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April 5, 2013

The JOBS Act After One Year: A Review of the New IPO Playbook

Just one year ago, the Jumpstart Our Business Startups (JOBS) Act became law. Title I of the JOBS Act significantly changed the IPO playbook, creating a new category of issuer called an emerging growth company (EGC) and rewriting the rules for EGC IPOs. Nearly 75% of issuers that priced a US IPO after April 5, 2012 identified themselves as EGCs.

We think the JOBS Act's first anniversary is a good moment to pause and consider trends we have seen since Title I implemented the IPO on-ramp reforms that the IPO Task Force recommended.[1] We focused on the US IPO market and took a close look at 184 EGC IPOs that either priced or are publicly in registration.[2]

The information and analysis we present is based on our review of SEC filings, SEC commentary on the JOBS Act and our experience as either issuer's or underwriters' counsel in nearly 25% of priced EGC IPOs. Here is what we learned.

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TOP TEN LESSONS LEARNED IN THE FIRST YEAR

1. *Title I has changed the IPO process.* Over 90% of EGCs that publicly filed their first registration statement after April 5, 2012 elected at least one accommodation offered by the JOBS Act.

2. *EGCs are found across many industries, with technology companies representing the largest group of EGC IPO issuers.* After technology, the top five industries were energy, healthcare, financial services, real estate and pharmaceuticals.

3. *Confidential submission is particularly popular.* Approximately 65% of EGCs that publicly filed their first registration statement after April 5, 2012 confidentially submitted at least one draft registration statement prior to public filing.

4. *Using two years of financial statements has gained market acceptance.* Almost half of EGCs that filed publicly for the first time after April 5, 2012 provided two years of audited financial statements rather than three.

5. *The extended phase-in of the internal controls audit is popular.* Nearly all EGCs that priced an IPO after April 5, 2012 indicated an intention to use this accommodation or reserved the right to do so in the future.

6. *Disclosure about EGC status has become standard.* EGCs include standard disclosure in their IPO registration statements about their status and the on-ramp accommodations they are using.

7. *Testing-the-waters practices are still evolving.* The decision of whether, when and how to test the waters is made by issuers and their underwriters on a case-by-case basis.

8. *Research practices are still developing.* Although analysts employed by participating broker-dealers may publish research on EGCs earlier than currently allowed for non-EGCs, pre-deal research in connection with EGC IPOs has not emerged, and most participants have been voluntarily restricting research publication for an agreed period (typically 25 days) following the IPO.

9. *Foreign private issuers are taking advantage of Title I.* Foreign private issuers (FPIs) comprised almost 10% of priced US IPOs by EGCs since April 5, 2012.

10. *The pipeline for EGC IPOs remains robust.* There are currently 65 EGCs in registration that have publicly filed a registration statement.

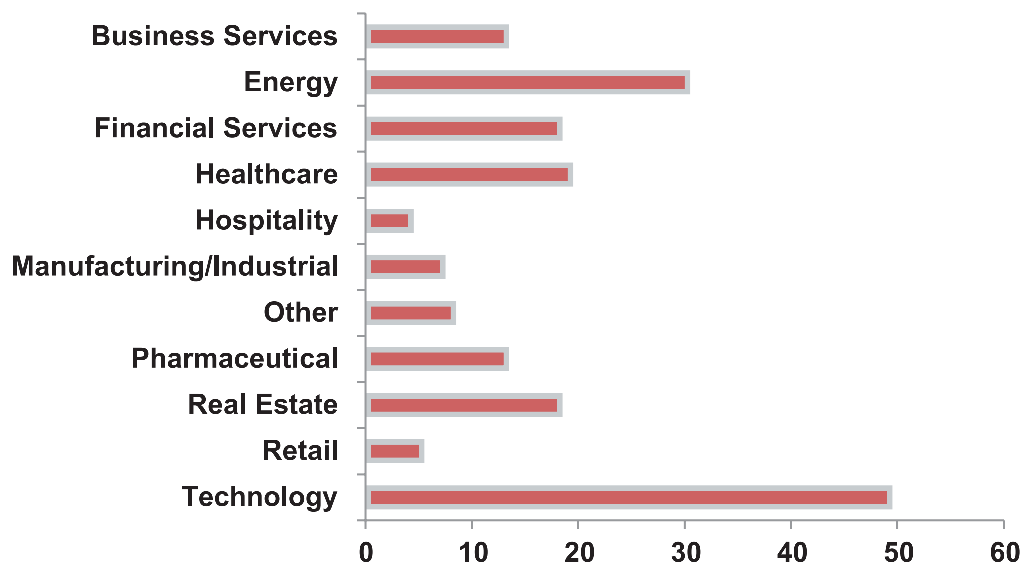
EGC IPOS BY THE NUMBERS

An EGC is a company with annual revenue of less than $1.0 billion for its most recently completed fiscal year, subject to disqualification events.[3] Companies with less than $250 million in annual revenue accounted for almost 85% of EGC IPOs that priced after April 5, 2012. FPIs comprised almost 10% of priced EGC IPOs during that period.

Many formerly public companies that went private are eligible for EGC status.[4] Five such companies priced an IPO as an EGC during the past year, and two EGCs that were previously public are currently in registration.

No EGCs lost their EGC status while in registration, although at least two newly public EGCs exceeded $1.0 billion in annual revenue for the 2012 fiscal year.[5] Thirty-three EGCs have conducted follow-on offerings.

Eleven master limited partnerships (MLPs) and ten real estate investment trusts (REITs) priced IPOs as EGCs.



USE OF EGC ACCOMMODATIONS

Title I gives EGCs a menu of options and allows them to choose all, some or none of the on-ramp accommodations. Over 90% of EGCs that publicly filed their first registration statement after April 5, 2012 elected to take advantage of at least one accommodation offered by the JOBS Act, although EGCs used the accommodations to varying degrees.[6] Forty-three now-public companies that were in registration or had recently priced their IPO when the JOBS Act became law took advantage of some or all of the accommodations immediately available to EGCs under the new law or reserved the right to do so in the future.

- **Testing the Waters** – Before or after filing a registration statement, EGCs may meet with qualified institutional buyers (QIBs) and other institutional accredited investors to gauge their interest in a contemplated offering.
- **Confidential SEC Review** – EGCs may initiate the SEC registration process confidentially.
- **Scaled Financial Disclosure** – EGCs may go public using two years, rather than three years, of audited financial statements and as few as two years, rather than five years, of selected financial data.
- **Internal Controls Audit** – EGCs are exempt from the internal controls audit required by Section 404(b) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).
- **Executive Compensation Disclosure** – EGCs may use streamlined executive compensation disclosure and are exempt from the shareholder advisory votes on executive compensation required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).
- **Extended Phase-In for New GAAP** – EGCs may use private-company phase-in periods for new accounting standards.
- **PCAOB Rules** – EGCs are exempt from any Public Company Accounting Oversight Board rules that, if adopted, would mandate auditor rotation or auditor discussion and analysis.

PRACTICE POINT

Determining Which EGC Accommodations to Use

At the very beginning of the IPO process, the issuer, the underwriters and counsel should consider which EGC accommodations to use. This discussion should include industry trends, market forces, the unique facts and circumstances of the issuer and the offering as well as materiality considerations generally. For example, some EGCs may elect to include additional executive compensation or historical financial information on a voluntary basis where the information is readily available and circumstances warrant its inclusion.

Testing the Waters

EGCs and their underwriters or other authorized persons may engage in oral or written communications with QIBs and other institutional accredited investors before or after the initial filing of a registration statement in connection with assessing investor interest in a proposed offering.[7] This testing-the-waters provision significantly modified the communications restrictions under Section 5 of the Securities Act and authorized a new way to approach the market. EGCs must still proceed thoughtfully, however, if they decide to test the waters with potential investors. The deal team should carefully consider the timing and content of these meetings based on the intended objectives of testing the waters, bearing in mind that the information in the draft registration statement will continue to change during the registration process and that the antifraud provisions of the federal securities laws continue to apply to the content of testing-the-waters communications.[8] As with traditional road-show materials, testing-the-waters materials should also be reviewed for consistency with the information contained in the registration statement.

The SEC Staff has taken an interest in testing-the-waters communications and routinely issues a comment seeking copies of written materials used to test the waters:

> *Please supplementally provide us with copies of all written communications, as defined in Rule 405 under the Securities Act, that you, or anyone authorized to do so on your behalf, present to potential investors in reliance on Section 5(d) of the Securities Act, whether or not they retain copies of the communications.*

PRACTICE POINT

Responding to the SEC Staff's Request for Testing-the-Waters Materials

The SEC Staff has indicated a desire to review testing-the-waters materials for consistency with the registration statement. The Staff has indicated that the materials will not be posted to EDGAR or otherwise made public by the SEC if correctly submitted. We recommend the following:

- Provide the materials supplementally in hard copy. Do not submit them to your SEC examiner via email or through EDGAR.
- Include the following confidential treatment request legend on each page of the materials: "CONFIDENTIAL TREATMENT REQUESTED BY [ISSUER NAME] UNDER SEC RULE 83" and comply with the other requirements of Rule 83 with respect to the submission.
- In the cover letter enclosing testing-the-waters materials, cite Securities Act Rule 418(b) and ask the SEC Staff to return the enclosed materials.

Confidential SEC Review

EGCs (including those that are FPIs) may confidentially initiate the SEC registration process by submitting to the SEC a draft registration statement for nonpublic review by the SEC Staff.[9] The Staff's review of a confidential submission should not take any longer than its review of a publicly filed registration statement (expect your first set of comments within 30 days of submission).

PRACTICE POINT

Combining Testing the Waters and Confidential Submission

In industries where valuation is uncertain and the timing of the IPO depends on regulatory or other approval (*e.g.*, biotech companies awaiting FDA approval of a new drug or product), the ability to submit confidentially and test the waters with prospective investors can provide additional flexibility. In these industries, EGCs and their underwriters may gain useful feedback from prospective investors while maintaining confidentiality as they await both clearance from industry regulators and market conditions that are favorable to the offering.

Confidential submissions must be substantially complete when submitted to the SEC for review. However, a confidentially submitted draft registration statement need not include the consent of auditors or other experts and does not need to be signed because the confidential submission does not constitute a filing under the Securities Act.[10] An issuer does not need to name any underwriters in its first confidential submission, but the SEC Staff will typically not continue substantive review of a draft registration statement if underwriters are not named by the second submission.

Thirty-six EGCs that priced an IPO began the IPO process with a confidential submission. Currently there are 30 EGCs publicly in registration with the SEC that previously submitted at least one registration statement for confidential review. The SEC Staff recently indicated that approximately 150 EGCs have used the JOBS Act's provision for confidential review, suggesting that approximately 85 EGCs are currently under confidential SEC review.[11]

EGC LISTINGS

PRACTICE POINT

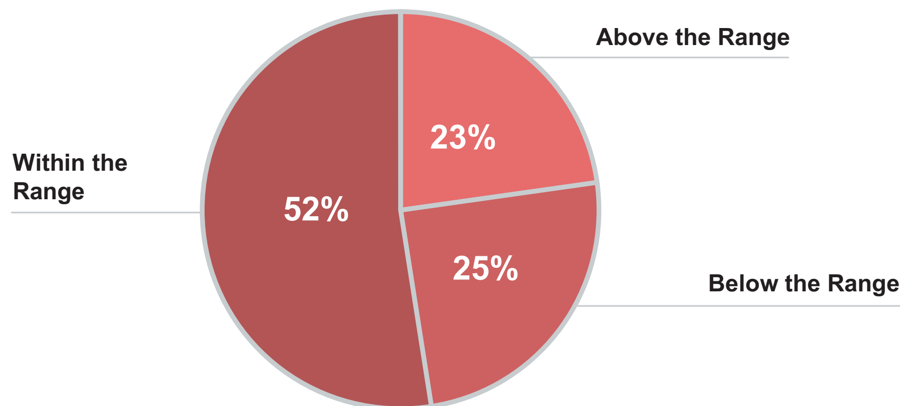
Confidential Submission vs. Filing

The distinction between “confidential submission” and “filing” is important.

- **Gun-Jumping**: Rule 163A provides a safe harbor from Section 5(c) of the Securities Act for certain communications made by or on behalf of an issuer more than 30 days before a registration statement is filed. The date of the public filing, not a confidential submission, determines the availability of the Rule 163A safe harbor.[12]
- **SEC and FINRA Filing Fees**: Because a confidential submission is not a filing, EGCs do not need to pay SEC filing fees when they confidentially submit. SEC filing fees are paid with the first public filing. However, confidential submissions do trigger FINRA filing requirements and payment of FINRA’s applicable filing fee (unless no FINRA member broker-dealer is yet involved in the offering).[13]
- **Sarbanes-Oxley**: Sarbanes-Oxley applies to an issuer that has filed a registration statement with the SEC, even if the registration statement has not yet gone effective. An EGC that has confidentially submitted a draft registration statement will not be subject to Sarbanes-Oxley (including Section 402’s prohibition on loans to directors and officers) until the registration statement is publicly filed.

An EGC may publicly announce that it has confidentially submitted a registration statement for SEC review, and that announcement will not constitute gun-jumping if Securities Act Rule 135 is followed.[14] To date, approximately 10% of confidential submissions have involved this type of announcement. EGCs may sometimes gain a strategic advantage from publicly announcing their confidential submission. For example, an EGC that is engaged in a dual-track M&A process may want potential bidders to be aware of its IPO while benefitting from nonpublic SEC review of its draft registration statement. This practice may become more frequent after the SEC implements Title II of the JOBS Act to permit general solicitation in private placements to accredited investors.[15]

MOST EGC IPOS PRICED WITHIN OR ABOVE THE RANGE



PRACTICE POINT

Numbering Confidential Submissions and Public Filings

The confidential submission process has practical implications for how registration statements should be numbered and how those registration statements will appear on EDGAR.

- All confidential submissions must be made via EDGAR using the draft registration statement form type DRS or DRS/A.
- The initial confidential submission should be titled “Confidential Submission” and subsequent confidential submissions should be titled “Amendment No. 1 to Confidential Submission,” “Amendment No. 2 to Confidential Submission,” etc.
- Confidential submissions typically include a header such as the following: *“As confidentially submitted to the Securities and Exchange Commission on [date] pursuant to the Jumpstart Our Business Startups Act.”*
- The first publicly filed version of the registration statement is made as an initial Form S-1 or F-1 filing and does not denote that the filing is an amendment.
- Subsequent public amendments to the registration statement then follow the traditional numbering format (*e.g.*, “Amendment No. 1 to Registration Statement on Form S-1,” etc.) and use the corresponding EDGAR form type (*e.g.*, S-1/A).

The 21-Day Requirement

An EGC may not commence its IPO road show marketing process until at least 21 days after publicly filing its initial confidential submission and all confidentially submitted amendments.[16]

PRACTICE POINT

The Timing Tradeoff

In considering when to make its first public filing, an EGC must weigh market uncertainty against the possible harm associated with failing to complete an IPO that has been publicly announced. An EGC that switches to a public process well in advance of a planned road show can more readily take advantage of favorable market changes. However, an EGC will not want to switch prematurely to a public process and unnecessarily give up the benefits of nonpublic SEC Staff review of the draft registration statement.

Approximately 65% of EGCs that publicly filed their first registration statement after April 5, 2012 began the registration process with a confidential submission. On average, these companies made two confidential submissions before their first public filing, launched their roadshow 49 days after public filing (126 days after the first confidential submission) and priced 10 days after launch.

Disclosure About EGC Status

The SEC Staff expects an EGC’s registration statement to disclose its EGC status and address related topics, such as exemptions available to EGCs, risks related to the use of those exemptions and how and when the issuer may lose EGC status. The Staff will typically comment on each of these points and ask the issuer to state its irrevocable election with regard to the extended

transition period for complying with new or revised accounting standards. If the issuer elects to use the extended transition period, the Staff will expect the issuer to explain the associated risks, such as decreased comparability with other issuers' financial statements.

PRACTICE POINT

EGC-Related Disclosure for an IPO

Below is a checklist of EGC-related disclosure to include in an IPO registration statement.

- *On the **prospectus cover***, disclose EGC status.
- *In the **summary box***, disclose:
  - a brief summary of the exemptions available to an EGC, in particular the exemption from Section 404(b) of Sarbanes-Oxley and the executive compensation voting requirements of Dodd-Frank, including golden parachutes (codified in Section 14A(a) and (b) of the Exchange Act), and the ability to provide scaled executive compensation and financial statement disclosure;
  - the requirements for qualifying as an EGC and how and when the issuer may lose EGC status; and
  - if the EGC has elected to opt out of the extended transition period for complying with new or revised accounting standards, the EGC must also indicate that this election is irrevocable.
- *In the **risk factors** section:*
  - if the EGC has elected to take advantage of the extended transition period for complying with new or revised accounting standards;
    - the EGC must include a risk factor explaining that this election allows it to delay the adoption of new or revised accounting standards that have different effective dates for public and private companies until those standards apply to private companies; and
    - the risk factor must indicate that the EGC's financial statements may not be comparable to companies that comply with all public company accounting standards.
  - EGCs often also include risk factors stating that:
    - the reduced requirements applicable to EGCs could make the issuer's securities less attractive to investors;
    - the issuer's exemption from Section 404(b) of Sarbanes-Oxley's auditor attestation requirements may result in unsuccessful internal controls; and
    - the issuer may have increased costs from operating as a public company and these costs will increase once the issuer loses EGC status.
- *In the **management's discussion and analysis (MD&A)** section*, if the EGC elects to follow the extended transition period for complying with new or revised accounting standards, the EGC must include a statement in its critical accounting policies disclosure explaining that its financial statements may not be comparable to companies that comply with public company effective dates.

Many EGCs also choose to include additional disclosure beyond what is required, even when not requested by the SEC Staff. For example, many EGCs briefly describe in the summary box or risk factors the requirements to qualify as an EGC. Even though risk factors should not describe "risks that could apply to any issuer or any offering," EGCs often include additional EGC-related risk factors, such as a warning that the reduced requirements for EGCs could make the issuer's securities less attractive to investors or that its costs as a public company will increase further after the issuer loses EGC status. We have summarized above our recommendations for typical EGC disclosure in an IPO registration statement.

Scaled Financial Disclosure

At the time of its IPO, an EGC can provide two, rather than three, years of audited financial statements and as few as two, rather than five, years of selected financial data.[17] After its IPO, an EGC must phase into full compliance by adding one additional year of financial statements in each future year until it presents the traditional three years of audited financial statements plus two additional years of unaudited selected financial data.[18] An EGC's MD&A may address only the years for which it provides audited financial statements and any subsequent interim period.[19]

PRACTICE POINT

Financial Statements for Recently Acquired Businesses

An EGC that is required to include audited financial statements of a recently acquired business or significant equity investee under Regulation S-X Rule 3-05 or 3-09 may present two, rather than three, years of financial statements for these entities if the EGC is presenting only two years of its own audited financial statements in the registration statement.[20]

Almost half of EGCs that filed publicly after April 5, 2012 and priced their IPO provided two years of audited financial statements rather than three.[21] Of the EGCs that provided three full years of audited financial statements, approximately one-third partially used this accommodation and provided fewer than five years of selected financial data. Approximately 20% of EGCs had an operating history of fewer than five years when their IPOs priced. Nearly all EGC IPOs with gross proceeds over $250 million provided three full years of audited financial statements and five years of selected financial data.

PRACTICE POINT

Providing Two Years of Audited Financial Statements

The decision whether to provide two years or three years of audited financial statements should be informed by a number of factors, including industry trends, market conditions and other issuer- and offering-specific considerations. In our experience, for example, MLP issuers that are EGCs find this accommodation particularly attractive because historical predecessor financial statements for MLP issuers are often hard to come by, and creating fewer years can save significant time and cost and get the issuer to market more quickly. This accommodation may also benefit issuers that have recently changed audit firms, allowing the new auditors to avoid re-auditing the third year of historical financial statements and resulting in cost savings for the issuer and a faster time to market. In this situation, we have also seen issuers present a third year of unaudited financial statements.

Executive Compensation Disclosure

EGCs may use streamlined executive compensation disclosure.[22] Approximately 75% of EGCs that first filed publicly after April 5, 2012 took advantage of this accommodation, generally by dispensing with compensation discussion and analysis (excluding FPIs, which are not required to provide detailed CD&A).

Internal Controls Audit

Nearly all EGCs that priced an IPO after April 5, 2012 indicated an intention to use the JOBS Act's extended phase-in for compliance with Section 404(b) of Sarbanes-Oxley or reserved the right to do so in the future. In our experience, this accommodation often receives significant discussion when an EGC and its underwriters consider which JOBS Act accommodations to use. Approximately 25% of EGCs that priced an IPO disclosed a significant deficiency or material weakness in internal control over financial reporting. None of these issuers indicated an intention to comply with Section 404(b) of Sarbanes-Oxley sooner than was required by the JOBS Act.

Extended Phase-In for New GAAP

Approximately 80% of all EGCs that first filed publicly after April 5, 2012 (excluding FPIs that use IFRS) irrevocably opted out of the accommodation for extended phase-in for new accounting standards and elected from day one to follow the public company phase-in periods for new or revised accounting standards.

PRACTICE POINT

Opting Out of the Extended Phase-In

An EGC wishing to opt out of the extended phase-in for new or revised accounting standards must disclose this election in the first registration statement that is submitted to the SEC, regardless of whether it is a confidential submission or public filing.[23]

If an EGC decides not to opt out of the extended phase-in, the SEC Staff will require (i) a risk factor that indicates that the EGC's financial statements may not be comparable to those of other companies that follow public company accounting standards and (ii) a similar statement in the critical accounting policies disclosure in the MD&A.

- **Sample Opt-Out Disclosure**: "Section 107 of the JOBS Act provides that an emerging growth company can use the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. This permits an emerging growth company to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this extended transition period and, as a result, we will adopt new or revised accounting standards on the relevant dates on which adoption of such standards is required for other companies."
- **Sample Disclosure for Extended Phase-In**: "We have elected to use the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards that have different effective dates for public and private companies until the earlier of the date we (i) are no longer an emerging growth company or (ii) affirmatively and irrevocably opt out of the extended transition period provided in Section 7(a)(2)(B)."

Underwriting Agreements

The JOBS Act also has implications for the typical representations, warranties and covenants found in underwriting agreements. For example, in over half of IPO underwriting agreements filed by EGCs, the indemnity and contribution provisions cover any written testing-the-waters communications.

EGCs may be asked to provide standard representations and covenants to their underwriters related to:

- EGC status;
- timely public filing of the registration statement at least 21 days before any road show;
- whether to engage in testing the waters and, if so, who may engage in those activities; and
- the contents of testing-the-waters materials.

Almost all EGC underwriting agreements include a representation from the issuer that it is an EGC. Most underwriting agreements also include representations by the issuer that it has not engaged in any testing-the-waters activities, distributed any testing-the-waters materials or authorized any other party other than the lead underwriters to engage in testing-the-waters activities. About half of EGC underwriting agreements include representations by the issuer confirming that the underwriters are permitted to conduct testing-the-waters activities for the issuer and affirming that there are no material misstatements or omissions in the testing-the-waters materials. Only a few EGC underwriting agreements include representations by the issuer stating that it will timely file the registration statement 21 days before any road show or affirming that no one will engage in testing-the-waters activities. In a few instances, EGCs have agreed to reimburse their underwriters for expenses relating to testing-the-waters activities.

Nearly all EGC underwriting agreements include a covenant requiring the EGC to notify the underwriters of any change in EGC status. Almost half of EGC underwriting agreements also include a covenant that the EGC must inform the underwriters of any change that would cause previously distributed testing-the-waters materials to contain a material misstatement or omission.

RESEARCH ISSUES

The JOBS Act modified the rules of the road relating to analyst research reports and analyst interactions with non-research personnel in a number of significant ways.

First, Section 105(a) of the JOBS Act amended Securities Act Section 2(a)(3) to provide an exception from the definition of offer for purposes of Sections 2(a)(10) and 5(c) of the Securities Act for research reports issued by a broker-dealer regarding an EGC that is the subject of a proposed public equity offering. For purposes of this exception, a "research report" is defined expansively to include any "written, electronic, or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision." Accordingly, on its face, the definition of research report for purposes of this provision would encompass nearly any written or oral communication relating to an EGC issuer or its securities made by a broker-dealer. The SEC Staff, however, has indicated that it will view this definition somewhat more narrowly and in a manner consistent with how it views research reports that are issued pursuant to Rule 139 under the Securities Act.[24] Importantly, this means that the Staff believes the Section 2(a)(3) exception is generally available only for research reports issued by persons within a broker-dealer who function as research analysts and not by other broker-dealer personnel (*e.g.*, sales and trading personnel).

Second, the JOBS Act prohibited the SEC and FINRA from adopting or maintaining any rule or regulation in connection with an IPO of an EGC that:

- restricts based on "functional role" which employees of a broker-dealer may arrange for communications between research analysts and prospective investors;
- prohibits research analysts from participating in communications with company management in the presence of non-research personnel (*e.g.*, investment banking and sales force personnel); or
- prohibits the publication or distribution of a research report or making of a public appearance within any prescribed period of time either (a) following the pricing date of the EGC's IPO, or (b) prior to the expiration date of a company or shareholder lock-up agreement.

As a result, the JOBS Act effectively superseded (in respect only of EGC IPOs) existing FINRA rules that imposed research quiet periods during the 40 days (or, for participating firms other than managers and co-managers, the 25 days) immediately following an IPO, as well as during the 15 days preceding the expiration of a company or shareholder lock-up agreement with the underwriters.[25] The JOBS Act also effectively eliminated (again, in respect only of EGC IPOs) a FINRA interpretation[26] that prevented research analysts from participating in communications with internal sales personnel in the presence of company management, as well as other FINRA guidance that was generally viewed as restricting the ability of research analysts to participate in communications (other than for offering-related due diligence purposes) with company management in the presence of investment banking personnel.

The JOBS Act, however, did not provide a safe harbor for research reports from liability under the Exchange Act Rule 10b-5 or other federal and state antifraud provisions of the US securities laws. Moreover, the JOBS Act did not provide a safe harbor under Section 12(a)(2) of the Securities Act with respect to *oral* research reports. Consequently, an oral research report could still result in Section 12(a)(2) liability if it is deemed to constitute an offer of a security and meets the criteria for liability under that provision.

SEC and FINRA Response

On August 22, 2012, the staff of the SEC's Division of Trading and Markets issued a series of FAQs regarding the research-related provisions of the JOBS Act (the Research FAQs).[27] In response to the Research FAQs, FINRA submitted a rule change proposal that was approved by the SEC on October 11, 2012.[28] In addition to the changes mandated by the JOBS Act, FINRA also implemented a suggestion from the Research FAQs to eliminate the research quiet periods following an EGC secondary or follow-on offering and during the 15 days *after* (not only before) the expiration, termination or waiver of an EGC lock-up agreement.[29]

Importantly, the Research FAQs confirm that the provisions of the JOBS Act that permit certain communications between research analysts and investment bankers and other non-research personnel and that allow research analysts to be present during communications between EGC management and investment banking personnel relating to a proposed IPO (including during pre-mandate pitch meetings) do *not* change the restrictions applicable to firms that are party to the Global Research Analyst Settlement.[30] The Research FAQs also caution that while research analysts from non-settling firms can be present during EGC IPO pitch meetings pursuant to the provisions of the JOBS Act, those analysts are still prohibited under FINRA rules from engaging in efforts to solicit investment banking business. Because of this caution and the difficulties of drawing lines between permissible and prohibited conduct, many firms are continuing to employ pre-JOBS Act policies and procedures that prevent research analysts from attending investment banking pitch meetings.

Although investment banking personnel of non-settling firms may now assist in the arranging of communications between research analysts and current or prospective investors in connection with a proposed EGC IPO, FINRA rules continue to prohibit investment banking personnel from *directing* research analysts to engage in such communications or in sales and marketing efforts regarding an investment banking transaction. Research analysts also continue to be prohibited from participating in road shows or engaging in communications with current or prospective investors regarding an investment banking transaction in the presence of investment banking personnel or company management.[31]

Pre-Deal Research

In addition to requesting copies of testing-the-waters materials, the SEC Staff often issues a comment relating to pre-deal research:

> *Please supplementally provide us with any research reports about you that are published or distributed in reliance upon Section 2(a)(3) of the Securities Act as modified by Section 105(a) of the JOBS Act by any broker or dealer that is participating or will participate in your offering.*

PRACTICE POINT

Responding to SEC Comments Seeking Pre-Deal Research Materials

If there has been no pre-deal research coverage of an EGC, you may wish to use some variation of the following responses to SEC comments seeking pre-deal research materials:

- *As of the date of this letter, the Company is not aware of any research reports about the Company that have been published or distributed in reliance upon Section 2(a)(3) of the Securities Act (as modified by Section 105(a) of the JOBS Act) by any broker or dealer that is currently participating or is expected to participate in the offering.*
- *As of the date of this letter, the underwriters participating in the Company's initial public offering have confirmed to the Company that they have not published or distributed any research reports about the Company in reliance upon Section 2(a)(3) of the Securities Act as modified by Section 105(a) of the JOBS Act.*

To date, we are not aware of any pre-deal research reports published by participating broker-dealers in reliance on the new exception for EGC research reports added by Section 105(a) of the JOBS Act. This appears to be the result of both regulatory and practical limitations relating to the preparation and issuance of pre-deal research reports including:

- the continuing Global Research Analyst Settlement limitations applicable to settling firms (and other firms that have otherwise agreed to comply with the settlement's substantive provisions) on communications between investment banking personnel and research analysts;
- FINRA rules that prohibit investment banking personnel from directing research analysts to engage in investor communications or sales and marketing activities relating to an investment banking transaction;

- the time necessary to produce a well-reasoned report that reflects the analyst's own personal views and satisfies FINRA and other content requirements (including that it be fair and balanced, provide a sound basis for evaluating the facts relative to the security covered, and not omit any material fact or qualification necessary in order to make the statements made in the report not misleading);
- FINRA restrictions with respect to previewing a research report with the subject company; and
- general liability, selective disclosure and issuer entanglement concerns, particularly if the analyst has been engaged in vetting discussions or has been provided with company models or estimates that are not yet reflected in a publicly filed registration statement or are otherwise known to the general public.

Note, too, that the publication by participating broker-dealers of a research report regarding an EGC may be prohibited during the restricted period applicable to securities distributions under Rule 101 of the SEC's Regulation M. For IPOs, the Rule 101 restricted period will generally commence five business days prior to the pricing date and end upon the completion of the distribution (as determined in accordance with Regulation M). Thus far, the SEC has not indicated how or if they will modify Regulation M in response to the JOBS Act.

Post-Offering Research

Although the JOBS Act and subsequent FINRA rulemaking have eliminated post-IPO research quiet periods for EGCs under Rule 2711(f), and thus would allow participating broker-dealers to publish research reports on an EGC immediately after the IPO pricing date, it has become common for the lead underwriters in EGC IPOs to impose a contractual research quiet period on members of the underwriting syndicate. This voluntary research quiet period typically lasts (in the case of EGC IPOs that will be listed on an SEC-registered national securities exchange) until the 25th calendar day following the IPO effective date. This approach reflects the view of many industry participants that investors should be looking to the information provided in the prospectus during the prospectus delivery (or availability) period set forth in Securities Act Rule 174(d) and allows the covering analysts time to prepare their research reports and provide analysis that takes into account the information included in the final prospectus as well as post-offering developments.

PRACTICE POINT

Scope of Syndicate Research Restrictions

In cases where the EGC issuer is a subsidiary or spin-off of a parent company for which the Rule 139 safe harbor is available, consideration should be given as to whether the applicable syndicate research restrictions would allow a participating underwriter to continue to publish on the parent company. For example, a research report on the parent company may be viewed as a backdoor report on the subsidiary EGC if segment or other identifying information is provided with respect to the EGC. In addition, if the analyst covering the parent is involved in vetting the EGC offering and is in possession of material non-public information regarding the EGC or the transaction that would need to be disclosed in the parent company report in order to comply with FINRA content requirements or Rule 10b-5 or other disclosure principles, it may not be possible for the analyst to continue to publish on the parent company. Outside counsel and/or internal legal and compliance personnel should be consulted in such situations.

As noted above, FINRA rulemaking adopted in response to the JOBS Act has also eliminated for EGCs the 10-day research quiet periods applicable to secondary offerings and the research quiet periods applicable during the 15 days both before and after the expiration, termination or waiver of a lock-up agreement entered into between the underwriters and the company or its shareholders.[32] Participating underwriters appear to be taking advantage of this liberalization of the rules and are publishing research reports during these previously blacked-out periods in the ordinary course.

PRACTICE POINT

EGC Lock-Up Agreements

In our experience, lock-up agreements are rarely signed in connection with an issuer's confidential submission and generally continue to be signed in connection with the first public filing. Lock-up agreements no longer include provisions designed to extend the end date of the lock-up agreement in the event that the company issued an earnings release or another significant event involving the company occurred during a specified period prior to the scheduled lock-up expiration date.[33] These provisions are no longer necessary in light of the amendment to Rule 2711(f)(4).[34]

DEBT-ONLY FILERS

Eleven EGCs have completed *Exxon Capital*, or A/B, exchange offers on Form S-4.[35] Over 80% of these issuers are backed by private equity sponsors. While to date most of the EGCs conducting A/B exchange offers did not take advantage of the scaled disclosure accommodations offered by the JOBS Act, this may change. The A/B exchange offers that have been completed since April 5, 2012 were generally in connection with high yield debt offerings completed under the pre-JOBS Act disclosure regime. In time, the private debt market may follow registered equity offerings in adopting certain scaled disclosure requirements as debt investors become more comfortable with various provisions of the JOBS Act.

Although the sample size of EGC A/B exchange offers is small, approximately 45% of the these EGCs chose to take advantage of the extended phase-in for new financial accounting standards and nearly all either specifically stated they would take advantage of the exemption from the auditor attestation requirements of Section 404(b) of Sarbanes-Oxley or reserved the right to do so in the future.

CONCLUSION

The reforms in Title I of the JOBS Act changed significant aspects of the IPO process. Most IPOs now begin with a confidential submission to the SEC Staff, and the IPO process now offers EGCs increased flexibility, scaled disclosure and temporary relief from some of the regulatory burdens that apply to other public companies. These substantial improvements to the IPO process are still not widely understood by many private companies, and we expect to see a continuing increase in the number of issuers that take advantage of the IPO on-ramp. Although it remains to be seen how and when the SEC will implement other provisions of the JOBS Act, we believe that the IPO on-ramp reforms will continue to take on greater importance as we begin the second year of the new IPO process inaugurated with Title I's self-executing changes.

ENDNOTES

[1] The IPO Task Force was formed in mid-2011 following the US Treasury Department's "Access to Capital Conference" and was comprised of a group of industry experts, including venture capitalists, entrepreneurs, investors, investment bankers, academics and former government officials. Latham partner Joel Trotter served as one of two securities lawyers on the IPO Task Force. The IPO Task Force studied the market for IPOs over various periods in order to determine the relationship between IPO volume and job growth and concluded that the decline in the number of IPOs in recent years resulted in considerable job loss and damage to the US economy. The recommendations contained in the IPO Task Force's report to increase US job creation and overall economic growth served as the foundation for much of what was to become the "on-ramp" easing the transition from private to public company that is contained in Title I of the JOBS Act.

[2] Since the JOBS Act was passed, over 500 issuers identifying themselves as EGCs have publicly filed registration statements with the SEC. Out of this group, we selected for review 184 issuers that either successfully completed an IPO listed on a major US securities exchange or that we believed would be likely to complete such an IPO. We excluded from our data set certain REIT offerings made on a "best efforts" basis and all offerings by closed-end investment companies made on Form N-2. Unless otherwise noted, the data in this report are as of March 31, 2013 and are derived from the public filings of the 184 EGC issuers we selected as described above. When we refer to data regarding priced IPOs by EGCs, we are referring to the 101 EGCs out of this group of 184 that successfully completed an IPO listed on a major US securities exchange. Since April 5, 2012, there have been a total of 136 successfully completed IPOs (by both EGCs and non-EGCs) listed on a major US securities exchange.

[3] *See* JOBS Act Sections 101(a) and (b) (adding new Section 2(a)(19) of the Securities Act of 1933 and Section 3(a)(80) of the Securities Exchange Act of 1934). After the initial determination of EGC status, a company will remain an EGC until the earliest of:

- the last day of any fiscal year in which the company earns $1.0 billion or more in revenue;
- the date when the company qualifies as a "large accelerated filer," with at least $700 million in public equity float;
- the last day of the fiscal year ending after the fifth anniversary of the IPO pricing date; or
- the date of issuance, in any three-year period, of more than $1.0 billion in non-convertible debt securities.

EGC status will ordinarily terminate on the last day of a fiscal year. However, the issuance in any three-year period of more than $1.0 billion in non-convertible debt securities would cause an issuer to lose its EGC status immediately. For purposes of this calculation, all debt securities (whether outstanding or not) count towards the $1.0 billion limit. Debt securities issued in an A/B exchange offer do not count towards the $1.0 billion limit, since they are, in effect, "the completion of the capital-raising transaction." *See* SEC Division of Corporation Finance, "JOBS Act FAQs: Generally Applicable Questions on Title I of the JOBS Act" (Sept. 28, 2012), available at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (SEC Title I FAQs), Question 18. EGC status is generally unavailable to any public company that priced its IPO on or before December 8, 2011. *See* SEC Title I FAQs, Question 2.

[4] In order for a previously public issuer to qualify for EGC status, (a) it must have priced its initial IPO prior to December 8, 2011, (b) it must not currently be a voluntary filer and (c) it must otherwise qualify as an EGC. A previously public issuer that had its registration revoked under Exchange Act Section 12(j) or that appears to have gone private for the purpose of conducting an offering as an EGC is not eligible for EGC status. *See* SEC Title I FAQs, Question 54.

[5] A public EGC that loses its EGC status generally should disclose this fact in its next annual report. A public EGC that loses its EGC status by issuing more than $1.0 billion in non-convertible debt securities should disclose this fact in its next periodic report.

[6] By contrast, nearly all EGCs that were already in registration when the JOBS Act was signed into law chose not to revise their disclosure to take advantage of the benefits of EGC status.

[7] *See* JOBS Act Section 105(c) (adding new Securities Act Section 5(d)).

[8] The application of Exchange Act Rule 15c2-8(e) to testing-the-waters activities was clarified in Question 1 of JOBS Act-related frequently asked questions published by the SEC Division of Trading and Markets. *See* SEC Division of Trading and Markets, "Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters" (August 22, 2012), available at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm, Question 1. As discussed in the answer to Question 1, it should be possible for testing-the-waters activities to take place in a manner consistent with the requirements of Rule 15c2-8(e) (which generally has been interpreted to require the availability of a red herring prospectus prior to soliciting orders for the registered securities). In particular, the answer to Question 1 states that an underwriter should generally be able to seek non-binding indications of interest from prospective investors (including as to the number of shares they may seek to purchase at various price ranges) so long as the underwriters are not soliciting actual orders and the investors are not otherwise asked to commit to purchase any particular securities.

[9] *See* JOBS Act Section 106(a) (adding new Securities Act Section 6(e)(1)).

[10] *See* SEC Division of Corporation Finance, "JOBS Act FAQs: Confidential Submission Process for Emerging Growth Companies (Apr. 10, 2012), available at http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm, Question 7. In addition, a confidential submission does not constitute a "filing" for purposes of Sarbanes-Oxley.

[11] *See* Yin Wilczek, "SEC Division to Issue Guidance 'Soon' on Compliance with Conflict Minerals Rule," Bloomberg Securities Law Daily (Feb. 26, 2013) (reporting that the SEC has received "about 150 confidential submissions" under the JOBS Act).

[12] *See* Latham & Watkins *Client Alert* "The JOBS Act After Two Weeks: The 50 Most Frequently Asked Questions," available at http://www.lw.com/thoughtLeadership/jobs-act-faqs, Question 35; *cf.* SEC Title I FAQs, Question 3 ("The date of the initial confidential draft submission is not the 'initial filing date'. . . since it is not the filing of a registration statement.").

[13] *See* FINRA Rule 5110(b)(4).

[14] *See* Securities Act Rule 135 (providing a safe harbor for a limited public announcement of a proposed registered offering). The SEC Staff has informally confirmed that Rule 135 is available for an EGC wishing to announce its confidential submission of a draft registration statement in connection with a proposed IPO.

[15] *See* JOBS Act Section 201(a); *see also Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, SEC Release No. 33-9354 (Aug. 29, 2012); Latham & Watkins *Client Alert*, "The JOBS Act, Part Deux: Frequently Asked Questions About Title II of the JOBS Act," available at http://www.lw.com/thoughtLeadership/faq-jobs-act-title-II.

[16] *See* JOBS Act Section 106(a).

[17] *See* JOBS Act Section 102(b)(1) (adding new Securities Act Section 7(a)(2)).

[18] *See* JOBS Act Section 102(b)(2) (modifying Exchange Act Section 13(a)).

[19] *See* JOBS Act Section 102(c) (modifying Regulation S-K, Item 303(a)).

[20] SEC Title I FAQs, Question 16.

[21] Excluding EGCs with fewer than three years of operating history, approximately 30% of EGCs provided two years of audited financial statements.

[22] *See* JOBS Act Section 102(c) (modifying Regulation S-K, Item 402).

[23] *See* SEC Title I FAQs, Question 13.

[24] Securities Act Rule 139 provides a safe harbor for the issuance of research reports by broker-dealers participating in an offering of securities by certain seasoned issuers that is similar to amended Section 2(a)(3). Unlike Section 2(a)(3), however, Rule 139 is not available for the initiation of research regarding an issuer or its securities and covers only written (not oral) communications. Note also that this definition of research report is different from the manner in which a research report is defined for purposes of SEC Regulation AC as well as for purposes of FINRA's NASD Rule 2711 (Rule 2711).

[25] *See* Rule 2711(f)(1)(A), (f)(2) and (f)(4).

[26] *See* FINRA Notice 05-34 (May 2005).

[27] SEC Division of Trading and Markets, "Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters" (August 22, 2012), available at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm.

[28] *See* SEC Release No. 34-68037 (Oct. 11, 2012).

[29] The changes expressly mandated by the JOBS Act were effective retroactively to April 5, 2012. The other changes adopted to further the policies of the JOBS Act, but not expressly mandated by the provisions of the JOBS Act, were effective as of October 11, 2012. *See* FINRA Notice 12-49 (Nov. 2012).

[30] The Global Research Analyst Settlement (the Settlement) was entered into in 2003 between a number of major investment banks and the SEC and other regulators. Although the terms of the Settlement were amended in 2004 and 2010 to modify and remove certain requirements (largely due to the adoption by FINRA of similar requirements applicable on an industry-wide basis), the remaining provisions of the Settlement are still in effect. The terms of the Settlement may be modified only by court order or by an SEC or FINRA rule or interpretation that is expressly stated to supersede a particular provision of the Settlement. Thus far, the SEC and FINRA have indicated that they are not inclined to modify the terms of the Settlement in response to the JOBS Act.

[31] In addition, analyst communications continue to be subject to certification and other requirements under SEC Regulation AC and to the content, approval, supervision, compensation and other requirements of Rule 2711 and FINRA Rule 2210 (regarding member communications with the public).

[32] *See* Rule 2711(f)(1)(B), (f)(4) and new (f)(5).

[33] These provisions were included to allow research analysts to continue to publish research around the time of the earnings release or other significant event without running afoul of the research quiet periods set forth in Rule 2711(f)(4).

[34] For existing EGC lock-up agreements that contain this extension language, firms may be called on to waive the extension provision. In such case, consideration should be given to the requirements of FINRA Rule 5131, which may (particularly if the prospectus disclosure includes a reference to the extension mechanics) necessitate the issuance of a press release at least two business days prior to proposed effective date of the waiver.

[35] A line of SEC Staff no-action letters permits issuers who have sold debt securities to QIBs pursuant to Rule 144A subsequently to register an exchange offer of identical securities for the Rule 144A securities. *See Exxon Capital Holdings Corp*. (avail. May 13, 1988); *Shearman & Sterling* (avail. July 2, 1993); *Morgan Stanley & Co. Inc.* (avail. June 5, 1991).

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The authors wish to thank Katherine Brown, Keely O'Malley and Victoria VanStekelenburg for their tremendous contributions to this report.

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