



# Competitive Enterprise Institute

**STATEMENT BY**

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**BEFORE THE**

**HOUSE COMMITTEE ON FINANCIAL SERVICES**

**SUBCOMMITTEE ON CAPITAL MARKETS AND  
GOVERNMENT SPONSORED ENTERPRISES**

**“The 10th Anniversary of the Sarbanes-Oxley Act”**

**Washington, DC**

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Chairman Garrett, Ranking Member Waters, and honorable members of this subcommittee, thank you for this opportunity to present testimony on behalf of my organization, the Competitive Enterprise Institute.

My organization, the Competitive Enterprise Institute, is a Washington-based free-market think tank that since its founding in 1984 has studied the effects of all types of regulations on job growth and economic well-being. As we have said before, we follow the regulatory state from “economy to ecology,” and propose ideas to “regulate the regulators” and hold them accountable so that innovation and job growth can flourish in all sectors.

Our theme on job growth has been “liberate to stimulate,” because as our Vice President Wayne Crews has observed, one doesn’t need to teach – or subsidize -- grass to grow. Rather, remove the rocks obstructing its growth, and it will grow wide and tall. And this law called SOX is definitely one of the biggest “rocks.”

This hearing marks the occasion of the tenth anniversary of the passage and signing of SOX, the Sarbanes-Oxley Act of 2002, and I must confess that on past anniversaries of this law, I had not found much to celebrate.

I had looked at the cost burden of just one section of this law, the “internal control” mandates of Section 404, originally estimated by the Securities and Exchange Commission to cost a public company an average of \$92,000 per year. The SEC has recently said that this burden is more like an average of \$2.3 million per year. And the worst part is that the SEC has found that the cost burden for smaller companies is still more than seven times greater than that imposed on large firms relative to their assets.

I had listened to Home Depot co-founder Bernie Marcus say several times that he and his partner could not have taken Home Depot public had SOX been in effect in 1981. Mr. Marcus has stated this belief to many interviewers, including radio Host Hugh Hewitt and FOX News’ Greta VanSusteren. And I heard him state his belief that if the company had not raised this initial capital by going public back then, he and his partner could not have built it into the powerhouse chain it is today, serving so many satisfied customers and employing more than 300,000 workers.

I had compared Home Depot’s size when it went public in 1981 – just four stores in the chain – to that of Facebook’s ill-fated initial public offering -- \$100 billion in market capitalization – as well as that of recent IPOs of Groupon and LinkedIn that had market caps exceeding \$1 billion. This is part of a post-SOX trend of both fewer U.S. IPOs – in no year since SOX passed has the number of IPOs approached that of the early ‘90s recession years, let alone the late ‘90s boom years – and much larger IPOs. According to President Obama’s Council on Jobs and Competitiveness, “the share of IPOs that were smaller [in market capitalization] than \$50 million fell from 80 percent in the 1990s to 20 percent in the 2000s.”

The reduced number of IPOs was making it that much harder to climb out of the economic hole. As the President’s Job Council noted, “the data clearly shows that job growth accelerates when companies go public.” As the council and others have noted, 90 percent of a public company’s job creation occurs after it goes public. Directly fingering SOX, the council observed: “Well-intentioned regulations aimed at protecting the public from the misrepresentations of a small number of large companies have unintentionally placed significant burdens on the large

number of smaller companies. As a result, fewer high-growth entrepreneurial companies are going public."

Companies waiting until they were almost as big as Facebook before they went public also meant that ordinary investors would lose out on opportunities, as they had with Home Depot and countless firms in the '80s of 90s, of buying into emerging companies at their growth stages and growing wealthy along with the firms.

And as an advocate for investors as well as entrepreneurs, I observed with deep sadness the implosions of many companies fully subject to SOX rules – such as Lehman Brothers and MF Global. The trivial minutiae that SOX had companies and their accountants document – at such high cost to legitimate companies – seemed to do little to prevent massive mismanagement or outright fraud at troubled firms. As Hal Scott, Nomura Professor of International Financial Systems at Harvard Law School, has written, despite SOX 404's "high costs, it remains empirically unclear whether adherence to SOX 404 achieves its intended benefit: reduced incidence of fraud or opaque or aggressive accounting practices by public companies."

So up until a few months ago, I and many entrepreneurs and investors were not exactly in a mood for celebration in looking forward to SOX's big 10. But then this House, the Senate, and President Obama pleasantly surprised me with a powerful first step towards SOX reform and relief. In April, President Obama signed, after it overwhelmingly passed this House and this subcommittee, the Jumpstart Our Business Startups (JOBS) Act.

Among other things, the JOBS Act creates a five-year "on-ramp" for firms going public that have market caps of less than \$1 billion and annual revenues of less than \$700 million in which they are exempt from the Sarbanes-Oxley internal control mandates, costly provisions of Dodd-Frank that specifically apply to public companies, and other burdensome regulations. And this provision, which went into effect immediately after the legislation was enacted, is already paying dividends to entrepreneurs, investors and the economy as a whole.

We know that in the mere three months since passage of the law, at least 46 emerging-growth firms have taken advantage of this JOBS Act provision in planned IPOs. I have attached the names of these companies in an appendix to this testimony. What's even more remarkable, and convincing evidence of SOX's true burden to smaller firms, is the size of these IPOs. For instance, ClearSign Combustion, a respected Seattle-based green technology firm, launched an IPO under the JOBS Act on-ramp in late April with a market cap of just \$12 million. I don't believe we have had IPOs this small since before SOX went into effect.

The JOBS Act is a big improvement, but there is so much more that can be done to nurture job growth and innovation at small and large public companies and to lift barriers to more firms going public. The Fostering Innovation Act (H.R. 6161), would provide a needed supplement to

the regulatory relief in the JOBS Act. By making sure that midsize companies aren't misclassified by the SEC as large due to a sudden spike in their share prices, the bill would help ensure that these job-creating firms have time to grow.

We also need to eventually get rid of Section 404 and other onerous SOX provisions for all public companies. If these rules aren't providing benefits to investors and the public that exceed their costs, there is no reason why any firm should be weighed down by these provisions when resources now devoted to compliance could be used to expand and create jobs. As Mallory Factor, serial entrepreneur and professor of international politics and American government at The Citadel, has put it, "This is capital that could be invested in infrastructure improvements, job creation, and innovative technologies or research and development."

But all in all, with the JOBS Act passage, there is reason to celebrate SOX's birthday this year, and I and thousands of investors and entrepreneurs who are little less burdened by this law are ready to break out the birthday cake and champagne. So thank you again for inviting me to testify and additional thanks to nearly all the members of this subcommittee who supported the JOBS Act. I am happy to answer any questions you may have.



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## Appendix

### **List of emerging-growth companies already utilizing Sarbanes-Oxley relief from the Jumpstart Our Business Startup Act**

#### July 2012:

Gigamon LLC  
Delek Logistics Partners, LP  
Hi-Crush Partners LP  
Audeo Oncology, Inc.  
Performant Financial Corp  
GlobelImmune INC  
MPLX LP

#### June 2012:

Natural Grocers by Vitamin Cottage, Inc. (NGVC)  
Qualys, Inc.  
iWatt Inc

#### May 2012:

Kythera Biopharmaceuticals Inc.  
Shutterstock  
OncoMed Pharmaceuticals  
Legalzoom

#### April 2012:

Southcross Energy Partners, LP

**“Emerging Growth Companies” that filed public registration statements prior to enactment of the JOBS Act but after December 8, 2011 and thus amended their registration statement to take advantage of the retroactivity of the law:**

#### April 1-15, 2012:

FiveBelow  
Stemline Therapeutics  
Hyperion  
Palo Alto

#### March, 2012:

Service NOW  
Reval Holdings  
ADMA Biologics  
Globus Medical  
Tesaro, Inc.  
Durata Therapeutics  
Ginkgo Residential Trust  
Exponential Interactive  
American Oil & Gas  
Fender Musical Instruments Corp

Feb 2012:

E2Open  
Diamondback Energy  
EQT Midstream Partners, LP  
Quicksilver Production Partners

Jan 2012:

Tria Beauty Inc  
Del Frisco's Restaurant Group  
China Auto Rental Holdings Inc  
Audience Inc  
Splunk Inc  
Pacific Coast Oil Trust  
Infoblox Inc  
Extend Health Inc  
UTE Energy Upstream Holdings LLC

Dec 2011:

Cancer Genetics, Inc.  
GoGo Inc.  
Avast Software  
Coskata, Inc.

\*Cantor Entertainment filed public S-1 in Dec and withdrew it after enactment of the JOBS Act in order to take advantage of confidential filing