Client Alert

JOBS Act: Initial Public Offering "On-Ramp"

The JOBS Act, signed into law on April 5, 2012, is intended to stimulate job creation and economic growth by improving access to the capital markets for smaller companies. In an effort to facilitate capital-raising for private companies, the JOBS Act created a new class of issuer known as an "emerging growth company," or an EGC. As described in greater detail below, EGCs are afforded certain benefits in the initial public offering (IPO) process, including the ability to make confidential submissions of registration statements, loosened restrictions on investor communications, and the option to comply with scaled disclosure requirements. These changes are effective immediately.

An EGC is an issuer, including a foreign private issuer, with under $1 billion in total annual gross revenue in its most recently completed fiscal year. An issuer will remain an EGC until the first to occur of:

- the last day of the fifth fiscal year after its first sale of common equity securities pursuant to an effective registration statement
- the issuer becoming a "large accelerated filer," defined as an issuer with a public float in excess of $700 million
- the issuer having issued $1.0 billion or more of non-convertible debt in the previous three years, or
- the issuer generating $1 billion or more in annual revenue

A company may only qualify as an EGC if, as of December 8, 2011, it had not yet made its first sale of common equity securities pursuant to an effective Securities Act registration statement (including registration statements on Form S-8 or registration statements in connection with secondary offerings by selling shareholders). Accordingly, any issuer that has conducted a public offering under the Securities Act prior to December 8, 2011 is ineligible to be treated as an EGC. However, an issuer that filed a registration statement after December 8, 2011, but prior to April 5, 2012, will still be able to take advantage of EGC status, even if it did not identify itself as an EGC in its registration statement.

Confidential Filing Process

Under the JOBS Act, the SEC is required to permit EGCs to submit draft IPO registration statements on a confidential basis. The ability to file on a confidential basis could benefit many issuers by allowing them to delay disclosure of competitive or otherwise sensitive information until such time as the issuer is reasonably sure that its IPO will

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proceed as planned. The ability to file on a confidential basis can also stave off the embarrassment often associated with the withdrawal of a registration statement due to lack of investor interest.

Under the new confidential filing process, the confidential draft registration statement submitted to the SEC must be "substantially complete" and must include a signed audit report and exhibits, but does not need to be signed by the issuer or include an auditor consent. The submission of a confidential draft registration statement is not deemed a filing for most purposes under the Securities Act unless and until the registration statement is filed on a non-confidential basis, though such filing may trigger certain filing requirements for FINRA purposes. Although an issuer is prohibited from publicly announcing the fact that a confidential submission has been made, it is allowed to inform Qualified Institutional Buyers (QIBs) and Institutional Accredited Investors (IAIs) of such submissions pursuant to the "testing-the-waters" communications discussed below. An issuer is also permitted to publicly announce its intention to engage in a public offering.

The registration statement does not need to be publicly filed until 21 days prior to the first roadshow, or 21 days before anticipated effectiveness of the registration statement, if no road show is to be held. Communications with QIBs and IAIs under the test-the-water provisions of the JOBS Act will not be deemed to constitute road shows. Upon the initial filing of a registration statement on a non-confidential basis, all previously filed confidential submissions must be filed as an exhibit to the publicly filed registration statement. Accordingly, even confidential submissions must be drafted with an eye toward eventual public disclosure (assuming the IPO is pursued).

Relaxed Restrictions on Investor Communications

The JOBS Act also eases restrictions on communications with investors before and after the registration statement becomes effective.

Generally, the solicitation of orders to buy securities before a registration statement becomes effective (sometimes referred to as "gun-jumping"), is prohibited under the Securities Act. However, under the JOBS Act, EGCs and their authorized representatives will be permitted to communicate orally or in writing with QIBs and IAIs to determine interest, or "test-the-waters," in a potential offering, whether before or after the filing of a registration statement for the offering. Such communications may only be with these type of investors; communications with any investors that do not qualify as QIBs or IAIs remain subject to the traditional prohibitions on gun-jumping. This new "testing-the-waters" exception is intended to allow an issuer to gauge interest in an offering prior to undertaking the significant expense of initiating the IPO process. Testing-the-waters communications are not limited to the EGC's IPO, but are also permitted during subsequent offerings, provided that the issuer still meets the qualifications of an EGC at such time. Issuers should be aware, however, that these activities will only be preempted from state blue sky laws if the securities will be "covered" securities when issued, i.e. listed on the NYSE, AMEX or Nasdaq.

In addition to testing-the-water communications, the JOBS Act loosened the restriction on communications by research analysts. Under the JOBS Act:

- Investment banks will be permitted to publish research on an issuer during the pendency of such issuer's public offering, even if the bank is also serving as an underwriter in the offering
- The research analyst conflict of interest rules related to marketing of IPOs and "three-way" communication between research, investment banking and management will not apply
- There will be no post-pricing quiet period or booster shot restrictions on research reports or other communications

These changes are intended to increase the availability of analyst research coverage of ECGs that may not otherwise receive attention from the investment community. These provisions override certain restrictive provisions of FINRA and the NYSE, but other Securities Act, FINRA and NYSE restrictions will continue to apply.

It should be noted that despite these changes instituted by the JOBS Act, disclosures during the IPO process will still be subject to existing regulations against fraud. Accordingly, issuers are advised to take care that any disclosures during this period are consistent with the information provided in the IPO submissions and filings. This potential for liability, especially in light of other continuing restrictions, may limit the overall impact of these provisions.

Scaled Disclosures

Under the JOBS Act, EGCs will be entitled to avail themselves of certain scaled disclosure requirements, similar to those permitted for smaller reporting companies. Other than with respect to certain accounting standards, EGCs can generally choose to provide greater disclosure with respect to some or all of the scaled disclosures, in their discretion.

Under the reduced disclosure requirements:

- EGCs will be permitted to include only two years of audited financial statements and two years of MD&A and selected financial information in their IPO registration statements
- EGCs will not be required to provide an auditor attestation of management's assessment of internal controls for financial reporting, as mandated under the Sarbanes Oxley Act
- EGCs will not be required to comply with new GAAP accounting pronouncements applicable to public companies, until such pronouncements are also applicable to private companies
- EGCs will be exempt from certain accounting requirements, including regarding audit firm rotation and the supplemental information by audit firm requirements
- EGCs may provide smaller reporting company compensation disclosures
- EGCs will be exempt from shareholder approval requirements of executive compensation ("Say on Pay")

Effects on IPO Market

The foregoing changes are designed to make the IPO process less burdensome for smaller issuers and to renew the market of smaller IPOS. Over the last decade, consolidation in the investment banking industry eliminated

the financial feasibility of conducting small IPOs. By effectively easing some of the burdens to pursuing and undertaking an IPO, the foregoing provisions of the JOBS Act may again open up the capital market to smaller issuers.

Thus far, issuers have appeared eager to take advantage of the changes. Within a month of the JOBS Act being signed into law, Proofpoint, Inc., Splunk, Inc., Midstates Petroleum Company, Inc. and Infoblox Inc. became the first companies to self-identify as EGCs under the JOBS Act in connection with their IPOs. According to research from Dealogic, ClearSign Combustion and Envivio were the first two EGCs to list as a result of the Jobs Act; Envivio raised $70 million and ClearSign raised $12 million.

While the long-term effects of these changes are yet to be seen, the JOBS Act shows great promise for growth in IPO activity for smaller issuers.

About TroyGould

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