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JOBS Act Eases IPOs

Title I liberalizes regulatory and disclosure burden for companies considering going public, explain Sheppard Mullin attorneys.

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Title I of the Jumpstart Our Business Startups Act, which has been dubbed the "IPO On-Ramp," is intended to encourage initial public offerings by easing the regulatory requirements on a new, inclusive class of companies called "emerging growth companies (EGCs)."

The liberalized regulatory requirements include (1) mechanisms for EGCs to confidentially assess the market for a public offering; (2) a reduced requirement to include only two years of audited financial statements rather than three years in IPO registration statements; and (3) other scaled disclosure requirements in the registration statement and subsequent periodic reports filed by EGCs that continue for up to approximately five years after an EGC's IPO.

Title I of the JOBS Act became effective upon its enactment on April 5, 2012, and does not require any implementing rulemaking by the Securities and Exchange Commission or any other agency. The SEC has, however, issued guidance in the form of frequently asked questions that clarify the application of Title I of the JOBS Act.

Qualifying as an Emerging Growth Company

To qualify as an EGC, an issuer must meet both of the following criteria. First, the issuer must have had less than $1 billion in annual gross revenues during its most recent fiscal year, as shown on the issuer's income statement prepared in accordance with GAAP. Second, the issuer must not have completed a registered sale of common equity securities on or before Dec. 8, 2011, including (a) offerings of common equity securities for cash, (b) offerings of common equity securities under an employee benefit plan on a Form S-8 or (c) a selling stockholder's secondary offering on a resale registration statement.

An issuer that completed its IPO after Dec. 8, 2011, but before the JOBS Act was enacted on April 5, 2012, can qualify as an EGC for purposes of the ongoing scaled disclosure requirements.

An issuer that qualifies as an EGC will continue to qualify as an EGC until the earlier of: (1) the end of the fiscal year in which the issuer's annual revenues exceed $1 billion; (2) the end of the fiscal year that is the fifth anniversary of the issuer's IPO; (3) the date on which the issuer has, during the previous rolling three-year period, issued publicly or privately more than $1 billion in nonconvertible debt; or (4) the date on which the issuer qualifies as a "large accelerated filer," which generally requires the issuer to have a public float (meaning the issuer's market capitalization minus the market value of the equity securities held by the issuer's affiliates) of $700 million or more.

Unless an issuer exceeds the revenue, debt issuance or "large accelerated filer" thresholds, an issuer that qualifies as an EGC at the time of the issuer's initial public offering can expect to retain the EGC status until the end of its fiscal year following the fifth anniversary of the issuer's IPO. After an issuer no longer qualifies as an EGC, it will no longer be able to avail itself of the scaled disclosure requirements applicable to EGCs.

Application of Title I

A foreign private issuer may qualify as an EGC; however, there are some differences in the EGC qualification requirements. In the case of foreign private issuers, the requirement to have less than $1 billion annual gross revenues as presented on the income statement is measured in accordance with IFRS as issued by the IASB rather than GAAP. In addition, if the financial statements are denominated in a currency other than U.S. dollars, total annual gross revenues should be calculated in U.S. dollars using the exchange rates as of the last day of the most recently completed fiscal year.

Companies that were previously public companies, but deregistered in the past and are now seeking to re-IPO may also qualify as an EGC. Issuers that had an IPO of its common equity and subsequently deregistered prior to Dec. 8, 2011 could qualify as an EGC if all the other criteria are met.

Asset-backed securities issuers and investment companies registered under the Investment Company Act cannot qualify as an EGC. However, a business development company, which is a category of closed-end investment companies that are not required to register under the Investment Company Act, can qualify as an EGC.

Reduced Regulatory Burdens for EGCs

Title I includes a variety of ways to ease the regulatory and disclosure burden on EGCs during the IPO process.

For example, EGCs need only present two years of audited financial statements and two years of selected financial data instead of three years in Form S-1 or Form F-1 IPO registration statements. For many issuers, this will result in meaningfully less cost related to auditing services and a lower burden on the time of those persons at the issuer who assist with accounting and the audit.

EGCs may also comply with the scaled disclosure requirements applicable to smaller reporting companies for executive compensation disclosure in the IPO registration statement. This should lessen the time and legal cost in connection with preparing the registration statement.

EGCs are exempted from the restrictions on communications ahead of public securities offering filings, provided the EGC and its representatives only communicate with potential investors who are qualified institutional buyers or institutional accredited investors. This enables EGCs and their representatives to "test-the-waters" with respect to a market for their offering prior to filing the registration statement.

EGCs may confidentially submit a registration statement to the SEC such that the registration statement will not be publicly available on EDGAR and will be invisible to the public. However, the registration statement must be publicly filed at least 21 days before any road show for the IPO. Comment and response letters with respect to the registration statement will also remain confidential until after the effectiveness of the Form S-1 registration statement. This enables an issuer to assess the interest in its IPO prior to publicly announcing the offering. If the issuer determines that there is insufficient interest in the offering, the issuer can cancel the offering without the risk of public disclosure that it had contemplated an IPO.

Finally, EGCs may wait to comply with new or revised accountings standards until such accounting standards are applicable to private companies. This lessens the accounting burden for EGCs when preparing to go public. EGCs are exempted from Public Company Accounting Oversight Board, or PCAOB, rules, including rules to be made in the future, regarding an expanded auditor report or mandatory audit firm rotation. However, the SEC can determine that any new rule promulgated by the PCAOB will apply to EGCs if such new rule is in the judgment of the SEC necessary for protecting the public.

Title I Application to Mergers and Exchange Offers

In merger and acquisition transactions and exchange offers, EGCs may confidentially test the waters with qualified institutional buyers or institutional accredited investors provided that the EGC makes any filings required under Rules 13e-4(c), Rule 14a-12(b) and 14d-2(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), related to pre-commencement tender offer communications and proxy soliciting materials.

In addition, EGCs may confidentially submit a registration statement to the SEC in connection with a merger and acquisition transaction or exchange offer that constitutes an IPO. The registration statement, including the initial submission of the registration statement and all amendments, must be filed at least 21 days before the road show or the effectiveness of the registration statement. An EGC using the confidential submission process will also be required to make other filings in connection with the merger and acquisition transaction or exchange offer as required by certain rules of the Securities Act of 1933 (as amended) and the Exchange Act, as described in the frequently asked questions promulgated by the SEC referred to above.

Title I Application Post-IPO

Following an IPO, EGCs may continue to avail themselves of eased regulatory and disclosure requirements until the EGC ceases to qualify as an EGC.

For example, EGCs are exempted from the requirement to hold advisory stockholder votes on executive compensation ("say on pay") and golden parachutes. In addition, EGCs may comply with the scaled disclosure applicable to smaller reporting companies with respect to executive compensation. EGCs will also not be required to comply with the disclosure requirements, which have yet to be implemented by the SEC, that public companies disclose (a) the relationship between executive compensation actually paid and the financial performance of the issuer and (b) the ratio between the annual compensation of the chief executive officer and the median of the annual total compensation of all employees of the issuer.

EGCs are exempted from the requirement in any later registration statement or periodic report to include audited financial statements or selected financial data for any period before the earliest audited period required to be presented in the IPO registration statement. EGCs will also continue to be exempted from PCAOB rules following the IPO, including rules to be made in the future, regarding an expanded auditor report or mandatory audit firm rotation. However, the SEC can determine that any new rule promulgated by the PCAOB will apply to EGCs if such new rule is in the judgment of the SEC necessary for protecting the public. EGCs are exempted from the auditor attestation requirements related to internal controls over financial reporting that apply to other public companies.

Finally, EGCs are not exempted from the requirements for public companies to file information with the SEC in XBRL format. EGCs should consult with their external auditors and legal counsel regarding the XBRL requirements, which are outside the scope of this article.

Conclusion

Title I of the JOBS Act has made it easier and less expensive for many companies to complete an IPO. However, the requirements are complex and great care should be taken to ensure that the SEC's relaxed rules are complied with in connection with any IPO or other public offering transaction that a company may consider pursuing under the new rules.

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