regarding an offering by one or more members of the issuer's management and includes discussion of one or more of the issuer, its management, and the securities being offered.

III: HOW HAVE MY COMPANY'S DISCLOSURE AND AUDIT REQUIREMENTS BEEN RELAXED?

Disclosures:

EGCs can now take advantage of the following relaxed disclosure requirements:

- Not required to hold a non-binding shareholder advisory vote every three years on executive compensation, nor is an EGC required to hold a shareholder vote on golden parachutes.[4]
- Won't have to show the relationship between executive compensation paid and the financial performance of the issuer in making required compensation disclosure reports.
- Don't have to disclose the median of the total annual compensation of all employees of the issuer, of the CEO of the issuer, and the ratio of the employees' compensation to that of the CEO.
- With respect to an IPO registration statement, an EGC will only need to provide two years of audited financial statements (as opposed to three years for all other issuers) and selected data for only such audited period (as opposed to five years for all other issuers).

Audit

The level of auditing previously required by Sarbanes-Oxley is now greatly reduced for EGCs. Although an issuer's annual report under the Exchange Act (Form 10-K or Form 20-F) must still contain an internal control report that states and assesses the issuer's internal control structure and procedures for financial reporting, EGCs are now exempted from the additional requirements that a registered public accounting firm attest to and report on, the assessment made by the issuer's management under Sarbanes-Oxley.

Additionally, EGCs are exempt from any rules promulgated pursuant to Sarbanes-Oxley with respect to mandatory audit firm rotation or a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and financial statements of the issuer. This

[3] The SEC has issued instructions for submitting a draft IPO registration statement: http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm

[4] However, when an issuer ceases to be an EGC before the second anniversary of its IPO, it must conduct its executive compensation advisory vote by the end of the third anniversary of its IPO. For all other issuers, they must conduct such advisory vote in the year following their loss of EGC status.

allows EGCs to avoid changing auditors with which they have become familiar and no doubt have set up a good working relationship with. Furthermore, any additional rules adopted after the enactment of the JOBS Act shall only apply to EGCs if the SEC determines that such additional requirements are necessary or appropriate in the public interest.

IV: WHAT OTHER CONSIDERATIONS SHOULD AN EGC BE AWARE OF?

Opt In: The JOBS Act allows EGCs to generally forego any of the benefits available to them under the JOBS Act, and instead comply with the requirements that apply to issuers that are not EGCs. However, with respect to new or revised accounting standards, if an EGC chooses to comply with such standards, it must comply with all such standards to the same extent that a non-EGC would have to comply with them (in other words, it cannot pick and choose which standards to comply with it). The EGC must elect to comply at the time the company is first required to file a registration statement, periodic report, or other report with the SEC under the Exchange Act. If it elects to opt-in to all such accounting standards, the company must continue to comply with all such standards for as long as it remains an EGC.

Regulation S-K: By October 5, 2012, the SEC is supposed to send to Congress a report of their review of Regulation S-K that analyzes the current registration requirements and determines how such registration requirements can be updated and modernized to simplify the registration process. A company contemplating filings pursuant to Regulation S-K may want to wait to see if their filing obligations will be made easier by the SEC's recommendations contained in their report.

For further information about the JOBS Act, Dodd-Frank, or corporate/business questions generally, please contact any of the following lawyers at Masterman, Culbert & Tully LLP by dialing (617) 722-8100:

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