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Securities Alert

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JOBS Act to Ease Capital Formation for Public and Private Companies and Reduce Regulatory Burdens on Emerging Growth Companies

Alert 1 of 2: Focus on the "IPO On-Ramp"

On April 5, 2012, after overwhelming bi-partisan support in Congress but criticism from regulators and investor protection groups, President Obama signed into law the Jumpstart Our Business Startups Act (the JOBS Act). The JOBS Act significantly amends the federal securities laws to:

- reduce regulatory burdens on smaller "emerging growth companies" and the investment banking community that serves them;
- expand access by start-ups and other small companies to private and public sources of financing in the United States; and
- increase the thresholds under which private companies are required to register with the Securities and Exchange Commission (the SEC) and begin filing periodic public reports.

This alert focuses on the portions of the JOBS Act that impact smaller public companies and public financing. We have also prepared a separate alert that focuses on the portions of the JOBS Act that are intended to spur additional private financing and provide regulatory relief from periodic public reporting.

Congress enacted the JOBS Act for the express purpose of "increas[ing] American job creation and economic growth by improving access to the public capital markets for emerging growth companies." The number of initial public offerings in the United States has fallen dramatically since 2000, in part because of increased costs of regulatory compliance as a result of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and other burdens, according to the IPO Task Force of the National Venture Capital Association, which has championed the JOBS Act's reforms through the legislative process over the past year.

Although the JOBS Act will result in significant changes to the federal securities laws, many of the changes are not self-effectuating and require rulemaking by the SEC, which in some cases could take up to a year or longer to complete. Moreover, given that the SEC has expressed concerns about the JOBS Act's loosening of existing regulations, the SEC could, in exercising its rulemaking authority, require changes that are more restrictive than what Congress has proposed if the SEC believes these changes are necessary for the protection of investors. We will monitor the rulemaking process and continue to provide further updates on these matters as they develop.

Title 1 of the JOBS Act: The IPO "On-Ramp"

One of the primary purposes of the JOBS Act is to ease the pathway to an initial public offering for

small, emerging companies. Title 1 of the JOBS Act reflects an attempt to respond to the concerns regarding the deterrent effect of Sarbanes-Oxley and other legislation and to make the public offering market available to companies that otherwise would have relied on private offerings to finance the development of their businesses.

The JOBS Act creates a new category of issuer for SEC registration and reporting purposes, called *"emerging growth companies"* (EGCs). Section 101 of the JOBS Act defines an "emerging growth company" as a company that had total annual gross revenues of less than $1 billion during its most recently completed fiscal year. This $1 billion threshold will be indexed for inflation every five years by the SEC. An issuer that is an EGC would continue to qualify as an EGC until the earliest to occur of:

- the last day of the issuer's fiscal year during which it had total annual gross revenues of at least $1 billion;
- the last day of the issuer's fiscal year following the fifth anniversary of its initial public offering of equity securities pursuant to the Securities Act of 1933, as amended (the Securities Act);
- the date on which the issuer has, during the previous three years, issued more than $1 billion in non-convertible debt; or
- the date on which the issuer is deemed to be a "large accelerated filer" as defined under the Securities Exchange Act of 1934, as amended (the Exchange Act). [1]

If an issuer completed an IPO on or before December 8, 2011, it will not qualify as an EGC.

Title 1 of the JOBS Act also creates a variety of exemptions from SEC regulatory requirements for EGCs, which are intended to serve as incentives for these companies to consider pursuing an IPO in lieu of a private financing. For this reason, these provisions have also been referred to as the "IPO On-Ramp" provisions.

The IPO On-Ramp provisions are effective immediately and do not require rulemaking by the SEC to implement these provisions.

Section 102: Easing of Disclosure Requirements. EGCs will be able to take advantage of disclosure requirements that are less onerous than those to which other public companies are subject in the following areas of compensation, say-on-pay, and financial statements:

- EGCs will not be required to comply with the "say-on-pay" provisions imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which created the obligation to hold non-binding shareholder advisory votes on executive compensation and golden parachute compensation. This exemption will apply until either one or three years after the issuer ceases to be an EGC (depending on how long the issuer continued to be an EGC after its IPO);
- EGCs will not be required to comply with the provisions of Dodd-Frank requiring issuers to (1) disclose the ratio of the CEO's compensation to the median compensation of all other company employees and (2) disclose the relationship between executive compensation actually paid and the financial performance of the company; [2]
- EGCs will be allowed to comply with the reduced executive compensation disclosure requirements that are available to smaller reporting companies [3], including the ability to omit the Compensation Discussion and Analysis section, as well as inclusion of fewer compensation tables in the proxy statement and fewer executive officers in these compensation tables; and
- EGCs will only be required to include two years of audited financial statements in registration statements for IPOs, and in any other registration statement, an EGC may exclude selected financial data for any fiscal period that is before the earliest audited period presented in its IPO registration statement.

Section 103: Elimination of requirement to provide auditor attestation on internal control over financial reporting. The JOBS Act amends Section 404(b) of Sarbanes-Oxley to provide that an EGC need not include an attestation report from its auditors on the company's internal control over financial reporting, which extends this relief that was provided to smaller reporting companies and other "non-accelerated filers" by Dodd-Frank. EGCs would remain subject to the requirement to provide management's own assessment of internal controls, but this change should make compliance with internal control reporting requirements substantially easier and less costly.

Section 104: New auditing standards would only apply after separate SEC evaluation. The JOBS Act amends Sarbanes-Oxley to provide that EGCs will be exempt from any rules of the Public Company Accounting Oversight Board (PCAOB) that may require mandatory audit firm rotation or a so-called "auditor discussion and analysis," which would be a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer. In addition, all PCAOB rules that are adopted after the passage of the JOBS Act will only apply to an EGC if the SEC determines that the application of such additional rules is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation. This should provide some additional comfort to EGCs that the burden of proof will be on the SEC to justify the application to them of additional PCAOB rules.

Section 105: Increased ability to communicate with certain investors and easing of restrictions on communications by and with research analysts. A very significant reform in Title 1 of the JOBS Act expands the scope of permissible communications by or relating to EGCs that are contemplating or conducting securities offerings. We believe this relaxation of the Securities Act's "gun-jumping" prohibitions represents a historic and long-overdue advance in the regulatory landscape applicable to certain communications regarding public offerings, which we hope will clarify and simplify the communication process for EGCs pursuing financings in the U.S. public markets.

- "Testing the waters" for a securities offering. The JOBS Act revises the Securities Act to allow both oral and written offers of securities by EGCs either before or after the filing of a registration statement for an offering, as long as the offerees are qualified institutional buyers (QIBs) or institutional accredited investors, and they are provided a final prospectus if they purchase the securities offered.

  This is a significant easing of the previous prohibition on making offers before the filing of a registration statement (other than for very large public companies), and will allow issuers and their agents greater insight into the likelihood of success of an offering before undertaking significant expense in its preparation. It also will enable EGCs more freely to conduct "road show" meetings with potential investors both before and after the filing of a registration statement, as well as to provide them with additional written materials beyond what is now allowed in the statutory preliminary and final prospectuses and certain free writing prospectuses.

  One question still to be answered is whether graphic communications, including all forms of electronic media, which are treated as "written communications" under the SEC's rules, will be treated as written communications for purposes of the new JOBS Act provision. In our view, this was undoubtedly the intention of the JOBS Act drafters, given the SEC's prior rulemaking to that effect and the well-established use of graphic communications in the public offering process. (Interestingly, the JOBS Act provision regarding securities analyst research reports, discussed below, explicitly includes electronic communications in the definition of a "research report"). Were the SEC to take a contrary position and deem a graphic communication a non-exempt offer, much of the benefit of this important new JOBS Act provision would be lost.

- Issuance of research reports about EGCs. The JOBS Act amends the Securities Act to exempt the publication or distribution by a broker or dealer of research reports about an EGC that proposes to engage, or is or has engaged, in a registered public offering, from the

definition of an “offer” of securities under the Securities Act, even if the broker or dealer is participating or will participate in the registered offering. In addition, the JOBS Act amends the Exchange Act to provide that rules restricting brokers, dealers, and members of national securities associations from publishing or distributing research reports during post-IPO quiet periods and lock-up windows will no longer apply. This should allow greater visibility, in the form of research reports, for EGCs who have completed or who are engaged in registered offerings, to the extent they have brokers and dealers who are interested in publishing research during those windows.

- Broader communications permitted with securities analysts. The JOBS Act also eliminates restrictions (1) on which associated persons of a broker, dealer, or member of a national securities association may arrange for communications between a securities analyst and potential investors in an EGC, and (2) on the ability of a securities analyst to participate in communications with management of an EGC that are also attended by other associated persons of the broker, dealer, or member of a national securities association who are not securities analysts (for example, investment bankers). This reverses some of the very strict restrictions on interactions between issuers and securities analysts, which restrictions were put in place in 2002 and 2003, following the corporate governance scandals that led to the passage of Sarbanes-Oxley.

Section 106: Confidential treatment of draft IPO registration statements. Title I amends the Securities Act to permit an EGC to submit a draft IPO registration statement for confidential review by SEC staff prior to its public filing, provided that the initial confidential submission and all amendments are publicly filed with the SEC not later than 21 days before the EGC conducts a “road show.” As a practical matter, this is clearly a fundamental change in the practice of preparation for IPOs, under which SEC rules currently require all registration statements and amendments for all U.S. issuers and most foreign issuers to be publicly filed on EDGAR, which allows potential investors, competitors, partners, customers, and employees to learn previously non-public information about the issuer and its finances. This change may have both benefits and drawbacks for issuers, which will no longer be required to reveal intricate details of their businesses until a road show is imminent, but which likewise will not be aware of potentially competing offerings until immediately before an offering is set to begin.

Section 107: “Opt-in Right” for Disclosure Requirements. EGCs also have the right under the JOBS Act to elect not to take advantage of one or more of the relaxed disclosure requirements provided for EGCs. However, with respect to accounting standards that are adopted after the passage of the JOBS Act, Title I provides that an EGC may not select some accounting standards to comply with and not others.

Section 108: Review of Regulation S-K. The JOBS Act requires that the SEC review Regulation S-K, which contains specific disclosure requirements for all public companies and companies going through the IPO process, to analyze the registration requirements and determine ways in which the registration process could be modernized and simplified. The SEC is directed to report the results of this review to Congress within 180 days of the passage of the JOBS Act.

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Only time will tell whether these provisions will actually increase the number of companies choosing to go public in the United States to levels that we saw prior to the implementation of Sarbanes-Oxley. However, given the enthusiasm with which Congress appears to have acted to pass the JOBS Act, we are optimistic that this will at least start conversations in more boardrooms about the possibility of accessing the U.S. public securities markets for smaller issuers.

Below is a chart showing a comparison between various provisions of the JOBS Act and the rules in this area prior to the enactment of the JOBS Act.

Communications with Potential Investors and with Research Analysts; Disclosure

	BEFORE THE JOBS ACT	AS CHANGED BY THE JOBS ACT
Confidential submissions of draft IPO registration statements and amendments	Not permitted for domestic issuers; allowed for foreign private issuers on a very limited basis.	An EGC may file its draft S-1 or F-1 for an IPO with the SEC on a confidential basis, allowing review and resolution of comments prior to any public filing. The S-1 or F-1 and all amendments would have to be filed publicly on EDGAR not later than 21 days before the start of the road show for the offering.
Ability to communicate with investors in connection with a securities offering	Very limited. No written offers are permitted before the filing of a registration statement other than by "well-known seasoned issuers."	The JOBS Act expands permissible communications to allow EGCs, either before or after filing a registration statement, to "test the waters" by engaging in oral or written communications with QIBs and institutional accredited investors to determine interest in an offering.
Restrictions on publication of research reports	Generally, managing underwriters of an IPO are prohibited from publishing a research report on the issuer until 40 days after the completion of the IPO.	The JOBS Act will allow brokers or dealers to publish and distribute research reports about an EGC that is involved in a public offering, even if the brokers or dealers are participating or will participate in the offering.
Communications with securities analysts	Communications by analysts with companies engaged in an offering are highly restricted and may not be conducted while investment banking representatives are present.	The JOBS Act eases these restrictions substantially, allowing securities analysts to participate in communications with management of an EGC when other representatives of the broker or dealer are present.

Financial Statements, Internal Control Reporting and Accounting Standards

	BEFORE THE JOBS ACT	AS CHANGED BY THE JOBS ACT
Internal control reporting under Section 404 of Sarbanes-Oxley	Auditor attestation on effectiveness of internal controls over financial reporting is required in second annual report after IPO. Non-accelerated filers are exempt from this requirement. However, management must still evaluate effectiveness of internal controls.	Auditor attestation as to effectiveness of internal controls over financial reporting is not required as long as the issuer qualifies as an EGC. Management of EGCs will be required to evaluate effectiveness of internal controls.
Accounting standards	Must comply with all applicable financial accounting standards.	EGCs will not be required to comply with any new or revised financial accounting standard until the standard

		applies to companies that are not subject to Exchange Act reporting requirements. EGCs may choose to comply with non-EGC accounting standards, but may not selectively choose which standards with which to comply.
Auditor rotation and other PCAOB rules	The PCAOB requires rotation of audit partners every five years. The PCAOB is also considering imposing a requirement to rotate audit firms periodically.	The audit partner requirement is unchanged, but EGCs would be exempt from any future rule of the PCAOB requiring audit firm rotation. Any new PCAOB rules adopted after the passage of the JOBS Act will not apply to EGC audits until the SEC determines that it is necessary to have them apply.
Requirements to include audited financial statements in registration statements	The last three completed fiscal years must be included. Selected financial data for each of five years or life of the issuer, if shorter, and any interim period must be included in the financial statements.	Only the last two completed fiscal years must be included. Selected financial data is not required for any period prior to the earliest audited period presented in connection with an IPO.

Executive Compensation Disclosure and Say-on-Pay

	BEFORE THE JOBS ACT	AS CHANGED BY THE JOBS ACT
Executive compensation requirements	Issuers must comply with the SEC's executive compensation disclosure requirements under Regulation S-K. However, smaller reporting companies may take advantage of reduced disclosure requirements. Companies will be required to calculate and disclose the median compensation of all employees compared to that of the CEO and to disclose the relationship between executive compensation actually paid and the financial performance of the company (however, these sections of Dodd-Frank are still subject to SEC rulemaking).	EGCs will be able to comply with executive compensation disclosure requirements by complying with the reduced disclosure requirements generally available to smaller reporting companies. EGCs will be exempt from the requirements to calculate and disclose the median compensation of all employees compared to that of the CEO and to disclose the relationship between executive compensation actually paid and the financial performance of the company.
Say-on-Pay	As imposed by Dodd-Frank, all companies other than smaller reporting companies must now hold non-binding advisory shareholder votes on executive compensation and "golden parachute" arrangements.	An EGC will be exempt from the say-on-pay requirements until one to three years after ceasing to be an EGC.

	Smaller reporting companies are exempt from these requirements until the first annual shareholder meeting that occurs on or after January 20, 2013.

If you have any questions regarding the matters discussed in this alert, please contact one of the attorneys listed below or your regular contact at Mintz Levin.

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Endnotes

1. Exchange Act Rule 12b-2 defines a "large accelerated filer" as an issuer with a public float value of $700 million or more which has also been subject to Exchange Act reporting requirements for at least 12 calendar months and has filed at least one annual report (e.g., Form 10-K or Form 20-F) with the SEC.
2. As of the date of this alert, these Dodd-Frank provisions remain subject to SEC rulemaking for all public companies.
3. Exchange Act Rule 12b-2 defines a "smaller reporting company" as an issuer with a public float value of less than $75 million or, in the case of an issuer with zero public float value, with annual revenues of less than $50 million in its most recently completed fiscal year.

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