The JOBS Act and Executive Compensation

On Thursday, April 5, 2012, President Obama signed into law H.R. 3606, the "Jumpstart Our Business Startups ("JOBS") Act." Primarily aimed at stimulating capital-raising transactions by small, developing businesses, the Act also contains provisions that (i) simplify the executive compensation compliance and disclosure requirements for certain growth-oriented companies and (ii) eliminate the risk that a privately-held company with a broad-based equity compensation program will have to "go public" before it is ready.

This Thoughtful Pay Alert summarizes these provisions and explains their potential impact for pre-IPO and newly-public companies.

Emerging Growth Companies

Title I of the JOBS Act creates a new category of issuer – the emerging growth company. To stimulate the initial public offering of equity securities by privately-held companies, the Act creates incentives for them by relaxing the Securities Act registration requirements and Exchange Act reporting requirements for any company that has not previously sold securities to the public pursuant to a registered offering before December 8, 2011, and which had annual gross revenue of less than $1 billion (adjusted for inflation every five years) in its previous fiscal year (an "Emerging Growth Company"). An Emerging Growth Company retains this status until the earliest to occur of:

- its annual gross revenue in its current fiscal year is $1 billion or more;
- the end of the fiscal year in which the fifth anniversary of its initial public offering of equity securities takes place;
- the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or
- the date on which it becomes a "large accelerated filer" (that is, a company with common equity "public float" of $700 million and that has been publicly reporting for at least one year).

Streamlined Process for Registering Securities

To streamline the process for "going public," an Emerging Growth Company is permitted to file its offering documents with the Securities and Exchange Commission confidentially, is allowed to communicate with certain investors and other parties while still in registration, is exempt from certain financial disclosure requirements, and is permitted to phase in the requirement for a public company's auditors to provide an attestation report on internal controls.

In addition, an Emerging Growth Company is permitted to comply with the executive compensation disclosure requirements of the federal securities laws by disclosing the same information as a "smaller reporting company" (that is, a company with a common equity "public float" of less than $75 million or, if unable to calculate its public float, annual revenue of $50 million or less).

Required Executive Compensation Disclosure

Thus, in its IPO registration statement, an Emerging Growth Company need only provide the following information about its executive compensation program:

- A Summary Compensation Table (but covering only three (rather than five) named executive officers (including the Chief Executive Officer, but not necessarily the Chief Financial Officer) and limited to two (rather than three) fiscal years' information;
- An Outstanding Equity Awards at Fiscal Year-End Table; and
- A Director Compensation Table.

An Emerging Growth Company is not required to prepare a Compensation Discussion and Analysis, nor is it required to provide four of the six tabular disclosures otherwise required of regular issuers. In addition, it need not prepare the disclosure about potential payments upon a termination of employment or a change in control of the company.

Relaxed Compliance with Public Company Reporting Requirements

Once an Emerging Growth Company has completed its initial public offering of equity securities, it is eligible for the following relaxed disclosure requirements with respect to executive compensation matters:

- It is permitted to comply with the executive compensation disclosure requirements of the federal securities laws by disclosing the same information as a "smaller reporting company" (as described above);
- It is exempt from the "pay for performance" and "CEO-employee pay ratio" disclosures requirements of Section 953 of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and
- It is exempt from the shareholder advisory vote requirements of Section 14A of the Exchange Act for a minimum of three years (that is, the shareholder advisory vote on executive compensation ("Say-on-Pay"), the shareholder advisory vote on the frequency of future Say-on-Pay votes, and the shareholder advisory vote on "golden parachute" compensation).

The JOBS Act provides that an Emerging Growth Company may elect not to take advantage of one or more of the relaxed disclosure requirements. In other words, such a company may opt to provide full executive compensation disclosure in the proxy materials for its annual meeting of shareholders, while still taking advantage of the exemption from conducting a Say-on-Pay vote.

Observations

Although the inclusion of information about a company's executive compensation program in its IPO registration materials has not been viewed as a significant obstacle to going public, it is expected that most privately-held companies will avail themselves of the streamlined disclosure requirements during their IPO and thereafter as they become accustomed to their new status as public reporting companies. Moreover, the exemption from the Dodd-Frank Act shareholder advisory votes is likely to be seen as a favorable result enabling a company to transition its executive compensation program to a more sophisticated design without undue scrutiny.

At this stage, however, it is unclear how these changes will be received by the market. Long-accustomed to receiving comprehensive information about a newly-public company's executive compensation policies and practices, the marked contrast in the information that will now be available about these companies could lead to investor pressure for these companies (certainly the larger ones) to provide more detailed information. Moreover, the national securities exchanges may prefer that these companies provide the same level of disclosure about their executive compensation programs as their other listed companies. Given the broad range of companies that are eligible for Emerging Growth Company status, the exchanges may attempt to use their listing standards as a way to accelerate compliance with the full complement of executive compensation disclosures.

Finally, the disparity in publicly-available information about executive compensation practices that will inevitably develop over the next few years could hamper the development of comprehensive compensation analysis for some companies and industries. A long-time public company that is competing against recently-public peers may have difficulty gathering information about their executive compensation programs given the simplified disclosure requirements applicable to those peers. Thus, these peer companies may enjoy a strategic advantage that won't be reciprocated until they relinquish their Emerging Growth Company status.

Inadvertent Public Company Status

Title VI of the JOBS Act addresses the requirements for when a company must register under the Securities Exchange Act of 1934. Previously, the federal securities laws required a company to register under the Exchange Act and, thereafter, file periodic reports once it had assets of $10 million and 500 or more shareholders of record, even if had never conducted an initial public offering of its equity securities. Companies with lengthy operating histories or broad-based equity compensation programs frequently encountered issues with this "shareholders of record" threshold, often necessitating an application to the SEC for an exemption from the registration requirement (as long as certain conditions, as well as information delivery requirements, were satisfied).

The JOBS Act increases the "shareholders of record" threshold from 500 to 2,000, provided that this expanded group includes less than 500 "non-accredited investors" (that is, investors who do not meet certain net worth standards set by the SEC). More importantly, the JOBS Act excludes from these calculations individuals who obtained their equity interests in the company through its equity compensation plans (as well as certain other investors).

Observations

The long-standing "shareholders of record" threshold has been a persistent thorn in the side of technology and life sciences companies, particularly those experiencing fast growth; often forcing them to become public companies earlier than desired. As a result of this change, privately-held companies with broad-based equity compensation programs will no longer need to closely monitor the number of employees who receive stock options or other stock awards to avoid inadvertently exceeding the Exchange Act registration threshold. Moreover, such companies will be able to better control the timing of their IPO, while continuing to offer equity compensation to existing and new employees consistent with their motivation, retention, and growth strategies.

Need Assistance?

Compensia has had significant experience in helping companies to prepare for an initial public offering of equity securities and their executive compensation disclosure. If you have any questions on the subjects addressed in this Thoughtful Pay Alert or would like assistance in preparing your executive compensation disclosure, please feel free to contact Mark A. Borges. ■

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