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The JOBS Act: What We Learned in the First Nine Months

Nine months have passed since the Jumpstart Our Business Startups Act (the JOBS Act), a package of legislative measures intended to ease regulatory burdens on smaller companies and facilitate public and private capital formation, was signed into law.1 While certain portions of the JOBS Act have yet to be implemented pending SEC rulemaking, the provisions related to IPOs have been effective since enactment. These provisions seek to encourage companies with less than $1 billion in annual revenue to pursue an IPO by codifying a number of changes to the IPO process and establishing a transitional “on-ramp” that provides for scaled-down public disclosures for a new category of issuers termed emerging growth companies (EGCs).2

Using nine-month data from the final prospectuses of 53 EGCs that successfully completed underwritten IPOs with gross proceeds of at least $75 million between April 5, 2012, and December 15, 2012, below is a summary of a number of developing market practices for EGC IPOs and certain related interpretative guidance issued by the staff of the U.S. Securities and Exchange Commission (Staff and SEC, respectively).*

<table>
<thead>
<tr>
<th>JOBS Act Benefit for EGC</th>
<th>Nine-Month Trends — Highlights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Confidential Submissions</td>
<td><strong>Strong acceptance.</strong> A significant majority of EGCs that commenced their IPOs after April 15, 2012, submitted at least one confidential draft registration statement.</td>
</tr>
<tr>
<td>Reduced Financial Statement and Selected Financial Data</td>
<td><strong>Weak acceptance.</strong> A substantial majority of EGCs continued to include three years of audited financial statements and, of those, most included five years of selected financial data.</td>
</tr>
<tr>
<td>Testing-the-Waters Communications</td>
<td><strong>Mixed acceptance.</strong> Use largely has been deal-specific and is still evolving.</td>
</tr>
<tr>
<td>Publication and Distribution of Research Reports</td>
<td><strong>Mixed acceptance.</strong> Underwriters generally are not publishing pre-deal research and publishing post-IPO research only after expiration of the 25-day prospectus delivery period.</td>
</tr>
<tr>
<td>Limited Executive Compensation Disclosures</td>
<td><strong>Strong acceptance.</strong> Virtually all EGCs that commenced their IPOs after April 15, 2012, have provided scaled executive compensation disclosure.</td>
</tr>
<tr>
<td>Auditor Attestation Reports Under Section 404(b) of Sarbanes-Oxley</td>
<td><strong>Strong acceptance.</strong> Virtually all EGCs have included disclosure that they intend to or may take advantage of the exemption to delay providing the auditor attestation report.</td>
</tr>
<tr>
<td>Extended Transition for New GAAP</td>
<td><strong>Weak acceptance.</strong> A substantial majority of EGCs have elected not to take advantage of the extended transition period for compliance with new GAAP standards.</td>
</tr>
</tbody>
</table>

* A shorter version of this article appeared in Skadden's 2013 Insights compendium. This alert provides additional details and analysis with respect to the nine-month data.

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Reforms to the IPO Process

In an effort to remove some of the traditional obstacles in the IPO process, the JOBS Act codified a number of substantive and procedural reforms, the most prominent of which are analyzed below.

Confidential Submission of Draft Registration Statements

An EGC may submit its IPO registration statement confidentially in draft form for Staff review, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 21 days prior to the EGC’s commencement of its roadshow. The new confidential submission process, formerly available only to foreign private issuers in select circumstances, permits an EGC to commence the SEC review process without publicly disclosing sensitive strategic, proprietary and financial information. Further, in the case of adverse market conditions, weak investor demand in response to testing-the-waters communications or regulatory concerns, an EGC may withdraw its draft registration statement and terminate the IPO process without ever making a public filing, thus removing a potential disincentive to commencing an IPO, and permitting the immediate pursuit of a private placement.

Nine-Month Data: Strong Acceptance. Almost 70 percent of EGC IPOs that commenced after mid-April 2012 (two weeks after the enactment of the JOBS Act) involved at least one confidential submission. Among this group, 70 percent chose to submit two draft registration statements before making their first public filing. A small number of EGCs submitted three draft registration statements, and no EGCs submitted four or more draft registration statements.

Not surprisingly, virtually all EGCs that commenced their IPOs earlier than mid-April declined to take advantage of the confidential submission process notwithstanding that the Staff stated that EGCs that commence an IPO with a public filing may switch to a confidential submission for future pre-effective amendments if otherwise eligible.

While the decision to take advantage of the confidential submission process always should be made based on the particular facts and circumstances facing an EGC, we believe that market practice will continue to trend strongly in favor of confidential submissions. Some EGCs, however, may determine not to do so for a variety of reasons. For example, we are aware of a number of EGCs that did not use the confidential submission process based on the belief that a public filing would help attract bidders in the case of a “dual track” IPO/M&A process.

Practice Points

Press Releases. The SEC cannot reject a confidential submission even if an EGC issues a press release that publicly announces the offering. However, any press release must comply with limitations imposed by Rule 135 to avoid gun-jumping issues. We note that, to date, very few EGCs have issued press releases announcing a confidential submission.

Mergers and Acquisitions. While the JOBS Act focused on IPOs and scaled disclosures for newly public companies, it does not contain language precluding its application to registered business combinations conducted by EGCs. The Staff recently confirmed that an EGC may submit confidentially a draft registration statement for a merger or exchange offer that constitutes an IPO of its equity securities.

Publicly Filing Confidential Submissions Ahead of the Roadshow. Confidently submitted registration statements have to be filed publicly at least 21 days before an EGC conducts its roadshow. The Staff has provided informal guidance that it does not view internal sales force presentations as commencing the roadshow so long as the sales force does not make outbound calls on that date and the net roadshow has not been activated.

Reduced Financial Statements and Selected Financial Data

An EGC is permitted to present only two years of audited financial statements in its IPO registration statement, as compared to the three years required for non-EGCs. An EGC presenting only two years of audited financial statements in its IPO registration statement may limit the number of years of selected financial data to two years as well.
Nine-Month Data: Weak Acceptance. Of the 44 EGC IPO offerings in the sample, 39 included three years of audited financial statements and five included two years of audited financial statements. Of the 39 EGCs that included three years of audited financial statements, 29 included five years of selected financial data, seven included three years of selected financial data and three included four years of selected financial data. Of the five EGCs that included two years of financial statements, four included two years of selected financial data and one included four years of selected financial data.

If the sample is revised to remove EGCs that commenced their IPO before mid-April (on the theory that these EGCs already had prepared and included three years of audited financial statements and five years of selected financial data in a publicly filed prospectus and would not be inclined to present less disclosure in later filings), the preferences for three years of audited financial statements and five years of selected financial data are reduced only marginally.

Where three years of audited financial statements are included in the prospectus, several reasons typically are cited. The primary reason, by a wide margin, is that the extra year of audited financial statements is necessary to show investors the longer-term trends and historical growth trajectory of the company, which may have a positive impact on marketing the offering as well as satisfy liability concerns. Also, buy-side investors often have been demanding the third year of audited financial statements. The decision to include two versus three years of audited financial statements did not appear to be linked to the size of the offering.

Practice Points

Abbreviated Financial Statements of Acquired Businesses and Equity Method Investees. An EGC registration statement that is required to present only two years of audited financial statements also may limit the audited financial statements of acquired businesses and equity method investees under Rules 3-05 and 3-09 of Regulation S-X, respectively, to two years.

Abbreviated Financial Statements in Non-IPO Registration Statements. Notwithstanding that the accommodation for abbreviated financial statements is limited to an EGC equity IPO, the Staff has stated that it will not object if, in other Securities Act registration statements (covering, for example, a follow-on equity offering or a debt offering), an EGC does not present audited financial statements for any period prior to the earliest audited period presented in the IPO prospectus.

No Abbreviated Financial Statements in a Form 10 Filed in Connection With a Spin-Off of an EGC. The accommodation permitting an EGC to file only two years of audited financial statements is limited to sale transactions registered under the Securities Act. A typical spin-off will not involve a sale that would trigger Securities Act registration. Accordingly, any Form 10 filed by the EGC in connection with the spin-off must contain three years of audited financial statements (unless the EGC is a smaller reporting company, in which case two years would suffice).

Testing-the-Waters Communications

The JOBS Act significantly eases the Section 5 restrictions on gun-jumping by permitting an EGC, or a person authorized to act on the EGC's behalf, to make oral and written offers to qualified institutional buyers (QIBs) and institutional accredited investors before or after the filing of a registration statement to gauge their interest in the offering.

Nine-Month Data: Mixed Acceptance. The frequency and degree to which EGCs or their authorized representatives have conducted testing-the-waters communications in the past nine months is not readily apparent from SEC filings, as these communications do not need to be publicly filed with the SEC. In our experience, however, the use of these communications has been uneven and largely deal-specific. Current market practices related to testing-the-waters communications are best understood if the communications are separated into pre- and post-filing communications. Pre-filing communications (which typically precede any confidential submission) increasingly are being used in connection with “Meet the Management” presentations between EGCs and underwriter-selected QIBs. The substance of these meetings generally is focused on explaining the EGC’s “story,” with a view toward assisting the EGC in determining whether to proceed with an IPO. Financial statements and performance-related information are not part of the presentation, and there generally is no discussion of valuation or solicitation of non-binding indications of interest.
Post-filing testing-the-waters communications, on the other hand, have been used, albeit less frequently, to explore valuation for EGCs that had a “story” or were a part of an industry that was the subject of heightened interest from investors. Not surprisingly, the timing of these more substantive discussions is heavily influenced by buy-side interest. Companies should note that many underwriters prefer to schedule substantive testing-the-waters meetings only after the draft registration statement has been through at least one (and preferably two) rounds of Staff legal and accounting comments, in an effort to ensure that the content of the communications will conform to the prospectus. Consideration must be given to the launch date of the offering, as investors increasingly have been unwilling to entertain a testing-the-waters meeting close in time to the actual roadshow. In this regard, a number of buy-side and sell-side participants have questioned whether the exploration of value in connection with testing-the-waters communications would present sufficient upside to investors to justify their attention given their limited resources.

In sum, market practice in this area — similar to when free writing prospectuses were first permitted — is developing slowly and cautiously. We expect practices will continue to evolve over the course of the next year.

Practice Points

**Liability.** Given that the JOBS Act does not exempt issuers and underwriters from potential anti-fraud liability for any oral or written testing-the-waters communications, EGCs and their authorized personnel generally should follow the same procedures and protocols as would be the case for a roadshow (e.g., conforming the communications to the statutory prospectus disclosure and generally avoiding the use of projections). EGCs should not treat a testing-the-waters presentation as a “mock” roadshow; rather, management should be prepared to deliver a final and refined pitch as would be the case with the roadshow.

**SEC Comments.** Unlike an issuer free writing prospectus, a testing-the-waters communication does not need to be filed with the SEC. EGCs, however, should expect to receive a standard comment from the Staff requesting that any “written materials” used in connection with testing-the-waters communications be provided supplementally to the Staff in connection with its review of the registration statement. Senior Staff recently stated that “written materials” include slide decks or similar visual aids, even if the materials are taken back after the presentation. The Staff will analyze these materials primarily with a view to ensuring consistency between any testing-the-waters communications and the prospectus. Because of the prospect of having to include these materials in the prospectus, EGCs and underwriters generally prefer oral presentations. We believe underwriters will continue to require that written materials be taken back after a presentation notwithstanding that they will have to provide the materials to the Staff.

**Use of a “Pink Herring” Prospectus.** In connection with testing-the-waters meetings, some EGCs have posted a password-protected version of the confidential registration statement on the Internet roadshow and disabled the print option. These precautions are intended to ensure that the EGC is not deemed to be using a noncompliant prospectus in violation of Section 5, which requires that a valid preliminary prospectus be publicly filed and include a bona fide price range.

**Representations/Indemnification.** As with free writing prospectuses, EGCs are being asked to make representations to the underwriters with respect to the information contained in testing-the-waters materials and to indemnify the underwriters for any damages arising from material misstatements in or omissions from the materials.

**Gauging Investor Interest Versus Soliciting Orders.** In August 2012, the Staff addressed the impact on testing-the-waters communications of the limitations under Exchange Act Rule 15c2-8(e), which requires a broker-dealer to provide a customer a preliminary prospectus prior to any solicitation of orders. The Staff guidance confirmed that Rule 15c2-8(e) applies only after the filing of a registration statement, and clarified that underwriters may discuss price, volume and market demand and solicit nonbinding indications of interest without being considered to be improperly soliciting a customer’s order.
**Mergers and Acquisitions.** The Staff recently confirmed that an EGC may use testing-the-waters communications with QIBs and institutional accredited investors in connection with a merger or exchange offer. While qualifying testing-the-waters communications would not be deemed pre-filing offers or post-filing prospectuses that would need to be timely filed under Rule 425 to ensure the protections of the Rule 165 safe harbor, the JOBS Act did not provide similar relief from the gun-jumping provisions of the proxy and tender offer rules. As such, tender offer communications and proxy solicitations by the EGC outside the business combination registration statement would be subject to the relevant filing and legending requirements of Exchange Act Rules 13e-4(c), 14a-12(b) and 14d-2(b).

**Publication and Distribution of Research Reports**

The JOBS Act permits a broker-dealer to publish or distribute a research report about an EGC that proposes to register an equity offering under the Securities Act or has a registration statement covering an equity offering pending, and the research report will not be deemed an “offer” under the Securities Act, even if the broker-dealer is participating or will participate in the offering. Together with recent NYSE and FINRA rulemaking, the JOBS Act also eliminates, for IPOs of EGCs, the existing FINRA-based 40-day (for managing underwriters and co-managers) and 25-day (for other syndicate members) quiet periods imposed immediately after IPOs and the 15-day (for managers and co-managers) quiet period extension imposed prior to and after the expiration, waiver or termination of a lock-up agreement. Anti-fraud liability under Exchange Act Section 10(b) and Rule 10b-5 thereunder and state law is not impacted by the JOBS Act provisions addressing the publication and distribution of research reports.

**Nine-Month Data: Mixed Acceptance.** Underwriters, at least for now, appear to have settled on a cautious approach to the publication and distribution of pre-deal and post-deal research, based largely on liability concerns. First, we are not aware of any underwriters publishing research before or during a traditional offering by an EGC. Second, as it relates to post-deal research, underwriters have settled on a “best practices” consensus that research should be published no earlier than 25 days after the date of the EGC IPO, so as not to compete with the IPO prospectus during the prospectus delivery period. We believe that market practices related to deal research will continue to evolve with the passage of time.

**Streamlined or Exempt Disclosures**

Under the JOBS Act, an EGC is eligible to make scaled disclosures or rely on exemptive relief from certain disclosure and other requirements for up to five years following its IPO. The EGC may elect to forego reliance on any disclosure accommodation or exemption available to it. As explained below, EGCs have moved aggressively to take advantage of many of these accommodations.

**Limited Executive Compensation Disclosures**

EGCs are permitted to avoid the detailed compensation disclosures that otherwise would be required by Item 402 of Regulation S-K and instead provide scaled executive compensation disclosure under the requirements generally available to smaller reporting companies. Accordingly, insofar as relevant to IPOs, an EGC may (1) omit the detailed Compensation Discussion and Analysis (CD&A); (2) provide compensation disclosure covering the top three (including the CEO), rather than the top five, executive officers; and (3) omit four of the six executive compensation tables required for larger companies.

**Nine-Month Data: Strong Acceptance.** Of the 39 EGC IPOs that otherwise would be required to include traditional executive compensation disclosures (i.e., excluding offerings by foreign private issuers, externally managed REITs, commodity pools, etc.), 23 included a CD&A section and 16 did not. Almost all the EGCs that included a CD&A also included the executive compensation tables required of larger companies, while almost all that did not include a CD&A took advantage of the ability to omit certain executive compensation tables required for larger companies. Finally, the majority of companies included executive compensation disclosure for more than three named executive officers.

If the sample, however, is refined to focus solely on the 16 EGC IPOs that commenced after mid-April, the data shows that only four companies included a CD&A section, included more than the minimum number of executive compensation tables, or included more than the minimum number of named executive officers.
Practice Points

**Abbreviated CD&A.** In our experience, most investors primarily are interested in the historical executive compensation data and, to the extent they desire an analysis and discussion of a company’s executive compensation disclosures, these investors may be more interested in a forward-looking discussion of the company’s executive compensation philosophy and practices as a newly public company as compared to the executive compensation decisions made while a private company. Absent special circumstances, however, the inclusion of an abbreviated CD&A generally is not necessary to market successfully an EGC IPO.

**Auditor Attestation Report Under Section 404(b) of Sarbanes-Oxley**

EGCs are exempt from the requirements under Section 404(b) of Sarbanes-Oxley to have an auditor attest to the quality and reliability of the company’s internal control over financial reporting. The exemption remains valid for so long as the company retains its EGC status. It should be noted that, in many cases, the practical effect of this exemption is to extend relief already available to almost all newly public companies. That is, under current SEC rules, all newly public companies, regardless of size, generally have until their second annual report to provide the auditor attestation report, and smaller public companies (generally those with a public float less than $75 million) are permanently exempted.

**Nine-Month Data: Strong Acceptance.** Virtually all EGCs have included disclosure that they intend to or may take advantage of the exemption to delay providing the auditor attestation report under Section 404(b). Many companies that did not affirmatively state that they would be taking advantage of the exemption preserved their optionality by disclosing that they “had not made a decision” as to whether to take advantage of the exemption. The decision almost universally is tied to potential significant savings in terms of time and money. However, there is some debate whether the perceived savings are overestimated given the costs that companies already incur in connection with IPO due diligence related to internal controls and will incur related to management’s opinion on internal control over financial reporting. Further, for any EGC that quickly graduates to large accelerated filer status, the exemption offers no relief that would not otherwise be available based on the newly public company exemption set forth in the instructions to Item 308 of Regulation S-K.

Practice Points

**Management’s Report Under Section 404(a) of Sarbanes-Oxley.** An EGC is not exempt from having to provide management’s opinion on internal control over financial reporting. As is the case with virtually all newly public companies, however, an EGC generally would not provide management’s opinion until it files its second annual report with the SEC.

**CEO and CFO Certifications.** The Section 404(b) exemption does not change the requirement for an EGC’s CEO and CFO to provide compliance certifications under Sections 302 and 906 of Sarbanes-Oxley in 10-Ks and 10-Qs.

**Extended Transition for New GAAP**

EGCs are not required to comply with new or revised financial accounting standards until those standards apply to private companies. Under this provision, an EGC will be permitted to follow a longer, private company transition where there is a different effective date for an accounting standard specified for private companies.

**Nine-Month Data: Weak Acceptance.** Approximately 20 percent of EGCs have elected to take advantage of the extended transition period for compliance with new or revised financial reporting standards. Decisions to take advantage of the extended transition period do not appear to have been impacted materially by the size of the offering. This aggregate figure, however, may be over-representative of the current market consensus, as 22 of the 25 EGC IPOs completed since September 1, 2012, have involved companies that declined to take advantage of the extended transition period.
We believe the reasons that EGCs are declining the extended transition period for new or revised financial standards in larger numbers are two-fold. First, EGCs and their advisers are concerned that taking advantage of the extended transition period will cause comparability concerns in the marketplace to those of peer competitors. Second, an EGC IPO registration statement still must satisfy the line-item requirements of the relevant Securities Act form, including as it relates to then-current accounting disclosures required by Regulation S-X. Thus, the transition provides only a prospective benefit and therefore is of limited utility, especially when the comparability issues are considered.

Practice Points

Opt Out/Opt In. A determination by an EGC to opt out from or reject the transition period for complying with new or revised financial accounting standards is irrevocable. An EGC should notify the Staff of its choice at the time of the initial confidential submission or, if it chooses not to make a confidential submission, at the time it first publicly files its registration statement. An EGC that initially decides to opt in or take advantage of the extended transition period may determine at any time to opt out (i.e., abandon the extended transition period and comply with the accounting standard effective dates applicable to non-EGCs). This decision, which will be irrevocable, must be disclosed prominently in the EGC’s next periodic report or registration statement.

Determining “New or Revised Financial Accounting Standards.” The term refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after the JOBS Act enactment date, April 5, 2012.

Extended Phase-In for Foreign Private Issuers. A foreign private issuer that qualifies as an EGC and reconciles its home country GAAP financial statements to U.S. GAAP can take advantage of the extended transition period for complying with new or revised financial accounting standards in its U.S. GAAP reconciliation.

Determining EGC Status

An EGC is defined as an issuer (including a foreign private issuer) with total annual gross revenues of less than $1 billion during its most recently completed fiscal year. For an issuer to qualify as an EGC, its initial registered offering of common equity must not have occurred on or before December 8, 2011. Status as an EGC is maintained until the earliest of:

- The last day of the fiscal year following the fifth anniversary of the date of its IPO;
- The last day of the fiscal year in which it has total annual gross revenues of $1 billion or more;
- Any date on which it has, during the prior three-year period, issued more than $1 billion in non-convertible debt; or
- The date on which it becomes a “large accelerated filer” (generally, a company with a public float of at least $700 million that has been publicly reporting for at least one year).

Practice Points

Timing of Revenue Determination. In applying the revenue test, an EGC must look to its most recently completed annual period, regardless of whether financial statements for such period will be required to be presented in the registration statement. To illustrate, assume a calendar year-end EGC will file an equity IPO registration statement in January 2013. The registration statement will include audited financial statements for 2011 and 2010 and unaudited financial statements for the nine months ended September 30, 2012 and 2011. The most recently completed fiscal year would be 2012 notwithstanding that the registration statement would not be required to include audited financial statements for 2012.

Application to Successor Issuers. An issuer that succeeds to a predecessor’s Exchange Act registration or reporting obligations under Rules 12g-3 and 15d-5 will not qualify for EGC status upon
completion of the succession transaction if the predecessor’s first sale of common equity securities occurred on or before December 8, 2011, because the predecessor was not eligible for EGC status.¹⁷

**Application to Subsidiary Issuers of Non-EGC Parents.** In the case of a non-EGC parent’s spin-off of a wholly-owned subsidiary, resale of the wholly-owned subsidiary’s common stock, and a carve-out IPO of the wholly-owned subsidiary, the EGC determination focuses on the EGC test as applied to the subsidiary and not the parent. Accordingly, so long as the subsidiary’s total annual gross revenues are less than $1 billion and it otherwise does not trigger any of the EGC disqualifications, the subsidiary can qualify as an EGC even when the parent does not qualify as an EGC.¹⁸

**Application to Previously Reporting Issuers.** A reporting company that goes dark or is taken private (such as through a leveraged buyout) and therefore is no longer required to file Exchange Act reports generally may qualify (absent bad faith) as an EGC notwithstanding that it registered a public offering(s) of common equity securities on or before December 8, 2011.¹⁹

**Application to Nontraditional Issuers.** Asset-backed securities issuers and registered investment companies do not qualify as EGCs. Business development companies, however, may qualify as EGCs.²⁰

**Conclusion**
We believe that the majority of the reforms, accommodations and exemptions discussed above have become or increasingly will become an established part of the EGC IPO “playbook.” However, as is the case with any significant reforms, we expect market practices will continue to develop and the true impact of the JOBS Act on the IPO market only will become apparent with the passage of time.

**END NOTES**


2. An EGC is defined as an issuer (including a foreign private issuer) with total annual gross revenues of less than $1 billion during its most recently completed fiscal year.

3. Rule 135 permits an issuer to discuss the “anticipated timing of the offering.” Thus, so long as the confidential submission is noted narrowly in the context of the timing of the offering, the press release will comply with Rule 135 (assuming the conditions of the rule are otherwise satisfied).

4. SEC, JOBS Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act (Title I FAQs), at Question 43. The Title I FAQs can be found here: http://www.sec.gov/divisions/corpfin/guidance/cfjobsactfaq-title-i-general.htm.

5. Title I FAQs, at Question 11.

6. The nine-month data related to audited financial statements and selected financial data excludes the nine EGC IPOs that were otherwise permitted to include less than two years of audited financial statements (e.g., companies that recently commenced operations).

7. Title I FAQs, at Question 16. Question 45 expands this guidance to an EGC business combination registration statement, and provides that an EGC that is not a shell company and includes only two years of audited financials in its business combination registration statement needs to present only two years of audited financial statements of a (non-smaller reporting) target company notwithstanding its significance. Id. at Question 45.

8. Id., at Question 12.

9. The Form 10 may include only three years of selected financial data under Item 301 of Regulation S-K.


11. Title I FAQ, at Question 42.

13 Title I FAQs, at Question 13.

14 Id., at Question 37.

15 Id., at Question 33.

16 Id., at Question 34.

17 Id., at Question 24.

18 Id., at Question 53.

19 Id., at Question 54.

20 Id., at Questions 19-21.
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