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The JOBS Act: An Update

A brief review of the JOBS Act, a look at recent emerging growth company filings with the SEC and an analysis of EGCs and smaller reporting companies

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Overview

The Jumpstart Our Business Startups (JOBS) Act became law in April 2012. Its major provisions were to:

- Create an IPO "on-ramp" for a new class of registrants called "emerging growth companies" (EGCs)
- Permit general solicitation in offerings under Rule 506 and Rule 144A, provided sales are made only to persons reasonably believed to be qualified
- Create an offering exemption for crowdfunding transactions
- Create an exemption for offerings not exceeding US$50 million within the prior 12-month period
- Raise thresholds triggering registration obligations under the Exchange Act

Some of the initiatives under the JOBS Act have been suggested by market participants for many years in light of the significant changes to the markets and the ways people and companies communicate information. In key ways, Title I of the JOBS Act represents the latest stage in the evolution of the SEC's regulation of issuers according to their "categories"—meaning, generally, regulations scaled to the nature and size of an issuer's business, offerings and the trading markets for its securities.

Whether categorizing issuers or offerings for purposes of Regulation S, eligibility for short-form registration or "on-demand" registration, the challenge for the SEC has always been how to adopt more efficient capital raising techniques in balance with its need to protect investors all within a coherent regulatory framework. This challenge is perhaps one reason why the SEC is taking more time than expected (at least by Congress) to adopt many of the more interesting provisions under the JOBS Act, such as lifting the ban on general solicitation or advertising for offers and sales under Securities Act Rules 506 and 144A and proposing rules to permit crowdfunding. While Title I has already had a measurable impact on the IPO environment, it may be that the elements of the JOBS Act that the SEC has yet to effect will have an even greater impact on the capital markets—both in the US and globally.

EGCs have filed a large majority of the IPOs so far this year and the IPO on-ramp provisions in Title I are being widely used. To provide an update on this use, we completed a random survey of 90 of the approximately 400 IPO filings by EGCs between January 1, 2013, and June 25, 2013, approximately 200 of which were declared effective during that time period. Here is what we learned:

- The IPO on-ramp is increasingly well-trafficked, with a majority of EGCs taking advantage of many of the accommodations provided:
  - Although not yet a majority, EGCs that did not describe themselves as either "development stage" (which we define in more detail below) or speculative companies seem to be increasingly relying on the ability to present two, rather than three, years of audited financial statements. EGCs that are also "smaller reporting companies" (SRCs) more frequently present two years of audited financial statements.
  - A significant majority of EGCs disclosed their intention (or ability) to defer having their auditors attest to the effectiveness of their internal control over financial reporting.

  - A large minority of the EGCs we surveyed disclosed their election to comply with new or revised accounting standards applicable to public companies, thus rejecting the relief under the JOBS Act to comply with such standards only when they are applicable to private companies. The EGCs driving this result tended to be larger companies that did not describe their business as being in the "development stage."
  - A large majority of EGCs, both larger companies and smaller reporting companies, did not provide a Compensation Discussion & Analysis (CD&A), or a level of disclosure that would come close to complying with S-K Item 401(b), and relied on scaled compensation disclosure requirements already applicable to smaller reporting companies.
  - Many EGCs submitted draft registration statements on a confidential basis.
- EGCs exist in good numbers across industries including health care and pharmaceuticals (19 percent), services (18 percent), financial and insurance (16 percent), construction and real estate (10 percent), energy and natural resources (10 percent), technology and telecommunications (9 percent) and industrial and manufacturing (7 percent), with the balance relating to wholesale and retail, agriculture and livestock, transportation and other industries.
- There are clear overlaps between EGCs and SRCs and EGC/SRCs and development stage companies (DSCs). We define development stage companies as those that are highly speculative or that have been in existence for less than a year.
  - 41 of the 90 researched identify as both EGC and SRC.
  - 23 of the 41 EGCs/SRCs also described themselves as DSCs:
    - See, e.g., Camp Nine, Inc. and Lion Consulting Group.
    - Several of these self-described EGCs/SRCs/DSCs present less than one year of audited financial statements, have one or two executive officers, have boards comprised of three or fewer members and seek to raise proceeds of US$200,000 or less.
- Many EGC IPOs are underwritten by well known investment banks on a firm commitment basis, seek a listing on the NYSE or Nasdaq and are audited by a "big four" accounting firm. Some of these include:
  - Domestic companies: Phillips 66 Partners LP; Bright Horizons Family Solutions, Inc.; RetailMeNot, Inc.; Gogo, Inc.; Evertec, Inc.; LipoScience, Inc.; Portola Pharmaceuticals, Inc.; PTC Therapeutics, Inc.; TriState Capital Holdings, Inc.
  - Foreign private issuers: Knot Offshore Partners LP; QIWI plc; FleetMatics Group PLC (selling shareholder offering); UBIC, Inc.
  - REITs: Rexford Industrial Realty, Inc.; ZAIS Financial Corp.
- More EGC IPOs in our sample are made on a self-underwritten, best efforts/continuing basis, to raise proceeds of less than US$50 million—in many cases far less than that amount.
- Of the 90 EGCs we surveyed, 17 indicated a listing on the NYSE, 25 on Nasdaq (includes all three market tiers), 13 on the OTC markets and pink sheets, five on Canadian exchanges and one on a foreign exchange. The remainder did not indicate any market.

- Foreign private issuers (FPIs) are identifying as EGCs and utilizing the accommodations made available to them as such (and also as FPIs). Six of the 90 researched disclosed they were foreign private issuers.
- Our survey indicated that EGCs generally fall into three groups:
  - The first category comprises EGCs identifying also as SRCs and DSCs. Companies in this group are making highly speculative offerings and providing materially less disclosure than the two other categories of EGCs.
  - The second category is the EGC/SRC group, which is generally utilizing most of the disclosure accommodations for SRCs and EGCs.
  - The third category is the EGC group. These companies tend to be larger with higher revenues and use fewer EGC disclosure accommodations than the other two EGC groups we observed.
  - It will be interesting to see whether these observations hold over time.
- The state or jurisdiction of issuers of all EGC IPOs filed between January 1, 2013, and June 23, 2013 shows some interesting concentration information: Delaware, 39 percent; Nevada, 30 percent; Maryland, 10 percent; other states,17 percent; and foreign countries, 4 percent.

Quick Review of the JOBS Act – Title I

Title I of the JOBS Act created a new category of issuers: the emerging growth company. An EGC is generally defined as any issuer (including an FPI) seeking to go public after December 8, 2011, that had total annual gross revenues of less than US$1 billion during its most recently completed fiscal year (as calculated under US Generally Accepted Accounting Principles or, with respect to FPIs, International Financial Reporting Standards established by the International Accounting Standards Board). Once an issuer has determined it has status as an EGC, it will retain that status and may continue to use the accommodations extended to EGCs until the earliest of:

- the last day of the fiscal year during which the issuer has total gross revenues of US$1 billion or more;
- the date on which it becomes a "large accelerated filer;"[1]
- the last day of the fiscal year following the fifth anniversary of the EGC's IPO of equity securities; or
- the date on which it has, during the prior three-year period, issued more than US$1 billion in non-convertible debt. (SEC FAQs clarify that all issued debt needs to be counted, even if it is no longer outstanding, and that debt issued in an A/B exchange offer does not need to be counted toward this ceiling.)

Once an EGC loses its status as such, it may not regain it. Therefore, under the provisions above, the longest an EGC can retain that status is for five years following its equity IPO, or potentially indefinitely if it never issues equity in a public offering. SEC FAQs clarify that an A/B exchange offer or merger could qualify as an equity IPO and allow the EGC registrant to make a confidential submission of the registration statement for such transactions and use other EGC accommodations but would also trigger the five-year sunset provision noted above.

The accommodations the JOBS Act provides to EGCs are significant and broader in important ways compared to regulatory accommodations previously extended to any category of issuers, including smaller reporting companies. The key elements of those accommodations, as well as some SEC FAQs clarifying those accommodations, are summarized below.[2]

Financial Disclosure

- An EGC is allowed to present two, rather than three, years of audited financial statements in its IPO registration statement. Because the JOBS Act's definition of an EGC's IPO is based on an IPO of equity securities, SEC FAQs clarify that an EGC must present three rather than two years of audited financial statements in any registration statement for an offering of debt. SEC FAQs also contemplate a scenario where an EGC completes an equity IPO with only two years of audited financial statements and shortly afterwards files a registration statement for a follow-on offering. In that case, the SEC clarifies that the EGC's follow-on registration statement may not need to present audited financial statements for any period before the earliest audited period presented in its equity IPO registration statement.

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[1] A large accelerated filer is an issuer that has been a reporting company for 12 months and during that period has filed at least one annual report, and that has a worldwide public float of US$700 million or more as of the end of the issuer's most recently completed fiscal quarter.

[2] The SEC has issued several sets of FAQs relating to the JOBS Act. A close reading of all of these FAQs is necessary for a clearer understanding of some of the most important provisions of the JOBS Act, although the FAQs are not "rules or regulations." The SEC has noted that it may periodically update or modify the FAQs.

- Selected financial data need be presented only for the periods that are audited, rather than five years.
- MD&A disclosures may be limited to the periods covered by the audited financial statements.
- With respect to an EGC's first annual report following its equity IPO, SEC FAQs clarify that the report may only need to have two years of audited financial statements but that subsequent annual reports must include three years (unless the EGC qualifies as a smaller reporting company).

Internal Controls Audit

- EGCs, for so long as they qualify as such, are not required to have their auditors attest to the effectiveness of their internal control over financial reporting (ICFR). This benefit saves EGCs considerable resources and time, as the auditor's attestation report on ICFR can require extensive work by both the auditor and the issuer, as well as its management, accounting and auditing teams.

Accounting and Auditing Standards

- If an EGC so elects, any new or revised accounting standard issued by the FASB after the JOBS Act will not apply to the EGC unless and until private companies are also required to comply with such new or revised standard. Where an accounting standard does not distinguish between private and public companies, the EGC must comply with the new or revised standard. (See "Nonfinancial Disclosure" below.)
- Any new auditing standards that are adopted by the PCAOB after the JOBS Act may not apply to the audit of an EGC unless the SEC determines otherwise.
- EGCs are not required to comply with any rule adopted by the PCAOB that mandates auditor rotation or the preparation of a supplemental auditor report about the audit and the EGC's financial statements.

Nonfinancial Disclosure

- EGCs are required to identify themselves as such on the cover of the prospectus and also to highlight in the prospectus each of the elections it has made regarding use of the EGC scaled disclosure requirements and other accommodations under the JOBS Act.
- EGCs are required to disclose whether they irrevocably elect to forgo compliance with any new or revised accounting standard applicable to private companies. No "a la carte" selection is permitted with respect to new or revised accounting standards. The EGC should make this disclosure to the SEC as soon as possible (including in a confidential submission of a registration statement) so that the SEC can properly review the EGC's financial statement disclosures. An EGC may initially elect to comply with private company standards for so long as it is an EGC and later change that election, but, once it elects to forgo such compliance, its election to comply with public company standards is irrevocable. Any EGC that elects to comply with standards applicable to private companies should provide disclosures consistent with SAB Topic 11M in connection with its adoption of any new or revised standard.
- Risk factor disclosure of these elections is almost universally provided, in particular relating to the election to use scaled financial and auditing and accounting standards, which may result in, among other things, a lack of comparability of the issuer's financial statements with those of other companies.

Executive Compensation and Compensation-Related Disclosures

- EGCs are allowed to comply with the scaled executive compensation disclosure accommodations extended to smaller reporting companies (which are described in more detail below).
- EGCs are not required to comply with Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act provisions mandating "say-on-pay," "say-on-golden parachutes" or "say-on-frequency" votes.

Test-the-Waters Communications

- EGCs and their underwriters and other authorized agents are allowed to communicate orally and in writing with qualified institutional buyers (QIBs) and institutional accredited investors to determine their interest in a potential offering by the EGC, both before and after the EGC files a registration statement for the offering. Any written communications do not need to be filed with the SEC, although the SEC will request to review all such communications together with the registration statement. Issuers and their agents should, as always, give careful consideration to the content of the communications, which should be consistent with disclosures made or expected to be made in the issuer's registration statement and which are subject to antifraud rules.
- An EGC must confirm its status as such at the time it makes any test-the-waters communication. If an EGC loses its status as such prior to making its initial public filing for its offering, it must promptly file a publicly available registration statement that includes all required disclosure for a non-EGC issuer and refrain from any further test-the-waters communications.
- SEC FAQs clarify that an A/B exchange offer or merger may constitute an EGC's equity IPO, allowing the EGC to have test-the-waters communications—including written communications that do not need to be filed with the SEC. Other provisions under the Exchange Act, however, including the tender offer and proxy rules, may be implicated and require public disclosure and a filing with the SEC.
- SEC FAQs provide guidance on whether test-the-waters communications may be treated as a roadshow.

Research Reports

- With respect to EGCs only, broker-dealers are allowed to publish and distribute research about an EGC that proposes to complete a public offering and also to participate in the offering. Broker-dealers may also publish and distribute research about, or make a public appearance with respect to, an EGC's securities immediately after its IPO or after the expiration of any lock-up agreement relating to the IPO. FINRA may not prohibit this research.
- Neither the SEC nor FINRA is allowed to adopt rules in connection with an IPO by an EGC that would restrict:
  - Broker-dealers from arranging communications between a securities analyst and a potential investor.
  - Securities analysts from participating in any communications with the EGC's management, so long as certain procedures are observed.
- SEC FAQs provide considerable guidance on these research provisions, including how test-the-waters and post-offering communications allowed under the JOBS Act can be conducted consistent with relevant Exchange Act and SRO rules that were not amended by the JOBS Act.

Confidential Submissions of Draft Registration Statements

- An EGC may confidentially submit its IPO registration statement and respond confidentially to SEC comments until the 21st day before it starts any roadshow for the offering. The first public filing of the registration statement triggers the requirement to pay the SEC registration fee and must include as exhibits all of the prior confidential filings. An EGC must plan to ensure it meets these requirements and is not delayed in making its offering.
- All confidential filings must be substantially complete or the SEC will not review them. Filings made confidentially are not deemed to be "filed" and therefore need not be signed by the issuer or any of its officers and directors, nor need they include the consent of the issuer's auditors or other experts.
- SEC FAQs reiterate that the JOBS Act defines an EGC's IPO date as relating to its first public issuance of equity securities. Therefore, an EGC that files an IPO of debt securities will qualify for the confidential submission process for that and subsequent public offerings until it ceases to be an EGC or, in connection with its first public offering of equity securities, is required to make a public filing of the registration statement.
- SEC FAQs provide guidance regarding the confidential submission process. This guidance describes what activities and communications by the EGC may be viewed as a roadshow and when public announcements about a proposed public offering may be made if the EGC is using the confidential submission process for the offering.

Titles II-VI of the JOBS Act

Title I's creation of a new category of issuers with a broad set of regulatory accommodations has already had a significant impact on the process for and nature, and likely the number, of IPOs filed since the JOB Act's effective date. Other provisions of the JOBS Act, however, may have even greater significance once the SEC takes final action to implement them.

Title II: Access to Capital for Job Creators

Section 201(a) of the JOBS Act requires the SEC to adopt rules lifting the ban on general solicitation under Rule 506 and Rule 144A under the Securities Act. The SEC announced that it intends to hold an open meeting on July 10, 2013, to consider the adoption of rules to implement Section 201(a).

For many years, market participants have been suggesting that the SEC adopt rules that would lift the prohibitions against general solicitation and advertising on the basis that the investor protections these restrictions are intended to provide are not necessary where the offers result in sales to only accredited investors and QIBs. In light of this pent-up demand, these rules have the obvious potential to change dramatically not only the processes for conducting private offerings, but also possibly to spur use of the so-far tentatively accepted provisions of the JOBS Act relating to test-the-waters communications and liberalizing use of research reports in connection with EGC offerings.

It also seems likely that these rules will propel the initiation of regulatory action or at least impact, if not clash with, regulations in other countries, in particular those that may view general solicitation for securities offerings over the Internet as triggering broker-dealer registration or other regulation. In general, foreign regulators have not moved to liberalize their communications restrictions at the same pace that the United States has. Most have taken either a wait and see approach to what happens here or have taken a harder line against the flow of unrestricted offering communications that cross their borders. Either way, issuers that seek to comply with new SEC rules implementing Section 201(a) should be mindful of the cross-border implications of any unrestricted offering communications made through the Internet or other borderless mode of communication.

In addition, Title II expanded Section 4 under the Securities Act to add new Section 4(b), which provides an automatic exemption from the broker-dealer registration requirements for so-called "Regulation D portals," which are platforms or mechanisms (through the Internet or other modes of social media) by which securities are offered and sold under Rule 506. Section 4(b) imposes the very significant requirement that the person maintaining the Regulation D portal or anyone associated with that person "receives no compensation" in connection with transactions effectuated through the portal. SEC FAQs state that the SEC interprets the term "compensation" broadly, to include "any direct or indirect economic benefit to the person or any of its associated persons" but generally exclude profits associated with any co-investments in the securities offered on the platform or mechanism. As a result, it is expected that, as a practical matter, the exemption may not be available to persons outside the venture capital area. Securities Act Section 4(b) is one element relating to crowdfunding that is operative without SEC action and has been relied upon by certain market participants (as noted in recent SEC no-action letters).

Title III: Crowdfunding

Section 302(a) of the JOBS Act adds Section 4(6) under the Securities Act, which provides an exemption for "crowdfunded" offerings of up to US$1 million in any 12-month period, where the aggregate amount sold to any investor during any 12-month period does not exceed (i) US$2,000 or five percent of the investor's annual income or

net worth (where either is less than US$100,000); or (ii) ten percent of the investor's annual income or net worth, up to US$100,000. An issuer must conduct a crowdfunding offering through a broker-dealer or funding portal and issuers must meet certain disclosure, operational and filing requirements, some of which are quite rigorous given the US$1 million ceiling but which are intended to compensate for the anticipated participation in crowdfunding by retail investors. At this time, there seems to be some consensus that the issuer disclosure and other requirements (including the need to present audited financial statements for capital raises over US$500,000) may practically thwart the stated goals behind the crowdfunding provision. Nevertheless, enthusiasm for crowdfunding continues to grow.

The SEC has yet to adopt rules to permit crowdfunding, not only with respect to the issuer disclosure and other requirements but also the activities of crowdfunding intermediaries. SEC FAQs remind interested participants that the SEC must adopt rules governing both crowdfunding before issuers can rely on the JOBS Act crowdfunding provision and funding portals before permitting anyone to register with the SEC as a funding portal or to act as a crowdfunding intermediary, even currently registered broker-dealers. The SEC also reiterated that the JOBS Act imposes significant duties on crowdfunding brokers and funding portals to provide information to investors, reduce the risk of fraud and ensure, as applicable, that investors and issuers satisfy the requirements outlined in Title III.

Meanwhile, an interesting corollary question is whether banks or other financial intermediaries or businesses may seek to develop payment platforms with adequate processes that facilitate cross-border crowdfunding by addressing issues like money laundering, taxation and other regulatory issues, such as those noted above that may arise following the elimination of the prohibitions against general solicitation and advertising. Since crowdfunding involves Internet and other borderless communications methods, those issues are likely to arise.

Title IV: Small Company Capital Formation

This section of the JOBS Act calls for the SEC to issue rules creating an exemption for offerings of up to US$50 million in any 12-month period. The SEC has not yet adopted rules for the so-called Regulation A+ exemption. These rules must set forth the standards for issuer qualifications and disclosure requirements (including the requirement that issuers must file audited financial statements with the SEC on an annual basis, which the SEC may review and comment upon), test-the-waters communications and other items. Offerings of securities made under Regulation A+ would only be exempt from state blue sky laws if the securities are listed on a national securities exchange or offered and sold only to "qualified purchasers."

As with other provisions of the JOBS Act, market participants have previously suggested the SEC adopt an exemption very much like Regulation A+, in view of the very limited historical use of current Regulation A. The limited value of Regulation A is attributed to the offering limitation of US$5 million, which is seen as too low considering that Regulation A offerings generally are not exempt from state blue sky regulations. Other market participants, however, suggest that the basic non-use of Regulation A is due to the overwhelming preference for Regulation D, which generally pre-empts state regulation and is otherwise far more flexible.

Offerings under Rule 506 do not have any dollar limitation, no specific disclosure requirements (when made only to accredited investors, although, in many cases, an offering memorandum for a Rule 506 offering looks just like a prospectus for a registered offering), no filing requirements with the SEC other than the Form D notice of offering, and can be sold to up to 35 nonaccredited, sophisticated investors and an unlimited number of accredited investors. Furthermore, communication restrictions will soon be lifted, as noted above. Given the flexibility of Rule 506 and potential disclosure drawbacks to Regulation A+, it is reasonable to wonder whether Regulation A+ will have a significant impact on private capital raising preferences.

Title V and VI: Private Company Flexibility and Growth; Capital Expansion

The JOBS Act amended Section 12(g) of the Exchange Act to increase the shareholder registration thresholds. As a result, a company is required to register under the Exchange Act where it has more than US$10 million in assets and a class of equity securities held of record by either (i) 2,000 persons or (ii) 500 persons who are not accredited investors (increased from, in each case, 500 or more persons). The JOBS Act provides different thresholds for banks or bank holding companies with respect to (i) Exchange Act registration, for which the shareholder cap was increased to 2,000 record holders (from 500 or more), and (ii) de-registration, in which case such banks or bank holding companies can de-register when they have fewer than 1,200 record holders (increased from 300).

Certain record holders are not included in the shareholder cap calculations, including persons who hold equity securities through exempt employee compensation plan transactions and/or crowdfunding transactions.

EGCs and Smaller Reporting Companies (SRCs) – Some Similar Themes

EGCs that are SRCs have, as noted above, filed many of the IPOs filed to date in 2013. In prior years, and most likely still today, SRCs comprised the largest in number of all categories of SEC filers (approximately half the total of all filers). In January 2008, the SEC adopted rules defining "smaller reporting companies" as those with a public equity float of less than US$75 million (consistent with the public float threshold for "non-accelerated filers") or, where the company had no calculable public float, revenues of less than US$50 million. The purpose behind the creation of this category of issuers was to reduce their regulatory compliance costs, in part by eliminating the need for such companies to comply with certain provisions of the Sarbanes-Oxley Act and Dodd-Frank Act. For SRCs, the SEC also scaled back disclosure requirements in Regulation S-K and added simplified financial reporting requirements to Regulation S-X (at the same time that it eliminated Regulation S-B). Smaller reporting companies were able to choose, on an item-by-item basis, which of these reporting accommodations they would use. These accommodations include:

- Two, rather than three, years of audited financial statements and balance sheets (with no sunset provision)
- A three-year, rather than five-year, description of the development of the issuer's business
- No requirement that the auditor provide an attestation report on the SRC's internal control over financial reporting
- Presentation of MD&A for a two-year, rather than three-year, period, corresponding to the periods for which audited financial statements are presented, with no requirement to present tabular disclosure of contractual obligations
- No requirement to provide market risk disclosures
- Less onerous executive compensation disclosures:
  - No requirement to provide CD&A
  - Executive compensation disclosure can be made only for the CEO and the two most highly compensated executive officers, and for two rather than three years
  - No requirement to disclose any link between compensation practices and risk management
  - Requirement to present only three of the seven compensation disclosure tables in Regulation S-K—Summary Compensation Table and tables for Outstanding Equity Awards at Fiscal Year End and Director Compensation
- No requirement to provide a compensation committee report, disclosure of compensation committee interlocks or, until January 2013, to conduct say on pay or frequency votes

Smaller reporting companies, as with other registrants in other contexts, have to test their status at least annually; however, if an SRC exits that reporting status, it is able to re-enter it once it again meets the qualifications (which are more stringent than the initial entry test). Similar re-entry rules apply to well known seasoned issuers (WKSIs). EGCs,

on the other hand, are permanently "kicked-out" of EGC status at the end of the year of the fifth anniversary of their equity IPOs, even if their total revenues remain under US$1 billion and they do not otherwise cease to qualify as an EGC. It seems possible that the group of EGC/SRCs that we reviewed in our sample, most of which had total revenues of less than US$100 million, may still also qualify as SRCs at the time that they lose, mandatorily, their status as EGCs. If that is the case, the former EGC would still be able to choose on an item-by-item basis the scaled back financial and non-financial disclosures tailored for SRCs.

The SRC reporting system bears discussion in connection with the discussion of Title I of the JOBS Act given the similarity in the disclosure accommodations. In fact, given that the disclosure accommodations are so similar, the primary effect of Title I appears to expand the disclosure accommodations to a broader group of new issuers having total revenues of less than US$1 billion at the same time it permits SRCs (that are not disqualified from EGC status due to having made a public offering before the EGC "start date"[3]) and this broader group of issuers to utilize entirely new approaches to the IPO process, such as confidential submission of the issuer's IPO registration statement, test-the-waters communications and relaxed rules around research.

The roads between the worlds of EGCs and SRCs, can handle traffic in opposing directions and have on- and off-ramps that, while clearly marked, seem to be quite randomly placed (in particular, the EGC start date and five-year sunset provision, which differentiates the EGC/SRC road from the roads between other filers, such as WKSIs and accelerated filers. To continue the driving analogy, this random placement of ramps on two-way roads may cause traffic and confusion. Moving back to the world of issuers and investors, this confusion may prove to practically limit, at least for some issuers, the ability to use the accommodations extended to them if investors fail to appreciate why similar companies with similar offerings may be providing very different disclosures and following very different offering procedures or vice versa.

Here is a hypothetical to explain. Today, an SRC (SRC #1) that does not qualify as an EGC for the sole reason that it made an offering prior to the EGC start date may not rely on the IPO on-ramp provisions, although it may rely on the SRC scaled disclosure requirements that are substantially similar to those available to EGCs. Another SRC (SRC #2) having the same financial, business, corporate governance and market profile as SRC #1 qualifies as an EGC. SRCs #1 and #2 may look the same, but the offering procedures they may use are vastly different. After SRC#2 completes its equity IPO as an EGC, assume that its business does not grow substantially and that it does not issue any other equity following its EGC IPO. By the end of the year of the fifth anniversary of its equity IPO, SRC #2 ceases to be an EGC and may no longer use the communications and other regulatory benefits extended to EGCs, but it may continue to use scaled disclosure requirements extended to SRCs. SRC #2 is now following the same rules as SRC #1. Next, at the same time SRC #2 exits EGC status, assume two EGCs come along, each with a financial, business, corporate governance and market profile that is vastly different from the other, but one with a profile that is very similar to that of SRC #2 at the time of its exit. The two very different EGCs may use all of the EGC on-ramp provisions and the scaled disclosure requirements that SRC #2 just lost. This example shows that, in the coming years, we are likely to see issuers moving in and out of the categories of SRCs and EGCs, with the result that vastly different issuers can be in the same reporting scheme and other very similar issuers can be in different reporting schemes.

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[3] The JOBS Act's "effective date" for the definition of an EGC is December 8, 2011. Any issuer that made its first public sale of equity securities under an effective registration statement before December 8, 2011, is ineligible to qualify as an EGC. Note again the JOBS Act focus on the first public issuance of equity securities. Any reporting company that has publicly sold only debt securities or made its first public sale of equity securities after December 8, 2011, may still qualify as an EGC provided it has total revenues of less than US$1 billion.

We query whether investors will appreciate the regulatory distinctions and simply insist, for comparability's sake, that generally similar issuers in (or in and out of) these separate issuer categories make disclosures that adhere to a single general framework. If that is the case, then the market will impose the disclosure requirements.

Furthermore, as to the EGC IPO on-ramp communications benefits, in particular the test-the-waters and research report provisions, market participants may argue that if those provisions work for a category of issuers that is merely a subset of another category of issuers, then both categories of issuers should be extended the same benefits. And if these benefits work for smaller and mid-sized companies (SRCs and EGCs), it is reasonably foreseeable that other issuers will want those same benefits. In sum, one can reasonably anticipate that (especially in light of the impending elimination of the ban on general solicitation and advertising under Rule 506 and Rule 144A), should the JOBS Act's changes to the IPO process prove successful (both in terms of more efficient capital raising and investor protection), market participants will claim the changes should be extended to other, broader categories of issuers. In fact, it is reasonable to wonder today why the EGC IPO on-ramp communications benefits should not be extended to SRCs that missed the EGC start date.

Tying Together the JOBS Act Initiatives with Other Developments

The SEC has received some harsh criticism for failing to meet rulemaking deadlines under the JOBS Act. Some of this criticism points out that the JOBS Act provides the SEC with very specific direction and that at least some of the initiatives mandated under the JOBS Act, including the elimination of the ban on general solicitation in offerings under Rule 506 and Rule 144A, have been the subject of discussion between the SEC and market participants for years.

The SEC, however, has a difficult task in identifying the connections between the various elements of the JOBS Act and existing regulations and anticipated market developments, including increased use of the Internet and social media to offer and sell securities, continued development of secondary trading markets, increased globalization and a long list of other factors. More important than identifying these connections is for the SEC to rationalize them within a framework that provides for smooth transitions by issuers among and between offering processes.

When the JOBS Act is fully implemented, the framework for offerings, both registered and exempt, will be much more complex, particularly for smaller and mid-sized companies. The questions these companies need to consider when seeking to raise capital include:

- Who should the company approach to raise capital initially: friends and family, government loan programs, venture capitalists or the general public?
- Should the company obtain a loan or to issue debt or equity?
- How much money should the company raise?

As tricky as those basic questions may be, even trickier is determining what method of capital raising should be used.

- Rule 506
- Rule 505
- Rule 504 (“seed capital” exemption)
- Regulation A+
- Regulation A
- Crowdfunding
- Section 4(a)(5) (accredited investor exemption)
- Section 3(a)(11) (intrastate offering exemption)
- Rule 4(a)(2)
- Rule 144A
- Regulation S
- IPO

A company will need to examine its current status and goals and balance the resulting determinations against the most efficient way to raise capital while maintaining options to efficiently raise additional capital in the future and achieving business goals. If a company cannot clearly anticipate its longer-term capital needs or business goals at the outset of an initial capital raise, it needs to be aware of how the rules will change as it moves from one offering alternative to another. For example, is the issuer an EGC, SRC, FPI or all three? Next, for how long does it anticipate retaining its status and what regulatory accommodations can it use and still have a successful deal? If an issuer goes public as an EGC, how should it plan to comply with all of the requirements that will apply once it ceases to have that status, in particular the costs that will be necessary to achieve compliance under Section 404(b) of the Sarbanes-Oxley Act? Or how will it adjust to offering restrictions on communications that apply to non-EGCs? Hopefully the SEC will also be thinking of these off-ramp issues that EGCs will face.

The SEC needs to rationalize not only the framework for offerings, both exempt and public, but also the disclosure requirements for the different offering alternatives available. To do that, the SEC needs to understand how regulatory differences among all of the alternatives that will exist as a result of the JOBS Act may impact how issuers raise capital in the future. As just one example, at an earlier point this year, overall EGC trends indicated that most EGCs were not relying on the ability to present two rather than three years of audited financial statements. The trends we observed in our sample, however, indicate that EGCs are increasingly relying on this accommodation, perhaps because more smaller reporting companies have recently come to the markets. In addition, while the provisions under the JOBS Act relating to test-the-waters communications and research reports still have not been widely used, that trend may also change in the coming year, with the possibility of ripple effects beyond the category of EGC issuers.

Furthermore, the SEC needs to examine how the changes to Exchange Act registration thresholds, together with the new offering alternatives mandated under the JOBS Act, development of secondary trading markets, reduced holding periods under Rule 144 and other developments, will impact the overall environment for IPOs going forward. The changes to Rule 506 and Rule 144 may, together with these other developments, result in companies postponing or even forgoing IPOs for so long as the regulatory requirements applicable to public companies, particularly those imposed under Section 404(b) under the Sarbanes-Oxley Act (from which EGCs are only temporarily exempted) and the Dodd-Frank Act (including certain executive/employee compensation disclosures, politically driven disclosure requirements, and corporate governance requirements), continue to become more costly and difficult to comply with.

For these reasons, it seems imperative that the SEC adopt clear and workable rules implementing the remaining provisions under JOBS Act within a rational and coherent framework that can flex as the markets continue to change.

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