Going Public After the JOBS Act

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The Jumpstart Our Business Startups Act of 2012 (JOBS Act) represents one of the most comprehensive overhauls of the securities laws in recent years. One of the principal goals of the JOBS Act is to improve access to the capital markets for smaller issuers, referred to in the Act as emerging growth companies, or EGCs. To accomplish this goal, the JOBS Act seeks to reduce the costs of conducting a public offering and complying with the ensuing reporting obligations by making certain disclosure requirements voluntary for EGCs.

This Article examines whether these scaled disclosure rules have increased the number of small issuers conducting an initial public offering (IPO) of their equity securities and the extent to which these issuers have taken advantage of the various exemptions available to them under the JOBS Act. The evidence presented in this Article shows that EGCs have increasingly taken advantage of several of the scaled disclosure provisions of the JOBS Act during their IPOs. EGCs that take advantage of these scaled disclosure provisions are smaller, younger, and more likely to belong to the R&D-intensive pharmaceutical industry. Notably, despite the fact that EGCs are embracing these scaled disclosure provisions, there has not been a noticeable increase in the proportion of IPOs conducted by issuers that qualify as EGCs. The Article explores two interrelated explanations for these seemingly contradictory findings.

First, the evidence indicates that the benefits of the JOBS Act may not be as significant as may have been expected. While the direct costs of conducting an IPO have not decreased for EGCs following the enactment of the JOBS Act, indirect costs may have actually increased. In addition, by their second fiscal year, over forty percent of issuers that went public as EGCs no longer qualify for such status, a fact that limits the expected ongoing benefits of the JOBS Act at the going public decision stage. Second, certain issuers that qualify for EGC status may be choosing to pursue private offerings, which certain provisions of the JOBS Act facilitate. Changes in the mix of small issuers going public following the enactment of the JOBS Act suggest such a shift in the pattern of going public decisions across firms.

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I. INTRODUCTION

The first decade of the twenty-first century witnessed a significant decline in the number of private companies conducting an initial public offering (IPO) of their equity securities[1] and a coinciding increase in the number of public

[1] *See, e.g.*, Graham Bowley, *Fleeing to Foreign Shores*, N.Y. TIMES (June 7, 2011), http://www.nytimes.com/2011/06/08/business/global/08exchange.html?pagewanted=all&_r=0, *archived at* http://perma.cc/A6YV-ZPHV (noting there were only 119 IPOs in U.S. in

companies undertaking going private transactions.[2] Practitioners, as well as scholars, attributed this fall in the number of public issuers to increases in regulatory compliance costs, particularly following the enactment of the Sarbanes-Oxley Act of 2002[3] and the accompanying rules promulgated by the Securities and Exchange Commission (SEC).[4] This trend has been more pronounced for small companies, reflecting the quasi-fixed nature of these compliance costs, which disproportionally burden smaller and younger issuers.[5]

In an effort to reverse this trend, Congress enacted the Jumpstart Our Business Startups Act of 2012 (JOBS Act) with the stated purpose of "increas[ing] American job creation and economic growth by improving access to the public capital markets for emerging growth companies."[6] The

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2010, compared with 756 in 1996); Xiaohui Gao et al., Where Have All the IPOs Gone? 8 (Aug. 26, 2013) (unpublished manuscript), *available at* http://ssrn.com/abstract=1954788, *archived at* http://perma.cc/B43R-X7H2 (noting a decrease in the average annual volume of IPOs from 310 during 1980–2000 to 99 during 2001–2012).

[2] *See, e.g.*, William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private*,*"* 55 EMORY L.J. 141, 153–59 (2006) (documenting an increase in going private transactions in the years following the enactment of the Sarbanes-Oxley Act); Christian Leuz et al., *Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations*, 45 J. ACCT. & ECON. 181, 192 (2008) (finding that many firms deregister to cease SEC reporting due in part to increased compliance costs after the enactment of Sarbanes-Oxley).

[3] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

[4] *See, e.g.*, Dale A. Oesterle, *The High Cost of IPOs Depresses Venture Capital in the United States*, 1 ENTREPRENEURIAL BUS. L.J. 369, 370 (2006) (noting that § 404 of the Sarbanes-Oxley Act has made IPOs more expensive); Stephen J. Redner, *Thinking of Going Public? Think Twice, Then Read the Sarbanes-Oxley Act of 2002*, 6 J. SMALL & EMERGING BUS. L. 521, 523–27 (2002) (examining the impact of the Sarbanes-Oxley Act on issuers' going public decision).

[5] *See, e.g.*, IPO TASK FORCE, REBUILDING THE IPO ON-RAMP 6 (2011), *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf, *archived at* http://perma.cc/QF25-66PB ("The average age at IPO of companies going public between 1997 and 2001 was approximately five and a half years, compared with more than nine years for companies going public between 2006 and 2011." (footnote omitted)); Leslie B. Fletcher & Morgan P. Miles, *The Law of Unintended Consequences: The Effects of the Sarbanes-Oxley Act on Venture Funding of Smaller Enterprises*, J. PRIVATE EQUITY, Winter 2004, at 70, 70 (arguing that the Sarbanes-Oxley Act resulted in a less attractive economic environment for smaller enterprises and their private equity investors); Ehud Kamar et al., *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*, 25 J.L. ECON. & ORG. 107, 129–30 (2009) (presenting evidence that the implementation of the Sarbanes-Oxley Act induced small firms to exit the public capital market but had little effect on the going-private decision of larger firms); Gao et al., *supra* note 1, at 8 (noting that the average number of IPOs for firms with annual revenues lower than $50 million declined from 165 IPOs per year in 1980–2000 to 28 IPOs per year in 2001–2012).

[6] Jumpstart Our Business Startups Act of 2012 (JOBS Act), Pub. L. No. 112-106, 126 Stat. 306, pmbl.

JOBS Act seeks to ease the regulatory compliance costs and burdens faced by smaller issuers accessing the public capital markets by relaxing the level of mandatory disclosures required during the IPO process and phasing in certain ongoing regulatory requirements following the completion of the IPO. These "IPO on-ramp" provisions are available to "emerging growth companies" (EGCs), a new category of issuers created by the JOBS Act.[7] To qualify as an EGC, an issuer must have, among other requirements, total annual gross revenues below $1 billion during its most recent fiscal year.[8] Anecdotal evidence suggests that many EGCs, such as Twitter, which tweeted about the confidential submission of its initial registration statement with the SEC, have been taking advantage of the IPO on-ramp provisions of the JOBS Act.[9]

This Article analyzes a hand-collected dataset of 448 IPOs that took place between January 1, 2010, and June 30, 2014, to perform an empirical assessment of the impact of the JOBS Act on EGCs' access to the public capital markets. The evidence indicates that issuers are increasingly taking advantage of many of the scaled disclosure requirements made available to them under the JOBS Act.[10] EGCs that take advantage of the scaled financial disclosure available under the JOBS Act are smaller, younger, and more likely to belong to R&D-intensive industries, such as pharmaceuticals.[11] However, despite the fact that EGCs are embracing these scaled disclosure provisions, there has not been a noticeable increase in the proportion of IPOs conducted

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[7] For an overview of the relevant provisions of the JOBS Act, see *infra* Part III.C.

[8] JOBS Act § 101. An issuer's EGC status terminates on the earliest of: (A) the last day of the first fiscal year of the issuer during which it had total annual gross revenues equal to or exceeding $1 billion; (B) the last day of the fiscal year following the fifth anniversary of its first sale of common equity securities pursuant to an effective registration statement; (C) the date on which such issuer has issued, on a rolling basis, more than $1 billion in non-convertible debt during the prior three-year period; or (D) the date on which the issuer is deemed to be a "large accelerated filer." *Id.* § 101(b)(2). An issuer becomes a "large accelerated filer" if the issuer (i) has a public float of $700 million or more; (ii) has been subject to the periodic reporting requirements of the Securities Exchange Act of 1934 (Exchange Act) for at least twelve calendar months; (iii) has filed at least one annual report under the Exchange Act; and (iv) is not eligible to use the scaled requirements for smaller reporting companies for its annual and quarterly reports. 17 C.F.R. § 240.12b-2 (2014). Therefore, an issuer can become a large accelerated filer, and no longer qualify as an EGC, as early as at the end of the company's first full fiscal year after its IPO.

[9] On September 12, 2013 Twitter tweeted: "We've confidentially submitted an S-1 to the SEC for a planned IPO. This Tweet does not constitute an offer of any securities for sale." TWITTER (Sept. 12, 2013), https://twitter.com/twitter/status/378261932148416512, *archived at* http://perma.cc/P3UM-62Y7; *see* Shira Ovide et al., *Twitter Files for Initial Public Offering*, WALL ST. J., http://online.wsj.com/news/articles/SB100014241278873233 92204579071511038487586 (last updated Sept. 12, 2013, 2:00 PM), *archived at* http://perma.cc/2KY9-4UW7. For a discussion of the specific JOBS Act provisions dealing with confidential submission of a draft registration statement with the SEC, see *infra* Part III.C.3.

[10] *See infra* Part IV.C.

[11] *See infra* Part IV.C.4.

by issuers that qualify as EGCs.[12] The Article explores two interrelated explanations for these seemingly contradictory findings.

First, the evidence indicates that the benefits of the JOBS Act may not be as significant as may have been expected. While the direct costs of conducting an IPO have not decreased for EGCs following the enactment of the JOBS Act, indirect costs (namely underpricing) may have actually increased.[13] In addition, by their second fiscal year, over forty percent of issuers that went public as EGCs no longer qualify for such status, a fact that limits the expected ongoing benefits of the JOBS Act at the going public decision stage.[14] Second, there appears to have been a shift in the characteristics of issuers going public. EGCs going public in the post-JOBS period are smaller and more likely to be pharmaceutical companies than those EGCs that went public in the pre-JOBS period.[15] This shift in issuer characteristics is not surprising given that the types of EGCs that seem to be taking advantage of the scaled disclosure made available by the JOBS Act.[16] In addition, certain provisions of the JOBS Act make private offerings more attractive to some companies relative to a public offering, potentially offsetting any reductions in IPO costs associated with the other provisions of the Act.[17] As a result, certain issuers that qualify for EGC status may be choosing instead to raise capital in private offerings.

An assessment of the effectiveness and an understanding of the unintended effects of the JOBS Act are both timely and informative. Congressional consideration of further deregulation of the federal securities laws, informally labeled by some as "JOBS II," makes an evaluation of the impact of the JOBS Act of 2012 particularly important.[18] More generally, an understanding of EGCs' adoption of the scaled disclosure provisions of the JOBS Act also reveals patterns that inform the ongoing debate surrounding the relative merits of mandatory and voluntary disclosure regimes, as well as more flexible hybrid systems that allow issuers to select from a menu of disclosure regimes.[19]

The Article proceeds as follows. Part II provides an overview of the legal and finance literature that explores the costs and benefits issuers must consider before making the decision whether or not to go public. Building on this

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[12] *See infra* Part IV.B.

[13] *See infra* Part IV.D.

[14] *See infra* Part IV.E.

[15] *See infra* notes 220–24 and accompanying text.

[16] *See infra* Part IV.C.4.

[17] *See infra* Part III.C.4.

[18] For an overview of these proposed regulations, see John Coffee, *The JOBS Act II is Coming!*, CLS BLUE SKY BLOG (Apr. 14, 2014), http://clsbluesky.law.columbia.edu/2014/04/14/the-jobs-act-ii-is-coming, *archived at* http://perma.cc/35ZC-2AVL.

[19] *See infra* Part III.A. For example, the smaller, younger EGCs with little or no operating history that are choosing to disclose less financial information are doing so because such information may not be that useful to investors in assessing the value of the securities being offered. *See infra* Part IV.C.4.

background, Part III examines the relevant provisions of the JOBS Act and explores the theoretical impact of these provisions on an EGC's decision to go public. A description of the data and the results of the empirical analyses are presented in Part IV. Part V discusses the general implications of these findings and concludes.

II. THE COSTS AND BENEFITS OF GOING PUBLIC

The various benefits enjoyed by issuers that successfully complete an IPO have been examined elsewhere.[20] First and foremost, if the issuer is selling stock in the IPO, it will raise a substantial amount of capital which the issuer can use to invest in its business without any of the contractual restrictions and periodic interest payments associated with debt.[21] Even if the issuer is not directly selling securities in the IPO, its ability to raise additional capital in the future is often enhanced after an IPO.[22] A successful IPO can also help the issuer's financial and operating performance indirectly. For example, the ability to offer stock compensation arrangements allows the issuer to attract and retain better employees, particularly at the managerial level.[23] A newly public issuer may also gain a significant amount of prestige and receive positive publicity, which could enhance its reputation among customers,

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[20] *See, e.g.*, James C. Brau & Stanley E. Fawcett, *Evidence on What CFOs Think About the IPO Process: Practice, Theory, and Managerial Implications*, J. APPLIED CORP. FIN., Summer 2006, at 107, 108–09 (presenting evidence of corporate insiders' views on the motives for going public); William K. Sjostrom, Jr., *The Birth of Rule 144A Equity Offerings*, 56 UCLA L. REV. 409, 432–41 (2008) (comparing the costs and benefits of selling securities via an IPO and a Rule 144A private offering). For a practitioner's perspective on the merits of conducting an IPO, see generally John F. Olson & Daniel W. Nelson, *What Makes a Company a Good Candidate for Going Public? Criteria, Advantages, and Disadvantages Related to Going Public*, *in* 1 POSTGRADUATE COURSE IN FEDERAL SECURITIES LAW 231, 231–44 (2001).

[21] *See* Sjostrom, Jr., *supra* note 20, at 432 ("The most obvious benefit of an IPO is that it provides the issuer with a large infusion of equity capital."); *see also* B. Espen Eckbo et al., *Security Offerings*, *in* 1 HANDBOOK OF CORPORATE FINANCE 233, 236 (B. Espen Eckbo ed., 2007).

[22] If the issuer's common stock performs well, the issuer can later return to the market and sell additional shares to the public in a seasoned equity offering. Moreover, following the IPO, the issuer, as a public company, will also be able to use its shares as currency to acquire stock in, or assets held by, other companies. *See* James C. Brau et al., *The Choice of IPO Versus Takeover: Empirical Evidence*, 76 J. BUS. 583, 590 (2003). The existing evidence also suggests that issuers' borrowing costs decrease following an IPO. *See* Marco Pagano et al., *Why Do Companies Go Public? An Empirical Analysis*, 53 J. FIN. 27, 53–56 (1998).

[23] *See* Richard A. Booth, *Going Public, Selling Stock, and Buying Liquidity*, 2 ENTREPRENEURIAL BUS. L.J. 649, 661–63 (2008) ("[O]ne of the primary benefits of going public is that it permits insiders to cash out of the business. . . . [It also] permits a company to use equity as compensation." (footnote omitted)).

suppliers, and other business partners.[24] The firm's founders and initial investors also benefit from the successful completion of an IPO, as they will enjoy a higher degree of liquidity for their investment, especially if the issuer's shares are subsequently listed on a national securities exchange.[25]

In making the decision whether or not to conduct an IPO, an issuer will weigh these benefits against the costs associated with the completion of the IPO itself, as well as future ongoing costs associated with public status.[26] This section examines the nature of the direct and indirect costs that are associated with becoming and being a public issuer. Understanding the nature of these costs is important in evaluating the impact of the JOBS Act reforms, as decreases in certain costs resulting from the Act's implementation may be accompanied by unintended, offsetting increases in other, less direct, costs.

A. *The Costs of Becoming Public*

1. *Regulatory Compliance Costs*

Under the regulatory framework of the Securities Act of 1933 (Securities Act), an issuer conducting an IPO must prepare a set of disclosure documents,

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[24] *See* Ronald J. Gilson & Charles K. Whitehead, *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets*, 108 COLUM. L. REV. 231, 257 (2008) (arguing that commercial counterparties, such as customers, lenders, and vendors are more willing to do business with a publicly traded firm due to the public availability of financial and other information and the market's scrutiny of such information); Stacy J. Kanter, *Deciding Whether to Go Public: Certain Basic Considerations*, *in* HOW TO PREPARE AN INITIAL PUBLIC OFFERING 31, 41 (2001) (noting that a broader shareholder base results in increased attention from analysts and the press).

[25] *See, e.g.*, William K. Sjostrom, Jr., *Carving a New Path to Equity Capital and Share Liquidity*, 50 B.C. L. REV. 639, 641 (2009) ("For many companies . . . the primary advantages of going public are securing a large infusion of equity capital and attaining share liquidity." (footnote omitted)). Liquidity is particularly important to investors who want to reinvest a portion of their capital in new ventures. *See* Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243, 256 (1998). The company founders also benefit from this liquidity since it allows them to diversify their assets, which may mostly consist of shares in the IPO issuer. *See* NASDAQ, GOING PUBLIC: A GUIDE FOR NORTH AMERICAN COMPANIES TO LISTING ON THE U.S. SECURITIES MARKETS 15–16 (Nicole Lew ed., 2005). Sales by insiders and large shareholders, however, remain subject to any applicable contractual and regulatory restrictions. *See* CHARLES J. JOHNSON, JR. & JOSEPH MCLAUGHLIN, CORPORATE FINANCE AND THE SECURITIES LAWS § 7.08[A] (4th ed. Supp. 2013) (discussing contractual restrictions arising from lock-up agreements); 1 HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK ch. 14 (2006) (discussing reporting and short-swing profit liability under § 16 of the Securities Exchange Act of 1934).

[26] *See Small Business and the SEC: A Guide for Small Businesses on Raising Capital and Complying with the Federal Securities Laws*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/info/smallbus/qasbsec.htm (last modified Feb. 27, 2014), *archived at* http://perma.cc/4UF6-6QQ6 (summarizing factors an issuer should consider in determining whether it should go public).

including a registration statement (which must be filed with the SEC) and a prospectus (which is part of the registration statement and must be distributed to the initial investors).[27] Form S-1, the form commonly employed in IPOs, requires the issuer to disclose various details about its financial situation, operations, principal shareholders, material contracts, and executive compensation, among other items.[28] The discussion that follows focuses on two of the most extensive disclosure requirements: the presentation of financial information and details relating to executive compensation.

In its registration statement, the issuer must include audited balance sheets as of the end of each of the two most recent fiscal years[29] and audited statements of income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet included in the registration statement.[30] In addition to these financial statements, the issuer must include five years of selected financial information[31] and provide certain quantitative and qualitative disclosures about market risk, along with other supplementary financial information.[32] The prospectus and registration statement must also include a Management Discussion and Analysis (MD&A) section discussing, among other things, the company's financial condition and results of operations during the periods covered by the financial statements and included in the registration statement (generally the three preceding fiscal years).[33]

The registration statement also contains a Compensation Discussion and Analysis (CD&A) section wherein the issuer must explain all material elements of its compensation program and provide a discussion and analysis of the material factors underlying its compensation policies and decisions.[34] The

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[27] *See* Securities Act of 1933, 15 U.S.C. §§ 77a–77z (2012) (governing the primary public offerings of securities by issuers, provided that, unless otherwise exempt, all offers and sales of securities must be registered with the SEC); *see also* THOMAS LEE HAZEN, FEDERAL SECURITIES LAW 2–3 (3d ed. 2011). An issuer may not offer securities to the public unless a registration statement has been filed with the SEC and sales of such securities cannot be completed until the registration statement has been declared effective by the SEC. Securities Act §§ 5(a)–(c), 15 U.S.C. §§ 77e(a)–(c).

[28] *See* Form S-1 Registration Statement Under the Securities Act of 1933 , *available at* http://www.sec.gov/about/forms/forms-1.pdf, *archived at* http://perma.cc/FDL2-T5WP; *see also* 17 C.F.R. § 239.11 (2014).

[29] Rule 3-01 of Regulation S-X, 17 C.F.R. § 210.3-01 (2014).

[30] Rule 3-02 of Regulation S-X, 17 C.F.R. § 210.3-02 (2014).

[31] Item 301 of Regulation S-K, 17 C.F.R. § 229.301 (2014). These include net sales or operating revenues, income (loss) from continuing operations, total assets, long-term obligations, and declared cash dividends, among others. *Id.*

[32] Items 302(c) and 305(e) of Regulation S-K, 17 C.F.R. §§ 229.302(c), 229.305(e) (2014).

[33] Items 303(a) and 303(d) of Regulation S-K, 17 C.F.R. §§ 229.303(a), (d) (2014). As part of its MD&A, the issuer must discuss, for example, its results of operations, contractual obligations, and capital expenditures.

[34] Item 402(b) of Regulation S-K, 17 C.F.R. § 229.402(b) (2014). The CD&A was introduced as part of the amendments to the disclosure requirements for executive and

CD&A is centered on information relating to the compensation of five named executive officers, which is presented in a series of tables.[35] A summary table includes the total amounts paid to each named executive officer for the three preceding years.[36] This summary table is complemented by five more detailed tables that provide information on outstanding equity grants, amounts realized upon the exercise or vesting of equity grants during the year, as well as tables covering retirement benefits and nonqualified deferred compensation.[37]

In addition to mandating the disclosure of certain information, the Securities Act regulates the timing, manner, and form of communications made during the offering process. Issuers, as well as other participants involved in the IPO, including underwriters, are prohibited from making any oral or written offers regarding the IPO securities prior to the filing of the corresponding registration statement.[38] Once this initial registration statement has been filed, the issuer and other offering participants are prohibited from making written offers other than pursuant to a statutory prospectus,[39] a free

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director compensation adopted by the SEC in August 2006. *See* Executive Compensation and Related Person Disclosure, Securities Act Release No. 33-8732A, Exchange Act Release No. 34-54302A, 71 Fed. Reg. 53,158 (proposed Aug. 29, 2006). Practitioners have noted the costs and challenges associated with the preparation of the CD&A. *See* Robert M. Hayward & Theodore A. Peto, *Executive Compensation: The New Compensation Discussion and Analysis*, INSIGHTS, Nov. 2006, at 19, 19.

[35] These "named executive officers" include the principal executive and financial officers and the three other most highly compensated executive officers. Item 402(a)(3) of Regulation S-K, 17 C.F.R. § 229.402(a)(3).

[36] Item 402(c) of Regulation S-K, 17 C.F.R. § 229.402(c).

[37] The accompanying tables are captioned the Grants of Plan-Based Awards Table, the Outstanding Equity Awards Table, the Option Exercise and Stock Vested Table, the Pension Benefits Table, and the Non-Qualified Deferred Compensation Table. Items 402(d), (f), (g), (h), and (i) of Regulation S-K, 17 C.F.R. §§ 229.402(d), (f), (g), (h), (i). Issuers must also disclose any potential payments that would be due to these officers in the event of their termination or of a change of control of the registrant. Item 402(j) of Regulation S-K, 17 C.F.R. § 229.402(j).

[38] *See* Securities Act of 1933 § 5, 15 U.S.C. § 77f(c) (2012). "Offer" and "sale" are defined broadly and include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security . . . ." 15 U.S.C. § 77b(a)(3) (2012); *see also* Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 907 (2011) (noting broad sweep of Section 5 of the Securities Act). To ease the burdens imposed by the § 5 limitations on communications during an offering, the SEC promulgated a number of safe harbors in 2006. *See* Securities Offering Reform, Securities Act Release No. 33-8591, Exchange Act Release No. 34-52056, 70 Fed. Reg. 44,722 (proposed Aug. 3, 2005). These safe harbors are contained in Rule 168, Rule 169, and Rule 163 of the Securities Act. The latitude afforded to issuers under these rules vary according to the issuer's size and history as a public issuer. The available safe harbor for most IPOs, Rule 169, is the narrowest. *See, e.g.*, STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 416–19 (3d ed. 2012) (describing the public offering process and the role played by the underwriters).

[39] *See* Securities Act §§ 2(a)(10), 5(b)(1).

writing prospectus,[40] and certain other limited communications.[41] Violation of these "gun jumping rules" can expose the issuer, as well as other offering participants, to substantial liability.[42]

Preparing the required disclosure documents and complying with the gun jumping rules of the Securities Act is not only time consuming but also costly. The regulatory compliance costs incurred by issuers include SEC registration and stock exchange listing fees, management time and attention, and auditor and attorney fees, among others.[43] Take for example the June 29, 2010 IPO of Tesla Motors, Inc. (Tesla), in which a total of 13.3 million shares were sold at an offering price of $17, for an aggregate offering size of $226.1 million.[44] The total regulatory compliance costs of the offering amounted to $4.5 million, just slightly under 2% of the aggregate offering size.[45] Although these regulatory compliance costs should increase with the amount and complexity of the information that the issuer is required to disclose, as well as with the size of the offering itself, these costs have a significant fixed component that can disproportionately impact smaller issuers.[46] The quasi-fixed nature of these regulatory compliance costs has driven the special treatment of smaller issuers by Congress and the SEC.[47]

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[40] Securities Act Rules 164 and 433, 17 C.F.R. §§ 230.164, 230.433 (2014).

[41] Securities Act Rule 134, 17 C.F.R. § 230.134 (2014).

[42] For example, the Securities Act grants rescissionary damages to those purchasing securities in an offering where there has been a violation of the Section 5 gun jumping rules. Securities Act § 12(a)(1).

[43] Other direct, out-of-pocket costs include printing, advertising, and road show expenses. In addition, prior to the commencement of the IPO, the issuer will likely incur related legal costs in simplifying its capital structure and reorganizing various corporate matters to make the issuer's securities more attractive to public investors. For an overview of the direct and indirect costs issuers face when selling securities in a public offering, see Eckbo et al., *supra* note 21, at 263–65.

[44] *See* Tesla Motors, Inc., Prospectus (Form 424B4), at 9 (June 28, 2010) [hereinafter Tesla Prospectus], *available at* http://www.sec.gov/Archives/edgar/data/1318605/0001193 12510148468/ds1a.htm, *archived at* http://perma.cc/TWU5-YFFX. Of these shares, 11.88 million were sold by Tesla. *Id.* The remaining 1.42 million were sold by existing shareholders. *Id.*

[45] *See* Tesla Motors, Inc., Amendment No. 8 to Registration Statement (Form S-1), at II-1 (June 28, 2010) [hereinafter Tesla Amendment], *available at* http://ir.teslamotors.com /secfiling.cfm?filingID=1193125-10-149105&CIK=1318605, *archived at* http://perma.cc /WK4H-THJR. For a description of these costs, see *infra* note 173.

[46] That is, although the total regulatory compliance costs increase with the size of the offering, the share of these costs as a percentage of the total offering decreases with the size of the offering. For evidence of these scale effects among the sample of firms studied here, see *infra* notes 234–36 and accompanying text. *See generally* Eckbo et al., *supra* note 21, at 262–65 (citing studies finding that flotation costs as a percent of gross proceeds were fall with a rise in issue size).

[47] *See infra* Part III.B.

2. *Underwriters' (Gross) Spread*

Underwriters play a critical role in a public offering. Generally, underwriters advise the issuer throughout the IPO process and help the issuer market its securities and gauge the interest of potential investors before a final determination is made regarding the number of securities to be sold and their initial offering price.[48] In a firm commitment offering, underwriters purchase all of the IPO securities from the issuer and then resell them to the initial set of public investors.[49] Underwriters are compensated for their advising role and risk bearing in a firm commitment offering via the gross spread, i.e., the difference between the offering price (at which the underwriter sells the securities to the initial set of public investors) and the price at which the underwriter purchases the securities from the issuer.[50]

The underwriters' spread, which historically has averaged 6.7% of the total offering size, represents a significant cost issuers incur in conducting an IPO.[51] Returning to the Tesla IPO, in which a total of 13.3 million shares were sold at an offering price of $17 (for an aggregate offering size of $226.1 million),[52] Tesla did not receive the full offering price of $17 per share that was paid by the initial investors participating in the IPO. Instead, Tesla received $15.895, i.e., 6.5% less than the offering price, from the underwriters.[53] The $1.105 difference per share (which amounts to a total of $14.7 million)[54] represents the underwriters' compensation, or the profit they made by buying the IPO securities from the issuer at a discount and immediately reselling these to the initial investors at the full offering price.

Studies analyzing variations in the size of the underwriting spread across issuers and offerings have found that the gross spread decreases with the size of the offering, the size of the issuer (e.g., measured by annual revenues),[55]

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[48] *See, e.g.*, CHOI & PRITCHARD, *supra* note 38, at 393–98 (describing the underwriters' role in a public offering).

[49] *See id.* at 396–97.

[50] *Id.* at 398.

[51] *See* Eckbo et al., *supra* note 21, at 266 (reporting underwriting spreads of IPOs over the 1970–2000 period and finding that average underwriting spreads have fallen from 7.7% in the 1970s to 6.7% in more recent IPOs).

[52] *See supra* notes 44–45 and accompanying text.

[53] *See* Tesla Prospectus, *supra* note 44.

[54] *Id.* at 190 (displaying the total underwriting discounts and commissions paid to the underwriters).

[55] *See* Oya Altınkılıç & Robert S. Hansen, *Are There Economies of Scale in Underwriting Fees? Evidence of Rising External Financing Costs*, 13 REV. FIN. STUD. 191, 200–06 (2000) (documenting a similar relationship in seasoned equity offerings); Hsuan-Chi Chen & Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105, 1108–11 (2000) (documenting overall average spreads and that spreads are higher for smaller IPOs); Dongcheol Kim et al., *Are Initial Returns and Underwriting Spreads in Equity Issues Complements or Substitutes?*, 39 FIN. MGMT. 1403, 1411 (2010) (documenting a positive relationship between underwriter spread and the inverse of the log of offer size in IPOs).

and the quality of the accounting and other information provided by the issuer.[56] Other studies have found that the underwriting spread rises with a security's risk.[57] An evaluation of the effects of the JOBS Act on the costs of conducting an IPO must therefore consider whether any of the Act's provisions could unintentionally increase the spread demanded by underwriters. Part III.D provides a theoretical and empirical assessment of whether any of the applicable provisions of the JOBS Act could have an indirect effect on any of the factors that drive the level of the underwriters' spread in IPOs.

3. *IPO Underpricing*

One of the most striking and persistent characteristics of IPOs is underpricing, i.e., the fact that the price of the offered shares jumps substantially above the offering price during the first day of trading.[58] As an illustration, consider once again the Tesla IPO. At the close of its first day of trading, the price of each share of Tesla stock was $23.89, approximately 40% higher than the offering price of $17 per share.[59] Although such high returns on the day of an IPO are favorable for the initial IPO investors—who are able to purchase the IPO shares at the offering price and immediately resell them in the secondary market at a higher price—such returns come at the expense of the issuer, which is arguably leaving considerable amounts of money on the table.[60] If investors were in fact willing to pay much more than $17 for each Tesla share, Tesla could have set a higher offering price for its IPO. The aggregate amount of the underpricing in the Tesla IPO, $92.8 million, dwarfs the direct compliance costs and underwriting spread illustrated earlier.[61] Underpricing thus represents an indirect and subtle, yet quite significant, cost of going public.[62]

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[56] *See* Gemma Lee & Ronald W. Masulis, *Seasoned Equity Offerings: Quality of Accounting Information and Expected Flotation Costs*, 92 J. FIN. ECON. 443, 444 (2009) (finding that as accrual quality deteriorates, the underwriting spreads for seasoned equity offerings increase).

[57] *See, e.g.*, Kim et al., *supra* note 55, at 1411.

[58] For a general discussion of the IPO underpricing phenomenon, see Alexander Ljungqvist, *IPO Underpricing*, *in* 1 HANDBOOK OF CORPORATE FINANCE, *supra* note 21, at 375–422 and Jay R. Ritter, *Investment Banking and Securities Issuance*, *in* HANDBOOK OF THE ECONOMICS OF FINANCE 255, 286–91 (G.M. Constantinides et al. eds., 2003).

[59] Tesla's historical stock quotes are available at *Tesla Motors, Inc. Stock Quote & Summary Data*, NASDAQ, http://www.nasdaq.com/symbol/tsla (last visited Mar. 19, 2015), *archived at* http://perma.cc/6WNH-7D2W.

[60] *See* TIM JENKINSON & ALEXANDER LJUNGQVIST, GOING PUBLIC: THE THEORY AND EVIDENCE ON HOW COMPANIES RAISE EQUITY FINANCE 4–5 (2d ed. 2001); Ritter, *supra* note 58, at 281.

[61] *See supra* notes 45, 53 and accompanying text.

[62] Historically, underpricing has averaged around 19% in the U.S., though there has been variation across time. *See* JAY R. RITTER, INITIAL PUBLIC OFFERINGS: UPDATED

Several theories seek to explain what drives the underpricing of IPOs. The most developed of these models hinges on informational asymmetries, wherein one of the parties participating in the IPO is better informed than the other parties.[63] In some of these models, the underwriter is better informed than the issuer,[64] while in others, the issuer is better informed than the other parties regarding its true intrinsic value.[65] The most prominent model assumes that some investors are better informed than others regarding the true value of the issuer.[66] These well-informed investors avoid participating in overvalued IPOs, which results in uninformed investors purchasing a disparate amount of overvalued IPOs.[67] Underpricing arises to counter some of the losses experienced by these uninformed investors in order to keep them interested in participating in the IPO market.[68]

STATISTICS 2 tbl.1 (Jan. 4, 2013), *available at* http://bear.warrington.ufl.edu/ritter/Money_yearly.pdf, *archived at* http://perma.cc.AC5C-P4JC. In the sample of IPOs analyzed later in the Article, the average underpricing is 18.30%, *see infra* Table A2, col. (1), more than twice the average underwriting discount (6.60%), *see infra* Table A1, col. (3), and over five times the average share of the total offering represented by regulatory compliance costs (3.20%), *see infra* Table A1, col. (2). For a description of the sample and the variables included in the dataset, see *infra* Part IV.D.

[63] *See* Ljungqvist, *supra* note 58, at 379–81. Another set of theories link underpricing to the increased litigation risk that issuers and underwriters, among others, face under the civil liability provisions of the Securities Act. *See* Randolph P. Beatty & Ivo Welch, *Issuer Expenses and Legal Liability in Initial Public Offerings*, 39 J. LAW. ECON. 545, 545–46 (1996); Seha M. Tiniç, *Anatomy of Initial Public Offerings of Common Stock*, 43 J. FIN. 789, 797–800 (1988). Section 11 of the Securities Act provides a cause of action for investors for losses arising from a misstatement in the registration statement. Underwriters (as well as the issuer and the issuer's directors and high ranking officers) are potential defendants under § 11. Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a) (2012). Underpricing comes into play because the lower the offering price, the lower the possible § 11 damages are under the statutory formula. *Id.* § 11(e). Other theories treat underpricing as an additional benefit for the underwriters. *See, e.g.*, Kim et al., *supra* note 55, at 1404–05 (arguing that underpricing can be viewed as an additional form of compensation, which underwriters can capture through their power to allocate offers to favored customers).

[64] *See* David P. Baron, *A Model of the Demand for Investment Banking Advising and Distribution Services for New Issues*, 37 J. FIN. 955, 955–57 (1982) (showing that if the bank is better informed about demand conditions than the issuer, underpricing may be employed as an inducement of optimal selling effort in response to the principal-agent problem).

[65] *See* Ivo Welch, *Seasoned Offerings, Imitation Costs, and the Underpricing of Initial Public Offerings*, 44 J. FIN. 421, 421–23 (1989).

[66] *See* Kevin Rock, *Why New Issues Are Underpriced*, 15 J. FIN. ECON. 187, 188 (1986).

[67] *See* Reena Aggarwal et al., *Institutional Allocation in Initial Public Offerings: Empirical Evidence*, 57 J. FIN. 1421, 1427–31 (2002) (finding that institutional investors are allocated more shares in favorably priced IPOs and thus earn greater returns on their IPO allocations than retail investors).

[68] *See* Randolph P. Beatty & Jay R. Ritter, *Investment Banking, Reputation, and the Underpricing of Initial Public Offerings*, 15 J. FIN. ECON. 213, 214 (1986) (arguing that

Regardless of the underlying sources driving these informational asymmetries, the various models yield a common set of predictions. First, they predict a positive relation between initial returns and *ex ante* uncertainty about the issuer or the offering. Empirically testing this proposition is a nuanced task, as the best measure of uncertainty—the variance of a stock's price—is not readily available for a company undertaking an IPO. To address this problem, various proxies have been used in the literature, including company characteristics such as age, size (measures by sales, for example), and industry.[69] Second, these models predict that underpricing should be lower if information about the issuer and the offering is distributed more homogeneously across investors, thus reducing informational asymmetries between informed and uninformed investors.[70] These predictions will help assess whether the provisions of the JOBS Act discussed later in the Article could unintentionally impact the underpricing of the IPOs of EGCs.[71]

B. *The Costs of Being Public*

Upon completion of its IPO, an issuer becomes subject to the periodic reporting requirements of the Exchange Act.[72] As a result, the issuer has to prepare and file with the SEC current (Form 8-K), quarterly (Form 10-Q), and annual (Form 10-K) reports, which, just like the registration statement, require the disclosure of operating and financial information.[73] In complying with these ongoing reporting and disclosure requirements, the issuer will incur legal and accounting fees, as well as management opportunity costs, all of which are substantially higher than those incurred by private companies.[74] Issuers'

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investment banks, as repeat players in the IPO market, have the incentive to ensure that new issues are underpriced to appease investors).

[69] *See, e.g.*, Lawrence M. Benveniste et al., *Evidence of Information Spillovers in the Production of Investment Banking Services*, 58 J. FIN. 577, 577–79 (2003); Alexander Ljungqvist & William J. Wilhelm, Jr., *IPO Pricing in the Dot-com Bubble*, 58 J. FIN. 723, 723–26, 742 (2003); William L. Megginson & Kathleen A. Weiss, *Venture Capitalist Certification in Initial Public Offerings*, 46 J. FIN. 879, 897 (1991); Jay R. Ritter, *The "Hot Issue" Market of 1980*, 57 J. BUS. 215, 222–23 (1984).

[70] *See* Roni Michaely & Wayne H. Shaw, *The Pricing of Initial Public Offerings: Tests of Adverse-Selection and Signaling Theories*, 7 REV. FIN. STUD. 279, 280, 294 (1994) (arguing that as investor heterogeneity is reduced, the winner's curse disappears, thus reducing the need to underprice offerings).

[71] *See infra* Part III.D.

[72] 15 U.S.C. §§ 77a–77z, 78a–78ll (2012); *see also* HAZEN, *supra* note 27, at 4.

[73] 17 C.F.R. §§ 249.308, 249.308a, 249.310 (2014). *See generally* 1 BLOOMENTHAL, *supra* note 25, §§ 12:26, 12:31, 12:33, 12:52 (describing annual, quarterly, and current reports). Given the public nature of these filings, all the information periodically disclosed by the issuer is not only available to investors, but also to competitors.

[74] The direct expenses incurred in complying with these reporting obligations can be substantial; more employee time will need to be devoted to investor relations, as well as to administrative and compliance matters. In addition, the issuer will most likely have to

discussion of such costs in their IPO prospectuses evidences the significant role played by these additional costs in an issuer's going public decision.[75]

The ongoing costs of being a public company have increased substantially in recent years, mostly as a result of the passage of new federal legislation, including the Sarbanes-Oxley Act and the Dodd-Frank Act.[76] One particular federal mandate has proven to be exceedingly expensive and time consuming for issuers—the Sarbanes-Oxley Section 404 requirement that an issuer's independent auditors furnish an attestation of management's assessment of the effectiveness of internal control over the issuer's financial reporting.[77]

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expand or replace its existing corporate information systems to comply with these reporting and disclosure requirements. *See* NASDAQ, *supra* note 25, at 16.

[75] *See, e.g.*, The Container Store Group, Inc., Prospectus, at 36 (Oct. 31, 2013) [hereinafter Container Store Prospectus], *available at* http://www.nasdaq.com/markets/ipos/filing.ashx?filingid=9156657, *archived at* http://perma.cc/2X6V-2Y4X ("As a public company, we will incur significant legal, accounting, insurance and other expenses that we have not incurred as a private company, including costs associated with public company reporting requirements. We also have incurred and will incur costs associated with the Sarbanes-Oxley Act and related rules implemented by the [SEC]. The expenses incurred by public companies generally for reporting and corporate governance purposes have been increasing. We expect these rules and regulations to increase our legal and financial compliance costs . . . .").

[76] In fact, several practitioners and scholars attribute the recent reduction in the number of IPOs to these increased costs. *See generally* HENRY N. BUTLER & LARRY E. RIBSTEIN, THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT 37–42 (2006). One estimate puts the cost of complying with SOX at $4.36 million per company. *See id.* at 40. In addition to the monetary costs imposed on issuers, these recent regulations have been characterized by a growing intrusion in the internal governance of public corporations. *See, e.g.*, Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137, 141–42 (2011) (generally noting the increasing role of federal regulation in the governance of public companies); Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1021–32 (2013) (describing how various provisions of the Sarbanes-Oxley and Dodd-Frank Acts intrude on the internal governance mechanisms of public issuers). For example, the Dodd-Frank Act introduced a number of non-binding, advisory "say-on-pay" shareholder votes that issuers are required to hold at their first annual meeting following the IPO and periodically thereafter. Dodd-Frank Wall Street Reform & Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, 15, 18, 22, 31, and 42 U.S.C.). These include (i) a vote on the company's executive compensation; (ii) a vote to determine the frequency of say-on-pay votes; and (iii) a vote on certain golden parachute arrangements in proxy statements for meetings at which shareholders are being asked to approve a merger or similar transaction. Dodd-Frank Act § 951.

[77] Sarbanes-Oxley Act of 2002 § 404(b), 15 U.S.C. § 7262(b) (2012). One report estimated the average cost of compliance for a public company in 2004 to be well over $4 million. *See* Robert Prentice, *Sarbanes-Oxley: The Evidence Regarding the Impact of SOX 404*, 29 CARDOZO L. REV. 703, 726 (2007). The costs associated with this requirement are often stressed by issuers in their IPO prospectuses. S*ee e.g.*, Hilton Worldwide Holdings, Inc., Amendment No. 4 to Registration Statement (Form S-1), at 39–40 (Dec. 2, 2013) ("[B]eginning with our second annual report on Form 10-K, we will be required to furnish a report by management on the effectiveness of our internal control over financial

Notably, the cost of complying with this requirement has generally impacted smaller companies disproportionately and thus has been identified as a significant disincentive for these issuers to conduct an IPO.[78] Exempting EGCs from some of these regulatory requirements, as the JOBS Act does, would decrease the costs of being public for these issuers.[79]

There are other more subtle costs faced by newly public issuers which are unrelated to the securities laws. Because a public company has numerous shareholders and market analysts following its performance, it must consider, as part of its decision-making process, how different courses of action may affect the market price of its stock.[80] Market pressures associated with public status may cause management, under some circumstances, to make suboptimal decisions.[81] For example, shareholder expectations and pressures from the market may force companies to make decisions that will boost or maintain current earnings per share or other key indicators of short-term stock performance even if the long-term prospects of the company would be better served by another decision.[82] In addition, the attention public issuers receive

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reporting, pursuant to Section 404 of the Sarbanes-Oxley Act. Our independent registered public accounting firm is required to express an opinion as to the effectiveness of our internal control over financial reporting beginning with our second annual report on Form 10-K. The process of designing, implementing, and testing the internal control over financial reporting required to comply with this obligation is time consuming, costly, and complicated.").

[78] For example, during the year 2004, U.S. companies with revenues exceeding $5 billion spent 0.06% of revenue on SOX compliance, while companies with less than $100 million in revenue spent 2.55%. *See* SEC. & EXCH. COMM'N, FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES 33 (2006), *available at* http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf, *archived at* http://perma.cc/T27C-9XCZ.

[79] *See infra* notes 126–28 and accompanying text. Quantifying the benefits for public issuers under the JOBS Act is complicated by the fact that although issuers may remain eligible for EGC status for up to five years, they may lose such eligibility as soon as a year after their IPO. *See supra* note 8 and *infra* Part II.E.

[80] *See* NASDAQ, *supra* note 25, at 16 ("As a matter of practical necessity, the management of a public company must consider the likely impact of business decisions on the price of the company's shares.").

[81] *See, e.g.*, John Asker et al., *Corporate Investment and Stock Market Listing: A Puzzle?*, 28 REV. FIN. STUD. 342, 384 (2015) (finding that stock market listed firms invest substantially less and are less responsive to changes in investment opportunities compared to private firms).

[82] *See* Jeremy C. Stein, *Agency, Information and Corporate Investment*, *in* HANDBOOK OF THE ECONOMICS OF FINANCE, *supra* note 58, at 109, 120–21. *But see* Gilson & Whitehead, *supra* note 24, at 256 ("[T]he informational efficiency of public company share prices provides an important management tool—a company receives virtually instant feedback through prices and periodic feedback through analyst reports, concerning its strategy and performance and that of its competitors . . . .").

from shareholders and the investment community in general can also lead to increased risks (and costs) of litigation.[83]

III. THE JOBS ACT AND AN ISSUER'S GOING PUBLIC DECISION

A. *Justifying a Mandatory Disclosure Regime*

As noted earlier, a substantial portion of the costs of becoming and remaining a public issuer relates to compliance with the various mandatory disclosure requirements of the federal securities laws. Several of the reforms introduced in the JOBS Act relax some of the disclosure requirements for EGCs to incentivize these issuers to raise capital in the public markets.[84] There are, however, potential risks associated with reducing the amount of information that issuers must disclose during the registration process. The registration system under the federal securities laws is designed to protect investors and ensure confidence in the integrity of the public capital markets.[85] To the extent that smaller companies present a disproportionately high risk of failure and fraud, expanding exemptions to the registration requirements for these issuers may be undesirable.[86] Thus, to understand the positive and negative implications of providing a scaled disclosure menu to EGCs, it is helpful to examine the rationales behind the existing mandatory disclosure regime.

Generally, the disclosure of issuer information is socially desirable to the extent it bridges informational asymmetries between the issuer (and its insiders) and the market. The incentive for issuers to voluntarily disclose information is stronger when it is selling securities to the public, as investors may demand a large discount to purchase securities from issuers who choose not to disclose sufficient information, thus increasing the cost of capital for the latter.[87] Although an issuer's incentive to voluntarily disclose information may

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[83] *See, e.g.*, Carney, *supra* note 2, at 146, 154 (noting the litigation risks associated with being a public company and how litigation costs rise in tandem with disclosure costs).

[84] *See infra* Part III.C.

[85] *See* Daniel J. Morrissey, *The Securities Act at Its Diamond Jubilee: Renewing the Case for a Robust Registration Requirement*, 11 U. PA. J. BUS. L. 749, 757–59 (2009) (describing the SEC's objectives in requiring securities registration).

[86] *See* Jill E. Fisch, *Can Internet Offerings Bridge the Small Business Capital Barrier?*, 2 J. SMALL & EMERGING BUS. L. 57, 58 (1998) ("[R]egulators have identified small businesses as some of the riskiest investment opportunities." (footnote omitted)).

[87] Moreover, if companies that voluntarily disclose are those with positive information, investors will presume the worst of firms that fail to disclose. As more companies choose to disclose to avoid being pooled with the other silent firms, more firms seeking to raise capital will also be forced to disclose. *See* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 669–73 (1984) (arguing in favor of a voluntary disclosure regime assuming companies can make credible disclosures). *But see* Anne Beyer et al., *The Financial Reporting Environment: Review of the Recent Literature*, 50 J. ACCT. & ECON. 296, 307–10 (2010)

not be as strong once its securities are trading in the secondary market, committing to an ongoing disclosure policy can still benefit the issuer by enhancing the price accuracy of the issuer's stock[88] and deterring untoward behavior from its insiders.[89] Whether issuers will voluntarily disclose a socially desirable level of information is an open question.[90] To the extent that market failures result in firms systematically disclosing less than an optimal amount of information, a mandatory disclosure regime can lead to a more efficient outcome.[91] Scholars have identified a number of market failures that support the adoption of a mandatory disclosure regime.

One set of these market failures hinges on the fact that each individual firm ignores the positive external effects from voluntary disclosure on (1) competing firms;[92] (2) other firms that rely on the accuracy of price signals in the capital markets; [93] and (3) third parties and the economy at large which

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(reviewing weaknesses in the arguments linking increased disclosure to a lower cost of capital).

[88] *See* Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 764 (1995) (concluding that "[t]he dominant view is that the goal of required securities disclosure is to make prices in securities markets more accurate"). *But see* Jeff Schwartz, *Fairness, Utility, and Market Risk*, 89 OR. L. REV. 175, 186–89 (2010) (arguing that share-price accuracy as a theory of regulation lacks an "intellectual core"). For a discussion of why inaccurate stock prices may be undesirable in the public securities context, see generally David Easley & Maureen O'Hara, *Information and the Cost of Capital*, 59 J. FIN. 1553 (2004); Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977 (1992); Richard A. Lambert et al., *Information Asymmetry, Information Precision, and the Cost of Capital*, 16 REV. FIN. 1 (2011).

[89] *See* Gerard Hertig et al., *Issuers and Investor Protection*, *in* THE ANATOMY OF CORPORATE LAW 275, 280 (Reinier Kraakman et al. eds., 2d ed. 2009) ("[I]nformed shareholders can better exercise their decision and appointment rights."); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047, 1048 (1995) ("[T]he principal purpose of mandatory disclosure is to address certain agency problems that arise between corporate promoters and investors, and between corporate managers and shareholders.").

[90] *See generally* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) (discussing the efficiency and necessity of mandatory disclosure rules).

[91] *See* Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules That Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151, 186–87 (2013).

[92] An individual firm will ignore the positive externality of disclosure on competing firms since it may give its rivals a competitive advantage. *See* Michael D. Guttentag, *An Argument for Imposing Disclosure Requirements on Public Companies*, 32 FLA. ST. U. L. REV. 123, 149–53 (2004) (arguing that positive interfirm externalities significantly distort a firm's disclosure policies and that regulatory intervention can provide a beneficial redress).

[93] Firms that make higher quality disclosures than other firms with securities traded on the same venue as the disclosing firm will provide a positive spill-over benefit to firms making lower quality disclosures on that same venue. *See, e.g.*, Guttentag, *supra* note 91, at 181–84.

rely on the accuracy of price signals in the capital markets.[94] As a result, each firm acting individually may not disclose information—both financial and non-financial—to the extent desired by diversified investors. A second set of market failures relates to insiders' incentives to capture the firm's disclosure policies (and under-disclose) in order to maximize their own personal gains rather than overall firm value.[95] For instance, under-disclosure of information may facilitate insider self-dealing of firm assets (e.g., via excessively high salaries).[96]

The optimality of a mandatory disclosure regime with respect to a particular set of issuers hinges on the relative benefits (to investors and the markets) and costs (to the issuers) associated with the corresponding mandatory disclosures. One can expect these net benefits to vary across issuers of differing sizes. The social benefits of forcing disclosure requirements upon small, young issuers appear less significant given the minimal role these companies play in the secondary markets and in the economy in general.[97] In addition, capture by insiders of the disclosure mechanisms is less of a concern for these smaller, younger issuers since following an IPO, the issuer's founders and initial investors (such as venture capital funds), may continue to hold a significant portion of the company's shares.[98] Not only are the social benefits of imposing mandatory disclosures on smaller issuers low, but also the compliance costs incurred by these issuers are probably high.[99] If smaller issuers face higher disclosure costs and the social benefit of mandating disclosure is not as significant, then a system which allows these issuers to

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[94] *See* Kahan, *supra* note 88, at 1005–42 (identifying various pathways through which more accurate share prices can provide benefits to the real economy).

[95] *See, e.g.*, Lucian A. Bebchuk & Zvika Neeman, *Investor Protection and Interest Group Politics*, 23 REV. FIN. STUD. 1089, 1089–94 (2010) (formalizing a model in which corporate insiders are systemically able to expend firm resources for political influence in a way that serves their personal interests, rather than those of the firm's shareholders).

[96] *See* Michael D. Guttentag, *Protection from What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207, 228 (2013).

[97] *See* Michael D. Guttentag, *Accuracy Enhancement, Agency Costs, and Disclosure Regulation*, 3 REV. L. ECON. 611, 625–27 (2007) (showing that, under certain assumptions, requiring disclosure of larger firms may be more efficient and socially desirable but also noting that a less liquid market for securities of smaller firms may make requiring disclosure from these issuers desirable).

[98] *See, e.g.*, Pagano et al., *supra* note 22, at 56 (presenting evidence that initial owners generally retain a controlling stake in the issuer following an IPO). In the sample of IPOs by EGCs analyzed in this Article, insiders still own on average 34.7% of the issuer's stock two years after the IPO. *See infra* note 268.

[99] As noted earlier, the regulatory compliance costs associated with mandatory disclosure requirements disproportionally burden smaller issuers due to their quasi-fixed nature. *See supra* note 46 and accompanying text. Moreover, smaller firms are more likely to be harmed by the revelation of previously confidential information that could be exploited by larger competitors.

select a scaled disclosure regime may be preferable.[100] This insight underlines the approach that the SEC has historically taken with respect to small business issuers, and which Congress adopted for EGCs as part of the JOBS Act.

B. *Pre-JOBS Exemptions for Small Issuers*

Historically, the SEC has exempted smaller issuers from certain mandatory disclosure requirements to ease their regulatory burdens and related compliance costs.[101] The latest set of scaled disclosure rules for smaller companies adopted by the SEC became effective on February 2008.[102] This set of rules replaced the existing Regulation S-B framework that applied to "small business issuers,"[103] expanding the eligibility for scaled disclosure and reporting requirements to a new and broader category of issuers, namely

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[100] *See* Guttentag, *supra* note 91, at 151 (proposing a multi-tiered regime where small issuers are exempt from various disclosure requirements); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 375 (2013) (arguing that small and mid-cap companies should face less disclosure requirements than larger, "systemically significant public issuers"); Jeff Schwartz, *The Law and Economics of Scaled Equity Market Regulation*, 39 J. CORP. L. 347, 367–85 (2014) (presenting a model showing that reducing the regulatory burdens on small issuers may be welfare-enhancing). Several authors have more generally weighed the potential costs and benefits of allowing issuers to self-select into regulatory regimes. *See, e.g.*, Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 906–08 (1998); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1345–68 (1999); Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 691–704 (2002); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2361 (1998); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQQUIRIES L. 387, 390–91 (2001).

[101] *See, e.g.*, Informal Guide for Small Entities, 62 Fed. Reg. 15,604, 15,605 (Apr. 2, 1997) (codified at 17 C.F.R. pt. 202) (describing the SEC's historical formal and informal efforts on behalf of small entities); *see also* Sanjay M. Shirodkar & Kristi Darnell-Weichelt, *Smaller Reporting Companies: Disclosure and Governance Considerations*, BUS. L. TODAY (Apr. 2011), at 1, 1.

[102] SEC. & EXCH. COMM'N, CHANGEOVER TO THE SEC'S NEW SMALLER REPORTING COMPANY SYSTEM BY SMALL BUSINESS ISSUERS AND NON-ACCELERATED FILER COMPANIES: A SMALL ENTITY COMPLIANCE GUIDE 1 (2008) [hereinafter SMALL ENTITY COMPLIANCE GUIDE], *available at* http://www.sec.gov/info/smallbus/secg/smrepcosysguid.pdf, *archived at* http://perma.cc/KC9Q-5K85. In March 2005, the Commission formed an Advisory Committee on Smaller Public Companies and charged the committee with assessing the existing federal securities regulatory system for smaller companies and recommending changes to that system. Shirodkar & Darnell-Weichelt, *supra* note 101, at 1.

[103] This category of "small business issuers" included issuers with (1) less than $25 million in public float; and (2) less than $25 million in annual revenues. Item 10 of Regulation S-B, 17 C.F.R. § 228.10(a)(1) (2008) (removed and reserved by 73 F.R. 934, 956 (Jan. 4, 2008)).

"smaller reporting companies," or SRCs. An issuer qualifies as a SRC if it has a common equity public float of less than $75 million or, if its public float cannot be calculated, its annual revenues do not exceed $50 million upon initially entering the system.[104]

SRCs are exempt from some of the disclosure requirements that generally apply to other companies in their registration statements and periodic reports. Issuers that qualify as SRCs only need to include audited financial statements (e.g., statements of income and cash flows) for two (rather than three) fiscal years.[105] As a result, a SRC only needs to discuss its financial condition and results of operations for the two most recent fiscal years (rather than three years) in its MD&A section.[106] In addition, SRCs are not required to provide selected financial data for each of the five preceding fiscal years,[107] nor are they required to provide other supplementary financial information that is required of other issuers in their registration statements, such as certain quantitative and qualitative disclosures about market risk.[108]

SRCs are also exempt from most of the disclosure requirements relating to executive compensation discussed earlier.[109] SRCs only need to provide information on the compensation for two named executive officers (rather than five).[110] Moreover, SRCs only need to present two tables—a summary compensation table (with information from the two, as opposed to three, previous years) and a table detailing the outstanding equity awards as of the end of the last fiscal year.[111] Most importantly, SRCs do not have to prepare the detailed CD&A section that is generally required of other issuers. Rather, SRCs only need to provide some additional narrative explaining the items

[104] Item 10(f)(1) of Regulation S-K, 17 C.F.R. § 229.10(f)(1) (2014). For the rules governing the calculation of a company's public float, see Item 10(f)(2) of Regulation S-K, 17 C.F.R. § 229.10(f)(2) (2014) and SMALL ENTITY COMPLIANCE GUIDE, *supra* note 102, at 8–10. If, at the time of the filing of its IPO registration statement, the issuer did not qualify as a SRC, the issuer may recalculate its public float at the time it completes its IPO to determine whether it then qualifies for scaled disclosure in its periodic reports following the IPO. SMALL ENTITY COMPLIANCE GUIDE, *supra* note 102, at 9–10.

[105] Item 8-02 of Regulation S-X, 17 C.F.R. § 210.8-02 (2014). Article 8 of Regulation S-X sets forth the form and content of and requirements for financial statements required to be filed as a part of registration statements under the Securities Act and annual or other reports under sections 13 and 15(d) of the Exchange Act. Rule 1-01(a) of Regulation S-X, 17 C.F.R. § 210.1-01(a)(2) (2014).

[106] Items 303(a) and 303(d) of Regulation S-K, 17 C.F.R. §§ 229.303(a), (d) (2014).

[107] Item 301 of Regulation S-K. 17 C.F.R. § 229.301(c) (2014).

[108] Items 302(c) and 305(e) of Regulation S-K, 17 C.F.R. §§ 229.302(c), 229.305(e) (2014).

[109] *See supra* notes 34–37 and accompanying text.

[110] These three named executive officers include the principal executive officer and the other two most highly-compensated executive officers. Item 402(m)(2) of Regulation S-K, 17 C.F.R. § 229.402(m)(2) (2014).

[111] Items 402(n) and (p) of Regulation S-K, 17 C.F.R. §§ 229.402(n), (p).

contained in the summary compensation table and outstanding equity awards table.[112]

SRCs have the flexibility to comply with these scaled disclosure requirements on an "a la carte" basis, i.e., they can either comply with the scaled disclosure and reporting requirements made available for SRCs or voluntarily report under the more rigorous requirements that are applicable to larger companies.[113] Regardless of the level of disclosure it chooses to adopt, issuers who qualify as SRCs must identify themselves as such by checking the appropriate box in the corresponding Securities Act or Exchange Act filing.[114]

C. *The JOBS Act & the Going Public Decision of EGCs*

This section provides an overview of the provisions of the JOBS Act that impact the going public decision for EGCs. As the discussion will reveal, several provisions of the JOBS Act extend some of the scaled disclosure rules generally available to SRCs to a broader set of issuers (i.e., EGCs) during, and in the years immediately following, their IPOs.[115]

1. *Scaled Disclosure Requirements During IPO*

EGCs are exempt from a number of the financial disclosure requirements that generally apply to issuers conducting an IPO. For example, the JOBS Act allows EGCs to choose whether to include only two years of audited financial statements and selected financial data, with a correspondingly shorter MD&A section in their IPO registration statements.[116] Generally, issuers that do not

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[112] Item 402(s) of Regulation S-K, 17 C.F.R. § 229.402(s). The narrative on the issuer's compensation policies and practices should address risks arising from policies and practices that are reasonably likely to have a material adverse effect on the issuer.

[113] Item 10(f) of Regulation S-K, 17 C.F.R. § 229.10(f) (2014). SRCs are, however, required to comply with certain SRC requirements that are more rigorous than the generally applicable Regulation S-K requirements. *See id.* For example, Item 404(a) of Regulation S-K requires issuers to disclose and describe transactions involving the issuer that involve amounts exceeding $120,000, and in which a related person has a direct or indirect material interest. 17 C.F.R. § 229.404(a) (2014). SRCs, on the other hand, must disclose and describe related transactions involving amounts exceeding the lesser of $120,000 or one percent of the average of the issuer's total assets, a more exacting standard. Item 404(d)(1) of Regulation S-K, 17 C.F.R. § 229.404(d)(1).

[114] If a company qualifies as a SRC, it is required to check the SRC box on the cover of any registration statement or periodic report it files with the SEC. Item 10(f)(2)(ii) of Regulation S-K, 17 C.F.R. § 229.10(f)(2)(ii).

[115] For an overview of the disclosure rules applicable to SRCs, see *supra* Part III.B.

[116] JOBS Act, Pub. L. No. 112-106, § 102(b)(1)(A), 126 Stat. 306, 309 (2012) (codified at 15 U.S.C. § 7212 (2012)). The SEC has clarified that it will not object if an EGC that is only presenting two years of audited financial statements in its IPO registration statement also limits its selected financial data to two years even though the JOBS Act provision specifically addressing selected financial data refers to "any other registration statement." *See Jumpstart Our Business Startups Act Frequently Asked Questions*, U.S.

qualify for EGC status must include select financial information for the preceding five years and audited financial statements for the preceding three years (together with the corresponding MD&A section).[117] These exemptions for EGCs parallel the pre-existing scaled disclosure regime available to SRCs.[118]

EGCs can also take advantage of reduced executive compensation disclosure similar to that available to SRCs.[119] As a result, EGCs may provide executive compensation disclosure for the principal executive officer and the two other most highly paid executive officers only, rather than for the five named executive officers required of non-EGC registrants.[120] In addition, EGCs may omit the CD&A section (replacing it with a shorter narrative summarizing executive compensation) and include only two tables of information (i.e., the summary compensation table and the outstanding equity awards table) instead of the five that are generally required of non-EGC issuers in their registration statements.[121]

2. *Scaled Disclosure Requirements After IPO*

In addition to making the IPO process less burdensome for EGCs, the JOBS Act also delays the applicability of certain requirements that periodically apply to issuers following their IPO. During this gradual phase-in, EGCs retain some of the benefits of the scaled financial reporting and auditing requirements, as well as the reduced executive compensation disclosure described earlier.[122] Thus, EGCs are able to continue to take advantage of these scaled disclosure alternatives in future registration statements, proxy statements, and annual reports for as long as they retain their EGC status.[123] The JOBS Act also allows EGCs to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies in their Exchange Act filings until those standards are also

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SEC. & EXCHANGE COMMISSION (Apr. 16, 2012), http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm, *archived at* http://perma.cc/28TD-TRW5 (referring to the answer to question 11).

[117] *See supra* notes 29–33 and accompanying text.

[118] *See supra* notes 104–08 and accompanying text.

[119] *See* JOBS Act § 102. The rules in existence prior to the enactment of the JOBS Act provided certain exemptions under these areas for SRCs, which rules remain unaffected by the JOBS Act. *See supra* notes 109–12 and accompanying text.

[120] The generally applicable rules require information for the principal executive officer, principal financial officer, and the three other most highly paid executive officers. *See supra* note 35 and accompanying text.

[121] *See supra* notes 34–37 and accompanying text.

[122] *See supra* Part III.C.1.

[123] Although issuers may remain eligible for EGC status for up to five years following their IPOs, they may lose such eligibility as soon as a year after their IPO. *See supra* note 8. Part IV.E explores the disclosure choices of EGCs as public issuers following their IPOs.

broadly applicable to private, non-reporting companies.[124] However, issuers may choose to irrevocably "opt out" of this provision in their registration statements and comply with new or revised accounting standards when their adoption is generally required for public issuers.[125]

EGCs are also exempted from certain provisions of the Sarbanes-Oxley and Dodd-Frank Acts that generally apply to public issuers following their IPOs. For example, EGCs may choose not to hold the various advisory "say-on-pay" votes that are required under the Dodd-Frank Act.[126] More noteworthy, EGCs are exempted from the independent auditor attestation of management's assessment of the effectiveness of its internal controls over financial reporting required by Section 404(b) of the Sarbanes-Oxley Act.[127] This provision of the JOBS Act is not the first exemption provided to smaller issuers from Section 404(b) of the Sarbanes-Oxley Act.[128] In 2006, the SEC granted newly public issuers an exemption from the Section 404(b) in the first annual report that they file after becoming an Exchange Act reporting companies.[129] The Dodd-Frank Act amended Section 404 of the Sarbanes-Oxley Act to provide a broader exemption covering all issuers that do not meet the definition of either an "accelerated filer" or a "large accelerated filer"

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[124] JOBS Act § 107.

[125] *Id.*

[126] *Id.* § 102. For a description of these votes, see *supra* note 76. EGCs will also be excluded from the rules that the SEC has to adopt under the Dodd-Frank Act requiring public companies to disclose (i) the ratio comparing the median of total annual compensation for employees to the total annual compensation of the CEO and (ii) the relationship between executive compensation the company paid to named executive officers and the company's financial performance. Dodd-Frank Act, Pub. L. No. 111-203, § 953, 124 Stat. 1376, 1903–04 (2010) (codified as amended at 15 U.S.C. § 78n(i) (2012)). Although the SEC has proposed rules to implement these provisions of the Dodd-Frank Act, the rules have yet to be promulgated. *See* Pay Ratio Disclosure, Securities Act Release No. 33-9452, Exchange Act Release No. 34-70443, 78 Fed. Reg. 60,650 (proposed Sept. 18, 2013).

[127] JOBS Act § 103. However, an EGC must still provide management's report on the effectiveness of internal controls, the CEO and CFO are still required to provide certifications regarding their internal controls in their periodic reports, and the issuer must maintain in place sufficient internal controls as to provide a reasonable assurance of accuracy and completeness in its financial reporting.

[128] For arguments in favor of and against such "small business" exemptions to section 404(b), see generally Joseph A. Grundfest & Steven E. Bochner, *Fixing 404*, 105 MICH. L. REV. 1643, 1669–72 (2007) and John L. Orcutt, *The Case Against Exempting Smaller Reporting Companies from Sarbanes-Oxley Section 404: Why Market-Based Solutions Are Likely to Harm Ordinary Investors*, 14 FORDHAM J. CORP. & FIN. L. 325, 355–57 (2009).

[129] *See* Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies, Securities Act Release No. 33-8760, Exchange Act Release No. 34-54942, 71 Fed. Reg. 76,580 (proposed Dec. 21, 2006). Issuers relying on the transition rules must include a statement in their first annual report that the report does not include management's assessment report or the auditor's attestation report. *See* Instruction 1 to Item 308 of Regulations S-B and S-K and Exchange Act Rules 13a-15(a), (c), and (d) and 15d-15(a), (c), and (d), 17 C.F.R. § 229.308 (2014).

under Exchange Act Rule 12b-2.[130] Thus, Section 103 of the JOBS Act extends the scope of the existing exemptions to issuers that meet the definition of an "accelerated filer"—but not the definition of a "large accelerated filer"—during their second through fifth fiscal years following their IPOs (assuming they still otherwise qualify as EGCs).[131]

Although these provisions of the JOBS Act do not affect the direct costs associated with the IPO itself, future periodic regulatory compliance costs do factor into an issuer's going public decision. Therefore, a reduction in expected future compliance costs could make an IPO more attractive. It is worth noting, however, that the magnitude of these ongoing savings is by no means entirely certain. Once a registrant no longer qualifies as an EGC, it must phase in such disclosures, with the timing of implementation of certain disclosures hinging on how long it qualifies as an EGC, which can be for as long as five years and as short as one year.[132]

3. *Testing the Waters & Confidential Submissions*

Besides providing EGCs a set of more relaxed disclosure requirements during and following an IPO, the JOBS Act simplifies the regulatory framework governing the offering process in two important ways. Issuers, as well as other participants involved in an IPO, including underwriters, are generally prohibited from making any oral or written offers prior to the filing

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[130] Dodd-Frank Act § 989G(c), 15 U.S.C. § 7262(c) (2012). An accelerated filer is an issuer that "had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $75 million or more, but less than $700 million, as of the last business day of the issuer's most recently completed second fiscal quarter" and a large accelerated filer is an issuer that "had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter." Exchange Act Rule 12b-2(1), 17 C.F.R. § 240.12b–2 (2014). In addition, to meet either definition, an issuer needs to have been subject to the Exchange Act reporting requirements for at least twelve calendar months, have filed at least one annual report, and not be eligible to use the SRC disclosure provisions in its annual and quarterly reports. *Id.* On September 15, 2010 the SEC issued the rules implementing Section 989G of the Dodd-Frank Act. *See* Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers, Securities Act Release No. 33-9142, Exchange Act Release No. 34-62914, 75 Fed. Reg. 57,385 (proposed Sept. 15, 2010).

[131] It is worth noting that prior to the enactment of JOBS Act, the SEC had advised against extending the exemption from Section 404 of Sarbanes-Oxley to issuers with public floats between $75 million and $250 million. *See* SEC. & EXCH. COMM'N, STUDY AND RECOMMENDATIONS ON SECTION 404(B) OF THE SARBANES-OXLEY ACT OF 2002 FOR ISSUERS WITH PUBLIC FLOAT BETWEEN $75 AND $250 MILLION 107–13 (2011), *available at* http://www.sec.gov/news/studies/2011/404bfloat-study.pdf, *archived at* http://perma.cc/96VB-L82T.

[132] *See supra* note 8 and accompanying text. Part IV.E tracks the continuing eligibility for EGCs status for a subset of issuers in the sample.

of a registration statement covering such IPO securities.[133] This restriction significantly constrains the ability of issuers to "test the waters" and gain a sense of how the prospective offering will be received and priced by the market before incurring the expenses associated with publicly filing a registration statement and officially commencing an IPO.[134]

The JOBS Act allows EGCs (as well those authorized to act on their behalf, including underwriters) to engage in oral or written communications with potential investors that are "qualified institutional buyers"[135] and institutions that are "accredited investors"[136] before or after the initial filing of a registration statement.[137] This exemption allows an EGC to market the securities and gauge the interest of these investors prior to subjecting itself to the costs and public exposure associated with the filing of an initial registration statement and without having to worry about the potential liability that may result from an improper offer.[138]

In addition, the JOBS Act allows EGCs to confidentially submit a draft registration statement, as well as subsequent amendments, to the SEC for

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[133] *See supra* notes 38–42 and accompanying text.

[134] *See, e.g.*, Jeffrey A. Brill, Note, *"Testing the Waters"—The SEC's Feet Go from Wet to Cold*, 83 CORNELL L. REV. 464, 481–83 (1998) (summarizing various reasons why issuers would like to test the waters).

[135] JOBS Act, Pub. L. No. 112-106, § 105, 126 Stat. 306, 310–11 (2012). The term "Qualified Institutional Buyers" (QIBs) is defined in Rule 144A of the Securities Act and includes, among others, certain entities (such as insurance companies and investment companies) that in the aggregate own and invest on a discretionary basis at least $100 million in securities; registered dealers, acting for their own account or the accounts of other QIBs, that in the aggregate own and invest on a discretionary basis at least $10 million of securities; and banks acting for their own account or the accounts of other QIBs, that in the aggregate own and invest on a discretionary basis at least $100 million in securities and have an audited net worth of at least $25 million. 17 C.F.R. § 230.144A(a)(1)(i) (2014).

[136] Rule 501 defines "accredited investors" as specified institutional investors such as banks, insurance companies, registered investment companies, business development companies, and small business investment companies, as well as individuals with a net worth over $1 million or annual income over $200,000 for the previous two years. Securities Act Rule 501(a), 17 C.F.R. §§ 230.501(a)(1)–(6) (2014).

[137] Not only does this provision of the JOBS Act allows EGCs to more freely conduct "road show" meetings with potential investors, but it also lets EGCs provide investors with additional written materials beyond the limited set of prospectuses allowed under the statute. For a description of the rules governing the use of written materials during the IPO process, see CHOI & PRITCHARD, *supra* note 38, at 422–30. It is worth noting that while the JOBS Act eases the limitation on offers imposed by the Securities Act, it does not exempt such offers from potential anti-fraud liability under Rule 10b-5 of the Exchange Act or Section 12(a)(2) of the Securities Act.

[138] These communications need not be filed and are not considered prospectuses, although the SEC may ask to have copies of such communications provided to them as part of the comment process.

confidential nonpublic review by the SEC staff.[139] Generally, the filing of any draft registration statement is public and thus available not only to potential investors, but also to competitors, allowing them to access previously non-public information about the issuer.[140] An EGC is thus able to begin the IPO registration process and gain more certainty as to whether it will ultimately complete the offering process without having to make its intention to do so public and without disclosing the kind of sensitive information about its business and finances that is required to be included in the initial draft of a registration statement.[141]

4. *Alternatives to IPOs in the Post-JOBS World*

To fully understand how the JOBS Act's IPO on-ramp provisions may impact issuers' going public decision, it is important to consider the potential effects of other provisions of the Act that could make the pursuit of alternative sources of capital, namely private exempt offerings, more attractive to certain issuers.[142]

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[139] JOBS Act § 106. The initial confidential submission and all amendments must be made public no later than 21 days prior to the date on which the company conducts a road show. A "road show" is generally a presentation regarding the issuer and the securities being offered conducted by one or more members of the issuer's management. *See* Securities Act Rule 433(h)(4), 17 C.F.R. § 230.433(h)(4) (2014). Comment letters relating to the nonpublic submissions are made public in the same manner applicable to public filings, generally 60 days after the registration statement is declared effective (or withdrawn).

[140] Regulation S-T, 17 C.F.R. § 232 (2014) requires most filings made with the SEC to be made via the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. Rule 406 of the Securities Act, 17 C.F.R. § 230.406 (2014), and Rule 24b-2 of the Exchange Act, 17 C.F.R. § 240.24b-2 (2014), set forth the substantive and procedural rules under which issuers may request confidential treatment of certain information contained in documents publicly filed with the SEC. For a summary of these rules and an overview of their application, see U.S. SEC. & EXCH. COMM'N, OFFICE OF INSPECTOR GEN., OFFICE OF AUDITS, ASSESSMENT OF CORPORATION FINANCE'S CONFIDENTIAL TREATMENT AND PROCEDURES 1–9 (2010), *available at* http://www.sec.gov/about/offices/oig/reports/audits/2010/479.pdf, *archived at* http://perma.cc/9JU5-YUTT.

[141] Such confidential submissions of draft registration statements are not deemed "filed" for purposes of Section 5 of the Securities Act. As a result, a company that confidentially submits a draft registration statement is subject to the general ban on offers imposed by Section 5, but such ban is relaxed by JOBS Act § 105, which provides a "testing the waters" exception for EGCs. *See supra* Part III.C.3.

[142] The primary statutory exemption for private placements is Section 4(2) of the Securities Act, which exempts "transactions by an issuer not involving any public offering." 15 U.S.C. § 77d(a)(2) (2012). Since the statute does not explicitly define "public offering," this term has been construed by the SEC and federal courts. The SEC promulgated Regulation D to provide additional clarity and predictability in the use of Section 4(2)'s private placement exemption. *See* Heminway & Hoffman, *supra* note 38, at 915–20 (highlighting the clarifying purpose of Regulation D).

One the most commonly used exemptions from the registration requirements of the Securities Act are the Rule 506 and Rule 144A offerings.[143] In a Rule 506 offering an issuer may offer and sell, without registration, an unlimited aggregate principal amount of securities to any number of "accredited investors" so long as certain conditions are met.[144] In a Rule 144A offering the issuer sells the securities to a set of initial purchasers in a Rule 506 offering who can then offer and sell, without registration, these securities to any number of qualified institutional buyers (QIBs).[145]

Despite the fact that it also allows issuers to raise unlimited amount of funds, a Rule 144A offering is generally less expensive and time consuming than an IPO since the issuer does not need to prepare the disclosure documents that are required under the Securities Act or worry about complying with the act's gun jumping rules.[146] Following the offering, the issuer will generally not be subject to the various burdens imposed on public issuers by the federal securities law.[147] There are, however, two noteworthy disadvantages that have traditionally limited the attractiveness of conducting an exempt offering.

First, non-compliance with any of the requirements contained in the rules can result in substantial liability.[148] One such requirement for most private placement exemptions, including Rule 506 offerings, is that issuers cannot use "any form of general solicitation or general advertising" as part of the offering.[149] This prohibition restricts the use of advertising, newspaper or magazine articles, Internet websites, media broadcasts, email campaigns, and

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[143] *See* Sjostrom, Jr., *supra* note 20, at 418–20 (discussing the securities law framework for resale of privately placed securities).

[144] 17 C.F.R. § 230.506(b)(2)(ii) (2014). See *supra* note 136 for the definition of accredited investor.

[145] The resale of privately placed securities in a so-called "secondary transaction" in which an existing shareholder sells to a third-party must also fit within an available exemption from registration under the Securities Act. 17 C.F.R. § 230.502(d) (2014). Rule 144A exempts resales of securities with no required holding period if the buyer is a QIB, which is an institution that in the aggregate owns and invests at least $100 million in securities of non-affiliated entities. 17 C.F.R. § 230.144A(a)(1)(i) (2014). See *supra* note 135 for the definition of QIB. Another exemption, Rule 144, allows for the sale of restricted securities provided the seller has held them for a certain period of time—at least one year if the security was issued by a non-reporting company—among other conditions. 17 C.F.R. § 230.144(d)(1)(ii) (2014).

[146] It should be noted that issuers conducting a Rule 144A offering will often prepare an offering memorandum and related materials that are distributed to investors. *See, e.g.*, Sjostrom, Jr., *supra* note 20, at 438. In preparing such document, the issuer will have to incur some costs and any misstatements contained therein could subject the issuer to liability under Rule 10b-5 of the Exchange Act (though not under Sections 11 and 12(a)(2) of the Securities Act). *Id.*

[147] *See supra* Part II.A.1.

[148] Securities Act § 12(a)(1), 15 U.S.C. § 77l(a)(1) (2012).

[149] Exchange Act Rule 502(c), 17 C.F.R. § 230.502(c) (2014).

public meetings to promote the Rule 144A offering.[150] And, prior to the JOBS Act, the reseller could only make offers to QIBs. Restricting the promotion of the offering in this manner could limit the number of investors participating in the Rule 144A offering and the amount of capital that the issuer may raise.

A second potential drawback of a Rule 506 or Rule 144A offering is that subsequent resales of securities issued in private offerings may eventually trigger registration requirements under Section 12(g) of the Exchange Act even if the issuer has never conducted an IPO.[151] This has the practical effect of forcing some companies to become public reporting companies earlier than they otherwise would have chosen, decreasing the ongoing savings in regulatory compliance costs associated with private placements.[152] Prior to the JOBS Act, Section 12(g) provided that any company with total assets exceeding $10 million and a class of equity security "held of record by five hundred or more . . . persons" had to register such security under the Exchange Act.[153]

Certain provisions of the JOBS Act address these two concerns, thus increasing the attractiveness of a Rule 144A offering. As mandated by the JOBS Act,[154] the SEC recently promulgated rules eliminating the prohibition on general solicitation and advertising in Rule 506 offerings and Rule 144A

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[150] *See* Charles A. Sweet, *SEC Adopts Amendments to Rule 506 and Rule 144A to Permit General Solicitation and General Advertising, and Proposes Additional Related Requirements*, MORGAN LEWIS (July 16, 2013), http://www.morganlewis.com/pubs/sec-adopts-amendments-to-rule-506-and-rule-144a, *archived at* http://perma.cc/8BWL-P6MM.

[151] Exchange Act § 12(g), 15 U.S.C. § 78l(g) (2012). In addition to crossing the Section 12(g) threshold, a company can also become subject to disclosure requirements of the Exchange Act by listing securities on a national securities exchange or by making a registered public offering under the Securities Act. 15 U.S.C. §§ 78l(a), 78o(d)(1) (2012).

[152] For example, after reaching this threshold in 2003, Google conducted its IPO in early 2004 and noted in its registration statement that "by law, certain private companies must report as if they were public companies. The deadline imposed by this requirement accelerated our decision [to go public]." Google, Inc., Registration Statement (Form S-1), at iv (Apr. 29, 2004), *available at* http://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm, *archived at* http://perma.cc/YX83-YBHS; *see also* William K. Sjostrom, Jr., *Questioning the 500 Equity Holders Trigger*, 1 HARV. BUS. L. REV. ONLINE 43, 44 (2011) (noting that Facebook planned to surpass 499 owners in 2012, the year it went public).

[153] Exchange Act § 12(g), 15 U.S.C. § 78l(g) (2012). The measurement date for the threshold is the last day of the company's fiscal year. If it exceeds the threshold, the company has 120 days to register. *Id.* The total assets threshold was increased to $10 million, from the original $1 million, in 1996. *See* Relief From Reporting by Small Issuers, Securities Act Release No. 34-37157, 61 Fed. Reg. 21,354 (proposed May 9, 1996).

[154] JOBS Act, Pub. L. No. 112-106, § 201, 126 Stat. 306, 313–15 (2012) (codified at 15 U.S.C. § 78j-1 (2012)). The JOBS Act also raised the offering limits under Regulation A from $5 to $50 million and created a new exemption under the Securities Act for a type of capital raising known as "crowdfunding," which uses the Internet to pool small individual contributions. *Id.* §§ 301–402.

resales.[155] These amended rules not only allow the issuer to use a broader array of marketing tools to promote its private offering, but also eliminate the risk of inadvertent communications being deemed general solicitations, which can potentially subject the issuer to liability and disrupt a Rule 144A offering.[156] In addition, the JOBS Act amended Section 12(g) to increase this 500-record-holders threshold to 2,000, provided no more than 499 of those holders are unaccredited investors.[157]

As a result of these changes introduced by the JOBS Act, not only should issuers be able to raise more funds in Rule 144A offerings at a lower cost, but also those issuers that choose to raise capital in private exempt transactions will be able to remain exempt from the mandatory periodic disclosure requirements of the Exchange Act for longer, reaping the savings associated with a private placement.[158]

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[155] *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, Exchange Act Release No. 34-69959, 78 Fed. Reg. 44,771 (proposed July 10, 2013). The amendments allow general solicitation in connection with an offering of securities under Rule 506, provided that, among other conditions, all purchasers of securities in the offering are accredited investors. An issuer engaging in general solicitation must take "reasonable steps to verify" that the purchasers of its securities are accredited investors. *Id.* at 44,771. The amendment to Rule 144A eliminates the references to "offer" and "offeree," enabling Rule 144A securities to be offered to persons other than QIBs, including by means of general solicitation, so long as they are actually sold only to persons that the seller and any person acting on its behalf reasonably believes are QIBs. *See id.* at 44,786.

[156] For example, factual communications made by the issuer in the ordinary course of business for the benefit of customers, employees, and existing shareholders could be seen as impermissibly "conditioning the market" for the issuer's securities and thus be deemed a general solicitation. In that eventuality, the issuer would have to postpone the offering to avoid any potential liability under Section 12(a)(1) of the Securities Act.

[157] JOBS Act § 501. The JOBS Act excludes from the 2,000-holder limit those holders who obtained equity under the company's equity compensation plans. *Id.* § 502. For a more detailed discussion of these changes, see Guttentag, *supra* note 91, at 169–78.

[158] One potential drawback of remaining a private issuer would be the lack of a trading market for the issuer's securities. This lack of liquidity could lead early investors, such as venture capital funds, to force the issuer to register the sale of their securities. However, the recent development of more liquid and robust secondary trading markets for privately-issued securities could ease this pressure and lead many issuers to avoid the public capital markets and remain private for longer periods. *See* Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 183–93 (2012) (describing the recent development of secondary markets for privately issued stock). Such developments, coupled with recent legislative and administrative actions, have blurred the lines between the private and public securities markets, potentially reducing the relative disadvantages of the former. For recent scholarly discussions of the ever-shifting boundaries separating public and private issuers, see generally Langevoort & Thompson, *supra* note 100; Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389 (2013).

D. *Assessing the Potential Impact of the JOBS Act*

By reducing the amount of disclosure required in a registration statement and the accompanying financial statements, the JOBS Act can directly reduce some of the regulatory compliance costs, such as the legal and audit fees that are incurred by EGCs during the course of an IPO.[159] In addition, the broader set of permissible communications that EGCs can make during the process and the opportunity to confidentially submit a draft registration statement with the SEC can result not only in reduced legal costs, but could also expedite the offering process and reduce the risk of conducting a failed offering.[160] Thus, at a first glance, it appears that the IPO on-ramp provisions of the JOBS Act should make public offerings more attractive to EGCs.

However, the very same provisions of the JOBS Act that are intended to lessen the regulatory burden and decrease the related compliance costs of IPOs could unintentionally impact the two other types of IPO costs incurred by issuers—the underwriter spread and underpricing. One particular concern is that the IPO on-ramp provisions of the JOBS Act may lead to greater informational asymmetries between the issuer and the market, as well as across investors, relating to the prospects of the issuer. As noted earlier, the level of disclosure of information about an issuer can play a role in determining the spread demanded by the underwriters and the underpricing of an IPO.[161]

EGCs generally discuss the tension between the relative advantages (e.g., lower regulatory compliance costs) and disadvantages (e.g., market participants drawing negative inferences) associated with the adoption of the scaled disclosure made available by the JOBS Act as "risk factors" in their prospectuses.[162] Consider as an illustration, the following two risk factors disclosed by Restoration Hardware in its IPO prospectus:

- We will incur new costs as a result of becoming a public company, and such costs may increase when and if we cease to be an "emerging growth company."
- As an "emerging growth company," we cannot be certain whether taking advantage of the reduced disclosure requirements applicable to

[159] *See supra* note 43.

[160] *See supra* Part III.C.3.

[161] *See supra* notes 56–57 and accompanying text (discussing the factors affecting the size of the underwriter spread) and *supra* notes 68–70 and accompanying text (discussing the factors affecting the level of underpricing in an IPO). For a theoretical and empirical assessment of the effects of the JOBS Act on the underwriters' spread and IPO underpricing, see *infra* Part IV.D.2 and Part IV.D.3, respectively.

[162] The "Risk Factors" is a section of the prospectus in which issuers must disclose and discuss the most significant factors that make the offering speculative or risky. Item 503 of Regulation S-K, 17 C.F.R. § 229.503 (2014).

> "emerging growth companies" will make our common stock less attractive to investors.[163]

One can expect the relative costs and benefits of adopting scaled disclosures to vary across issuers. For example, in deciding whether to provide two or three years of audited financial statements, issuers will consider whether the benefit of such reduced disclosure is worth incurring the risk that the market will draw a negative inference from such reduced disclosure.[164] For some EGCs, such as younger companies in the early stages of development for which prior financial results are not necessarily informative, the advantages of providing only two years of financial statements will likely be greater than the disadvantages. On the other hand, more established issuers in mature industries may choose to voluntarily disclose more than the required two years of financial information, particularly if prior periods are important to understand the company's financial condition and future prospects. One may thus expect these smaller and younger EGCs to take advantage of the IPO on-ramp provisions of the JOBS Act at higher rates than larger and more mature EGCs and to represent, perhaps, a larger share of the IPOs in the post-JOBS Act era.

Even if the IPO on-ramp provisions of the JOBS Act do in fact reduce the overall costs of conducting an IPO and being a public issuer, an EGC may still choose to raise capital in a private offering if the net benefits of doing so are greater than the net benefits associated with an IPO.[165] As noted earlier,

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[163] Restoration Hardware Holdings, Inc., Prospectus (Form 424B4), at 40–41 (Nov. 10, 2012) [hereinafter Restoration Hardware Prospectus], *available at* http://sec.gov/Archives/edgar/data/1528849/000119312512449830/d70987d424b4.htm, *archived at* http://perma.cc/ZY8N-R5CR.

[164] Issuers qualifying as EGCs recognize these concerns and generally include a risk factor describing the reporting obligations from which they, as EGCs, are exempt under the JOBS Act and describing as a risk the possibility that the reduced reporting requirements will make their common stock less attractive to investors and have an impact on the trading market for its stock and result in greater volatility. *See, e.g.*, The Container Store Prospectus, *supra* note 75, at 36 ("We cannot predict if investors will find our common stock less attractive if we elect to rely on these exemptions, or if taking advantage of these exemptions would result in less active trading or more volatility in the price of our common stock.").

[165] In other words, the key question is whether the reduction in IPO costs that results from the JOBS Act is sufficient to overcome the pre-existing attractiveness of private offerings. *See, e.g.*, *Spurring Job Growth Through Capital Formation While Protecting Investors: Hearings Before the S. Comm. on Banking, Hous. & Urban Affairs*, 112th Cong. 3 (2011) (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School) (noting that "smaller issuers have displayed a marked preference for private offerings, and this preference is likely to persist"). *But see* Phillip J. Kardis II et al., *Capital Markets Relief: JOBS (Jumpstart Our Business Startups) Act Eases Regulatory Barriers to IPOs and Other Capital Raising Alternatives*, K&L GATES 3 (Apr. 5, 2012), http://www.klgates.com/files/Publication/5b34af79-4611-46e7-95b6-2ab3aa230263/Presentation/PublicationAttachment/dd483ff5-cd05-4202-8e77-d51f85ccbb2d/Capital_Markets_Alert.pdf, *archived at* http://perma.cc/JDP9-R2VN (expecting, as a result of the JOBS Act,

certain provisions of the JOBS Act may increase the attractiveness of private offerings relative to IPOs, which could mitigate the impact of the IPO on-ramp provisions of the JOBS Act on the number of IPOs by EGCs.[166] Thus, certain issuers that qualify for EGC status—particularly those which would not take advantage of the scaled disclosure provisions of the JOBS Act—may prefer to pursue the now more attractive private offerings instead of conducting an IPO. If this is in fact the case, we may expect larger, more established issuers (that qualify for EGC status) to represent a lower share of IPOs relative to smaller, less established ones, following the enactment of the JOBS Act.[167]

IV. GOING PUBLIC AFTER JOBS: THE EVIDENCE

A. *Constructing the IPO Database*

The analyses in this section focus on IPOs of common stock by domestic corporate issuers between January 1, 2010, and June 30, 2014.[168] For each IPO, I downloaded the final prospectus from the SEC EDGAR database.[169] The final prospectus provides an array of information about the issuer and the offering, including each issuer's gross revenue during the fiscal year immediately preceding its IPO, the issuer's Standard Industrial Classification code,[170] the number of securities being offered and their offering price, as well

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"an increase in the number of small IPOs compared to the diminished levels of recent years").

[166] *See supra* Part III.C.4.

[167] Such a shift in IPO issuer characteristics is documented in the dataset analyzed in this Article. *See infra* notes 219–27 and accompanying text.

[168] To construct this dataset, I initially compiled a list of IPOs from IPOScoop.com. *See IPO SCOOP Rating Scorecard*, IPOSCOOP.COM, http://www.iposcoop.com /index.php?option=com_trackrecord&Itemid=200 (last visited Feb. 13, 2015), *archived at* http://perma.cc/8M3F-Y7VS. From this initial list, I excluded transactions involving non-operating companies, foreign private issuers and non-corporate entities (i.e., Limited Partnerships, Limited Liability Companies, Business Development Companies, Blank Check Companies, Real Estate Investment Trusts), and transactions involving the issuance of instruments other than common stock. Finally, I excluded offerings involving issuers that identify themselves as SRCs in their Form S-1 because although technically EGCs, they already enjoyed the exemptions the JOBS Act affords EGCs. *See supra* Part III.B.

[169] Public securities law filings can generally be obtained from the SEC's EDGAR website. *See EDGAR Company Filings*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/edgar/searchedgar/companysearch.html (last visited Feb. 13, 2015), *archived at* http://perma.cc/HJW8-6WP6; *see also supra* note 140. Issuers file an electronic copy of the final statutory prospectus with the SEC under Rule 424(b)(2) of the Securities Act, 17 C.F.R. § 230.424(b)(2) (2014).

[170] Issuers must disclose their Primary Standard Industrial Classification (SIC) Code Number in the cover page of the Registration Statement on Form S-1. 17 C.F.R. § 239.11 (2014). The SIC is a 4-digit code that identifies the primary line of business of the issuer. *See Division of Corporation Finance: Standard Industrial Classification (SIC) Code List*,

as the underwriters' gross spread. Reading the prospectus also reveals whether an issuer that qualifies as an EGC has chosen to take advantage of any of the scaled disclosure provisions of the JOBS Act.[171] The information contained in the prospectuses is complemented with the founding date of each issuer[172] and the direct regulatory compliance costs incurred by the issuer in conducting the IPO.[173] The final dataset contains a total of 448 IPOs.

B. *Changes in IPO Volume After JOBS*

Of the 448 IPOs in the sample, 270 took place following the enactment of the JOBS Act in April 2012, which period is hereinafter referred to as the post-JOBS period.[174] The remaining 178 IPOs took place in the pre-JOBS period, i.e., prior to the enactment of the JOBS Act. Approximately 84.8% (229 out of 270) of the IPOs that took place in the post-JOBS period involve issuers that qualify as EGCs.[175] The fact that EGCs comprise such a commanding majority of the IPO market is not surprising given the criteria defining the eligibility of an issuer for EGC status.[176]

From a policy perspective, however, a more interesting question is whether the enactment of the JOBS Act has resulted in an increase in the number of issuers qualifying as EGCs that seek to access the public capital markets. One way to address this question is to look at the number of IPOs by smaller issuers before and after the JOBS Act. To do so, one can divide the

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U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/info/edgar/siccodes.htm (last updated Jan. 3, 2011), *archived at* http://perma.cc/CDT8-TZD5.

[171] Whether or not an EGC chooses to take advantage of the scaled disclosure available to it under the JOBS Act, the SEC's Division of Corporation Finance requests that EGC-issuers identify themselves as an EGC on the cover page of the prospectus. *See Jumpstart Our Business Startups Act Frequently Asked Questions*, *supra* note 116 (referring to the answer to question 4).

[172] Founding dates are obtained from the Field-Ritter dataset of company founding dates, an appendix to Tim Loughran & Jay R. Ritter, *Why Has IPO Underpricing Changed Over Time?*, 33 FIN. MGMT. 5 (2004), which is periodically updated by the authors. *See Founding Dates for 9,902 Firms Going Public in the U.S. During 1975-2014*, JAY R. RITTER, http://bear.warrington.ufl.edu/ritter/FoundingDates.htm (last updated Apr. 14, 2014), *archived at* http://perma.cc/74J6-U46K.

[173] These direct compliance costs include (i) fees payable to the SEC, the exchange where the securities will be listed, the Financial Industry Regulatory Authority, Inc. (FINRA), state securities regulators and the transfer agent; (ii) costs and fees relating to legal and accounting expenses; and (iii) a number of miscellaneous expenses such as printing and engraving costs. This information is available in the final amended registration statement filed by the issuer with the SEC wherein the issuer must disclose under Item 13 of Form S-1 an estimate of the expenses incurred in connection with the IPO. Item 511 of Regulation S-K, 17 C.F.R. § 229.511 (2014).

[174] The first IPO in the post-JOBS period in the sample took place on April 11, 2012.

[175] *See infra* Table 1, col. (3).

[176] Generally, issuers with revenues lower than $1 billion in the fiscal year preceding their IPO may qualify for EGC status. *See supra* note 8.

IPOs in the pre-JOBS period into two groups according to the revenues of the issuer in the fiscal year preceding the offering. Those non-accelerated filers with revenues lower than a billion dollars going public in the pre-JOBS period would have been eligible for EGC status in the post-JOBS period, while the remaining issuers would not have been eligible to take advantage of the JOBS Act's IPO on-ramp provisions.[177]

In the 821 calendar days comprising the pre-JOBS sample there were 156 IPOs by smaller issuers, or roughly 19 IPOs every 100 days. In contrast, in the 816 days comprising the post-JOBS sample, there were 229 IPOs by smaller issuers, or roughly 28 IPOs every 100 days. At a first glance, this metric suggests that there has been a slight increase in the number of IPOs by smaller issuers in the post-JOBS period. However, given the multiplicity of factors that drive overall IPO activity, it would be premature to draw any conclusions on the causal effects of the JOBS Act based solely on this statistic. Notably, the number of IPOs by larger issuers, which do not enjoy the same advantages as EGCs under the JOBS Act, also increased, from 2.68 per 100 days in the pre-JOBS period (22 IPOs in total) to 5.02 per 100 days (41 IPOs in total) during the post-JOBS portion of the sample. This suggests that the increase in the number of IPOs by smaller issuers could be the result of more robust overall IPO and economic activity or be driven by other extra-legal factors.

[177] Technically, the threshold level of revenues for the pre-JOBS period should be lower to account for the inflation between a pre-JOBS IPO date and the enactment of the JOBS Act. *See* JOBS Act, Pub. L. No. 112-106, § 101(a), 126 Stat. 306, 307 (codified at 15 U.S.C. § 7211 (2012)) (providing that the $1 billion threshold in the definition of an EGC will be adjusted going forward to account for inflation). However, given the limited time frame covered in the database and the low inflation rate during this period, such an adjustment would be minimal and would have no effect on the analyses. For simplicity, a $1 billion threshold will be used for the pre-JOBS period IPOs instead.

Table 1: *IPO Volume by EGC Status*

Note: Column (1) presents the total number of IPOs in a given period. Column (2) presents the number of IPOs conducted by issuers identified as EGCs, except for the Pre-JOBS period, in which column (2) includes issuers with revenues lower than $1 billion. Column (3) presents the percentage of all IPOs conducted by EGCs.

	(1)	**(2)**	**(3)**
Period	**Total**	**EGC**	**EGC Share**
Jan. 1–June 30, 2010	36	31	86.1%
July 1–Dec. 31, 2010	42	36	85.7%
Jan. 1–June 30, 2011	37	32	86.5%
July 1–Dec. 31, 2011	29	28	96.6%
Jan. 1–Mar. 31, 2012	34	29	85.3%
Total Pre-JOBS	*178*	*156*	*87.6%*
Apr. 1–June 30, 2012	20	16	80.0%
July 1–Dec. 31, 2012	31	26	83.9%
Jan. 1–June 30, 2013	56	43	76.8%
July 1–Dec. 31, 2013	78	68	87.2%
Jan. 1–June 30, 2014	85	76	89.4%
Total Post-JOBS	*270*	*229*	*84.8%*

Another way to measure the impact of the JOBS Act on the number of IPOs conducted by EGCs is to compare the proportion of issuers eligible for EGC status conducting an IPO in the pre- and post-JOBS periods. That is, if the JOBS Act does in fact encourage small issuers (i.e., those with revenues of less than $1 billion) to access the public capital markets, one could expect the proportion of smaller issuers in the universe of IPOs to increase following the

enactment of the Act.[178] Of the 178 IPOs in the pre-JOBS period, 156 involved issuers that would have satisfied the revenue threshold to be deemed EGCs. The proportion of these "EGCs" in the pre-JOBS period, about 87.6%,[179] is actually *greater* than the proportion of IPOs conducted by EGCs in the post-JOBS period, 84.8% (or 229 out of 270 IPOs).[180] These results suggest that the JOBS Act has not had a substantial effect in increasing the number of smaller issuers accessing the public capital markets via an IPO.

What can explain the underwhelming impact of the JOBS Act in the volume of IPOs conducted by EGCs? For one, it could be that, in response to market pressure, issuers may not be able to take advantage of the scaled provisions of the JOBS Act that are meant to facilitate their IPO process.[181] Or even if EGCs are taking advantage of these scaled disclosure provisions, it could be that the direct or indirect costs these issuers incur in conducting an IPO have not changed significantly following the enactment of the JOBS Act.[182] If the benefits of the JOBS Act IPO on-ramp provisions are not materializing in this manner, then EGCs may be opting to raise capital by tapping the private capital markets, a process facilitated by other provisions of the JOBS Act.[183] The sections that follow explore these possibilities in more detail.

C. *Adoption of Scaled Disclosure by EGCs*

The JOBS Act seeks to lessen the regulatory burdens and costs faced by EGCs during an IPO by providing these issuers several exemptions from the otherwise mandatory disclosure requirements of the Securities Act. An issuer that qualifies as an EGC, however, can always opt not to take advantage of these exemptions and disclose the information generally required for all issuers engaging in a public offering of securities. An assessment of the impact of the benefits bestowed by the JOBS Act on EGCs must therefore include an

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[178] This assumes that the applicable provisions in the JOBS Act have no effects on the behavior of those issuers that do not qualify for EGC status. Given that the JOBS Act does not reduce the costs to non-EGCs of becoming and being public but does make private offerings more attractive to all issuers, one could expect the number of IPOs by larger issuers to decrease. *See supra* Part III.C.4.

[179] The share of IPOs by EGCs (92 out of 105) is identical in the four quarters immediately preceding the enactment of the JOBS Act.

[180] This gap (about 2.8 percentage points) is not statistically significant. This finding is robust to eliminating any individual calendar quarter in the sample. For example, ignoring the period of January 1 to June 30, 2013, where the share of EGCs in the post-JOBS period is the lowest, the fraction of EGCs in the post-JOBS period is 86.9%, still lower than the pre-JOBS rate. Alternatively, removing the period of July 1 to December 31, 2011, where EGCs do best in the pre-JOBS period, the share of EGCs in the pre-JOBS period is 85.9%, still higher than the post-JOBS average.

[181] *See infra* Part IV.C.

[182] *See infra* Part IV.D.

[183] *See supra* Part III.C.4.

initial determination of whether these issuers are in fact taking advantage of such scaled disclosure requirements and other benefits made available to them by the Act.

This part explores five such decisions made by an EGC at the IPO stage under the JOBS Act framework:[184] (1) whether to confidentially submit a draft registration statement to the SEC; (2) whether to provide only two years of financial information in the selected financial data section of the prospectus;[185] (3) whether to provide audited financial statements only covering the preceding two fiscal years;[186] (4) whether to provide limited information relating to executive compensation;[187] and (5) whether to opt out of the extended transition period to comply with new or revised accounting standards applicable to public companies.[188]

1. *Filing of a Confidential Draft Registration Statement*

About 75% of EGCs conducting an IPO during the post-JOBS period filed a confidential draft registration statement with the SEC.[189] Notably, the proportion of EGCs that submitted a confidential registration statement increased markedly with the passage of time from under 20% in the first three quarters of the post-JOBS period (i.e., the 2012 portion of the sample) to over 98% in the last two quarters of the sample (i.e., the 2014 portion of the sample).

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[184] In addition, Part IV.E explores the decisions made by issuers with respect to the inclusion of the auditor attestation of internal controls required under Section 404 of the Sarbanes Oxley Act. *See supra* notes 127–31 and accompanying text.

[185] *See supra* note 116 and accompanying text. Generally, issuers must provide summary financial information for the preceding five years. *See supra* note 31 and accompanying text.

[186] *See supra* note 116 and accompanying text. Generally, issuers must provide audited financial statements for the preceding three years. *See supra* note 30 and accompanying text.

[187] *See supra* note 126 and accompanying text.

[188] *See supra* note 124 and accompanying text.

[189] *See infra* Table 2, col. (1).

Table 2: *IPOs by EGCs Finalized in Post-JOBS Period*

Note: This table presents the characteristics of IPOs conducted by EGCs subsequent to the enactment of the JOBS Act. Column (1) presents the percentage of EGCs that confidentially submitted a draft Form S-1 with the SEC. Columns (2) and (3) present the percentage of EGCs that included two years of information in their audited financial statements and in the selected financial information section of their prospectus, respectively. Column (4) presents the percentage of EGCs that include only two tables in the executive compensation section of the prospectus. Column (5) presents the percentage of EGCs that opted out of the grace period for complying with new or revised accounting standards.

		(1)	(2)	(3)	(4)	(5)
		Filed	*2-years*	*2-years*	*2-CDA*	*§107*
Period	*N*	*Conf. S-1*	*audited*	*selected*	*tables*	*Opt-Out*
Apr.–June 2012	16	0.0%	0.0%	6.3%	0.0%	68.8%
July–Dec. 2012	26	30.1%	19.2%	15.4%	38.6%	88.5%
Jan.–June 2013	43	72.1%	30.2%	27.9%	69.0%	83.7%
July–Dec. 2013	68	94.1%	50.0%	42.6%	77.3%	83.8%
Jan.– June 2014	76	98.7%	51.3%	47.4%	96.1%	93.4%
ALL	**229**	**77.7%**	**39.7%**	**35.8%**	**72.1%**	**86.5%**

These rates, however, underestimate the percentage of EGCs that submitted a confidential draft registration statement because issuers that filed their initial draft with the SEC before the JOBS Act became effective could not possibly take advantage of the opportunity to submit such a draft confidentially. If we focus exclusively on those IPOs in which the initial draft Form S-1 registration statement was filed following the enactment of the JOBS Act, the overall proportion of confidential submissions is closer to 90 percent.[190] Although the pattern is obviously less pronounced, the proportion of EGCs submitting confidentially still increases noticeably with the passage

[190] *See infra* Table 2A, col. (1).

of time—from 53% in the first three quarters of the post-JOBS period to over 98% in the last two quarters to the sample.[191]

Table 2A: *IPOs by EGCs Commenced in Post-JOBS Period*

Note: This table presents the characteristics of IPOs conducted by emerging growth companies in which the initial registration statement on Form S-1 was filed with the SEC after the enactment of the JOBS Act. Column (1) presents the percentage of EGCs that confidentially submitted a draft Form S-1 with the SEC. Columns (2) and (3) present the percentage of EGCs that included two years of information in their audited financial statements and in the selected financial information section of their prospectus, respectively. Column (4) presents the percentage of EGCs that include only two tables in the executive compensation section of the prospectus. Column (5) presents the percentage of EGCs that opted out of the grace period for complying with new or revised accounting standards.

		(1)	(2)	(3)	(4)	(5)
		Filed	*2-years*	*2-years*	*2-CDA*	*§107*
Period	*N*	*Conf. S-1*	*audited*	*selected*	*tables*	*Opt-Out*
July–Dec. 2012	15	53.3%	20.0%	13.3%	53.3%	93.3%
Jan.–June 2013	39	79.5%	31.8%	28.2%	73.7%	82.1%
July–Dec. 2013	68	94.1%	50.0%	42.6%	77.3%	83.8%
Jan.–June 2014	76	98.7%	51.3%	47.4%	96.1%	93.4%
ALL	**198**	**89.9%**	**44.5%**	**39.4%**	**82.1%**	**87.9%**

2. *Financial & Executive Compensation Disclosure*

A significant proportion of EGCs also appear to have embraced the option to provide scaled financial disclosure and reduced executive compensation information. Ninety-one of the 229 issuers (39.7%) that identity themselves as EGCs elected to present audited financial statements for the two fiscal years preceding the offering rather than the standard three years.[192] Eighty-two of these issuers (35.8%) also provide only two years of data in the selected

[191] *See infra* Table 2A, col. (1).
[192] *See supra* Table 2, col. (2).

financial information table, rather than the standard five years.[193] An even greater proportion of EGCs—over 70%—choose to provide scaled executive compensation disclosure by presenting two (rather than five) tables of information.[194]

Just as with confidential submissions, the proportion of EGCs opting to take advantage of the scaled disclosure requirements made available to them under the JOBS Act increases significantly with the passage of time. The share of issuers presenting two, rather than three, years of audited financial statements increases from under 12% in the three quarters immediately following the enactment of the JOBS Act to over 50% in the last two quarters of the sample. Similarly, the number of issuers providing scaled executive compensation disclosure increased from under 24% in the two quarters immediately following the enactment of the JOBS Act to over 96% in the first two quarters of 2014.

As noted earlier, some of the issuers who conducted their IPOs during the post-JOBS period in the sample had already filed their initial registration statements prior to the enactment of the JOBS Act. Since this subset of registration statements was prepared and filed under the pre-JOBS disclosure rules, these initial drafts included audited financials for the three preceding fiscal years, a summary consolidated data for the previous five years and a full CD&A section, including the required compensation tables.[195] Technically, these issuers could have amended the registration statement to include less financial and compensation information; however, since the costs associated with providing such information had already been incurred, these issuers would not have enjoyed the full benefits of scaling their disclosure.[196] Excluding those IPOs in which the initial registration statement was filed before the enactment of the JOBS Act, the results are qualitatively similar, though there is a mechanical decrease in the difference in adoption rates between earlier and later quarters.[197]

3. *Compliance with Revised Accounting Standards*

The JOBS Act allows EGCs to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies in their Exchange Act reports until those standards are also

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[193] *See supra* Table 2, col. (3).

[194] *See supra* Table 2, col. (4).

[195] *See supra* notes 29–37 and accompanying text.

[196] In addition, given the probability that the market could draw negative inferences from such scaling back of disclosure, one could expect these issuers to be careful in making this determination. One plausible reason to subsequently scale back the level of disclosure is to limit liability arising from misstatements in the registration statement and/or prospectus under Sections 11 and 12(a)(2) of the Securities Act. 15 U.S.C. §§ 77k(a), 77l(a)(2) (2012).

[197] *See supra* Table 2A, cols. (2)–(4).

broadly applicable to private non-reporting companies.[198] Although such compliance costs would be incurred following the IPO itself, issuers may choose to irrevocably "opt out" of this provision in their IPO registration statement.[199]

Since the enactment of the JOBS Act a steady and substantial majority of EGCs (over 85%) has chosen to irrevocably opt out of this extended transition period, a rate that appears fairly stable over time.[200] The low adoption rate—under 15%—of this extended transition period provided by JOBS Act stands in stark contrast with the manner in which EGCs have embraced the other scaled disclosure provisions of the Act.[201] A possible explanation for this low adoption rate is that public investors would need to spend additional time and money in analyzing the financial statements of an issuer if these are not readily comparable to those of the issuer's peer entities, making the issuer's securities less attractive.[202] Although issuers do not explicitly discuss in their prospectus the reasons behind their decision not to opt out, one can examine those risk factors disclosed by issuers that touch upon accounting standard and principles. Generally, issuers disclose that changes in or revisions to applicable accounting standards and principles can, according to these risk factors, have an effect on issuer's reported financials[203] as well as the market price for the issuer's stock.[204] More specifically, such changes can have an impact on

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[198] JOBS Act, Pub. L. No. 112-106, § 107, 126 Stat. 306, 312–13 (2012) (codified at 15 U.S.C. § 7217 (2012)).

[199] *Id.*

[200] *See supra* Table 2A, col. (5). Including offerings in which the initial registration statement was filed before the enactment of the JOBS Act has negligible impact. *See supra* Table 2, col. (5).

[201] In fact, this rate will likely be lower because EGCs may decide to opt-out subsequent to the IPO but before filing its initial report under the Exchange Act.

[202] *See, e.g.*, Ophthotech Corp., Prospectus (Form 424B4), at 47 (Sept. 24, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1410939/000119312513378605/d560505d424b4.htm, *archived at* http://perma.cc/N2V4-CGEN ("We have elected to delay such adoption of new or revised accounting standards, and, as a result, we may not comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for public companies that are not emerging growth companies. As a result of such election, our financial statements may not be comparable to the financial statements of other public companies.").

[203] *See e.g.*, Violin Memory, Inc., Prospectus (Form 424B4), at 30–31 (Sept. 26, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1407190/000119312513382136/d366503d424b4.htm, *archived at* http://perma.cc/4ZCU-ZK4H ("A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change."); *see also* Chuy's Holdings, Inc., Prospectus (Form 424B4), at 32 (July 23, 2012), *available at* http://investor.chuys.com/secfiling.cfm?filingID=1193125-12-314265&CIK=1524931, *archived at* http://perma.cc/S5UJ-DREK ("Our reported financial results may be adversely affected by changes in accounting principles applicable to us.").

[204] *See* Aerohive Networks, Inc., Prospectus (Form 424B4), at 41–42 (Mar. 27, 2014), *available at* http://www.sec.gov/Archives/edgar/data/1372414/000119312514119857/

stock-based compensation,[205] the issuer's effective tax rates,[206] the ability to borrow money,[207] and could potentially result in regulatory violations.[208] It is possible that those issuers choosing not to opt-out have financial and operating results that could be sensitive to changes in certain accounting principles.

4. *Scaled Disclosure & Issuer Characteristics*

The social welfare implications associated with the scaled disclosure made available to EGCs under the JOBS Act will depend on the types of issuers that are taking advantage of these exemptions.[209] For example, historical financial information for issuers with a limited history of operating results (such as young, small companies) or for which future profitability drives firm value (such as those in R&D intensive industries) may not be as valuable to

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d648720d424b4.htm, *archived at* http://perma.cc/3868-NBQP ("Factors that could cause fluctuations in the trading price of our common stock include . . . changes in accounting standards, policies, guidelines, interpretations or principles . . . ."); Twitter, Inc., Prospectus (Form 424B4), at 45–46 (Nov. 6, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1418091 /000119312513431301/d564001d424b4.htm, *archived at* http://perma.cc/Y67E-G4J2 ("Factors that could cause fluctuations in the market price of our common stock include . . . changes in accounting standards, policies, guidelines, interpretations or principles . . . .").

[205] *See, e.g.*, Realogy Holdings Corp., Prospectus (Form 424B4), at 36 (Oct. 10, 2012), *available at* http://www.sec.gov/Archives/edgar/data/1398987/000119312512421050 /d375292d424b4.htm, *archived at* http://perma.cc/9VX9-F7MH ("Generally accepted accounting principles in the United States and related accounting pronouncements, implementation guidance and interpretations with regard to a wide range of matters, such as stock-based compensation, . . . are highly complex and involve many subjective assumptions, estimates and judgments made by management. Changes in these rules or their interpretations or changes in underlying assumptions, estimates or judgments made by management could significantly change our reported results.").

[206] *See, e.g.*, Restoration Hardware Prospectus, *supra* note 163, at 35 ("In addition, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings, timing of the utilization of net operating loss carryforwards, changes in the valuation allowance for deferred taxes or by changes to existing accounting rules or regulations.").

[207] *See, e.g.*, *id.* ("The proposed new accounting pronouncement, if ultimately adopted in its proposed form, could result in significant changes to current accounting, including the capitalization of leases on the balance sheet that currently are recorded off balance sheet as operating leases. While this change would not impact the cash flow related to our store leases, it could adversely impact our balance sheet and could therefore impact our ability to raise financing from banks or other sources.").

[208] *See, e.g.*, Infoblox Inc., Prospectus (Form 424B4), at 28 (Apr. 19, 2012), *available at* http://www.sec.gov/Archives/edgar/data/1223862/000119312512173439/d240760d 424b4.htm, *archived at* http://perma.cc/H664-KLLV ("Any difficulties in the implementation of new or changed accounting standards could cause us to fail to meet our financial reporting obligations, which could result in regulatory discipline.").

[209] See *supra* Part III.A for a discussion of the merits of a mandatory disclosure regime.

investors or to the market in general. However, if larger firms in more mature industries that are in a good position to disclose information that is important to investors—and the market in general—are choosing not to do so, then the quasi-voluntary framework established by the JOBS Act may not be as socially desirable.[210]

Table 3 presents characteristics of issuers grouped according to the number of years of audited financials provided in the registration statement. EGCs that take advantage of the scaled financial disclosure are smaller (measured by revenues)[211] and younger than those choosing to provide three years of audited financials.[212] EGCs choosing to include only two years of audited financial statements also belong disproportionally to an industrial group that is mostly comprised of pharmaceutical companies.[213] Of the 88 EGCs that provide two years of audited financial statements, 52 (59.09%) belong to this group dominated by pharmaceuticals; on the other hand, this same group accounts for just 11 of the 110 EGCs (10%) that include three years of audited financial statements. In other words, 52 of the 63 EGCs (82.54%) belonging to this industrial group provide scaled financial disclosure.[214] As a point of comparison, we can consider the thirty-eight EGCs engaged in the computer and data processing service industry.[215] Thirty-three of these issuers (or 86.84%) include three years of financial information, while just five (or 13.16%) present two years of audited financial information.[216]

Two interesting conclusions follow from these findings. First, the results suggest that issuers choosing to disclose less information are doing so either because they lack such information or because the available information would not be useful to investors in assessing the value of the securities. This self-selection and sorting of issuers provides empirical support for a disclosure

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[210] An EGC may choose not to adopt the scaled disclosure requirements made available by the JOBS Act and disclose the information that is generally required of larger issuers. One can expect that companies with a more established history of operating results will likely feel pressure from the market to present their financial statements in a manner that is consistent with their new public peers. *See supra* Part III.D.

[211] The average (median) revenues in the fiscal year preceding the IPO for those EGCS adopting scaled disclosure $65.6 ($13.9) million, compared to $219.7 ($115.5) million for those EGCs presenting three years of audited financial statements. *See infra* Table 3, cols. (1) & (2).

[212] The average (median) age of for EGCs adopting scaled disclosure is 10.6 (8) years, compared to 16.6 (10) years for those EGCs presenting three years of audited financial statements. *See infra* Table 3, cols. (3) & (4).

[213] Issuers in the dataset were grouped according to their three-digit SIC code number. *See supra* note 170. The three-digit SIC code group number 283, Drugs, is mostly comprised of pharmaceutical companies in our sample.

[214] *See infra* Table 3, col. (5).

[215] Issuers in the dataset were grouped according to their three-digit SIC code number. *See supra* note 170. The three-digit SIC code group number 737 encompasses issuers in the Computer & Data Processing Services industry. *See Division of Corporation Finance: Standard Industrial Classification (SIC) Code List*, *supra* note 170.

[216] *See infra* Table 3, col. (6).

regime that allows issuers to weigh the benefits (e.g., lower expenses incurred) and the costs (e.g., lower offering price) of disclosing more or less information, rather than a one-size-fits-all mandatory disclosure regime.[217]

Table 3: *Financial Disclosure & IPO Characteristics*

Note: Columns (1) and (2) present the average and median revenues (in millions) for issuers during the fiscal year preceding their IPO. Columns (3) and (4) present the average and median age of issuers at their IPO. Columns (5) and (6) present the number of issuers belonging to the Standard Industrial Classification (SIC) three-digit code groups that include drug companies (283) and Computer and Data Processing Services companies (737), respectively. The table includes all IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed with the SEC after the enactment of the JOBS Act and classifies the IPOs according to the number of audited financial statements included in the prospectus.

		(1)	(2)	(3)	(4)	(5)	(6)
Years of Audited Financials		Sales ($ millions)		Age (years)		Belong to SIC three-digit Code	
	Freq.	Avg.	Med.	Avg.	Med.	283	737
Two	88	65.6	13.9	10.6	8	52	5
Three	110	219.7	115.5	16.6	10	11	33

Second, if the smallest and youngest EGCs are the ones more likely to take advantage of the scaled disclosure provisions of the JOBS Act, one could expect that these particular types of issuers may be more likely to go public in the post-JOBS period relative to the pre-JOBS period. On the other hand, larger and more mature issuers that are eligible for EGC status, but which would not take advantage of the JOBS Act's IPO on-ramp provisions, may opt instead to pursue private offerings, which are facilitated by other provisions of the JOBS Act.[218] If that is the case, one should expect to observe a change in

[217] *See supra* note 100 and accompanying text.

[218] *See supra* Part III.C.4. In addition, certain EGCs may find it more advantageous to issue securities in private, exempt offerings in order to not be pooled by investors with the greater number of younger and smaller EGCs going public after the JOBS Act.

the mix of EGC-eligible issuers going public in the post-JOBS period.[219] A review of the data reveals that there may have been such a shift in the composition of smaller issuers (i.e., those with revenues lower than $1 billion) going public in the post-JOBS period relative to the pre-JOBS period. Table 4 presents summary statistics relating to certain characteristics of small IPO issuers before and after the JOBS Act.

Table 4: *Characteristics of Small IPO Issuers*

Note: Columns (1) and (2) present the average and median revenues (in millions) for issuers during the fiscal year preceding their IPO. Column (3) presents the percentage of issuers that had under $25 million in revenues in the fiscal year preceding the IPO. Columns (4) and (5) present the average and median age of issuers at their IPO. Columns (6) and (7) present the number of issuers belonging to the SIC one-digit code group that include certain manufacturing companies (2) and to the SIC three-digit code group that include drug companies (283), respectively. The table includes all IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed with the SEC after the enactment of the JOBS Act and IPOs in the pre-JOBS period conducted by issuers that would have been eligible for EGC status under the JOBS Act.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Sales in $ millions		Sales Under	Age (years)		Belong to SIC Code	
Period	Avg.	Med.	$25M	Avg.	Med.	2xxx	283x
Post-JOBS	151.2	77.4	31.8%	14.0	10	33.3%	31.8%
Pre-JOBS	174.3	95.7	17.3%	15.8	10	19.9%	14.7%

EGCs conducting IPOs in the post-JOBS period are smaller: average revenues decrease from $174 million in the pre-JOBS period to $151 million in the post-JOBS period.[220] Although the magnitude of this drop is substantial (over 13%) the difference is not statistically significant.[221] However, the fact that the median decreases markedly in the post-JOBS period (over 19%)

[219] If a greater number of smaller EGC-eligible issuers are going public, but a greater number of the larger EGC-eligible issuers are conducting private offerings, then it would not be surprising to find that the number of IPOs by EGC-eligible issuers has not increased during the post-JOBS period as the earlier results suggest. *See supra* Part IV.B.

[220] *See supra* Table 4, col. (1).

[221] The p-value (t-statistic) for the two-tailed t-test that the average level of revenues of EGCs is the same in the pre- and post-JOBS periods is 0.3203 (0.9952).

suggests that the overall distribution may have shifted towards lower levels.[222] To illustrate this shift, consider the proportion of issuers with revenues below $25 million, which increased from 17.3% in the pre-JOBS period to 31.8% after the enactment of JOBS, a substantial and statistically significant increase.[223]

Despite the fact that the EGCs going public during the post-JOBS period are smaller, there has been little change in their age. The average age for this group decreased from 15.8 years to 14 years, but the difference is not statistically significant.[224] In addition, the median age remains unchanged at ten years, suggesting there has been no change in the distribution of the age of issuers.[225] There is, however, a noticeable shift in the type of business conducted by EGCs going public in the post-JOBS period. While in the pre-JOBS period, 19.9% belonged to the one-digit SIC code (2), which includes certain manufacturing companies, this type of issuer accounts for 33.3% of the IPOs by EGCs in the post JOBS period.[226] Notably, this shift is being driven by an increase in the number of drug companies (three-digit SIC code 283), which account for 31.8% of EGCs in the post-JOBS period after accounting only for 14.7% of the EGC IPOs in the pre-JOBS period. [227]

5. *Overview of Findings*

EGCs are generally taking advantage of the IPO on-ramp provisions of the JOBS Act. A sizable majority has taken advantage of the option to confidentially submit a draft registration statement with the SEC. In addition, EGCs have embraced the scaled disclosure requirements for the financial and executive compensation information that is included in their registration statement and prospectuses. Adoption rates have increased with the passage of time, suggesting that many issuers have decided to gauge the market's reaction to the adoption of these provisions of the JOBS Act by EGCs.[228] There

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[222] *See supra* Table 4, col. (2). The p-value (z-statistic) for the Wilcoxon rank-sum (Mann-Whitney) test that the median revenues of small issuers is the same before and after the JOBS Act is 0.0251 (2.240), confirming such a shift in the distribution.

[223] *See supra* Table 4, col. (3). The p-value (t-statistic) for the two-tailed t-test that the percentage of small issuers with revenues under $25 million is the same in the pre- and post-JOBS periods is 0.0018 (-3.1474).

[224] *See supra* Table 4, col. (4). The p-value (t-statistic) from the two-tailed t-test that the average age of EGCs is the same in the pre- and post-JOBS periods is 0.2874 (1.0654).

[225] *See supra* Table 4, col. (5).

[226] *See supra* Table 4, col. (6). The p-value (t-statistic) from the two-tailed t-test that the percentage of small issuers that belong to the one-digit SIC Code 2 is the same in the pre- and post-JOBS periods is 0.0047 (-2.8434).

[227] *See supra* Table 4, col. (7). The p-value (t-statistic) from the two-tailed t-test that the percentage of small issuers that belong to the three-digit SIC Code 283 is the same in the pre- and post-JOBS periods is 0.0002 (-3.7832).

[228] This pattern is consistent with the existing literature on legal innovation, which suggests that while certain parties may take advantage of a change in the legal rules soon

appears, however, to be a shift in the composition of EGC issuers. EGCs in the post-JOBS period are smaller and more likely to be in the pharmaceutical industry—the same type of issuers that are taking the most advantage of the JOBS Act's scaled disclosure provisions.

D. *The Costs of Going Public After JOBS*

The overwhelming adoption of the scaled disclosure provisions of the JOBS Act by EGCs makes the lack of growth in EGCs' share of IPOs in the aftermath of the JOBS Act even more puzzling because the rate of adoption suggests the benefits of the IPO on-ramp provisions are real for most of these issuers. One possible explanation for this lackluster growth in EGCs' IPOs is that the IPO costs incurred by EGCs did not decrease following the JOBS Act. To explore this possibility, the analyses presented in this part examine the effect of the JOBS Act on EGC's IPO costs.

1. *Regulatory Compliance Costs*

An issuer conducting its IPO must incur a number of direct costs related to complying with applicable rules and regulations, including accounting and legal fees and other expenses incurred in the preparation of the registration statement and prospectus.[229] By reducing the amount of information that must be disclosed in a registration statement, the JOBS Act may, in a very direct manner, help reduce the level of these professional fees that issuers must pay during an IPO. Table 5 presents the aggregate direct offering costs for the IPOs in both the pre-JOBS (Panel B) and post-JOBS period (Panel A), grouping issuers by their EGC status (in the post-JOBS period) or by revenues (in the pre-JOBS period).[230]

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thereafter, many will choose to adopt later, once the reaction of the market to a new trend becomes less uncertain. *See, e.g.*, Carlos Berdejó, *Revisiting the Voting Prohibition in Bond Workouts*, 89 TUL. L. REV. (forthcoming 2015) (manuscript at 7–18), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423607 (analyzing changes in the contractual terms of public debt in response to changes in applicable legislation); Stephen J. Choi et al., *The Evolution of Contractual Terms in Sovereign Bonds*, 4 J. LEGAL ANALYSIS 131, 175–76 (2012) (examining the evolution of contract provisions in sovereign debt contracts and in response to major exogenous shocks and events).

[229] These regulatory expenses also include fees that must be paid to the SEC and state securities regulators, FINRA, the listing exchange, as well as a number of miscellaneous expenses such as transfer agent fees and printing and engraving costs. However, the legal and accounting expenses comprise most of the regulatory compliance costs. For example, $3,050,000 of the $4,500,000 in direct expenses incurred by Tesla in connection with its IPO related to legal and accounting fees and expenses. *See* Tesla Amendment, *supra* note 45, at II-1.

[230] Issuers must disclose this information in one of the final amendments to their Registration Statement on Form S-1. *See* 17 C.F.R. § 229.511 (2014). This information is not available for three of the IPOs in the sample.

Table 5: *IPO Regulatory Compliance Costs*

Note: Columns (1) and (2) present the average and median total direct offering cost (in thousands) as disclosed by issuers in Item 13 of their Form S-1. Columns (3) and (4) present the average and median, respectively, of these costs divided by the total amount being raised in the offering. Panel A includes IPOs conducted after the enactment of the JOBS Act and classifies issuers according to their status as EGCs. IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed prior to April 2012 are excluded. Panel B includes IPOs conducted prior to the enactment of the JOBS Act and classifies issuers according to their annual revenues in the fiscal year preceding the IPO—those with revenues under $1 billion are classified as EGCs.*

Panel A: *Post-JOBS*

	(1)	(2)	(3)	(4)
	Total (in thousands)		Relative to Offering	
	Average	Median	Average	Median
EGC	3,494	3,100	3.36%	2.98%
Not EGC	5,773	5,289	1.28%	0.95%

Panel B: *Pre-JOBS*

	(1)	(2)	(3)	(4)
	Total (in thousands)		Relative to Offering	
	Average	Median	Average	Median
EGC*	3,478	3,029	3.45%	3.00%
Not EGC*	6,097	5,250	2.28%	1.46%

There is little, if any, change in the total direct offering costs incurred by smaller issuers (i.e., those with revenues below the $1 billion threshold) in the post-JOBS period relative to the pre-JOBS period. The average regulatory compliance costs for these smaller issuers remains relatively steady at just below $3.5 million.[231] To provide some context to these figures, consider the subset of larger issuers, which are not affected by those provisions of the JOBS Act that are of interest in these analyses. For these larger issuers, the average regulatory compliance costs slightly decreased from $6.10 million in the pre-JOBS period to $5.77 million in the post-JOBS period. [232]

[231] *See supra* Table 5, col. (1).
[232] *See supra* Table 5, col. (1).

If there is a correlation between the size of an offering and the aggregate costs, a better metric to assess changes in the IPO regulatory compliance costs following the enactment of the JOBS Act is the relative magnitude of these costs as a percentage of the total offering (i.e., the aggregate amount being raised in the IPO).[233] This information is provided in columns (3) and (4) of Table 5.[234] For small issuers, the average (median) direct costs seem to have gone down slightly in the post-JOBS period, from 3.45% (3.00%) to 3.36% (2.98%).[235] However, the average (median) regulatory compliance costs for bigger issuers decreases during the post-JOBS period by a more substantial amount, from 2.28% (1.46%) to 1.28% (0.95%).

The evidence thus suggests that the JOBS Act has not resulted in lower regulatory compliance costs for small issuers conducting an IPO.[236] The Appendix conducts a series of more rigorous analyses that control for shifts in issuer characteristics that may explain changes (or the lack thereof) in these compliance costs. These analyses confirm that there has been no significant decrease in the regulatory compliance costs of smaller issuers following the enactment of the JOBS Act.[237]

2. *Underwriters' Spread*

A major component of the cost of conducting an IPO is the underwriters' spread, namely the difference between the price paid by the underwriters to the issuer for the IPO securities and the offering price at which the underwriters sell those securities to the initial purchasers during the IPO.[238] Generally, IPOs conducted by EGCs should be characterized by higher underwriting spreads given the relative small size of these issuers, as well as the higher risk in the market for their securities.[239] The data confirms this: in the more recent period, for example, the average (median) underwriting spread for EGCs is 6.79% (7.00%), while for larger companies the average (median) spread is 5.35% (5.50%).[240]

A more interesting question is whether certain provisions of the JOBS Act may have had an unintended effect on the underwriting spread paid by EGCs. *Ex ante*, it is not clear the effects, if any, that the various provisions of the

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[233] *See supra* note 46 and accompanying text.

[234] One can note that these direct costs represent a higher proportion of the total offering size for smaller issuers, which highlights the quasi-fixed nature of these costs.

[235] This decrease in the average regulatory costs for small issuers is not statistically significant.

[236] It is worth noting that perhaps in the long run, these costs will eventually decrease for EGCs as attorneys and accountants familiarize themselves with the applicable rules and prior experiences facilitate providing tailored advise to clients.

[237] *See infra* Part A of the Appendix.

[238] *See supra* Part II.A.2.

[239] *See supra* notes 55–57 and accompanying text.

[240] *See infra* Table 6, Panel A, col.s (1) & (2).

JOBS Act may have on the average gross spread demanded by underwriters participating in the IPOs of EGCs. On one hand, more limited disclosure by EGCs (financial and otherwise) could make any securities offered by these issuers harder to market to public investors, who may also perceive them as more uncertain propositions.[241] If this makes underwriting an offering more risky (e.g., reducing the probability of underwriters being able to sell their allotted IPO shares quickly), then the underwriters may seek additional compensation by demanding a higher underwriting spread. On the other hand, EGCs' ability to initially communicate confidentially with the SEC and test the waters with certain investors could allow underwriters to address potential problems or, if necessary, abandon an offer, at an earlier stage, thus reducing their risks.[242]

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[241] *See supra* notes 56–57.

[242] *See* Usha Rodrigues, *The Effect of the JOBS Act on Underwriting Spreads*, 102 KY. L.J. 925, 931–33 (2014).

Table 6: *Underwriting Spreads*

Note: Columns (1) and (2) present the average and median underwriters' spread, respectively. The spread is calculated by dividing the underwriter commission per share by the offering price per share. Panel A includes IPOs conducted after the enactment of the JOBS Act and classifies issuers according to their status as EGCs. IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed prior to April 2012 are excluded. Panel B includes IPOs conducted prior to the enactment of the JOBS Act and classifies issuers according to their annual revenues in the fiscal year preceding the IPO—those with revenues under $1 billion are classified as EGCs.*

Panel A: *Post-JOBS*

	(1) Average	(2) Median
EGCs	6.79%	7.00%
Non EGCs	5.35%	5.50%

Panel B: *Pre-JOBS*

	(1) Average	(2) Median
EGC*	6.81%	7.00%
Not EGC*	5.63%	5.88%

The data provides no evidence of any change in the underwriting spread paid by EGCs following the enactment of the JOBS Act. The average (median) underwriting spread paid by smaller issuers is unchanged at about 6.81% (7.00%) in the pre- and post-JOBS periods.[243] To provide a baseline for

[243] *See supra* Table 6, cols. (1) & (2). The result is robust to including IPOs conducted in the post-JOBS for which the initial draft Form S-1 was filed prior to the effectiveness of the JOBS Act—the average (median) underwriting spreads are similar, 6.81% (7.00%). A contemporaneous study finds that IPOs by EGCs that file a confidential draft Form S-1 with the SEC are characterized by lower underwriting spreads. *See* Rodrigues, *supra* note 242, at 940–42. However, in the sample analyzed in this Article, there are no significant differences in the spreads for EGCs that submit a confidential S-1 and those that do not. In fact, the spreads are slightly greater for the former. Limiting our analysis to the time frame analyzed by Rodrigues (i.e., through July 27, 2013), *see id.* at 927, yields similar results: the average spread for those filing confidentially is 6.83% while the average spread for those who do not is 6.89%, a small and statistically insignificant difference. Though it is

comparison, one can look at the changes in the underwriters' spread for larger, non-EGC issuers and focus on the relative differences between small and large issuers, both before and after the enactment of the JOBS Act. The average (median) underwriting spread paid by larger issuers decreases from 5.63% (5.88%) in the pre-JOBS period to 5.35% (5.50%) in the post-JOBS period.[244] Although it appears that the gap in the underwriting spread paid by small and large issuers has slightly widened following the enactment of the JOBS Act, the relative differences are not significant.[245]

The Appendix conducts a series of more rigorous analyses that control for additional factors that may explain changes in the underwriters' spread. These analyses confirm that there has been no significant decrease in the gross spread demanded by underwriters participating in the IPOs of smaller issuers following the enactment of the JOBS Act.[246]

3. *IPO Underpricing*

The results thus far indicate that the JOBS Act has had little effect on the direct IPO costs (i.e., regulatory compliance costs and underwriter fees) incurred by small issuers.[247] These direct costs, however, represent just a fraction of the total costs associated with conducting an IPO. Another major component of an issuer's total IPO costs is underpricing, i.e., the difference between the offering price and the closing price of the stock after the first day of trading.[248] The theoretical models developed to analyze IPO underpricing suggest that not only should the underpricing for EGCs be higher than for non-

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difficult to ascertain what factors give rise to these conflicting results, it is worth noting that the proportion of EGCs filing confidentially is substantially lower in the sample analyzed by Rodrigues (41.5%) than in the sample analyzed herein. *See supra* Part IV.C.1.

[244] *See supra* Table 6.

[245] One possible explanation for this result is perhaps not enough time has passed since the enactment of the Act for underwriters to converge to new contractual terms. In addition, the little variance that exists in the distribution of underwriting spreads may make pre-existing standards relating to the modal gross spread stickier. *See, e.g.*, Robert S. Hansen, *Do Investment Banks Compete in IPOs?: The Advent of the "7% Plus Contract*,*"* 59 J. FIN. ECON. 313, 319–20 (2001) (documenting that underwriter spreads average 6.98% but strongly cluster at 7%, which corresponds to the underwriting spread for smaller issuers). If the JOBS Act has in fact made the underwriting of IPOs by smaller issuers riskier, there is an alternative device (besides a higher underwriting spread) that underwriters may employ to ensure that all shares being offered in the IPO are purchased by public investors, thus reducing the risk being borne by the underwriters. One such alternative is to set a lower offering price—if the IPO securities are priced low enough, enough investors will be willing to buy. The next set of analyses examines changes in the underpricing of IPOs following the JOBS Act. *See infra* Part IV.D.3.

[246] *See infra* Part A of the Appendix.

[247] *See supra* Parts IV.D.1–2.

[248] *See supra* Part II.A.3.

EGCs, but also that the underpricing of IPOs conducted by EGCs should be higher in the post-JOBS period than in the pre-JOBS period.[249]

One particular concern is that some of the provisions of the JOBS Act may lead to greater informational asymmetries relating to the prospects of the issuer, which can play a role in determining the underpricing of an IPO.[250] For example, the scaled financial and executive compensation disclosure provisions of the JOBS Act could widen the informational gap between the issuer and market participants in general. In addition, those provisions of the JOBS Act that allow EGCs to "test the waters," can lead to greater informational asymmetries across investors. Though "testing the waters" may provide the issuer with a sense of whether particular investors are interested in participating in the IPO, it may also widen the information gap between investors if some of the information provided to these investors approached by the issuer is not later disclosed in the registration statement or in a free writing prospectus.[251] This could further exacerbate the underpricing of IPOs, as uninformed investors demand lower prices from EGCs to compensate for the winner's curse.[252] Table 7 presents average and median levels of underpricing for the IPOs in the sample, measured as the percentage difference between the price at which the IPO shares were sold to investors (i.e., the offering price) and the first-day closing price.[253]

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[249] *See supra* Parts II.A.3, III.D.

[250] *See supra* notes 68–70 and accompanying text (discussing the factors affecting the level of underpricing in an IPO).

[251] This is mainly a concern for IPOs. EGCs conducting a seasoned offering may be subject to Regulation FD, which limits the selective disclosure of material non-public information. *See* Regulation FD Rule 100, 17 C.F.R. § 243.100 (2014).

[252] *See supra* notes 66–68 and accompanying text (discussing the factors affecting the level of underpricing in an IPO).

[253] This is the standard methodology used in the finance literature to calculate underpricing. *See* Ljungqvist, *supra* note 58, at 381.

Table 7: *Underpricing*

Note: Columns (1) and (2) present the average and median IPO underpricing, respectively, calculated as (i) the closing price on the IPO date minus the offering price divided by (ii) the offering price. Panel A includes IPOs conducted after the enactment of the JOBS Act and classifies issuers according to their status as EGCs. IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed prior to April 2012 are excluded. Panel B includes IPOs conducted prior to the enactment of the JOBS Act and classifies issuers according to their annual revenues in the fiscal year preceding the IPO—those with revenues under $1 billion are classified as EGCs.*

Panel A: *Post-JOBS*

	(1) Average	(2) Median
EGC	24.00%	16.25%
Not EGC	10.55%	5.59%

Panel B: *Pre-JOBS*

	(1) Average	(2) Median
EGC*	14.50%	8.22%
Not EGC*	8.44%	4.15%

Historically, IPO underpricing has been greater for smaller issuers than for larger issuers, a fact confirmed in the dataset analyzed in this Article.[254] The key question, however, is whether there has been any noticeable change in the underpricing of IPOs of those smaller issuers that qualify as EGCs following the enactment of the JOBS Act. The average underpricing for these smaller issuers increased from 14.50% in the pre-JOBS period to 24.00% in the post-JOBS period, a substantial and statistically significant increase of 9.5 percentage points.[255] To confirm that a few outliers are not driving this result,

[254] *See supra* Table 7, col. (1). The fact that underpricing levels are greater in IPOs conducted by issuers with lower levels of revenues is well documented. *See, e.g.*, Loughran & Ritter, *supra* note 172, at 17; *see also supra* note 69 and accompanying text.

[255] The increase of 9.5 percentage points represents over 65% of the pre-JOBS average. *See supra* Table 7, col. (1). The p-value (t-statistic) from the two-tailed t-test that the mean underpricing for EGCs is the same in the pre- and post-JOBS periods is 0.0021 (-3.1028). The difference if we include all IPOs by EGCs in the post-JOBS period

one can compare differences in the median underpricing. The increase in the median IPO underpricing for EGCs is even more striking, as it almost doubles in the post-JOBS period relative to the pre-JOBS period.[256] Certainly, a number of market factors can drive the underpricing of IPOs. To partially control for such extraneous factors, we can look at the changes in the underpricing of IPOs for larger issuers (which do not qualify as EGCs) following the enactment of the JOBS Act. The increase in the average underpricing for these larger issuers—from 8.44% in the pre-JOBS period to 10.55% in the post-JOBS period—is substantially smaller (2.11 percentage points) and is not statistically significant.[257]

As a result, the difference in the average (median) underpricing of smaller issuers relative to larger issuers more than doubles from 6.06 (4.07) percentage points in the pre-JOBS period to 13.45 (10.66) percentage points in the post-JOBS period.[258] The striking and statistically significant increase in this gap suggests that IPO underpricing has increased for smaller issuers following the enactment of the JOBS Act. The Appendix presents a series of more rigorous analyses that control for additional factors that may explain these changes in underpricing levels. These analyses confirm that there has been a statistically significant increase in the underpricing of smaller issuers relative to their larger counterparts following the enactment of the JOBS Act.[259]

4. *Overview of Findings*

The evidence presented thus far shows that the costs associated with going public have not decreased for the smaller issuers that the IPO on-ramp provisions of the JOBS Act intended to help. This is true for the fixed and variable direct costs (e.g., legal and accounting fees and the underwriting spread), as well as for the indirect costs (e.g., underpricing) associated with conducting an IPO. In fact, the evidence suggests that IPO underpricing may have increased for smaller issuers, perhaps a market response to the increased

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(regardless of when the initial Form S-1 was filed) is 14.50 to 22.83, with a p-value (t-statistic) of 0.0047 (-2.8444).

[256] *See supra* Table 7, col. (2).

[257] The p-value (t-statistic) from the two-tailed t-test that the mean underpricing for EGCs is the same in the pre- and post-JOBS periods is 0.6884 (-0.4000). Similarly, the median underpricing for larger issuers does not change substantially in the post-JOBS period. *See supra* Table 7, col. (2).

[258] The difference in mean underpricing across issuers during the pre-JOBS period is not statistically significant. The p-value (t-statistic) from the two-tailed t-test that the mean underpricing for EGCs is the same as the mean underpricing for non-EGCs in the pre- and post-JOBS periods is 0.2257 (-1.2158). On the other hand, the difference in mean underpricing across issuers during the post-JOBS period is statistically significant. The p-value (t-statistic) from the two-tailed t-test that the mean underpricing for EGCs is the same as the mean underpricing for non-EGCs in the pre- and post-JOBS periods is 0.0122 (-2.5271).

[259] *See infra* notes 282–85 and accompanying text.

riskiness associated with these EGCs following the enactment of the JOBS Act. This provides an explanation for the lack of growth in EGCs' share of IPOs in the post-JOBS period.

E. *Being Public After JOBS*

The JOBS Act does not only provide exemptions to EGCs during their IPOs. EGCs also have the option of continuing to provide two rather than three years of audited financial statements and limited executive compensation information in the reports they must file subsequent to their IPOs (such as proxy statements and annual reports on Form 10-K), and they are exempted from the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act.[260] If the JOBS Act does reduce the costs of being public, then issuers will take that into account when deciding whether or not to conduct their IPO.[261] In particular, given the costs associated with the Sarbanes-Oxley Act Section 404 requirement, one may expect issuers to take advantage of this provision of the JOBS Act as long as they qualify as EGCs.[262]

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[260] *See supra* notes 127–31 and accompanying text.

[261] There is evidence that suggests that these ongoing savings could be substantial. In an event study, Professor Dharmapala and Professor Khanna found positive and statistically significant abnormal returns for already publicly-traded issuers that qualified as EGCs relative to a set of control firms. *See* Dhammika Dharmapala & Vikramaditya S. Khanna, *The Costs and Benefits of Mandatory Securities Regulation: Evidence from Market Reactions to the JOBS Act of 2012*, at 4 (Coase-Sandor Institute for Law and Economics, Working Paper No. 701, 2014), *available at* http://ssrn.com/abstract=2293167, *archived at* http://perma.cc/7W8F-ECWT. The authors argue that this evidence suggests that the value to investors of the disclosure and compliance obligations relaxed under the JOBS Act is outweighed by the associated compliance costs. *See id.* at 5–6.

[262] *See supra* notes 77–78 and accompanying text. Issuers who initially qualified as EGCs but no longer do so as of their second annual report note the increased costs associated with the loss of this exemption. *See, e.g.*, Wageworks, Inc., Annual Report (Form 10-K), at 24 (Feb. 27, 2014) [hereinafter Wageworks Annual Report], *available at* http://www.sec.gov/Archives/edgar/data/1158863/000119312514072956/d658333d10k.ht m, *archived at* http://perma.cc/Z8DY-9XXF ("We were an 'emerging growth company' until December 31, 2013, at which point we became a large accelerated filer and became subject to the requirements of Section 404 and other provisions of Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, for our audited 2013 financials. . . . We have experienced an increase in legal, accounting and other professional fees in 2013 associated with preparing our control environment to be compliant with Section 404 and other provisions of the Sarbanes-Oxley Act. If these requirements divert our management's attention from other business concerns, they could have a material adverse effect on our results of operations, financial condition, business and prospects."); Diamondback Energy, Inc., Annual Report (Form 10-K), at 43 (Feb. 19, 2014), *available at* http://ir.diamondbackenergy.com/secfiling.cfm?filingID=1539838-14-7&CIK=1539838, *archived at* http://perma.cc/8FEA-4CT3 ("Since the market value of our common stock held by non-affiliates exceeded $700 million as of June 30, 2013, we ceased to be an 'emerging growth company' as of December 31, 2013 and, as a result, expect to incur significant additional expenses and devote substantial management effort toward ensuring

Analyzing the disclosure choices made by the issuers that went public as EGCs in 2012 can help assess the impact of the JOBS Act on EGCs after their IPOs. These forty-two issuers are noteworthy because they have been Exchange Act reporting companies for more than twelve months by the time of their second annual report on Form 10-K.[263] Two of these forty-two EGCs were no longer public companies by the time their second annual report would have been filed. Of the forty issuers that were still public, seventeen (or 42.5%) no longer qualified as EGCs.[264]

Of the twenty-three public issuers that still qualified for EGC status, one also qualified for SRC status and another one was a non-accelerated filer. Thus, these two issuers would have been exempted from the Sarbanes-Oxley Section 404 requirements even before the enactment of the JOBS Act.[265] All except one of these twenty-three EGCs did not include the auditor's attestation on the effectiveness of the issuer's internal controls over financial reporting

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compliance with those requirements applicable to companies that are not 'emerging growth companies,' including Section 404 of the Sarbanes-Oxley Act.").

[263] This set of analyses focuses on IPOs that took place in 2012 because the issuers conducting such IPOs will have (i) filed their second annual report on Form 10-K by the summer of 2014 (i.e., when this study was being finalized) and (ii) been reporting companies for at least twelve months by the time they filed their second Form 10-K. Those two conditions make issuers ineligible for exemptions from the Section 404 Sarbanes-Oxley Act attestation requirements that were in place before the JOBS Act. *See supra* notes 127–31 and accompanying text.

[264] To determine an issuers EGC status, I reviewed the risk factors section of the issuer's second annual report on 10-K filed with the SEC to verify whether the issuer still discussed its status as an EGC and the associated risks for investors. For issuers that did not include such disclosure, I reviewed other sections of the annual report, as well as earlier filings with the SEC, to determine the reason underlying the issuer's change in EGC status. Fifteen of these issuers lost their eligibility by becoming large accelerated filers (i.e., having a public float greater than $700 million). *See, e.g.*, Wageworks Annual Report, *supra* note 262, at I (checking the "Large Accelerated Filer" box and disclosing that the issuer's public float as of the most recently completed second fiscal quarter was $924,131,723). One issuer initially lost its eligibility for EGC status by having more than $1 billion in revenues during its first year as a public issuer (and was also a large accelerated filer when it filed its second annual report). *See* Restoration Hardware Holdings, Inc., Annual Report (Form 10-K), at 46 (Apr. 25, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1528849/000119312513178723/d462171d10k.htm, *archived at* http://perma.cc/25UN-GEJK (disclosing net revenues of $1,193,046). One issuer that was not a large accelerated filer as of the time of its second annual report had lost its eligibility because it issued more than $1 billion in non-convertible debt following its IPO. *See* Midstates Petroleum Company, Inc., Annual Report (Form 10-K), at F-26 to -27 (Mar. 21, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1533924/000104746914002865/a2218798z10-k.htm, *archived at* http://perma.cc/JD9D-3SQY (describing issuances of non-convertible debt offerings exceeding in $1 billion in the aggregate).

[265] *See supra* notes 130–31 and accompanying text (discussing Dodd-Frank exemption for non-accelerated filers). In addition, the issuer that qualified as a SRC would also have been eligible for scaled financial and compensation disclosure. *See supra* Part III.B.

otherwise required by Section 404 of the Sarbanes-Oxley Act. It is worth noting that the EGC that did include such auditor attestation was the first EGC to file its second Form 10-K and had a reported public float of $680 million, quite close to the threshold for becoming a large accelerated filer, an indication that it will likely not be eligible for EGC status for its third annual report.[266]

All of these twenty-three EGCs include three years of audited financial statements in their annual report even though under the JOBS Act they are allowed to include two years. This is not surprising given the fact that the costs of preparing the information for the earliest of the three years have already been incurred in preparing preceding reports, including the registration statement on Form S-1.[267] However, fifteen of the EGCs (or 65%) do include only two tables of executive compensation information, rather than the standard five, as allowed by the JOBS Act.[268]

A number of interesting conclusions can be drawn from these results. First, the availability of scaled disclosure requirements for periodic reports appears less valuable for EGCs than the availability of scaled disclosure requirements at the IPO stage. Having said that, the exemption from Section 404 of the Sarbanes-Oxley Act, which becomes operative during the second year following the IPO, is perhaps the most beneficial exemption under the JOBS Act. However, the fact that a substantial number of EGCs lose their status and eligibility for these exemptions within two years of their IPOs complicates how the ongoing exemptions made available to public EGCs under the JOBS Act may affect an EGC's going public decisions in the first place.

V. CONCLUSION

The empirical evidence presented in this Article highlights both the successes and shortcomings of the JOBS Act in improving the access of small issuers to the public capital markets. EGCs have been increasingly taking advantage of the scaled disclosure requirements made available to them under the JOBS Act. Notably, EGCs that take advantage of these provisions of the JOBS Act are smaller, younger, and more likely to belong to drug

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[266] See Infoblox Inc., Annual Report (Form 10-K), at 111 (Sept. 30, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1223862/000122386213000026/blox201373110-k.htm, *archived at* http://perma.cc/RL7V-933Z ("Our independent registered public accounting firm has issued an attestation report regarding its assessment of our internal control over financial reporting as of July 31, 2013 . . . .").

[267] *See supra* notes 28–32 and accompanying text.

[268] *See supra* notes 119–21 and accompanying text. One concern is that insiders may be capturing this particular disclosure mechanism to further their own financial interests at the expense of shareholders. *See supra* notes 95–96 and accompanying text. EGCs that include two years of information have an average (median) inside ownership (i.e., directors and management) of 31.1 % (33.4%), while those including more than two tables have an average (median) inside ownership of 42.4% (45.2%). Overall, for the 23 EGCs the average (median) inside ownership is 34.7% (33.6%).

manufacturing industries, a pattern that could lend support to the adoption of a more flexible securities regulation framework that allows issuers to select from a menu of disclosure regimes.

Despite the fact that EGCs have increasingly adopted the scaled disclosure provisions of the JOBS Act, there has not been an increase in the number of IPOs conducted by these smaller issuers. The findings in this Article suggest several possible explanations for these seemingly contradicting results: (1) the direct costs of conducting an IPO for EGCs have not decreased, (2) certain indirect costs may have actually increased following the enactment of the Act, and (3) some issuers eligible for EGC status may instead be opting to raise capital in private offerings, a process which is facilitated by another set of provisions of the JOBS Act. Interestingly, the data reveals a shift in the characteristics of issuers going public. EGCs going public in the post-JOBS period are smaller and more likely to belong to the drug manufacturing industry than those EGCs that went public in the pre-JOBS period. This shift in issuer characteristics is not surprising given the types of EGCs that seem to be taking advantage of the scaled disclosure made available by the JOBS Act. Future research can examine the overall effect of the JOBS Act on private placements conducted by certain EGCs, particularly those larger ones which are not taking advantage of the scaled disclosure provisions of the JOBS Act.[269]

Certain caveats to these findings should be stressed. First, market paradigms may shift as issuers, auditors, lawyers, underwriters, and investors adjust to the new legal framework introduced by the JOBS Act. As a result, the different components of the IPO costs examined in the Article may behave differently with the passage of time, or investors could become more or less receptive to the adoption by EGCs of the scaled disclosures permitted by the JOBS Act. Second, a significant portion of the benefits conferred upon EGCs by the JOBS Act will be experienced by issuers on an ongoing basis following their IPOs, through lower costs of regulatory compliance. Although measuring these post-IPO benefits is difficult to do at the IPO stage (and the results in this Article suggest that for many EGCs these benefits are short-lived), future research could attempt to do so by focusing on the performance and market valuation of securities issued by EGCs that are trading in the secondary market. Such research could also examine the effects of the JOBS Act on the ability of EGCs to raise capital following their IPOs via seasoned equity offerings of securities or the issuance of public or private debt.

[269] Recent anecdotal evidence indicates that an uncharacteristically high number of large venture-capital-backed issuers are remaining private. *See, e.g.*, Yuliya Chernova, *While IPOs Soar, Many Firms Prefer to Stay Away*, WALL ST. J., Oct. 9, 2014, at A1, A6.

APPENDIX : COSTS OF GOING PUBLIC BEFORE AND AFTER THE JOBS ACT

The results presented in Part IV.D indicate that while EGCs' direct costs of conducting an IPO (i.e., regulatory compliance costs and the underwriters' spread) have not decreased following the JOBS Act, the indirect costs (namely, underpricing) may have increased. To examine changes in the costs of going public before and after the enactment of the JOBS Act in a more rigorous manner, one can estimate the following specification:

$$Y_i = \alpha + \beta_1 EGC_i + \beta_2 PostJOBS_i + \beta_3 EGC_i * PostJOBS_i + \Sigma\beta_{4j} Z_{ji} + \varepsilon_i \quad (1)$$

where Y_i, is the outcome of interest; EGC_i is an indicator variable equal to 1 if the issuer's revenues for the fiscal year preceding the IPO were less than $1 billion dollars; $Post\text{-}JOBS_i$ is an indicator variable equal to 1 if the IPO took place following the enactment of the JOBS Act (April 5, 2012); $EGC_i * PostJOBS_i$ is an interaction term between the variables EGC and Post-JOBS; Z_{ji} contains a set of issuer and IPO characteristics,[270] including Revenues,[271] Offering Proceeds,[272] and industry fixed effects,[273] and ε_i is a mean-zero stochastic error term. The purpose of these regressions is to control for various factors that may affect the level of these costs and thus provide reassurance that changes in issuer characteristics documented earlier are not driving the results presented elsewhere in the Article. [274]

A. *Regulatory Compliance Costs and Underwriters' Spread*

The results presented earlier revealed that there has been no significant change in the average regulatory compliance costs for EGCs conducting an IPO following the JOBS Act.[275] Similarly, there have been no changes in the gross spread demanded by underwriters in the IPOs conducted by EGCs.[276] To examine differences in these direct costs in IPOs conducted by small and large issuers before and after the enactment of the JOBS Act more thoroughly, one can estimate equation (1) using as the outcome of interest $RegCost_i$, the direct offering costs as disclosed by the issuer in its registration statement on Form

[270] Controlling for these IPO and issuer characteristics reassure us that any observed inter-temporal differences are not merely being driven by changes in the composition of issuers going public.

[271] To control for the size of the issuer, the specification includes the natural logarithm of 1 plus the total revenues of the issuer for the fiscal year preceding the IPO.

[272] To control for the size of the offering, the specification includes the natural logarithm of the aggregate proceeds in the IPO (excluding underwriters' exercise of their overallotment option).

[273] The industry fixed-effects are based on the Standard Industrial Classification one-digit code. Four of the nine one-digit code groups have more than forty observations in the sample (i.e., 2, 3, 5, 6, and 7). The remaining five groups, which have a total of fifty-six observations in the sample, are aggregated into one group.

[274] *See supra* notes 219–27 and accompanying text.

[275] *See supra* Part IV.D.1.

[276] *See supra* Part IV.D.2.

S-1[277] divided by the aggregate amount of the offering, or $Spread_i$, the underwriters' gross spread.[278] The results of the baseline specification for equation (1) using these outcome variables are presented in in columns (1)–(3) of Table A1.[279]

To confirm the results presented in Part IV.D.1 and Part IV.D.2, we can examine the coefficient sum *PostJOBS* + *EGC*PostJOBS*, which indicates whether there has been any change in the direct offering costs (columns (1) and (2)) or the gross spread (column (3)) for EGCs conducting IPOs in the post-JOBS period relative to the pre-JOBS period. For the three outcome variables presented in Table A1 the sum is close to zero and not statistically significant, confirming that there has been no change in these costs for small issuers in the post-JOBS period. The interaction term itself, *EGC*PostJOBS*, measures whether differences in these costs between large and smaller issuers has increased or decreased in the post-JOBS period relative to the pre-JOBS period. If the JOBS Act had in fact reduced these direct offering costs for the smaller issuers the Act intended to benefit, this interaction term would be negative and significant. However, the interaction terms for the three specifications are positive, and not statistically significant.

B. *Underpricing of IPOs*

The results presented in Part IV.D.3 revealed that the average underpricing of IPOs by issuers eligible for EGC status increased following the JOBS Act at a rate higher than the increase in the underpricing for IPOs conducted by their larger counterparts.[280] To examine changes in the underpricing of IPOs conducted by small and large issuers before and after the enactment of the JOBS Act in a more rigorous manner, one can estimate equation (1) using as the outcome of interest $IPORet_i$, defined as (i) the closing price on the IPO day for stock *i* minus the stock's offering price divided by (ii) the offering price for stock *i.* The results of the baseline specification for equation (1) using $IPORet_i$ as the outcome of interest are presented in column (1) of Table A2.[281]

Let us focus first on the coefficients for the variables *EGC*, *Post-JOBS* and their interaction. *EGC* measures the difference in first day IPO returns between small and large issuers during the pre-JOBS period. The coefficient on this variable is positive, but not statistically significant, indicating that

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[277] For a description of these regulatory compliance costs, see *supra* notes 173, 229–30 and accompanying text.

[278] For a discussion of the gross spread demanded by underwriters in an offering, see *supra* notes 48–53 and accompanying text.

[279] As in earlier analyses, IPOs by EGCs in which the initial draft Form S-1 was filed after the enactment of the JOBS Act are excluded.

[280] *See supra* notes 253–57 and accompanying text.

[281] As in earlier analyses, IPOs by EGCs in which the initial draft Form S-1 was filed after the enactment of the JOBS Act are excluded. However, the results are robust to the inclusion of this subset of IPOs. *See infra* text accompanying notes 283–85.

underpricing for smaller issuers may have been slightly higher than underpricing for larger issuers during the pre-JOBS period in the sample.[282] The coefficient on *Post-JOBS* measures the difference in first day returns for IPOs conducted by larger issuers in the pre- and post-JOBS periods. Consistent with the more general results presented earlier, this coefficient is small and is not statistically significant, indicating that the underpricing for larger issuers has not changed after the enactment of the JOBS Act. Finally, the coefficient sum "*PostJOBS + EGC*PostJOBS*" measures whether the underpricing for IPOs of smaller issuers has increased in the post-JOBS period relative to the pre-JOBS period. The sum is positive, large in magnitude and statistically significant, indicating that the underpricing of smaller issuers has increased significantly in the post-JOBS period. The interaction term itself, *EGC*PostJOBS*, measures whether the gap in underpricing between large and smaller issuers has increased or decreased in the post-JOBS period relative to the pre-JOBS period. The interaction term is positive, large in magnitude, and statistically significant.

These results are robust to winsorizing the outcome variable at the 1% level,[283] excluding the Facebook and Twitter IPOs,[284] and including those IPOs by EGCs in the post-JOBS period in which the initial Form S-1 was filed in the pre-JOBS period.[285]

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[282] This relationship between underpricing and issuer size has been documented in the underpricing literature. *See supra* note 254.

[283] *See infra* Table A2, col. (2). Winsorising is a technique employed to reduce the influence of outliers in statistical analyses, thus allowing more robust inferences. A 99% Winsorization sets all data points that fall below the 1st percentile level to the value of the 1st percentile, while data above the 99th percentile is set to the 99th percentile. This provides some reassurance that that the results are not being driven by outliers.

[284] *See infra* Table A2, col. (3). The Facebook and Twitter IPOs were both high profile and characterized by low (Facebook: 0.61%) and high (Twitter: 72.69%) levels of underpricing. Both took place after the enactment of the JOBS Act, and Facebook, unlike Twitter, was not an EGC. However, the results are not being driven by these IPOs.

[285] *See infra* Table A2, col. (4).

Table A1: *Direct Offering Costs in Pre- and Post-JOBS Periods*

Notes: Robust standard errors in brackets (* significant at 10%; ** significant at 5%; *** significant at 1%). The outcome in column (1) is the natural logarithm of the total regulatory compliance costs as disclosed by the issuer in their registration statement on Form S-1. The outcome in column (2) is the total regulatory compliance costs divided by the aggregate offering amount. The outcome in column (3) is the underwriters' gross spread as disclosed in the IPO prospectus. The explanatory variables of interest are: (i) *Small*, an indicator variable equal to 1 if the revenues for the issuer in the fiscal year preceding the IPO are less than $1 billion dollars; (ii) *Post-JOBS*, an indicator variable equal to 1 if the IPO took place following the enactment of the JOBS Act (April 5, 2012); and (iii) and interaction term between these two variables. The estimated specifications also include the following additional controls: (i) *LogRevenues*, the natural logarithm of 1 plus the issuer's revenues in the full fiscal year preceding the IPO, (ii) *LogProceeds*, the natural logarithm of the aggregate principal amount the proceeds received by the issuer in the IPO (excluding exercises of underwriter's over-allotment option) and (iii) a set of industry groups fixed effects based on the one-digit Standard Industrial Classification code (see text for more details). IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed prior to April 5, 2012, are excluded.

	(1)	(2)	(3)
	Offering Costs (Log)	Offering Cost (scaled)	Gross Spread
Small	-0.1960*	-0.0111***	0.0041***
	[0.109]	[0.0039]	[0.0015]
Post-JOBS	-0.1690	-0.0061	-0.0005
	[0.121]	[0.0042]	[0.0021]
Small*Post	0.1590	0.0036	0.0008
	[0.127]	[0.0047]	[0.0021]
LogRevenue	0.0139***	0.0003*	0.0001**
	[0.0037]	[0.0002]	[0.0001]
LogProceeds	0.2510***	-0.0182***	-0.0070***
	[0.0320]	[0.00194]	[0.0007]
Mean Outcome	15.0461	0.0320	0.0660
Observations	414	414	417
R-squared	0.368	0.423	0.684

Table A2: *IPO Returns During the Pre- and Post-JOBS Periods*

Notes: Robust standard errors in brackets (* significant at 10%; ** significant at 5%; *** significant at 1%). The outcome in columns (1)–(4) is the first day return of stock *i*, defined as the closing price on the IPO day for stock *i* and the stock's offering price, except that in column (2) the outcome variable is winsorized at 1%. The explanatory variables of interest are: (i) *Small*, an indicator variable equal to 1 if the revenues for the issuer in the fiscal year preceding the IPO are less than $1 billion dollars; (ii) *Post-JOBS*, an indicator variable equal to 1 if the IPO took place following the enactment of the JOBS Act (April 5, 2012); and (iii) and interaction term between these two variables. The estimated specifications also include the following additional controls: (i) *LogRevenues*, the natural logarithm of 1 plus the issuer's revenues in the full fiscal year preceding the IPO, (ii) *LogProceeds*, the natural logarithm of the aggregate principal amount the proceeds received by the issuer in the IPO (excluding exercises of underwriter's over-allotment option), and (iii) a set of industry groups fixed effects based on the one-digit Standard Industrial Classification code (see text for more details). Columns (1)–(3) exclude IPOs conducted by issuers identified as EGCs in which the initial registration statement on Form S-1 was filed prior to April 5, 2012. In addition, column (3) excludes the IPOs conducted by Twitter, Inc. and Facebook, Inc.

	(1)	(2)	(3)	(4)
	Baseline Specification	Winsor (1%)	Excludes FB, TWTR	All IPOs Post-JOBS
Small	0.0854	0.0849	0.0861	0.0926
	[0.0580]	[0.0578]	[0.0587]	[0.0579]
Post-JOBS	-0.0120	-0.0124	-0.0049	-0.0167
	[0.0542]	[0.0523]	[0.0544]	[0.0546]
Small*Post	0.115*	0.109*	0.106*	0.104*
	[0.0610]	[0.0584]	[0.0612]	[0.0608]
LogRevenue	-0.0020	-0.0025	-0.0021	-0.0016
	[0.0032]	[0.0031]	[0.0032]	[0.0031]
LogProceeds	0.0372**	0.0363*	0.0384**	0.0454**
	[0.0187]	[0.0185]	[0.0194]	[0.0186]
Mean Outcome	0.1830	0.1830	0.1821	0.1810
Observations	417	417	415	448
R-squared	0.125	0.137	0.122	0.119