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Quicker to Market? U.S. House of Representatives Passes the *Jumpstart Our Business Startups Act*

A number of recent studies have noted a substantial decrease in IPOs by smaller companies and a perceived lack of hospitality to smaller companies in the public markets. Commentators have pointed to a number of factors, including Sarbanes-Oxley compliance costs, lack of research coverage and the prospect of lower trading profits for intermediaries resulting from structural market changes over the last several years.

Yesterday, the U.S. House of Representatives passed the ***Jumpstart Our Business Startups Act***, which seeks to address each of these factors. According to a report in today's *Wall Street Journal*, citing Dealogic, 98 of 107 U.S. IPOs in 2011 would have qualified for relief under the "JOBS" Act.

The bill contains:

- the *IPO On−Ramp*—a bundle of reforms that would ease the IPO process and some public company reporting requirements for companies with annual revenues of less than $1 billion; and
- *Private Capital Formation Reforms*—a set of reforms that would reduce regulatory restrictions on private offerings and raise the thresholds that trigger public company reporting for companies that have not yet conducted a public offering.

While the bill still faces Senate and White House approval, it had broad bipartisan backing in the House and the Senate and White House have expressed support for many of the reforms it contains. If the bill is ultimately enacted in a form similar to the version passed by the House, we expect that it will help smaller and emerging growth companies access the U.S. capital markets, and generally make the U.S. capital markets more attractive for them.

IPO On-Ramp

The bill would ease the IPO process and public reporting requirements for "Emerging Growth Companies," which are IPO companies with annual gross revenues of less than $1 billion during their most recent fiscal year. A company would retain Emerging Growth Company status, and the reduced regulatory and reporting requirements associated with it, until the earliest of:

- the first fiscal year after its annual revenues exceed $1 billion;
- the first fiscal year following the fifth anniversary of its IPO;
- the date on which the company has, during the previous three-year period, issued more than $1 billion in non-convertible debt; and
- the first fiscal year in which the company achieves "large accelerated filer" status. (Basically, a company with $700 million of public equity float that has been reporting for at least one year.)

IPO Process Reforms

Reforms aimed at making the IPO process easier would permit Emerging Growth Companies to:

- Provide two years of audited financial statements in their IPO S-1 or F-1 registration statement instead of three. In any other registration statement, an Emerging Growth Company would not need to provide selected financial data for any period prior to the earliest audited period presented in its IPO registration statement, rather than for the previous five years. This accommodation is designed to reduce audit costs.

- File their IPO registration statement and subsequent registration statements on a confidential basis, provided a public filing is made at least 21 days prior to the offering road show. This option, which has, until recently been available only to foreign companies, would permit Emerging Growth Companies to explore an IPO without exposing sensitive competitive information to the market until conditions are ripe for an IPO.
- Hold meetings with accredited investors and qualified institutional buyers to “test-the-waters”—or gauge investor interest in their securities prior to an offering—without being subject to current restrictions on pre-offering communications.

The bill would also permit investment banks to publish research related to an Emerging Growth Company around the time of the company’s IPO or other offerings and the expiration of related lock-up periods even if the research analyst was employed by a firm participating in the offering. The bill would also permit research analysts to participate in meetings with the Emerging Growth Company alongside investment banking personnel.

Reduced Public Company Reporting Requirements

An Emerging Growth Company would not be required to:

- provide an auditor’s attestation report on its internal controls, otherwise required by Section 404(b) of the Sarbanes-Oxley Act;
- hold shareholder advisory votes on executive compensation, or disclose all executive compensation information required for other companies, such as a comparison of executive pay to performance and median compensation;
- comply with new U.S. GAAP accounting pronouncements applicable to public companies until the pronouncements are also applicable to private companies; or
- comply with any future PCAOB rules mandating auditor rotation or making modifications to the auditor report. (The PCAOB has issued concept releases on mandatory auditor rotation and modifications to the auditor report.)

Finally, the SEC is required to conduct a study on stock-price decimalization and its impact on smaller public companies; if it finds an adverse impact, the SEC can permit trading in Emerging Growth Company securities in increments of up to a dime rather than a penny.

Private Capital Formation Reforms

The bill also contains a number of reforms aimed at easing the capital formation process for private companies. The bill would:

- *Permit general solicitations in offerings to accredited investors*. The bill would require the SEC to amend Rule 506 of Regulation D under the Securities Act of 1933 to permit widespread advertising or other forms of “general solicitation” in offerings that otherwise comply with Rule 506, so long as the only purchasers are accredited investors.
- *Permit general solicitations in 144A offerings*. The bill would require the SEC to amend Rule 144A under the Securities Act of 1933 to permit widespread advertising or other forms of “general solicitation” in offerings that otherwise comply with Rule 144A, so long as the only purchasers are qualified institutional buyers.
- *Raise the thresholds triggering public company reporting*. The bill would amend Section 12(g) of the Securities Exchange Act of 1934 to raise the thresholds that trigger public company reporting

to $10 million in assets and 2,000 shareholders, or 500 shareholders who are not accredited investors. The bill would also exclude employees receiving company securities under equity compensation plans from the Section 12(g) calculation. Banks and bank holding companies would be permitted to have $10 million in assets and 2,000 shareholders before being subject to public company reporting. Currently, Section 12(g) and Rule 12g-1 subject companies to public company reporting once their assets exceed $10 million and their shares are held of record by more than 500 persons.

- *Facilitate "crowdfunding."* The bill would amend Section 4 of the Securities Act to create a new registration exemption permitting a private company to sell over a 12-month period:
  - $1 million of securities; or
  - $2 million of securities if the company provides investors certain financial information.

  The amount sold to any one investor over the 12-month period could not exceed the lesser of $10,000 or 10% of the investor's annual net income.
- *Expand Regulation A.* The bill would amend the Regulation A small offering exemption to increase the amount of securities that can be issued over a 12-month period from $5 million to $50 million.

Potential Impact on U.S. Capital Markets

Although the current bill will likely be modified in the Senate, the prospect that some form of legislation will eventually become law is good given the bipartisan Congressional and White House support it appears to enjoy. We believe these proposed reforms could help reduce many of the current disincentives to U.S. IPOs for a broad swath of companies.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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