CARLTON FIELDS

JOBS Act: Emerging Growth Companies

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On April 5, 2012, Jumpstart Our Business Startup Act of 2012 (the "JOBS Act") was enacted into law. One of the primary purposes of the JOBS Act was to make it easier for emerging growth companies to:

- pursue an initial public offering ("IPO") by reducing the regulatory burdens and processes associated with an IPO; and
- gradually absorb the costs of being a public company by relaxing certain disclosure obligations and delaying compliance with certain corporate governance provisions of the Sarbanes Oxley Act of 2002 ("SOX") and the Dodd–Frank Wall Street Reform and Consumer Protection Act enacted in 2010 ("Dodd Frank Act") during a phase-in period lasting up to five years following an IPO.

In addition, the JOBS Act also seeks to facilitate the IPO process for emerging growth companies by permitting and enhancing the ability of analysts to institute coverage of such companies engaged in the IPO process. **Emerging Growth Company Status** The centerpiece for the relaxed IPO process and the phase-in of full compliance with the reporting obligations of the Securities Exchange Act of 1934 (the "Exchange Act") following an IPO is the establishment of a new statutorily defined category of issuer referred to as an "emerging growth company." Under the JOBS Act, an emerging growth company (an "EGC") is a company that:

- has total gross revenues of less than $1 billion as of the end of its most recently completed fiscal year; and
- has not sold its common stock in an SEC registered IPO on or before December 8, 2011.

Public companies that have already *sold* their common stock in an IPO on or before December 8, 2011 cannot qualify as EGCs. The JOBS Act defines an IPO to mean the date of the first sale of *common equity* securities pursuant to an effective registration statement under the Securities Act of 1933 (the "Securities Act"). The staff of the Division of Corporation Finance (the "Division") of the

Securities and Exchange Commission ("SEC") broadly interprets this provision to not be limited to an initial primary offering for cash, but to include any first offering of a company's common equity pursuant to an effective registration statement, such as:

- an offering of common stock pursuant to an employee benefit plan on Form S-8;
- a selling shareholder's secondary offering on a resale registration statement; and
- a merger, exchange offer, or other transaction registered on Form S-4.

However, companies that are currently reporting companies by virtue of having registered their securities under the Exchange Act or having registered only debt securities under the Securities Act can qualify as an EGC if they have never conducted an IPO. The Division, in its recently issued frequently asked questions ("FAQs"), also clarified that:

- asset-backed securities issuers and investment companies registered under the Investment Company Act of 1940 cannot qualify as EGCs, but certain business development companies may qualify as an EGC.
- companies with revenues in excess of $1 billion in previous years that have not undertaken an IPO can qualify as EGCs so long as they meet the revenue test as of the end of its most recently completed fiscal year.

Duration of EGC Status A company that qualifies as an EGC will continue to have that status up to five years after its IPO unless earlier terminated. EGC status will be earlier terminated by the occurrence of any of the following disqualifying events:

- total annual gross revenues of the company exceed $1 billion (as adjusted for inflation every five years);
- the aggregate worldwide public float (i.e., market capitalization held by non-affiliates) of the company exceeds $700 million at the end of any second quarter period following the anniversary of its IPO (or, if no IPO, after it has been subject to the reporting requirements of the Exchange Act for at least 12 months); or
- upon the company issuing more than $1 billion in non-convertible debt over any consecutive three-year period.

While not specifically addressed by the Division in its FAQs, those reporting companies that qualify as EGCs (i.e., never conducted an IPO) could remain EGCs so long as they do not engage in an IPO or trigger one of the disqualifying events. The Division in its FAQs has clarified that:

- unless a disqualifying event earlier occurs, EGC status is terminated at the end of the fiscal year of the fifth anniversary of an IPO.

- debt securities issued in an A/B debt exchange do not count toward the $1 billion limit for purposes of determining whether a disqualifying event has occurred (because they replace existing debt as opposed to being a capital raising event). However, the Division has also indicated in public statements that refinancings of existing debt would count toward the limit (i.e., newly issued debt).

- a company that has conducted an IPO may not regain EGC status after termination of such status following a disqualifying event. The FAQs do not address whether EGC status can be regained if the company has not engaged in an IPO.

Reduced IPO Burdens and Procedures The JOBS Act significantly eases the IPO process for EGCs by permitting them to: (a) "test the waters" on a limited basis prior to filing an IPO, (b) file a draft registration statement with the SEC on a confidential basis, and (c) avail themselves of certain scaled-back disclosures for the IPO filing. In addition, in an effort to facilitate the offering process for an EGC, the JOBS Act also relaxes the restrictions on research analysts' coverage of EGCs engaging in an IPO. *Testing the Waters* The JOBS Act amends the Securities Act to specifically permit an EGC to communicate with the following potential investors, prior to or after the filing of a registration statement with the SEC, to determine whether there is adequate interest in a contemplated securities offering by the EGC (referred to as "testing the waters"):

- qualified institutional buyers as defined under Rule 144A promulgated under the Securities Act; and

- institutional accredited investors as defined under Regulation D promulgated under the Securities Act.

As a result, an EGC can gauge investor interest in its securities prior to commencement of the registration process without violating the current restrictions on pre-offering communications. *Confidential Pre-Filing and SEC Review of IPO Registration Statement* Under the JOBS Act, an EGC may seek a confidential review of a draft of its registration statement for a confidential nonpublic review by the SEC. Under the process established under the JOBS Act and as interpreted by the Division:

- a draft registration statement may be submitted prior to the IPO of an EGC.

- the information provided to or obtained by the SEC in connection with such submissions is deemed to be confidential information.

- the confidential submission of a draft registration statement under this program is not deemed to be "filed" and, as a result (a) no filing fee is payable until the registration statement is first filed publicly on EDGAR, (b) the registration statement does not need to be signed and (c) no consents of auditors or other experts are required.

- the draft registration statement should be substantially complete at the time of submission, including the signed audit report covering the fiscal years presented. All confidential drafts will eventually be filed if the securities offering is subsequently registered.

- an EGC may not make subsequent public communications about its proposed offering following the submission of a confidential draft registration statement under the safe harbor provisions of Rule 134. Rule 134 is not available until the registration statement is filed.

- the initial confidential submissions and all amendments must be "filed" with the SEC no later than 21 days before the EGC commences its road show. The Division has clarified that a "road show" does not include "testing the waters" communications.

The confidential submission program is only available for an IPO and is not available for any other subsequent registration statements of an EGC. As indicated above, the Division broadly interprets what constitutes an IPO. Further the confidential submission program is only available for Securities Act registration statements and not for Exchange Act registration statements (i.e., Form 10 and Form 20-F). *Scaled-Back Disclosure Requirements Available for IPO Registration Statements of a EGCs* The disclosure requirements for an IPO by an EGC are vastly scaled-back in an effort to facilitate the going public process. In particular, the JOBS Act provides that an IPO registration statement of an EGC may include:

- only two years of audited financial statements (as opposed to three years for most registration statements). Although the JOBS Act only references IPO registration statements, the Division has stated that audited financial statements in future filings, including registration statements, will not be required to go back further than those included in the IPO registration statement.

- selected financial data disclosures for only the periods covered by the earliest audited financial data included in the IPO registration statement (i.e., two years, rather than up to five years for most registration statements).

- Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") disclosures only for the audited periods included in the IPO registration statement.

- the reduced executive compensation disclosure requirements applicable to smaller reporting companies (e.g., generally companies with a public float of less than $75 million), which are described in greater detail below under Reduced Exchange Act Disclosure Requirements of EGCs.

If an EGC is a smaller reporting company, then it also may take advantage of any other scaled-back disclosure requirements applicable to smaller reporting companies. *Research Analysts Reports and Enhanced Analysts Communications* The JOBS Act made three significant changes applicable to EGCs that are designed to encourage the preparation of research reports about EGCs and to make it

easier for research communications to be made with management and investors.

- *Pre-Offering Research*. By revising what constitutes an "offer" under the Securities Act, research analysts, including those working for the investment bank participating in the IPO, are now permitted to publish research reports related to an EGC prior to or during the pendency of its proposed IPO. The JOBS Act, however, does not prevent the SEC or FINRA from adopting rules outside of the statutory definition of an "offer," which otherwise expressly prohibits the use of such reports prior and up to the IPO pricing date.
- *Analysts Communications in Connection with an IPO of EGC*. There is no restriction on research or research communications about an EGC during any particular period of time following the IPO or related to the expiration or release of a lock-up period.

> The JOBS Act requires FINRA to remove its existing rules that contain any such prohibitions. However, this requirement applies only to IPOs of an EGC and does not address prohibitions on publishing research in connection with subsequent offerings by an EGC. FINRA rules currently prohibit the publication of research reports within 10 days after an offering that is not an IPO and during the 15-day period before and after the expiration or release of any related lock-up agreement.

- *Post-IPO Communications and Research Reports for EGCs*. Research analysts are permitted to participate in meetings with an EGC together with the investment bankers.

> The JOBS Act requires FINRA to remove its existing rules that contain any such prohibitions. Research analysts will continue to be subject to other FINRA rules restricting research relating to EGCs, including the prohibition on participating in efforts to solicit investment banking business.

As a result of these statutory changes, investment banks are now permitted to prepare, publish, and distribute reports relating to an EGC that proposes to file a registration statement or is already in the registration process even if the investment bank is participating or will participate in the offering. These revisions do not affect current rules and regulations relating to research analysts' conflicts of interest. It is unclear whether the Global Research Analyst Settlement ("Global Settlement") entered into in 2003 (and amended in 2010) by the SEC and 12 investment banking firms will continue to be applicable as it relates to IPOs by EGCs. The Global Settlement, among other things, prohibits research analyst from participating in pre-marketing activities and only permits joint meetings with management for the purpose of conducting due diligence (and only when accompanied by outside counsel or internal legal or compliance personnel). **Reduced Exchange Act Disclosure Requirements by EGCs** The JOBS Act provides EGCs with the opportunity to gradually absorb the costs of becoming a public company over the period of time that they continue to qualify as EGCs by relaxing certain of the SEC disclosure requirements and delaying the applicability of certain

provisions of SOX and the Dodd-Frank Act. In particular, the JOBS Act provides that an EGC that has included only two years of audited financial statements in its IPO:

- may phase-in to full compliance with respect to its audited financial statements by providing an additional year of audited financial statements in the next annual report, at which time it will present the traditional three years of audited financial statements currently required by non-EGCs (other than smaller reporting companies).
- because MD&A disclosures are only required for the periods presented, these disclosures will phase-in concurrently with the audited financial statements.
- because selected financial data disclosures are not required for periods earlier than those presented in the IPO, an EGC is permitted to phase-in to full compliance by providing an additional year of selected financial data in each future year until it has presented the full five years of financial data currently required by non-EGCs (other than smaller reporting companies).

Further, for so long as a company qualifies as an EGC:

- it will not be required to comply with the auditor attestation over internal control requirements under §404(b) of SOX.

The phase-in under §404(b) of SOX does not apply to management's obligations under Section 404(a) of SOX to include a report regarding its assessment of internal controls (as well as disclosure controls and procedures) and to make the related disclosures in its quarterly and annual reports filed under the Exchange Act. As a result, the management assessment will still be required to be furnished at the time the EGC's second annual report is filed with the SEC. Similarly, the CEO and the CFO are still required to provide the certifications required as to the effectiveness of the company's disclosure control and procedures and evaluation of the company's internal controls for financial reporting.

- it will be exempt from the annual "say on pay" and "say on golden parachute" advisory voting requirements and rules promulgated under the Dodd-Frank Act.

The "say on pay" obligations phase-in as follows: (a) in the case of a company that qualified as an EGC for less than two years, the end of the three-year period following its IPO, or (b) for any other EGC, within one year after losing its EGC status.

- it will not be required to include disclosures (when implementing rules are adopted by the SEC) relating to the relationship between executive compensation and financial performance of the company, or relating to the CEO pay-ratio.

- it may elect to provide the same level of executive compensation disclosures as required by smaller reporting companies, which include, among other things, (a) the omission of a Compensation Disclosure and Analysis discussion, (b) inclusion of fewer tables, (c) disclosure of compensation for only the CEO and the two next highest paid officers (instead of the CEO, CFO, and three next highest paid officers) in the Summary Compensation Table during the prior two year period (instead of three years), (d) the omission of disclosures with respect to compensation policies and practices as they relate to risk management, and (e) reduced disclosures relating to post-termination compensation, including no requirement to disclose any numerical amounts.
- it may elect on a one-time basis not to comply with any new or revised accounting principles until the date that such accounting principles become broadly applicable to private companies.
- it will not be required to comply with any Public Company Accounting Oversight Board rules regarding mandatory audit firm rotation and auditor discussion and analysis

Opting Out of EGC Status An EGC is not required to take advantage of all of the benefits made available to it under the JOBS Act described above, but may instead opt-out of any permitted scaled-back disclosures or exemptions, and instead comply with the requirements that apply to other issuers. However, as discussed above, a company may not selectively opt-in or out of compliance with new or revised accounting rules or pronouncements. If a company elects to forego compliance with any such new or revised accounting rules or pronouncements until they are applicable to private companies, this election is irrevocable and it must be made at the time it files its first registration statement or Exchange Act report. *Smaller Reporting Company Status* If an EGC also qualifies as a smaller reporting company, it also may avail itself of all of the scaled-back disclosures applicable to smaller reporting companies (not just those relating to executive compensation) for so long as it qualifies as a smaller reporting company, including situations where a company is no longer has EGC status (e.g., five years after an IPO). Among other things, a smaller reporting company:

- is exempt from the auditor attestation requirements of §404(b) of SOX.
- is only required to provide two years of audited financial statements and, if only two years are provided, it only needs to provide a MD&A that covers two years.
- is not required to provide a performance graph comparing the yearly change in its cumulative total shareholder return on its common stock to peers or industry indices.
- is not required to provide selected financial data or supplementary financial information.
- is not required to provide annual tabular disclosure of certain contractual obligations.
- is not required to provide quantitative and qualitative disclosures about market risk.
- is subject to less burdensome executive compensation disclosures as described above.
- is subject to lower dollar thresholds with respect related person transaction disclosures.

- is not required to disclose whether it has an Audit Committee financial expert for its first annual report.
- is not required to provide disclosures relating to compensation committee interlocks or provide a compensation committee report.

Effective Dates and Related Disclosure Matters The provisions of the JOBS Act relating to EGCs (Title I) became effective upon enactment. No SEC rulemaking was required as a prerequisite to its implementation. However, the Division has established procedures for providing confidential submissions of draft registration statements, has issued FAQs on April 16, 2012 and May 3, 2012 to provide guidance with respect to the application of Title I, and has used the comment process to require disclosure of the impact of Title I to applicable issuers. In addition to the above:

- confidential submissions should include a transmittal letter identifying the issuer, the type of registration statement submitted, and confirming the EGC status of the issuer.
- the Division is requesting disclosures of how and when an EGC may lose its status.
- the Division is requesting disclosures of the regulatory exemptions available to EGCs.
- a company's EGC status should be disclosed on the cover page of the prospectus.
- EGCs are required to comply with XBRL filing requirements.

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