persist after the IPO may expose the company to stockholder litigation, SEC enforcement action, and criminal prosecution.[8]

§ 10:5 Impact of the JOBS Act

§ 10:5.1 Overview

On April 5, 2012, the Jumpstart Our Business Startups Act (JOBS Act) was enacted. Intended to spur job creation and economic growth by improving access to the capital markets for startup and emerging companies, the JOBS Act effects profound changes to the U.S. securities laws and has broad implications for pre-IPO companies, companies that recently went public, and the conduct of IPOs and other securities offerings. Although some aspects of the JOBS Act are subject to future SEC rulemaking, the provisions applicable to IPOs are immediately in effect. All JOBS Act provisions except crowdfunding are available to foreign companies.[9]

§ 10:5.2 "IPO On-Ramp"

The cornerstone of the JOBS Act is the creation of an "IPO on-ramp," which provides emerging growth companies (EGCs) with a phase-in period to fully comply with various disclosure and accounting requirements. An emerging growth company will have up to the last day of the fiscal year following the fifth anniversary of its IPO to come into full compliance with various disclosure regulations and accounting and auditing standards that are otherwise applicable to all U.S. public companies. Many of the act's benefits begin to apply during the IPO process, while others become applicable only following an IPO.

[A] Definition of "Emerging Growth Company"

The JOBS Act defines an emerging growth company as any issuer that had total annual gross revenues of less than $1 billion (adjusted for inflation every five years) during its most recently completed fiscal year, other than an issuer that completed an IPO on or before December 8, 2011.[10] A company that is an emerging growth company

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8. *See, e.g.*, SEC v. Veraz Networks, Inc. (N.D. Cal. June 29, 2010) (charging newly public company with FCPA violations and noting that "[i]t is particularly important that newly public companies doing business overseas establish the appropriate policies and procedures to prevent a culture of payments to foreign officials from developing").
9. Crowdfunding is discussed in chapter 2. *See* section 2:8.2[E].
10. For purposes of determining emerging growth company status, the revenue test is applied to the issuer's most recently completed fiscal year, regardless of whether financial statements for that fiscal year are presented in the

on the first day of its fiscal year will no longer qualify as an emerging growth company upon the earliest of:[11]

- the last day of its fiscal year following the fifth anniversary of the first sale of its common equity securities in a public offering;
- the last day of a fiscal year during which it had total annual gross revenues of $1 billion (adjusted for inflation every five years);
- the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or
- the date on which it is deemed to be a "large accelerated filer" (a company that has been public for at least twelve months, has filed one Form 10-K, and has a public float of at least $700 million).

[B] IPO Relief

An emerging growth company is entitled to the following exemptions from, and modifications of, the disclosure, accounting, auditing and other requirements that would otherwise apply, beginning with the IPO process:

- *Reduced Financial Statement and MD&A Disclosure*: In IPO registration statements, emerging growth companies are required to provide only two years of audited financial statements (instead of three) plus unaudited interim financial statements. If an emerging growth company is required to include separate financial statements for an acquired business, the maximum time period for which such separate financial statements must be provided is also two years, regardless of the significance of the acquisition under Regulation S-X. In addition, an emerging growth company need not present selected financial data in

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registration statement. For example, a company that files a Form S-1 early in its fiscal year and is permitted to include in the Form S-1 financial statements for the first nine months of the preceding fiscal year as the most recent financial statements presented would nevertheless use its gross revenues for the full preceding fiscal year to determine whether it qualifies as an emerging growth company. See section 4:4.1[A] for discussion of the periods for which company financial statements are required to be presented in a Form S-1.

11. The SEC staff has published detailed guidance regarding the determination of EGC eligibility and other JOBS Act interpretations. *See* Jumpstart Our Business Startups Act Frequently Asked Questions: Generally Applicable Questions on Title I of the JOBS Act, www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (Apr. 16, 2012, May 3, 2012, and Sept. 28, 2012).

the Form S-1 or other registration statements or Exchange Act reports for any period prior to the earliest audited period presented in its IPO registration statement. Similarly, MD&A must cover only the fiscal periods presented in the required financial statements. Over time, a third year of audited financial statements (and corresponding MD&A) and up to five years of selected financial data will be required in other registration statements and Exchange Act reports filed by the emerging growth company.[12]

- *Delayed Application of New Accounting Standards*: Emerging growth companies are not subject to any accounting standards that are adopted or revised on or after April 5, 2012, unless and until these standards are required to be applied to non-public companies (companies that are not subject to the reporting requirements of the Exchange Act and have not filed a pending registration statement under the Securities Act), although emerging growth companies may elect to be subject to such accounting standards at the time they become applicable to public companies. This election must be made on an "all or nothing" basis and is irrevocable.[13]
- *Exemption from New PCAOB Audit Requirements*: Emerging growth companies are exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors supplement their audit reports with additional information about the audit or financial statements of the company (a so-called auditor discussion and analysis) that the PCAOB might adopt. Any other new auditing standards adopted by the PCAOB will not apply to audits of emerging growth companies unless the SEC determines that application of the new rules to audits of emerging growth companies 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.[14]
- *Reduced Executive Compensation Disclosures*: An emerging growth company is allowed to provide the "scaled" executive compensation disclosures previously available only to smaller reporting companies.[15] As a result, an emerging growth

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12. See sections 4:4, 7:5.1, and 13:2.1[J] for further discussion of financial statement and MD&A requirements.
13. See section 4:4.1[B][2] for further discussion of this election.
14. See section 4:4.1[C][2] for further discussion of PCAOB audit requirements for emerging growth companies.
15. "Smaller reporting companies" are companies with a public float of less than $75 million, regardless of revenue or assets. If a company is unable to

company need not provide CD&A; compensation information is required only for three named executive officers (including the CEO); only three of the seven compensation tables otherwise required must be provided; the Summary Compensation Table is only required to cover two years (as opposed to three); and narrative disclosure of compensation policies and practices as they relate to risk management is not required.[16]

- *Expansion of Permitted Investor Communications*: Emerging growth companies and their agents have more freedom to communicate with potential investors that are "qualified institutional buyers" (as defined in Rule 144A) or institutions that are "accredited investors" (as defined in Regulation D), both before and after the filing of a registration statement for an IPO or other securities offering (including during the quiet period).[17]
- *Confidential Submission of Registration Statements*: An emerging growth company is permitted to submit a draft Form S-1 (and amendments to the Form S-1) to the SEC for confidential review instead of filing it publicly. A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements, signed audit reports covering the audited financial statements presented in the Form S-1, and exhibits, but need not be signed by the company or its directors or principal officers, include consents from auditors or other experts, or be accompanied by the registration fee. Required signatures, consents, and the registration fee are provided upon the first public filing. The SEC review process for a confidential submission is generally the same as for a public filing. Confidential submissions are exempt from Freedom of Information Act requests, but the initial submission and all amendments must be filed publicly no later than twenty-one days before the road show commences (or twenty-one days before effectiveness of the Form S-1, if there is no road show). This twenty-one-day

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calculate its public float—for example, if it has no common stock outstanding or no market price exists for its outstanding common stock—it must have had less than $50 million in revenue in its most recent fiscal year to qualify as a smaller reporting company.

16. See Table 21-1 for further information regarding the scaled executive compensation disclosures available to smaller reporting companies (and now emerging growth companies) under Item 402 of Regulation S-K. Emerging growth companies are not entitled to the other scaled disclosures available to smaller reporting companies summarized in Table 21-1.
17. See chapter 11 for further discussion of the quiet period.

period is intended to give the market sufficient time to digest the Form S-1 before marketing of the offering commences.[18]

- *Relaxation of Research Analyst Restrictions*: Research analysts have greater ability to communicate with investors and with the management of an emerging growth company in connection with the company's IPO. Research analysts are permitted to attend meetings with the company's management at which other broker-dealer personnel, including investment bankers participating in the IPO, are present, and are also able to attend investor meetings arranged by investment bankers. In addition, brokers-dealers, including underwriters participating in the IPO, may publish research reports and make public appearances regarding the company both prior to and after the filing of a registration statement for an offering of common equity securities, during any prescribed post-offering blackout period, and during any blackout period prior to or after the expiration, termination, or waiver of a lockup period. However, most major investment banks remain constrained by the global settlement (the terms of which are not modified by the JOBS Act).[19]

[C] Post-IPO Benefits

Following its IPO, an emerging growth company can also benefit from the following provisions of the JOBS Act:

- *Exemption from Internal Controls Audit Attestation*: Emerging growth companies are exempt from the requirement under section 404(b) of the Sarbanes-Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company's internal control over financial reporting (ICFR). However, emerging growth companies are not exempt from the requirement to maintain an effective system of ICFR and to provide an annual management report on ICFR and a quarterly ICFR certification from the CEO and CFO.[20]
- *Exemption from Say-on-Pay, Say-on-Frequency, and Say-on-Parachute Requirements*: Emerging growth companies are exempt from the requirements mandated by the Dodd-Frank Act that companies seek stockholder approval of an advisory vote on

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18. See section 16:5.4 for further discussion of the confidential submission process and chapter 17 for further discussion of the SEC review process.
19. See section 19:7 for further discussion of the global settlement, research analyst issues, and related FINRA and SEC rules.
20. See section 6:3.1 for further discussion of ICFR requirements and section 22:4.1 for discussion of CEO and CFO ICFR certification requirements.

their executive compensation arrangements, including golden parachute compensation.[21]

- *Exemption from Additional Compensation Disclosures*: Emerging growth companies are exempt from the Dodd-Frank Act requirements, which remain subject to SEC rulemaking, to include disclosures about the relationship between executive compensation and financial performance and the ratio between CEO compensation and median employee compensation.

§ 10:5.3 Adoption of Emerging Growth Company Standards

An emerging growth company may elect to forgo any of the exemptions available to it under the JOBS Act and instead comply with the requirements that apply to a company that is not an emerging growth company, but is not permitted to choose to comply with some but not all of the non-EGC accounting standards. An emerging growth company must decide whether it will avail itself of the extension of time to comply with accounting standards that are adopted or revised on or after April 5, 2012, at the time the company is first required to file a registration statement, periodic report, or other report with the SEC after April 5, 2012. A decision to forgo the extended transition period to comply with new or revised accounting standards is irrevocable, but an initial election to take advantage of the extended transition period can be reversed. The decision to change is irrevocable and should be prominently disclosed in the company's next registration statement or periodic report filed with the SEC.

Eligible companies that adopt emerging growth company standards should explain that they are providing EGC disclosures in their public filings. The SEC staff has indicated that an emerging growth company should state its EGC status on the cover of its IPO prospectus (whether or not the company is taking advantage of any of the benefits available to it as an emerging growth company). Emerging growth companies should also include risk factor disclosure concerning EGC standards that create additional risk for investors, such as the absence of an ICFR audit or the delayed application of new accounting standards to the company.[22]

Although the overwhelming majority of all IPO candidates are likely to qualify as emerging growth companies—approximately 90% of all IPO companies between 2007 and 2011 would have qualified—the extent to which EGC standards will be adopted by eligible

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21. See sections 5:4.2[C], 22:2.3[A][3], and 24:12.5 for further discussion of these requirements.
22. See chapter 13 for further discussion of EGC disclosures in the Form S-1.

companies and accepted by the market is uncertain. Institutional investors could, for example, demand that emerging growth companies continue to comply with non-EGC standards for some or all matters. A pre-IPO emerging growth company should discuss with its IPO underwriters the impact of adopting EGC standards on marketability of the offering. All emerging growth companies should also consider market and investor expectations before adopting EGC standards.

§ 10:5.4 General Solicitation in Rule 506 and Rule 144A Placements

The JOBS Act directs the SEC to modify its rules to eliminate:

- in private placements conducted pursuant to Rule 506 under Regulation D, the prohibition on general solicitation and general advertising, provided that all purchasers are "accredited investors" (as defined in Regulation D);[23] and
- in private placements conducted pursuant to Rule 144A, the prohibition on general solicitation, general advertising, and making offers to investors who are not "qualified institutional buyers" (as defined in Rule 144A), provided that securities are sold only to persons that the company (and any person acting on its behalf) reasonably believes are qualified institutional buyers.[24]

In August 2012, the SEC proposed rule amendments to implement the above requirements. The JOBS Act does not limit these changes to placements by emerging growth companies. The revised rules, once effective, will be available to all companies.

§ 10:5.5 Application of the JOBS Act to Existing Public Companies

Companies that went public on or before December 8, 2011, are not eligible to be emerging growth companies, but might benefit from the changes to Regulation D that will allow general solicitation and advertising in connection with Rule 506 private placements (provided that all purchasers are accredited investors)[25] and the comparable changes to Rule 144A.[26]

Companies that went public after December 8, 2011, but before enactment of the JOBS Act on April 5, 2012, can qualify as emerging

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23. See section 2:8.2[B] for further discussion of Regulation D.
24. See section 24:9 for further discussion of Rule 144A.
25. See section 2:8.2[B] for further discussion of Regulation D.
26. See section 24:9 for further discussion of Rule 144A.

growth companies but are unlikely to realize the EGC benefits as fully as a company completing an IPO after the act's enactment. For example, the reduced financial statement disclosure requirements may be of minimal value because the company has already publicly disclosed information for all periods prescribed by prior requirements.

§ 10:5.6 Required SEC Studies

The JOBS Act requires the SEC to conduct two studies that may result in further changes to the registration process for emerging growth companies or changes that affect trading in the securities of emerging growth companies:

- *Streamlining of Registration Process*: The SEC is required to comprehensively analyze the current requirements of Regulation S-K and determine how these requirements can be updated to modernize and simplify the registration process and reduce the costs and other burdens associated with these requirements for emerging growth companies. The JOBS Act calls for the SEC to report to Congress by October 2, 2012 (180 days after enactment of the JOBS Act) with specific recommendations on how to streamline the registration process in order to make it more efficient and less burdensome for the SEC and for emerging growth companies. The SEC has not yet issued this report.
- *Decimalization*: The SEC is required to examine the transition to trading and quoting securities in one penny increments, the impact that this "decimalization" has had on the number of IPOs and liquidity for small-cap and mid-cap company securities, and whether there is sufficient economic incentive to support trading in these securities in penny increments. If the SEC determines that the securities of emerging growth companies should be quoted and traded using a minimum increment of greater than \$0.01, the JOBS Act authorizes the SEC to designate a "tick size" greater than \$0.01 but less than \$0.10. In July 2012, the staff of the SEC issued its report on decimalization, concluding that further study is warranted to assess the impact of tick size on IPOs, trading, and liquidity for smaller companies as distinct from other potential factors, and recommending that the SEC not proceed with specific rulemaking to increase tick sizes as provided for in the JOBS Act and instead should consider the additional steps that may be needed to determine whether rulemaking should be undertaken in the future.

§ 10:5.7 SEC Rulemaking and Market Practices

The JOBS Act was created by combining various legislative proposals that had been under consideration by Congress over the preceding year or so, and was enacted quickly. The act calls for a substantial amount of SEC rulemaking and prescribes deadlines that the SEC has indicated are not achievable in light of the volume of rulemaking and the time required to draft new rules, prepare the accompanying economic analyses, permit proper review by the SEC, and afford opportunity for public input, as well as the backlog of uncompleted rulemaking mandated by the Dodd-Frank Act. Legal challenges to the upcoming rules are also possible, particularly in light of the successful effort to overturn the SEC's proxy access rule in July 2011 and the high judicial standards that must be satisfied for rules to be upheld. As a result, the timing of SEC rulemaking under the JOBS Act is uncertain.

In addition to the rulemaking required by the JOBS Act, the SEC staff has been issuing Frequently Asked Questions and providing other guidance on the JOBS Act. In doing so, the staff has indicated it is striving to implement Congress's intent in a pragmatic manner to make the act a success—for example, by finding solutions to technical glitches and filling in gaps in the act. Moreover, market practices with respect to the JOBS Act are only just beginning to emerge. The ultimate implications of the JOBS Act will become known over time as SEC rulemaking and interpretations continue and market practices develop.

§ 10:6 Sequence and Timing of Events in the IPO Process

The IPO process is not quick. In a typical IPO, the company spends six to twelve months in some level of preparations before holding the organizational meeting that launches the formal process. The Form S-1 usually is filed (or submitted by an emerging growth company for confidential SEC review, if applicable) one to two months later, and the offering typically is completed after another three to four months. Total elapsed time: twelve to eighteen months. Overall timing can vary widely, however, depending on numerous factors within and outside the company's control. It is, for example, often possible to compress the phase prior to the organizational meeting. It is unusual, however, to close an IPO in less than four or five months after the organizational meeting, or for a company not to devote at least two to three months to IPO preparations in advance of the organizational meeting.

Nor is the outcome of the IPO process certain. The reality is that the company must be ready for the market, and the market must be ready for the company. Without both, there can be no IPO, and the company controls only half the equation.

The length and uncertainty of the IPO process have several implications: