



IPO “On-Ramp”

In our November 2011 client alert,¹ we discussed many of the proposed legislative initiatives designed to ease the burdens on emerging and smaller companies and promote capital formation, particularly through exempt offerings. Regulators now have begun to focus on measures that would encourage smaller companies to pursue initial public offerings, or IPOs. One such measure was introduced in the Senate on December 1 by Senator Charles Schumer (D. NY), along with Senators Thomas Carper (D. DE), Mike Crapo (R. ID), Patrick Toomey (R. PA) and Mark Warner (D. VA).² The bill echoes a number of the recommendations that were included in a report entitled “Rebuilding the IPO On-Ramp” (the “Report”),³ presented to the U.S. Department of the Treasury by the IPO Task Force in October 2011.

Background— The IPO Task Force Report

In March 2011, the U.S. Treasury Department convened the Access to Capital Conference to “gather insights from capital markets participants and solicit recommendations for how to restore access to capital for emerging companies – especially public capital through the IPO market.”⁴ At this conference, a small group of professionals representing broad sectors of the IPO market decided to form the IPO Task Force (the “Task Force”) to examine the challenges that emerging growth companies face in pursuing IPOs, and to provide recommendations for restoring effective access to the public markets for emerging growth companies.⁵

In its Report, the Task Force noted that after achieving a one-year high of 791 IPOs in 1996, the U.S. IPO Market severely declined from 2001-2008, averaging only 157 IPOs per year during that period, with a low of 45 in 2008, with IPOs by smaller companies showing the steepest declines. The Report presents a nuanced view of the causes of this decline, pointing to a series of regulatory and market structure changes. The Report notes that these changes have coalesced and as a result have had the effect of driving up costs for smaller companies looking to go public; constraining the amount of information available to investors about such companies; and shifting the economics of investment banking away from long-term investing in such companies and toward high-frequency trading of large-cap stocks, thus making the IPO process less attractive to, and more difficult for, smaller companies. The Report made four principal recommendations to the Treasury Department: providing an “on-ramp” (or phasing in of disclosure requirements) for smaller companies that complete IPOs; improving the availability and flow of information for investors before and after an IPO; lowering the capital gains tax rate for investors who purchase shares in an IPO and hold these shares for a minimum of two years; and educating issuers about how to succeed in the new capital markets environment.

¹ See <http://www.mofo.com/files/Uploads/Images/11107-Capital-Formation.pdf>.

² See <http://www.gpo.gov/fdsys/pkg/BILLS-112s1933is/pdf/BILLS-112s1933is.pdf> for the full text of the bill.

³ See the IPO Task Force Report, available at <http://www.williamblair.com/Documents/IPOTaskForce.pdf>.

⁴ Id. at 1.

⁵ See id.

The Task Force stressed that these recommendations purport only to adjust the scale of current regulations, not change the focus on investor protection.

Proposed Legislation

The legislation, entitled the “Reopening American Capital Markets to Emerging Growth Companies Act of 2011,” proposes to amend Section 2(a) of the Securities Act of 1933 (the “Securities Act”) and Section 3(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) by creating a new category of issuer called an “emerging growth company” and exempting these emerging growth companies, at least initially, from certain requirements. Under the proposed legislation, an “emerging growth company” would be defined as an issuer that had total annual gross revenues of less than \$1 billion dollars at the end of its most recent completed fiscal year. An issuer that is an emerging growth company as of the first day of that fiscal year shall remain one until the earliest of:

- the last day of the fiscal year of the issuer during which it had total annual gross revenues of \$1 billion or more;
- the last day of the fiscal year of the issuer following the fifth anniversary of the date of first sale of common equity securities of the issuer pursuant to an effective Securities Act registration statement; and
- the date on which the issuer is considered to be a Large Accelerated Filer as defined by the SEC.

The bill creates a transitional on-ramp status for emerging growth companies to encourage them to go pursue IPOs by phasing in compliance measures in areas that will not compromise core investor protection. For example, the bill would exempt emerging growth companies from the requirement to hold a shareholder advisory vote on executive compensation arrangements, including golden parachutes under Section 14A(e) of the Exchange Act and from Dodd-Frank Act requirements to disclose the median of the annual total compensation of all employees under Section 953(b)(1). In addition, the legislation would require emerging growth companies to provide only two years of audited financial statements to the SEC (rather than three years), and would remove the auditor attestation requirement.

In order to promote access to information about emerging companies, the legislation would allow brokers and dealers, even if they were participating in the underwriting process, to publish research reports about emerging growth companies prior to the IPO. The bill does not remove other important protections in this area. The proposed legislation would also allow an emerging growth company to gauge preliminary interest in a potential offering by expanding the range of permissible pre-filing communications made to qualified institutional buyers or accredited investors, and filing a registration statement with the SEC on a confidential basis

Going Forward

While discussions regarding reforms in the area have been promising, and seem to attract broad bipartisan support, it is fair to predict that it will be a long and steep ramp to climb toward final measures in the area. Please see our other updates on developments related to capital formation:

[“Legislative Proposals to Facilitate Capital Formation Advance.”](#) November 7, 2011

[“Reg A A-Okay – House Approves the Small Company Capital Formation Act.”](#) November 4, 2011

[“Legislative Proposals to Facilitate Small Business Capital Formation.”](#) October 13, 2011

[“House Financial Services Committee Approves the Small Company Capital Formation Act; Regulation A Revival Closer?”](#) June 24, 2011

[“Legislative Action on Exchange Act Registration Thresholds.”](#) June 21, 2011

[“U.S. Capital Raising in the Spotlight.”](#) April 20, 2011

[“Small Company Capital Formation Act of 2011; Regulation A Revival?”](#) March 30, 2011

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