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JOBS Act: Go public or stay private?

By Irvin Brum

The recently enacted JOBS Act contains laws that, on the surface, appear to have inconsistent goals. On the one hand, the JOBS Act encourages IPOs by creating a new category of "emerging growth company" for which standard regulatory requirements for going public will be significantly relaxed. On the other hand, the JOBS Act makes it easier and more attractive for companies to remain private longer than before. Is the JOBS Act intended to rekindle an anemic IPO market or will it spur companies to remain private indefinitely? The short answer is: both.

The JOBS Act is a collection of disparate laws that proponents say will make it easier and less expensive for entrepreneurial companies to raise capital and create jobs. Much of the JOBS Act owes its genesis to the Treasury Department's 2011 IPO Task Force, whose mandate was to "examine the root causes of the current IPO crisis and … restore access for emerging growth companies to capital." The task force noted that the number of emerging growth companies entering the capital markets through initial public offerings had plummeted over the last 15 years due, in part, to the high costs of both going and staying public.

To lessen these burdens, the JOBS Act creates a new category of "emerging growth company" for which exemptions from disclosure and related requirements are made available including corporate governance reforms adopted as part of Sarbanes-Oxley and Dodd-Frank. While the term "emerging growth company" may evoke images of small startups, the JOBS Act definition of EGC includes companies whose annual revenues are just shy of $1 billion. Defined this way, the term would have covered the overwhelming majority of all companies that went public during the last 15 years.

Generally speaking, EGCs can maintain their status for five years post-IPO until their annual revenues reach $1 billion or until their public float hits $700 million, whichever occurs first. Thus protected, companies can avoid say-on-pay and say-on-golden-parachute shareholder voting, enhanced CEO compensation disclosure, three years of audited financials (only two will be required) and Section 406(b) auditor attestation reports. EGCs can also gauge interest in their proposed securities offering by communicating with investors before committing substantial resources to an uncertain IPO process.

Clearly, the JOBS Act was intended to revive the IPO market, but its success in doing so is uncertain at best. While the new law will result in cost savings for companies looking to go public, those savings will be relatively modest when compared to other unavoidable costs, such as underwriters fees. Further, dramatic changes have affected the public equity markets since the late 1990s, after which retail investors lost confidence in public equity markets and

institutional investors were faced with small-cap company liquidity issues, forcing underwriters specializing in these offerings to close shop.

Of far greater potential impact are the radical changes made by the JOBS Act to Rule 506 of Regulation D. Rule 506 permits companies to raise unlimited amounts of capital from any number of accredited investors without the use of offering memoranda and without regulatory review. However, because Rule 506 is a "private placement" exemption, capital must be raised without the use of general solicitation or advertising. The JOBS Act drops this requirement entirely, permitting companies to advertise their securities offerings anywhere, including newspapers, Twitter and Facebook, so long as all investors are accredited. Companies will now have the best of both worlds: the ability to publicly offer their securities while using a private placement exemption.

Of course, this is not the same as having publicly registered shares that are freely tradable on a recognized securities exchange. But the secondary market for private shares continues to develop and offers a greater degree of liquidity than ever before. With the JOBS Act now raising the shareholder threshold from 500 to 2,000 for Exchange Act reporting purposes, companies will be able to more easily raise capital using Rule 506 while remaining privately held indefinitely. And unlike crowdfunding – about which much ink has been spilled – Rule 506 has no dollar limit, requires no audited financials and no intermediary.

The bottom line? The JOBS Act will likely do little to increase the number of IPOs, but will absolutely help private companies raise capital and create much-needed jobs.

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