Practical Guidance

Emerging Growth Company Guide for Capital Markets

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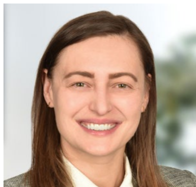

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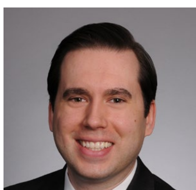

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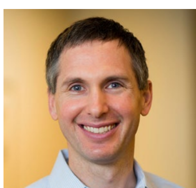

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This guide covers key information that a securities practitioner needs when working with an emerging growth company (EGC). It provides an overview of the market and covers applicable securities laws and regulations, securities offering process, disclosure and corporate governance obligations, stock exchange requirements, commercial and regulatory trends, and practical tips for counsel.

For more on IPOs generally, see Initial Public Offerings Resource Kit.

Overview

Under the Jumpstart Our Business Startups Act (the JOBS Act) (112 P.L. 106, 126 Stat. 306), which was passed in April 2012, a company qualifies as an EGC if, at the time of its initial public offering (IPO), total annual gross revenues were less than $1.235 billion during its most recently completed fiscal year. EGC status affords an issuer the ability to enjoy certain reduced executive disclosure requirements, including providing fewer years of historical audited financials and reduced compensation disclosure, and reduced corporate governance requirements, particularly around internal controls over financial reporting and say-on-pay advisory votes. A company will retain EGC status until the earliest of the following:

- The last day of the fiscal year ending after the fifth anniversary of its IPO
- The last day of the first fiscal year in which its annual gross revenue exceeds $1.235 billion
- The date it becomes a large accelerated filer, meaning the last day of the fiscal year in which it (1) has a public equity float held by non-affiliates of $700 million or

more (measured as of the last business day of its second fiscal quarter of such year) and (2) has been a reporting company under the Securities Exchange Act of 1934, as amended (the Exchange Act) for at least 12 calendar months, provided the company (a) has filed at least one annual report and (b) is not eligible for smaller reporting company status

- The date on which the company has issued more than $1 billion in non-convertible debt during the preceding three-year period

Other than excluding certain types of issuers, such as issuers of asset-back securities and investment companies registered under the Investment Company Act of 1940, there are no restrictions on companies qualifying for EGC status. In addition, companies organized in foreign jurisdictions as well as in the United States can qualify as EGCs.

Applicable Securities Laws and Regulations

A securities offering by an EGC is generally governed by the same statutes and regulations as those by non-EGCs, with the exception of the additional provisions of the JOBS Act and the Fixing America's Surface Transportation Act (the FAST Act) that apply to EGCs. The following key statutes and regulations govern a typical securities offering by an EGC:

- **Securities Act of 1933 (the Securities Act) and the rules and regulations promulgated thereunder.** The Securities Act regulates the offer and sale of securities, including those of EGCs. Generally speaking, any offer or sale of securities in the United States must be registered with the Securities and Exchange Commission (SEC) or otherwise be exempt from registration under the Securities Act. For a general review of statutes and regulations governing securities offerings, see U.S. Securities Laws.
- **Exchange Act and the rules and regulations promulgated thereunder.** The Exchange Act addresses the ongoing obligations attendant with listing a class of securities on a national stock exchange, including periodic reporting and the initial registration of such class. See Periodic and Current Reporting Resource Kit. In addition, a private company with a large number of stockholders (excluding holders of most compensatory equity) may also be subject to the reporting requirements of the Exchange Act. Companies (other than banks and bank holding companies or savings and loan holding companies) with either (1) 2,000 or more stockholders or (2) 500 or more stockholders who are not accredited investors are required to register. See Registration Requirements under Section 12 of the Exchange Act.
- **Regulation S-K promulgated under the Exchange Act.** This set of rules interplays with the Securities Act forms (e.g., registration statements on Forms S-1, S-3, and S-8) on which the offering is filed to provide specific disclosure requirements. Regulation S-K is also the framework for non-accounting-specific disclosure in reporting under the Exchange Act.
- **Regulation S-X promulgated under the Exchange Act.** This set of rules addresses the various accounting-specific disclosures required in Securities Act forms. Regulation S-X is also the framework for accounting-specific disclosure in reporting under the Exchange Act. See Financial Statements and Reporting Resource Kit and Securities Offerings and Financial Statements.
- **The JOBS Act.** The JOBS Act specifically amended the Securities Act and the Exchange Act to provide for certain reduced disclosure, reporting, and governance requirements for EGCs. Most notably, the JOBS Act reduced the audited financial statements required in a Securities Act filing from three prior fiscal years to two, exempted EGCs from the requirement that independent auditors attest to management's assessment of internal controls, reduced the executive compensation disclosures required, permitted testing-the-waters communications outside of the offering, and allowed EGCs to submit their draft Securities Act registration statements with the SEC on an confidential basis. In July 2017, the SEC also began to offer non-EGCs a confidential review of draft registration statements as well in the case of an IPO or registered offering within 12 months of an IPO. Further, the ability to engage in testing-the-waters communications was expanded to all issuers in 2019 (see SEC Adopts Rule Allowing All Issuers to "Test the Waters": Client Alert Digest).
- **The FAST Act.** The FAST Act further enhanced certain benefits under the JOBS Act for EGCs. Most notably, the FAST Act provided further flexibility for EGCs to begin the SEC review process on Securities Act registration statements without all the required years of audited financial statements if those statements would not be required later when the registrant planned to launch the offering. The SEC issued a Compliance and Disclosure Interpretation (C&DI) on August 17, 2017 that clarified that EGCs (and non-EGCs) could also omit interim financial statements if such interim financial statements will not be required to be presented separately at the time of the offering. See C&DI 1, available at https://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm.
- **Regulation G promulgated under the Exchange Act.** This set of rules addresses a registrant's use of financial measures not calculated in accordance with generally accepted accounting principles (non-GAAP financial

measures). Regulation S-K also addresses the use of non-GAAP financial measures included in a registration statement filed under the Securities Act for an offering by an EGC, but Regulation G extends broadly to any public disclosure of material information made by the registrant that contains a non-GAAP financial measure. See Market Trends 2019/20: Public Company Reporting and Corporate Governance and SEC Regulation of Non-GAAP Financial Measures.

- **Regulation FD promulgated under the Exchange Act.** This set of rules addresses the selective disclosure of material nonpublic information. See Regulation FD.
- **Regulation M promulgated under the Exchange Act.** This often overlooked set of rules addresses the timing of certain purchases and sales by a registrant in its own securities. This is relevant to EGCs that are already listed and may be engaged in any activity, including activity by affiliates, to repurchase its securities at a time proximate to a distribution of securities. See Regulation M.

Securities Offering Process

The IPO Process for EGCs

EGCs receive key accommodations during the IPO process. The IPO on-ramp contemplated by the JOBS Act relaxed certain regulatory barriers that policy-makers believed were keeping EGCs from accessing the public markets. These accommodations include, among other benefits, confidential submission and review of IPO registration statements, reduced financial statement audit and disclosure requirements, and the ability to engage in oral or written testing-the-waters communications with certain types of sophisticated investors before filing a registration statement with the SEC. This guide focuses on the IPO process for an EGC, which is the principal point in its lifecycle where an EGC first benefits from its differentiated status as an EGC.

Key Transaction Documents and Regulatory and Stock Exchange Filings

The documents and filings required in the IPO process for an EGC generally mirror those in the process for non-EGCs. Some of the key documents in the IPO process are described below.

Draft Registration Statement

A registration statement provides key financial and non-financial information about the company, its business operations, and the securities being offered to the public. The JOBS Act allows an EGC to submit a draft of its registration statement and exhibits to the SEC on a confidential basis via the EDGAR system (which, as discussed above, the SEC subsequently allowed for non-EGCs too). For a form of cover letter to accompany a draft registration statement when confidentially submitted to the SEC, see SEC Transmittal Letter (Confidential Treatment of an Emerging Growth Company Registration Statement). The confidential submission and review process provides a filer with greater control over the timing of their IPO process and keeps them out of the public spotlight during the planning phase of the transaction. Although the SEC Staff has stated that they will review a confidential submission in draft form so long as it at least complies with the financial statement requirements, EGCs generally should provide a reasonably complete and high quality draft to the Staff to reduce the likelihood of a long comment process and as a courtesy. In addition, although the confidential draft submission is not initially filed, it eventually becomes publicly available on EDGAR as part of the registration process. For a further discussion of confidential treatment requests, see Treatment of Confidential Information in Filings with the U.S. Securities and Exchange Commission. Because the underwriters involved in the IPO will be members of the Financial Industry Regulatory Authority (FINRA) they will be required to file the draft confidential registration statement with FINRA for review as well.

As part of its draft registration statement, EGCs are required to include only two fiscal years of audited financial statements and related MD&A disclosure. (By comparison, non-EGCs generally must provide three years of audited financial statements and related MD&A disclosure in its registration statement, whether or not confidentially submitted as a draft.) However, despite the JOBS Act's accommodation, some EGCs choose to provide more than the minimum two years of financial information in the summary financial statements and the audited financial statements. Additionally, although selected financial data is no longer required, this disclosure is sometimes included to provide greater transparency to investors. Providing more information to prospective investors may have a positive impact when marketing the IPO and underwriters in some IPOs have therefore recommended including this additional financial information to the extent feasible for the issuer.

Relevant to both the draft registration statement as well as ongoing SEC reporting once public, EGCs require fewer named executive officers in their executive compensation disclosure under Item 402 of Regulation S-K (17 C.F.R. § 229.402) compared to non-EGCs. An EGC may have as few as three named executive officers, including the chief executive officer (CEO) and the two next most highly paid executive officers of the company. Non-EGCs that are not smaller reporting companies are required to have at least five named executive officers (assuming they have that many executive officers), including the CEO, chief financial officer (CFO), and the next three most highly paid executive officers.

The SEC will issue comments on the draft registration statement after it has been submitted, which the issuer will respond to by submitting an amended draft and a response letter. The SEC will frequently issue more than one round of comments, requiring additional amendments and response letters. For a form of response to an SEC comment letter on an EGC registration statement, see SEC Comments Response Letter (Emerging Growth Company Registration Statement).

Under the JOBS Act, EGCs can also engage in written or oral testing-the-waters communications with certain types of sophisticated investors while the registration statement is still under review. Although limited to qualified institutional buyers (QIBS) and institutional accredited investors, these communications allow EGCs to gauge investor interest in a contemplated offering of securities without violating the gun-jumping rules of the Securities Act. However, EGCs should be careful regarding the timing and content of such communications, as information in the draft registration statement is likely to change and antifraud provisions of the federal securities laws still apply to testing-the-waters communications. In addition, the SEC frequently requests copies of any written testing-the-waters materials used during the IPO process. In 2019, the SEC permitted non-EGCs to engage in testing-the-waters communications too. For a further discussion of testing-the-waters, see Road Show Preparation.

Registration Statement (Preliminary and Final Prospectuses)

EGCs must publicly file their IPO registration statement at least 15 days prior to the start of the road show for their offering (as is also the case for non-EGCs). An amendment to the registration statement is then typically filed shortly before the road show commences, which will include a preliminary prospectus with an estimated price range that will be distributed to potential investors as part of marketing the offering during the road show.

Once the SEC has confirmed that it has no further comments on the registration statement, the issuer will request that the SEC declares the registration statement effective and then proceed to price IPO. Following pricing, a final prospectus—updated with final pricing information and further detail on the underwriting syndicate—must be prepared and filed with SEC.

Listing Application with Stock Exchange

Securities issued in an IPO are not restricted securities, so they can be freely resold after the initial sale except to the extent they are also control securities (i.e., securities held by affiliates). Companies contemplating an IPO typically apply for listing on a major stock exchange such as the New York Stock Exchange (NYSE) or the Nasdaq Stock Market (Nasdaq). An EGC could of course conduct an IPO without listing, but market forces would generally dictate the EGC list the class of equity on an exchange to ensure there will be ongoing reporting and an aftermarket for the securities.

Each stock exchange publishes information about its listing requirements and standards, the process for listing, and fees. EGCs should become acquainted with the various listing requirements and corporate governance standards early on in the planning process, so any necessary changes can be made (e.g., compliance with corporate governance standards on director and board committee independence). Although EGCs have the ability to take advantage of certain reduced reporting requirements, the independence requirements of the exchanges are as rigorous for an EGC as they are for a non-EGC. See NYSE and Nasdaq Listing Requirements Compliance.

Underwriting Agreement

The underwriting agreement is the primary agreement for the sale of the securities in a public offering. It contains details about the terms of the public offering, as agreed by the issuing company and the group of investment banks that will work together as a syndicate to underwrite the securities offering. Most EGC underwriting agreements are identical to their non-EGC counterparts but for a few additional representations about the issuer's status as an EGC as well as the conduct of any testing-the-waters activities by the EGC and its underwriters.

High-profile IPOs, including those of EGCs, are typically underwritten on a firm commitment basis in which the underwriters commit to purchase the shares from the company at a negotiated discount and then resell the shares to the public.

The underwriting agreement will generally also contain an over-allotment option (greenshoe), which typically gives underwriters 30 days to purchase additional shares—often up to 15% of those sold in the offering—at the offering price. For a form of underwriting agreement, see Underwriting Agreement (Primary Offering).

Comfort Letters

As part of the due diligence process and as a condition to the underwriting, the company's auditors will be requested to deliver a comfort letter to the underwriters and the issuer's board of directors. The comfort letter confirms the auditor's independence with respect to the issuer, describes the procedures performed by the auditor on the issuer's financial statements and also provides certain negative assurance as to changes in those financial statements since the date thereof. In addition, the comfort letter provides certain assurance as to various financial and related information that is presented in the registration statement that is derived from the

issuer's books and records on which the auditor performed procedures. See Comfort Letter Review and Negotiation Checklist and IPO Key Documents.

Lock-up Agreements

In an effort to promote an orderly trading market following the offering, the managing underwriters generally require the company and key stockholders to sign lock-up agreements. Lock-up agreements require a company's directors, officers, and existing stockholders not to sell any securities of the company for a period of time after the commencement of the public offering. The lock-up period agreed in connection with an IPO, including for an EGC issuer, is typically 180 days, and includes standardized carveouts and sometimes contemplates early release provisions. For a form of lock-up agreement, see Lock-Up Agreement (IPO).

General IPO Timeline for an EGC

A general overview of the steps and an illustrative timeline of the IPO process for an EGC is set forth below. An EGC usually takes about the same amount of time to complete an IPO as a non-EGC. Submitting draft registration statements and responding to SEC comments on a confidential basis allows an EGC (and any non-EGC that files a draft registration statement) substantially more control over the public message regarding its IPO. For example, an EGC (or other confidential filer) can complete a rigorous SEC comment process without close public scrutiny as to its expected launch timing. This helps protect the filer from negative market conditions that are external, but are often blamed on issuers that have publicly filed a registration statement and failed to launch their offering.

- Week 1:
  - Conduct organizational meeting
  - Begin due diligence
- Weeks 2-4:
  - Draft registration statement
  - Continue due diligence
- Weeks 5-6
  - Finish drafting registration statement
  - Submit draft registration statement confidentially to the SEC (filed as a DRS)
- Weeks 10-12
  - Approximately four weeks after date of initial confidential submission, receive and review comments from the SEC on the draft registration statement
  - Revise draft registration statement
  - Submit revised draft registration statement to the SEC as a confidential amendment (or DRS/A), along with a response letter to the SEC's comments
- Weeks 13-14
  - Continue to resolve comments from the SEC
  - Submit additional revised draft registration statement amendments, as necessary
- Weeks 15-16
  - Make first public filing of registration statement at least 15 days prior to the start of road show (filed on Form S-1)
- Week 17:
  - Once SEC comments have been resolved, print preliminary prospectus, if desired
  - Begin road show
- Weeks 19-20
  - Request that the SEC declare the registration statement effective 48 hours prior to the anticipated pricing date
  - Price the offering, sign the underwriting agreement and commence trading
  - File the final prospectus with SEC
  - Close the offering

Although an IPO can be completed on the illustrative timeline set forth above, and in some cases faster, companies considering an IPO are strongly encouraged to begin preparing much earlier.

Due Diligence

Due diligence will vary across industries, rather than by EGC and non-EGC status. For example, issues and concerns faced by a software company will almost certainly differ from those faced by a midstream oil and gas company, even if both technically qualify as EGCs. Due diligence for the software company will likely focus more on intellectual property, licensing agreements, and customer lists; while the review for the oil and gas company may emphasize documenting ownership of tangible property, partnership and joint venture agreements, and compliance with environmental regulations. Regardless of industry, due diligence will likely extend across certain important areas, including basic corporate documents, financial information, and information about directors and officers. Although EGCs are permitted to confidentially submit draft registration statements with the SEC, most EGCs attempt to complete material due diligence and factual backup verification in advance of the initial confidential submission because any such confidentially submitted drafts will eventually become public, and the disclosure included in those submissions can create a factual record for plaintiffs' lawyers later that might suggest the EGC was lax in its reporting ability. Legal counsel typically requests the following information during IPO due diligence:

- Basic corporate documents, including certificate of incorporation, bylaws, and board minutes
- Comparable documents for any subsidiary
- Stockholder information, including stockholder lists and capitalization tables with ownership information
- Information with respect to any issuance of securities, including copies of agreements
- Financial information
- Copies of material agreements
- Operational information, including lists of suppliers and manufacturers
- Sales and marketing information
- Industry information
- Director and officer information, including compensation plans and other agreements, as well as completed director and officer questionnaires
- Employee information, including organizational charts and copies of agreements
- Intellectual property information, including lists of patents and licensing agreements
- Tangible property information, including copies of leases and documents of title
- Litigation information
- Insurance information
- Partnership or joint venture agreements
- Foreign operations information
- Applicable government regulations and related filings

For a further discussion of due diligence in general, see Initial Public Offering Process, Top 10 Practice Tips: Underwriters' Counsel Due Diligence for Securities Offerings, and Due Diligence for Securities Offerings Resource Kit.

Disclosure Obligations

Generally, the information required to be disclosed to potential investors in connection with a securities offering is the same for EGCs and non-EGCs. One of the benefits of being an EGC, however, is that EGCs are permitted to disclose less historical financial information—in particular, reduced financial statement disclosure requirements (and, correspondingly, management's discussion and analysis of financial condition and results of operations (MD&A) disclosure if fewer periods are presented) and reduced executive compensation-related disclosure requirements. EGCs are only required to provide two years of audited financial statements (instead of three) plus unaudited interim financial statements. Additionally, if an EGC is required to include separate financial statements for an acquired business, the maximum time period for which separate financial statements must be provided is also two years, regardless of the significance of the acquisition under Regulation S-X. Further, in January 2016, the SEC adopted rules as required by the FAST Act that further reduce financial statement disclosure requirements for pre-effective IPO registration statements filed by EGCs as follows:

- EGCs may omit financial information related to a historical period that the EGC reasonably believes will not be required to be included in the registration statement at the time of the contemplated offering.
- Prior to distributing preliminary prospectuses to investors, the EGC must amend its registration statement to include financial information required by Regulation S-X as of the date of the amendment.

Under SEC guidance, a non-EGC may also omit from its draft registration statements interim and annual financial information that it reasonably believes will not be required at the time of the public filing of the registration statement, but may not omit any required financial information from its publicly filed registration statements. See C&DI 101.05.

For a further discussion of EGC disclosure requirements, see Emerging Growth Company versus Smaller Reporting Company Comparison Chart.

Risk Factors

The SEC has provided guidance for all issuers indicating that risk factors should describe what management believes to be the material risks the registrant faces, organized under appropriate headings and prioritized under such headings with the most material risks first. Additionally, the SEC has indicated that issuers should include specific examples in risk factors and not simply recite every potential risk that the issuer or other companies in its industry faces. The SEC has also expressed that including mitigating language in the risk factors is not appropriate, but may be discussed elsewhere in the registration statement. For a further discussion of risk factors, see Risk Factor Drafting for a Registration Statement and Top 10 Practice Tips: Risk Factors.

EGCs typically include a risk factor which states: "We are an emerging growth company and cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors." This risk factor should set out the reduced reporting requirements, including:

- Not being required to comply with the independent auditor attestation requirements of Section 404 (15 U.S.C.S. § 7262) of the Sarbanes-Oxley Act
- Reduced disclosure obligations regarding executive compensation in periodic reports and proxy statements

- Exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved
- Extended transition periods for complying with new or revised accounting standards

EGCs also typically note in a separate risk factor regarding internal control risks that their independent registered public accounting firm is not required to audit the effectiveness of their internal control over financial reporting until after it is no longer an emerging growth company, as defined in the JOBS Act. At that time, the EGC's independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which the EGC's internal control over financial reporting is documented, designed, or operating.

Business and MD&A

The Business section explains the issuer's business and the disclosure will depend on many factors, including the issuer's industry. Typically, the underwriters will be integrally involved in the drafting of the forepart of the Business section, including Overview, Industry, Strengths, and Strategy. The underwriters will help the issuer articulate its story in a way that resonates with investors. The remaining subsections within the Business section tend to be more fact-based or are included per specific form requirements, such as Products, Technology, Sales and Marketing, Customer Support, Research and Development, Intellectual Property, Competition, Human Capital Resources, Facilities, Legal Proceedings, and Government Regulations.

Key operating or financial metrics are also typically dictated by sub-sectors within the issuer's industry (e.g., fintech, adtech, edtech, Software as-a-service companies, etc. for a technology company). The key is that companies, including EGCs, are disclosing metrics that management is actually using to evaluate the business and will be comfortable disclosing on a quarterly basis going forward, and that are also compliant with SEC rules and guidance. Counsel is encouraged to review the SEC's recent guidance on non-GAAP financial measures to ensure compliance with SEC rules for key operating metrics that are not GAAP compliant. See Non-GAAP Financial Measures, Compliance & Disclosure Interpretations (May 17, 2016, as updated through December 13, 2022). For a further discussion of non-GAAP regulations, see SEC Regulation of Non-GAAP Financial Measures.

The SEC Staff encourages the use of key performance indicators (KPIs) and non-financial business and operational data in the MD&A to provide investors with a better view of the "key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company." For many years, KPIs and metrics have been a frequent area of SEC comment, but there has been little formal guidance specific to non-financial KPIs. In January 2020, the SEC Staff announced guidance on disclosure of KPIs and metrics in MD&A, which includes information relating to (1) the disclosure of KPIs and metrics in MD&A, generally, (2) disclosures that companies should consider when changing the methodology by which they calculate their KPIs and metrics from one period to another, and (3) the requirement to maintain effective disclosure controls and procedures when disclosing company-derived information. See Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations.

The SEC Staff has also continued to promote a more principles-based, company-specific approach to MD&A disclosure in response to the general market practice that has developed to primarily provide mechanical analyses focused on the quantitative disclosure requirements. In November 2020, the SEC Staff adopted amendments to modernize, simplify, and enhance certain financial disclosure requirements in Regulation S-K, including MD&A. The new amendments, among other things:

- Set forth the objective of MD&A to encourage a more thoughtful discussion of the material events and uncertainties that provide context for the financial information presented
- Provide issuers with the opportunity to present sequential quarter comparisons instead of quarter comparisons on a prior year period basis –and–
- Streamline and eliminate certain other financial disclosures, including the elimination of the contractual obligations tabular disclosure and the requirement to disclose selected financial data

Counsel is encouraged to review the SEC's Final Adopting Release to ensure compliance with the new rules.

Market practice has also developed for high-growth companies to provide quarterly income statements for the eight prior quarters so that investors can see more detailed trends on a quarter-by-quarter basis for the prior two years. Auditor comfort issues typically arise around this historical financial information, so it is best to discuss the level of comfort the auditors can provide early with the underwriters and their counsel to ensure there are no surprises later that could delay the offering or create unforeseen risk for

the offering participants. While this disclosure is no longer required by the SEC (except in cases of material retrospective changes to quarterly data within the two most recent fiscal years), the importance of this information in trend analysis at the offering stage for many companies will likely mean that issuers in many sectors will continue to voluntarily provide this information.

Additionally, when drafting the MD&A, as opposed to merely providing a period-over-period comparison, registrants and their counsel should provide thoughtful trend analysis around the historical performance of the business and expected future trends that may impact results of the business. Registrants should view the MD&A as a way to tie the Business section disclosures to the financials to explain why the business has performed and will perform the way management expects it to. SEC rules now also provide greater flexibility in the period-over-period comparisons, including the ability to compare to a recent period as opposed to the same period in the prior year if it is more representative of trends. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Management's Discussion and Analysis Section Drafting Checklist.

One area of focus that often arises with EGCs in the MD&A is the disclosure of equity incentive compensation, known as the cheap stock disclosure issue. The SEC often seeks to understand if the registrant has taken adequate accounting expense for stock awards in the periods leading up to the IPO, with a particular focus on the valuation applied to such awards made in the 1-2 years immediately prior to the offering. Many registrants now use third-party valuation consultants to inform their decisions of fair value on a quarterly or less than annual basis, which is largely reducing the SEC's focus on this area. However, EGCs should take appropriate steps to validate their valuation of equity awards leading up to the IPO to prepare for the inevitable disclosure. For more information, see Cheap Stock Problems Avoidance.

Other Disclosure

The following additional information is typically included and/or required for EGCs in the registration statement and prospectus:

- EGC-specific checkboxes on the facing page of the registration statement
- An explicit statement on the cover page of the prospectus indicating such company is an EGC
- An extra paragraph in the box summary of the prospectus regarding the implications of being an EGC
- The risk factors noted above
- A short section in the MD&A noting that the EGC intends to take advantage of lengthier phase-ins for new accounting pronouncements, if appropriate

Additional Disclosure Issues

The disclosures for EGCs in registration statements have become relatively settled at this point. As described above, there is standard language that registrants should be sure to include in the registration statement. Outside of these disclosures, the emphasis of registrants and their counsel should be on company- and industry-specific disclosures that help investors understand the story, business, risk profile, and financial performance of the registrant, as with any non-EGC company going through the registration process.

Underwriting Agreements

An underwriting agreement is a contract in which an issuer and any selling shareholders promise to sell securities to the underwriters on a specified future closing date at a price and in a quantity set forth in the underwriting agreement and a corresponding promise by the underwriters to purchase those securities at the specified price. Although EGC status modestly affects certain representations and warranties, covenants, and some aspects of how an offering are conducted, whether a company is an EGC generally does not have a material impact on the terms or negotiation of underwriting agreements.

The basic structure of an underwriting agreement is as follows:

Introduction	Provides overview of transaction terms and creates defined terms.
Representations and warranties of the company	Establishes the representations and warranties that the issuer makes about itself and its business. Unlike non-EGC offerings, these will include a representation that the issuer is an EGC and a representation as to any details about any testing-the-waters communications, if applicable.

Representations and warranties of the selling shareholders	Establishes the representations and warranties that the selling shareholder makes about itself and its ownership of the securities to be sold.
Agreement to sell and purchase	Contains basic agreement of the sellers to sell the securities and the securities to be sold.
Terms of the public offering	Establishes the price at which the securities will be sold to the underwriters and at which the underwriters will sell the securities to the public. The pricing does not necessarily vary from EGCs to non-EGCs. However, non-EGCs are often larger issuers that may have increased leverage to obtain better IPO discounts from their underwriters.
Payment and delivery	Sets out the mechanics of the closing.
Conditions to the underwriters' obligations	Establishes the conditions that have to be met for the closing to occur.
Covenants of the company	Establishes the issuer's agreements to take and refrain from taking, specific actions.
Expenses	Establishes the allocation of offering-related expenses among the sellers and the underwriters.
Indemnity and contribution	Allocates the risk in the event of litigation that alleges material misstatements or omissions in the prospectus or registration statement.
Directed share program	If applicable, establishes indemnification of the underwriter if litigation arises from a program where the issuer can direct the placement of a portion of the securities being sold.
Termination	Establishes the conditions under which the underwriting agreement can be terminated.
Effectiveness, defaulting underwriters	Establishes when mutual obligations created by the underwriting agreement become effective, and what happens if some, but not all, of the underwriters default in their obligations at closing
Remaining provisions	Miscellaneous technical provisions.

Compared to other types of transactions, underwriting agreements for securities offerings registered under the Securities Act are not heavily negotiated. There are at least a few reasons for this dynamic. First, the actual purchase and sale is relatively straightforward. Second, there is an established and well understood legal and regulatory regime regarding liability (and therefore risk allocation) for registered offerings. Third, given the first two points, there really is not much variation in the form agreements used by various underwriters, and underwriters are disciplined in maintaining adherence to those forms across time and issuers, particularly since the form of underwriting agreement is publicly filed with the registration statement and creates substantial precedential value.

There are, however, certain sections where transaction participants can expect to spend more time on than others.

Company Representations and Warranties

The Company representations and warranties serve three purposes:

- As a basis for termination of the underwriting agreement by the underwriters if the representations and warranties are untrue at the closing
- As a basis for risk allocation

- As an information-forcing mechanism to support disclosure and to aid the underwriters as they seek to establish a due diligence defense

Of the three, the last is by far the most important as a practical matter. Although it certainly can happen, given that typically only two or three trading days pass between signing the underwriting agreement and closing, it is highly unusual for a breach of company representations and warranties to trigger termination. In addition, the primary risk to a company in connection with a registered securities offering relates to a material misstatement or omission from the disclosure contained in the offering materials. With the exception of very limited information provided by the underwriters that is unlikely to be material, companies agree to indemnify underwriters for liability that arises from such disclosure-based liability. As a result, although the parties to the underwriting agreement will spend time negotiating around the edges of the company representations and that negotiation will surface issues that impact the disclosure in the company's offering materials, they typically are not showstoppers.

Selling Shareholder Representations and Warranties

Most of the selling shareholder representations and warranties relate to technical matters that are not controversial. However, some underwriters' standard forms will include representations and warranties regarding the accuracy of the company's representations and warranties as well as the accuracy and completeness of the company's offering materials. In addition, underwriters' standard forms will include representations and warranties that each selling shareholder has reviewed the company's offering materials and that (1) the selling stockholder is not aware of a material omission or misstatement in the registration statement (sometimes called a clean hands representation) and (2) the selling stockholder is not motivated by some undisclosed reasons to sell securities (sometimes called a sandbagging representation). Selling shareholders and their counsel generally resist inclusion of any of these provisions, arguing that they are not in a position to provide such representations and warranties beyond the limited information about themselves that they are required to include in a registration statement. This argument is not as strong for selling shareholders that have access to more information than shareholders generally (e.g., as a result of having representation on the company's board of directors), but institutional shareholders are typically successful in resisting inclusion of such provisions altogether or particularly underwriter-friendly formulations of such provisions. Practice varies with respect to selling shareholders that are affiliates or part of a company's senior executive team, such as the issuer's chief executive officer, but parties should expect at least some coverage of the company's information by such management selling shareholders.

Lock-up Provisions

In connection with any registered offering of equity or equity-linked securities, the company will also be subject to a lock-up restriction on transactions in its own securities that often parallels the lock-up entered into by stockholders. The purpose of the lock-up agreement is to allow time for the market to discover the worth of the stock in a stable market as well as give comfort to investors that insiders will continue to act in line with the goals of the company. In connection with an IPO, the lock-up period extends for 180 days after pricing. The lock-up period for other offerings can vary, but most usually extend up to 90 days after pricing.

The issuer may negotiate exceptions to the restrictions imposed by the lock-up provisions. Companies will generally have exceptions for activity it is already contractually obligated to honor, such as the grant and settlement of options and restricted stock units, made pursuant to their employee equity incentive agreements and for the settlement of equity-linked securities, like warrants and convertible debt securities, that are outstanding as of the time of the offering. Companies may also ask for additional exceptions to allow them to pursue other types of transactions, like the acquisition of other companies, that might involve the issuance of company stock. As long as there is a reasonable basis for such exceptions, the persons to whom the shares will be transferred will be subject to the provisions of the lock-up agreement, and there is no immediate public announcement of such transfers that create market "noise," underwriters will often accommodate such exceptions.

Expenses

Most underwriters' standard forms provide that almost all expenses incurred in connection with a registered offering will be borne by someone other than the underwriters. There are exceptions for the underwriters' out-of-pocket expenses, such as the legal fees of the counsel they engage to advise them in connection with the offering, but even here the underwriters will seek to shift some of those costs, such as fees and costs associated with FINRA compliance back to the company. Some companies attempt to negotiate such provisions (including imposing caps for maximum amounts) with varying levels of success based on the leverage they are in a position to exert.

The expense provisions will also allocate responsibility for expenses between the company and the selling shareholders. The underwriter discount applicable to the selling shareholder shares is for the account of the selling

shareholders. Other expenses are typically allocated in accordance with a pre-existing investor rights agreement, with a bulk of the expense more often than not borne by the company.

Continuous Disclosure and Corporate Governance

Once public, EGCs are generally subject to the same ongoing disclosure and corporate governance requirements that apply to non-EGCs, with several key differences highlighted below.

- EGCs are exempt from the requirement that a public accounting firm attest to internal controls, as required by Section 404(b) of the Sarbanes-Oxley Act. However, most try to comply with the underlying internal controls requirements even if they do not provide the public report until required.
- EGCs are exempt from formal requirements for compensation discussion and analysis (CD&A) and the corresponding compensation committee report in periodic reporting. Most EGCs take advantage of this.
- EGCs are exempt from any new or revised financial accounting standard as issued by the Financial Accounting Standards Board until such accounting standard becomes broadly applicable to private companies. Some EGCs opt out of this extended transition period, choosing to voluntarily comply with such standards as they are adopted. However, it is important to note that this election is irrevocable. Practice on this was historically mixed. However, as the new revenue recognition rules were the first major accounting standard to allow delayed adoption by EGCs, many EGCs have taken advantage of this where permitted.
- EGCs also enjoy reduced financial disclosure requirements for future registration statements, such as for follow-on offerings. Most EGCs use this to the extent they have not subsequently filed additional financial statements under the Exchange Act.
- During fiscal years beginning on or after July 1, 2020, EGCs must comply with the newly adopted hedging disclosure rules with respect to the election of directors.

Stock Exchange Requirements

Listing Requirements

Generally, both NYSE and Nasdaq subject EGCs to the same listing requirements as non-EGCs. One exception is that the NYSE affords EGCs a minor accommodation in meeting its minimum financial standards, requiring only two years of pre-tax earnings from continuing operations to qualify rather than three years. Nasdaq's financial and liquidity requirements for initial listing apply uniformly to EGCs and non-EGCs.

Corporate Governance Standards

The major stock exchanges' corporate governance standards generally treat EGCs and non-EGCs alike. There are additional exceptions for foreign private issuers and controlled companies that may apply to some EGCs, but those are unrelated to EGC status.

Several key corporate governance issues relevant to EGCs navigating the IPO process are discussed here for reference, but counsel should note that these same issues would also apply in the non-EGC context. Also, there are additional requirements not discussed here for the sake of brevity, including differences between the NYSE and Nasdaq, the requirements of which can be very similar but are not always identical. See NYSE Corporate Governance Listing Requirements Table and Nasdaq Corporate Governance Listing Requirements Table.

Majority of Independent Directors

Both exchanges require that a public company must have a board of directors comprised of a majority of independent directors within one year of listing.

There are phase-in periods for compliance with director and board committee independence requirements to help ease the company's transition to public status. Despite these available phase-in periods, EGCs may try to comply with these independence requirements early as it is useful in marketing the offering. As a practical matter, many companies (and their underwriters) may wish to ensure that the company fully meets the independent board and committee requirements before even marketing the offering, both for diligence purposes and also for investor marketing purposes.

Independent Audit Committee

Both exchanges also require that a public company has a fully independent audit committee, subject to a one-year phase-in period as follows:

At least one independent member of the audit committee by the listing date (or in the case of Nasdaq, by the effective date of the IPO registration statement); a majority of independent members within 90 days of the effective date of the IPO registration statement; and a fully independent audit committee within one year of the effective date of the IPO registration statement.

In addition, both exchanges require that audit committee members must meet the enhanced independence requirements under Section 301 of the Sarbanes-Oxley Act and Rule 10A-3(b)(1) (17 C.F.R. § 240.10A-3) of the Exchange Act.

Number of Audit Committee Members

Both exchanges require a minimum of three audit committee members within one year of listing. The NYSE allows a phase-

in over one year: at least one member of the audit committee at listing; at least two members within 90 days; and at least three members within one year. Nasdaq, however, requires at least three members of the audit committee at listing.

Independent Compensation and Nominating/ Governance Committees

Both exchanges also require that a public company has fully independent compensation and nominating and corporate governance committees (or Nasdaq requires the nomination be made solely by the independent members of the board of directors if not by an independent nominating committee), subject to one-year phase-in periods detailed below.

The NYSE requires at least one independent member on each committee within five business days of listing or by the IPO closing date, whichever is earlier; a majority of independent members on each committee within 90 days of listing; and fully independent committees within one year listing. Similarly, Nasdaq requires at least one independent member on each committee by listing; a majority of independent members within 90 days of listing; and fully independent committees within one year of listing.

An EGC may consider making changes to its board of directors and committee composition early on in the IPO process to comply with these requirements before listing.

For a further discussion of independence requirements, see NYSE and Nasdaq Board of Directors and Committee Governance Requirements Under Sarbanes-Oxley and Dodd-Frank.

Other Key Laws and Regulations

An EGC will generally be subject to all of the laws and regulations of its industry. Since private placements or public offerings of debt or equity will typically require some combination of representations and disclosures regarding an issuer, a securities lawyer will need to be versed in the laws relevant to the issuer's industry. Most EGCs will have issues related to employees and taxes, but some EGCs may require specialized disclosure on subjects such as oil and gas regulations, consumer protection laws, communications laws, financial services and insurance laws, cybersecurity, data privacy, export controls, and numerous other fields. A securities lawyer should take care to consult with experts within their own firm or the other counsels representing the EGC in those areas to help plan for the necessary disclosures and representations.

Practice Tips

In addition to the legal implications, lawyers working with EGCs must be mindful of the business implications of their disclosure and governance decisions. For example, EGCs are afforded much greater flexibility in implementing and certifying internal controls as compared to non-EGCs. However, that does not necessarily mean that an EGC should not implement stronger internal controls over financial reporting concurrently or prior to an IPO. The risk of a restatement or fraud is just as great for an EGC, and the issuer's directors, officers, and underwriters continue to expect a due diligence defense for offerings of securities. Simply complying with the SEC-mandated disclosure may not always be sufficient to protect the issuer and investors. EGCs should consult closely with their lawyers, auditors, and bankers to make sure that their decisions reflect both legal practice and market practice that is consistent with the risks of their business. For additional information, see Top 10 Practice Tips: Emerging Growth Companies.

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Prior to joining the London office, Michael was resident in the Washington, D.C., office, where he supported Wilson Sonsini's clients across the U.S. East Coast and Europe. Prior to his legal career, Michael was a certified public accounting in the assurance practices of Arthur Andersen and Ernst & Young, where he audited public, private, and not-for-profit entities in several sectors, including telecommunications and technology.

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Michael specializes in corporate and securities law, including general corporate representation, public offerings, private placements, and mergers and acquisitions. He also has considerable experience in counseling publicly held companies on disclosure matters and complex securities laws issues. Michael frequently represents investment banks in their underwriting transactions and he also has broad transactional experience representing venture capital and private equity firms. Throughout the course of his career he has had responsibility for structuring and negotiating in excess of $40 billion in public and private financing transactions, for both companies and investment banks.

Prior to joining the firm in 2007, Michael practiced in the corporate group at Davis Polk & Wardwell in New York and Menlo Park, California. Michael also served in the United States Navy as an engineering officer aboard USS *Lake Champlain (CG57)*, as executive and weapons officer aboard USS *Monsoon (PC4)*, and at the Pentagon as an action officer responsible for international technology transfer issues.

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Prior to joining Wilson Sonsini, Megan practiced law at Ropes & Gray and Skadden Arps Slate Meagher & Flom in New York and Chicago.

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Victor has represented U.S. and international issuers, leading investment banks, and investors in more than 50 public and private securities offerings, ranging from IPOs, follow-on offerings, secondary offerings, private placements, and venture financings to convertible note offerings and high-yield and investment-grade debt offerings, collectively raising tens of billions of dollars. Victor has considerable experience guiding clients through complex and less common transaction structures (such as Up-C IPOs, concurrent private placements, PIPEs, registered direct offerings, confidentially marketed public offerings, at-the-market offerings, block trades, and spin-offs) and issuances of a wide variety of securities (such as preferred stock, American depositary shares, non-voting common stock, convertible notes, warrants, and pre-funded warrants).

Victor also regularly advises management teams and boards of directors on SEC reporting and public disclosure issues, compliance with corporate and securities laws and stock exchange rules, and corporate governance matters.

As a native of Sweden, Victor is fluent in Swedish and leverages his background, experience, and connections to counsel and support Nordic companies throughout their U.S. life cycle—from U.S. launch and expansion to capital raising, regulatory compliance, strategic transactions, and exits.

Prior to joining the firm, Victor practiced in the capital markets group at Shearman & Sterling in New York and the corporate and securities group at Perkins Coie in Seattle. Before entering private practice, Victor served as a law clerk to the Honorable John Pelander of the Arizona Supreme Court and the Honorable Peter B. Swann of the Arizona Court of Appeals, Division One.

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In addition, Mark has experience counseling clients on U.S. government matters. He assists companies with compliance with federal regulations, obtaining and maintaining security clearances to perform work on classified contracts, and issues arising from changes of control with mergers and acquisitions.

Prior to law school, Mark worked at the U.S. Department of Justice and U.S. Department of Homeland Security.

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