



NEW LEGISLATION EASES THE PATH TO AN IPO

An Overview of the Compensation and Governance Implications of the Jumpstart Our Business Startups (JOBS) Act of 2012

By Alexander Cwirko-Godycki and Brett Harsen

A New Approach to Going Public

When President Barack Obama signed the JOBS Act into law on April 5, his signature set in motion one of the most significant overhauls of the US initial public offering (IPO) system in recent history. With strong bipartisan support, this new bill creates a more streamlined approach to on-ramping companies through the IPO pipeline by reducing potential costs, lowering disclosure hurdles and eliminating significant accounting requirements. Simultaneously, the law also makes it easier for firms to remain private by opening the door for companies to explore investor interest confidentially and increasing the shareholder count threshold after which companies must disclose financial information. In sum, the JOBS Act provides the vast majority of private companies with far more flexibility to consider a public offering with fewer financial and regulatory burdens. That's good news for most organizations currently in the IPO pipeline, but there's plenty of homework to do as issuers adjust to a number of important new guidelines.

Emerging Growth Companies (EGCs)

At the core of the JOBS Act is a new class of issuers called Emerging Growth Companies or EGCs. Defined as companies with less than \$1 billion in annual revenues as of their last fiscal year end, EGCs qualify for the new IPO transition programs outlined in the law. These protections, which can extend to a maximum of five years after an IPO, remain in place so long as a company retains EGC status. However, the EGC classification can be removed once any one of the following criteria is met:

- > the last day of any fiscal year in which a company earns \$1.0B or more in revenue;
- > the date on which a company qualifies as a "large accelerated filer," principally defined as having at least a \$700MM market capitalization as of the last business day of the issuer's most recently completed second quarter;
- > the issuance, in any three-year period, of more than \$1.0B in nonconvertible debt securities; or
- > the last day of the fiscal year ending after the fifth anniversary of an IPO pricing date.

Key IPO On-Ramp Protections

In addition to pre-IPO benefits — such as the ability to confidentially test the waters with potential investors and initiate the SEC registration process privately— companies granted and retaining EGC status will enjoy a number of regulatory benefits intended to significantly lower the cost of entering the US public markets. Among these benefits are a number of key changes related to accounting rules, compensation disclosure and corporate governance, including:

- > ***An exemption from Section 404(b) of the Sarbanes-Oxley Act***
Rather than having to fully comply with Section 404(b) within two years of going public, EGCs will be treated as small or non-accelerated filers during the duration of their IPO on-ramp period. This means they will not need to provide auditor attestation of internal control over financial reporting while retaining EGC status.
- > ***An exemption from producing the detailed narrative sections of the Compensation Discussion and Analysis Report (CD&A)***
In addition to significantly reduced narrative disclosure requirements, EGCs will also enjoy the benefits of small company treatment when preparing tabular disclosures. This includes providing compensation information on only the top-3 executives, rather than the top-5, and only providing two years of pay data vs. the standard three years.
- > ***An exemption from key executive compensation related voting and disclosure requirements of the Dodd-Frank Act***
Perhaps among the most important JOBS Act protections, EGC status allows companies to bypass say-on-pay, say-on-pay frequency and say-on-golden-parachutes votes in their entirety. Only after losing EGC status will companies need to arrange shareholder votes on these issues, typically within a year. Additionally, EGC companies will not need to provide pay-for-performance graphs and CEO pay ratio disclosures in their proxy statements after these elements of the Dodd-Frank Act are implemented by the SEC.
- > ***A longer phase-in period for new or revised GAAP accounting standards***
Generally speaking, EGC companies will not be required to comply with new accounting standards until those same standards also apply to private companies, which will include any extra phase-in periods granted to private firms.
- > ***An exemption from any rules the Public Company Accounting Oversight Board (PCAOB) might adopt concerning mandatory audit firm rotation or auditor discussion and analysis reports***
In light of the PCAOB's controversial decision to explore potential rules governing audit rotations and auditor discussion and analysis reports (still in the concept phase), the JOBS Act provides EGCs with a forward-looking exemption from such rules should they ever come into effect. Furthermore, EGCs will be exempt from all other future PCAOB rules unless the SEC specifically determines that it is "necessary or appropriate in the public interest" for EGCs to comply and "whether the action will promote efficiency, competition and capital formation" in the markets.

Shareholder Trigger Increase

In addition to the key EGC exemptions listed above, the JOBS Act provides a large number of other benefits to companies in the IPO pipeline. Chief among these is an increase from 500 to 2,000 in the shareholder count threshold for public disclosure. Under the new law, the requirement to register with the SEC will only be triggered at the end of any fiscal year when a company has either 2,000 record holders of a class of securities or 500 non-accredited record holders. Furthermore, employees who receive securities from employee compensation plans (in a transaction exempt from Securities Act registration) will not be counted toward the 2,000 shareholder limit.

Legislation Effective Dates

ECG classifications are available to any issuer that prices its IPO offering after December 9, 2011, and all ECG IPO on-ramp protections went into immediate effect upon the signing of the JOBS Act. Companies in the midst of planning a public offering should immediately seek counsel to consider whether they qualify for EGC status and the wide array of potential benefits assigned to EGC companies.

To read the full text of the JOBS Act (H.R.3606), please [click here](#).

Contact Us

For more information, please contact:

Boston Office

Ed Speidel, Senior Vice President
+1 (508) 628-1552
espeidel@radford.com

Ted Buyniski, Senior Vice President
+1 (508) 628-1553
tbuyniski@radford.com

Rob Surdel, Asst. Vice President
+1 (508) 628-1551
rsurdel@radford.com

New York Office

Ram Kumar, Asst. Vice President
+1 (212) 441-2007
rkumar@radford.com

San Diego Office

Ken Wechsler, Asst. Vice President
+1 (858) 755-8675
ken.wechsler@radford.com

San Francisco Office

Linda Amuso, President
+1 (415) 486-7255
lamuso@radford.com

David Knopping, Vice President
+1 (415) 486-7122
dknopping@radford.com

San Jose Office

Brett Harsen, Vice President
+1 (408) 321-2547
bharsen@radford.com

Press Contact

Alex Cwirko-Godycki
+1 (415) 486-6973
acwirko@radford.com

Locations

Bangalore, Beijing, Boston, Brussels, Chicago, Frankfurt, Hong Kong, London, New York, Philadelphia, San Francisco, Shanghai and Singapore

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