Chapter 1

The Registered Offering

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§ 1:1 Introduction

Registration with the U.S. Securities and Exchange Commission (SEC) is the gateway to the U.S. public capital markets, the largest in the world. However, companies increasingly are delaying the marquee event of an initial public offering (IPO) as private financing options have grown. In recent years, the average age of a company going public was approximately eleven years; during the dot-com bubble in 1999–2000, the average was five.[1] At the same time, an eventual debut as a public company remains an incredibly popular goal. In 2014, Alibaba carried out the largest-ever IPO, and was just one of 288 companies to go public in the United States that year—a volume not seen since 2000.[2]

This chapter provides an introduction to the SEC registration process, with a particular focus on the IPO as the paradigmatic and most significant public offering in a company's lifecycle. It touches first on pre-IPO financing options and the reasons why a company might eventually choose to go public. The chapter then details the IPO process, and next surveys some of the chief requirements that accompany being a public company. Finally, the chapter examines financing alternatives for a public company and its stockholders.

§ 1:2 Pre-IPO Financing

In recent years, private company valuations, particularly in the tech sector, have swelled. As of September 2015, there were more than 115 "unicorns"—that is, private companies backed by venture capital with valuations exceeding $1 billion[3]—twice the number that existed only a year before.[4] This trend reflects a combination of factors, including a historically low interest rate environment and a chase for yield. These conditions may have led some investors to disregard the general illiquidity of pre-IPO securities and their lack of a valuation based on extensive SEC reporting and public trading. Private companies also are taking a more active hand in facilitating trading among their shareholders, which has been further spurred by the rise of third-party platforms that facilitate pre-IPO secondary markets.

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1. Peter Coy, *IPOs Get Bigger But Leave Less for Public Investors*, BLOOMBERG (July 24, 2014); Jay Ritter, Initial Public Offerings: Median Age of IPOs Through 2013 (May 9, 2014).
2. Ernst & Young Global Limited, EY Global IPO Trends, 2014 Q4 [hereinafter E&Y 2014 IPO Report], at 6.
3. Daniel Roberts & Andrew Nusca, *The Unicorn List*, FORTUNE (last updated Aug. 25, 2015).
4. Rolfe Winkler & Telis Demons, *Tech Firms Are Notably Scarce in IPO Market*, WALL ST. J. (Sept. 10, 2015).

In addition, the recent poor performance of some tech companies following their IPOs may have resulted in management in some cases seeking to stay private longer,[5] thereby avoiding the scrutiny of research analysts and quarterly reporting—particularly when substantial sums can be raised through private financing. A longer pre-IPO period also allows a company to mature before going public, which can result in a more favorable valuation when the IPO ultimately occurs. Finally, stock market volatility due to the Chinese market crash, among other factors, has made it harder to go public by exacerbating the challenges of properly timing the launch of the transaction, as well as correctly pricing the offering.

These market trends have dovetailed with increasingly liberalized rules relating to private placements introduced by the Jumpstart Our Business Startups (JOBS) Act. These trends are covered in more detail in chapter 2, *Limited Offerings and Private Placements*, and include the following:

- The threshold relating to mandatory registration of a class of securities under the Securities Exchange Act of 1934 (the "Exchange Act") being increased from 500 record holders to 2,000 (so long as fewer than 500 holders are not accredited investors), and excluding certain categories of holders from counting toward that threshold, including persons who received securities pursuant to employee compensation plans in transactions exempt from registration under the the Securities Act of 1933 (the "Securities Act"). This increase has allowed pre-IPO companies to grant equity compensation to employees without worrying about inadvertently becoming Exchange Act-reporting issuers before they are ready.

- General solicitation and general advertising being permitted in the context of certain securities placements under Regulation D. Easing publicity requirements in the context of Regulation D offerings allows issuers to reach potentially far larger investor bases. It also has helped fuel the growth of crowdfunding platforms that cater to accredited investors.

- Regulation A+ being introduced. The regulation allows companies to raise up to $50 million through securities offerings in a twelve-month period, subject to a lighter disclosure and reporting regime than applies in connection with a full-blown public offering.

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5. *See id.*

- The creation of a framework that will allow crowdfunding from retail investors without requiring SEC registration.

§ 1:3 Advantages of Going Public

A company usually chooses to go public for one or more of the reasons discussed below.

§ 1:3.1 Raising Capital

The most common rationale for an IPO is to raise cash. SEC registration allows the offering to be extended to all types of investors in the United States, including retail investors. Coupled with a listing on a securities exchange, such as the New York Stock Exchange (NYSE) or Nasdaq Stock Market (NASDAQ), an IPO provides an issuer both with initial financing (to the extent the IPO is done on a primary basis), as well the prospect of readily accessing the public markets for future funding.

§ 1:3.2 Venture Capital or Private Equity Exits

Venture capital and private equity sponsors typically look to exit their positions after a set number of years by way of an acquisition, or a public offering followed by a sell-down over time of remaining interests. A sponsor sometimes pursues both strategies simultaneously in a "dual track" process. The possibility of a near-term IPO generates pressure on potential acquirers to move quickly and can provide the sponsor with a valuation to compete with acquisition bids. IPOs by sponsor-backed companies have been a significant driver of recent IPO activity. In 2014, 63% of deals in the United States (and 72% of proceeds) were for private equity- or venture capital-sponsored companies.[6]

§ 1:3.3 Founder Liquidity

As with sponsors, an IPO creates a path to liquidity for founders. Even if the founders do not sell in the IPO, going public allows them to sell some or all of their stake over time.

§ 1:3.4 Employee Compensation

Going public creates a compensation currency for employees. Equity-based compensation further aligns the incentives of employees with the long-term financial success of a company.

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6. E&Y 2014 IPO Report, *supra* note 2, at 7.

§ 1:3.5 *Acquisition Currency*

Public stock creates an acquisition currency that can be used instead of, or alongside, cash to purchase other companies.

§ 1:3.6 *Branding and Prestige*

Going public confers prestige and indicates that a company has arrived successfully at a major stage in its lifecyle. Doing an IPO can signal that a company has developed the infrastructure necessary for being a public company—for example, sufficiently sophisticated and sized accounting, financial, compliance, legal, and IR staffs; strong internal and disclosure controls; and good governance and compliance practices—and is ready to withstand the scrutiny of public markets. An IPO also can be a significant branding and profile-raising opportunity.

§ 1:4 Disadvantages of Going Public

Although doing an IPO, particularly in the United States, remains an enormously popular transaction and confers the benefits described above, it is of course not without its costs and considerations, which include the factors discussed below.

§ 1:4.1 *Increased Expenses*

The IPO process can be expensive. Legal and accounting fees, as well as other costs, frequently amount to several million dollars. Once public, the company continues to incur multiple additional costs, often running more than $1 million per year, but which can be substantially higher for larger issuers in complex industries and multiple geographies.[7] Public companies generally must subject themselves to audits of their internal control over financial reporting, which can be costly. In addition, disclosure requirements have become increasingly complex and time-consuming to comply with in recent years. For example, substantial new disclosure requirements have been introduced in respect of compensation arrangements. As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), many issuers also have had to engage in extensive work and reporting around the use of "conflict minerals" in their products.

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7. Pricewaterhouse Coopers LLP, Considering an IPO? An Insight Into the Costs Post-JOBS Act, at 5 (2015).

In addition, due to increased focus by the SEC on cybersecurity following major hacks on a number of public companies, many are now significantly ramping up their cyber protections, both to protect their businesses and to insulate themselves against liability should they suffer an attack. Exiting the SEC reporting regime can be extremely difficult as a practical matter once a company is public. A company preparing for an IPO therefore should anticipate potentially significant future costs to the extent regulatory burdens under the securities laws continue to increase.

§ 1:4.2 Increased Liability Exposure

The capital markets lifeblood of a public company is its disclosure. Accordingly, federal and state securities laws impose a range of potential penalties for companies and their directors and officers for materially inaccurate or incomplete disclosure. Directors and officers also have fiduciary duties toward a company and can be subject to shareholder claims for breaching them. Although directors and officers usually have the benefit of directors and officers insurance and indemnification from their companies, these may not be fully protective.

§ 1:4.3 Loss of Privacy and Flexibility

A U.S. issuer is required to report quarterly, and many foreign private issuers[8] also do so under home country requirements or voluntarily to satisfy investor demand. Quarterly reporting and current reporting on Form 8-K (or Form 6-K for foreign private issuers) in respect of significant events, together with often-intensive research analyst coverage, as well as financially focused internet sites, place public companies in the spotlight. From an operational standpoint, Exchange Act disclosure can provide competitors with sensitive information that a company otherwise might choose not to release. Internal events, such as senior management departures, significant mergers and acquisitions (M&A) and financing transactions, and loss of key business relationships can become potential news stories that must be managed more carefully than prior to being public. From a financial

8. A "foreign private issuer" is a company incorporated or organized under the laws of a foreign country unless (i) more than 50% of its outstanding voting securities are directly or indirectly owned by residents of the United States, and (ii) any one of the following: (a) the majority of its executive officers or directors are U.S. citizens or residents; (b) more than 50% of its assets are located in the United States; or (c) its business is administered principally in the United States.

perspective, a public company often can find its focus drawn toward short-term financial and stock price performance, rather than long-term business results. In recent years, for example, instead of reinvesting in their businesses, many companies have engaged in extensive stock buybacks as a way of returning the capital to investors, but also boosting their stock price, resulting, in some cases, in criticism from investors with a more fundamental or long-term focus.[9] Some members of the financial community even have called for the elimination of quarterly reporting as a way of mitigating these pressures.[10]

§ 1:4.4 Management Distraction

Senior management is an integral part of the IPO working group, and completing an IPO can distract it from other business initiatives. Additionally, once public, the chief executive officer (CEO), chief financial officer (CFO), and other executive officers, as well as directors, often must devote a substantial amount of time to quarterly earnings and ongoing efforts to communicate with their public shareholders, as well as the compliance requirements from being public. Time spent on these activities is time not spent on the business.

§ 1:4.5 Loss of Control

Selling a percentage of a company to the public usually requires surrendering a degree of control, although companies sometimes implement dual-class stock or similar structures to maintain control in the hands of a sponsor or founder. Even if a company only sells a minority of its shares, and insiders can control votes on corporate matters, the company's directors and officers still must heed their fiduciary duties, which sometimes can conflict with the wishes of sponsors, founders, and insiders. In addition, once a company becomes public and lists on a securities exchange, it becomes subject to corporate governance requirements that can reduce the control of these parties. For example, for most companies, the majority of the board must be

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9. *See, e.g.*, *The Repurchase Revolution*, THE ECONOMIST (Sept. 13, 2014); Dan Strumpf, *Companies' Stock Buybacks Help Buoy the Market*, WALL ST. J. (Sept.13, 2014).

10. *See, e.g.*, David Benoit, Time to End Quarterly Reports, Law Firm Says, WALL ST. J. (Aug. 19, 2015); Dominic Barton, *Capitalism for the Long Term*, HARV. BUS. REV. (Mar. 2011). In 2014, England removed a rule that required companies based in there to report quarterly, but to date few firms have taken advantage of it. *See, e.g.*, Drew Hasselback, *The Case for Ditching the Quarterly Financial Report: 'Quarterly Earnings Are Mostly Noise'*, FIN. POST (June 8, 2015).

independent, and there must be independent audit, compensation and nominating/corporate governance committees.[11]

§ 1:4.6 Exposure to Governance Scrutiny and Shareholder Activism

Public companies are subject to attack by the increasingly formidable activist community. Proxy advisory services, such as Institutional Shareholder Services (ISS) and Glass Lewis, publish guidelines about corporate governance practices and executive compensation matters, and advise voting against directors of companies that do not comply. These recommendations can carry significant weight. Companies that an activist investor believes are deficient in governance or are poorly run can become subject to aggressive attacks, with investors engaging in proxy campaigns in support of their own proposals (for example, to obtain seats on the board or to seek other changes at the company). Even when successfully defended, these attacks can be time-consuming, expensive, and distracting.

§ 1:4.7 Valuation Fluctuation

Once a company becomes public, its valuation is determined daily by the market. Macroeconomic and industry conditions, market sentiments and other factors can adversely (or positively) affect its stock price. This fluctuation can affect the ability of the company to pursue strategic initiatives and lead to an undue focus on the stock price, rather than more essential business considerations.

§ 1:5 The Working Group

Once the decision has been made to do an IPO, the first step is to assemble a team of outside advisers in addition to an internal IPO working group, which may include the CEO, CFO, controller/treasurer, and general counsel, among others.

Selecting investment bankers to underwrite the IPO is a crucial decision for its success. The underwriting syndicate includes one to

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11. Foreign private issuers, limited partnerships, and "controlled companies" are exempt from these requirements, but still must have an independent audit committee.

Other than audit committee requirements, a listed foreign private issuer generally is permitted to follow its home country governance practices, but is required to include in its annual report on Form 20-F a description of how those practices differ from those that would apply to a U.S. issuer listed on the relevant securities exchange.

three investment banks that serve as the lead underwriters, or "book-runners." The lead underwriters generally run the IPO process on behalf of the syndicate, which includes advising the company on valuation and offering structure, marketing the transaction, and, most importantly, building a book of orders and pricing the IPO. The lead underwriters may be chosen based on factors such as their existing relationship with the company, IPO experience, sector knowledge, buy-side relationships, depth and scope of their sales force, and many other factors. Combining several lead underwriters often allows a company to maximize their individual strengths. Additional underwriters, referred to as "co-managers," fill out the syndicate, but usually play a more passive role in execution. They nonetheless receive their proportionate share of the underwriting fee and bear a corresponding amount of underwriting risk.

Increasingly, companies contemplating IPOs also hire an independent IPO adviser to provide additional strategic advice and help assess input from the lead underwriters. This adviser may be engaged before the underwriting syndicate to assist with the selection of banks.

Both the company and the underwriting syndicate must engage counsel to help guide them through the process and facilitate execution. Lawyers play a key role in drafting offering documentation and transaction agreements, coordinating with the SEC and other regulators, and providing legal opinions, in addition to ensuring legal issues are correctly resolved.

A sponsor also may play a significant role in the working group, even if it does not plan to sell shares in the offering. A sponsor or other significant existing stockholder often has its own counsel to represent its interests. For example, a sponsor may be focused on optimizing valuation and the governance and control arrangements a company puts in place, as well as the sponsor's registration rights, which allow it to cause the company to register the sponsor's shares after the IPO to facilitate the sponsor's exit from its position as, and when, desired.

Another key player in the working group is the company's auditor, which will be expected to provide a clean audit report on the company's financial statements, as well as comfort letters to the underwriters regarding specified unaudited financial information in the offering document.

In addition, the company must choose a financial printer to file documents with the SEC and to print the preliminary and final prospectuses used in the IPO. The financial printer also may serve as the data room provider and virtually house documents for due diligence purposes. The company must engage a transfer agent to handle the mechanics relating to the issuance of its shares, too.

§ 1:6 EGC Status

The JOBS Act created a new category of company—the emerging growth company, or EGC—that is entitled to certain regulatory concessions. An EGC is a company with total annual gross revenues (that is, top-line revenues under Generally Accepted Accounting Principles (U.S. GAAP) or, for a foreign private issuer, International Financial Reporting Standards (IFRS)) of less than $1 billion. A company remains an EGC until (i) the last day of the financial year five years after its common stock IPO, (ii) the last day of the financial year in which it has total annual gross revenues of $1 billion or more, (iii) the day on which it has issued more than $1 billion in non-convertible debt securities (whether SEC-registered or not) during the preceding three years, or (iv) 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).

EGCs benefit from more liberal regulation across a number of areas implicated by the IPO process. An EGC is permitted to exclude the earliest of the three years of audited financial statements that otherwise would be required and, correspondingly, to include only two years of Management's Discussion and Analysis (MD&A) of its results of operations. Even if eligible to present and discuss only two years, an EGC often may find it preferable to include the third year (if available) to facilitate marketing the offering.

An EGC also enjoys scaled-back disclosure requirements in the area of executive compensation. Instead of being required to disclose the compensation of five named executive officers (the CEO, CFO, and three most highly paid executive officers who are not the CEO or CFO), an EGC must disclose only the compensation of three named executive officers (the CEO and two most highly paid executive officers who are not the CEO). An EGC also is not required to include a Compensation Discussion and Analysis (CD&A) section, thereby avoiding detailed additional disclosure on compensation matters. In addition, an EGC is exempt from the requirement to hold a non-binding stockholder vote on executive compensation arrangements ("say-on-pay" and "say-on-golden parachute" provisions), and the requirement to disclose "pay-versus-performance" information showing the relationship between executive compensation and the financial performance of the company, and the median total compensation of all employees compared to the CEO.

An EGC need not have an independent audit of its assessment of its internal control over financial reporting, among other relief from accounting-related requirements.

One of the most frequently used features of EGC status is the ability to have the SEC confidentially review "substantially complete"

registration statements. Confidential filings later must be made public prior to the IPO being completed, but the ability to engage with the SEC on a confidential basis for the initial rounds of review is advantageous, particularly in a dual-track scenario, because the company can credibly pursue an IPO without having to disclose any information if it is bought before public disclosure is required. If a company takes advantage of confidential review, the working group should carefully plot the execution timeline, as SEC rules require that the registration statement be made public no later than twenty-one days before the road show commences.[12]

An EGC also is allowed more latitude in its communications with potential investors than otherwise would apply. In particular, an EGC or a party authorized to act on its behalf (for example, an underwriter) may engage in communications with certain types of institutional investors even before the registration statement is first filed with the SEC, or after filing but before a preliminary prospectus with a price range is available. These "testing the waters" communications can be used to gauge the early level of interest for the contemplated offering. The benefit of testing the waters must be balanced against potential disclosure liability for the communications, and, as an execution matter, that it may be more desirable to wait until later in the process before engaging with potential investors, who can be reluctant to devote time to an offering until a later stage.[13]

§ 1:7 Terms of the Offering

Setting the size and price of an IPO, and determining whether to include a primary or a secondary component or both and, if so, their relative sizing, requires a careful balancing of a number of variables. By analyzing the company's historical and projected financial performance, business, management, and other factors, and comparing them to publicly traded peers, as well as taking into account buy-side input, industry factors, and market and macroeconomic conditions, the company and the lead underwriters determine a target valuation for the company. The company and the lead underwriters also consider the company's current and near-term financing needs and how recent IPOs (including especially peer company IPOs) have fared, as well as whether

12. In certain limited circumstances, such as when it is concurrently listing on a non-U.S. exchange (or already so listed), a foreign private issuer also is permitted to confidentially submit its IPO registration statement to the SEC for review, and is not subject to the 21-day requirement.
13. The SEC may ask for copies of any written "testing the waters" communication matierals. A company has liability for statements made in these materials, so should take care to ensure their accuracy and conformity to what is proposed to be, or is, in the draft registration statement.

any competitors are planning an IPO, along with any other significant market activity. In addition, they take into account how much control the existing owners might be willing to cede to the public, how much money they might be looking to raise for themselves, and how much dilution the company reasonably can incur.

The company and lead underwriters also consider the extent to which the structure leaves a significant amount of "overhang" in place. Overhang refers to unsold shares of a company creating downward pressure on the stock price due to the expectation that those shares soon will be sold. Because existing stockholders, directors, and officers (to the extent they are not selling in the IPO) usually are precluded from selling for 180 days (or more) after the offering, overhang concerns can be particularly acute when this "lock-up" period terminates. Companies sometimes stagger the termination of lock-up restrictions to mitigate this risk.

Some IPOs include directed share programs, which allow a company to reserve a percentage of the IPO share allocations (normally 5% or less) for "friends and family." Care must be taken by the company and the underwriters when administering a directed share program to ensure compliance with the relevant communication rules.

§ 1:8 Accounting and Auditing Issues

SEC rules generally require that a registration statement include audited financial statements of the company registering its offering, any significant business acquired by the company during or after the end of its most recent fiscal year, and companies in which the company has significant equity investments but not majority control.[14] Pro forma financial information generally also must be provided when a significant acquisition or disposition has occurred or is probable, showing what certain balance sheet and income statement line items would have been had the transactions taken place at the beginning of the fiscal year or period. If the company cannot provide these audited financial statements, it cannot proceed with the offering. In addition, companies in certain industries (for example, mining, natural resources

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14. In the case of certain very significant acquisitions that have become probable, inclusion of the financial statements of the entity to be acquired is required (*i.e.*, even before the transaction completes).

    In the context of a debt offering, audited financial statements of guarantors of the securities generally must be included, subject to certain exceptions allowing condensed consolidating information for the guarantors where the issuer is a parent company offering securities guaranteed by wholly owned subsidiaries, or the issuer is a wholly owned subsidiary offering securities guaranteed by its parent and other wholly owned subsidiaries.

and banking, among others) are required to provide certain supplemental financial and business information. Ensuring the ability to comply with these requirements is a critical gating item to proceeding with an IPO.

A non-EGC will prepare a prospectus that includes three years of audited income statements, cash flow statements and statements of stockholders' equity, two years of balance sheet data, and two additional (that is, earlier) years of selected financial data (generally drawn from audited financial statements). As discussed above, an EGC may exclude the earliest three years and need not provide selected financial data for earlier years. The prospectus also must include unaudited (but reviewed) financial information for any relevant subsequent interim period, together with the corresponding information for the same period in the prior year. The number of years of financial statements for any acquired business depends on the significance of the acquisition. The SEC will not review a registration statement or declare it effective unless the financial statements are sufficiently current in accordance with SEC rules (and are kept current as the registration process progresses). The financial statements also must be prepared under U.S. GAAP or, for a foreign private issuer, IFRS as issued by the International Accounting Standards Board (IASB) (or otherwise must be reconciled to U.S. GAAP).

In addition, there are numerous accounting issues on which the SEC may well focus in its review—for example, the need to change accounting policies to comply with GAAP, including segment reporting; the granting of "cheap" stock (that is, below fair value) to insiders or employees, which can result in the company being required to expense the undervalued grant (and make significant revisions to its financial statements as a result); overly aggressive revenue recognition or other accounting policies; and any improper impairment or treatment of goodwill or other intangibles.

The auditor of the company's financial statements must be registered with the Public Company Accounting and Oversight Board (PCAOB) and be "independent" of the company, within the meaning of that term under SEC rules and PCAOB standards. If the auditor does not meet these requirements, a new accounting firm must be engaged to re-audit the financial statements to be included in the registration statement.

§ 1:9 Listing Venue

The NYSE and NASDAQ are the dominant U.S. securities exchanges, both in terms of market share and prestige. Governance rules between the two exchanges are broadly similar, so the key driver for

selecting between them generally turns on branding, and, to a lesser extent, listing fees and ancillary services. The NYSE has a physical trading floor and began operations in 1792. NASDAQ is an entirely electronic platform that began operations in 1971. Although the NYSE historically has been the home of the large, "blue chip" issuers, while NASDAQ traditionally has attracted companies in the tech sector, that distinction has eroded in recent years. Regardless of the exchange selected, the bulk of the trading volume in a company's stock may well happen through a different trading venue, as brokers generally must route orders to the location with the best price for execution.

§ 1:10 Pre-IPO Corporate Clean-Up

§ 1:10.1 Corporate Governance—Board Matters

Once the company has decided on an exchange, it should ensure that it has (or will have within the one-year phase-in period) a sufficient number of directors to satisfy the exchange's independence requirements. (As noted above, foreign private issuers, "controlled companies," and limited partnerships generally are exempt from the requirement to have a majority independent board and most other corporate governance requirements, other than the requirement to have an independent audit committee.)

In addition to independent members for the board, the company will need to ensure it has enough independent directors to serve on its audit committee, compensation committee and nominating and governance committees (subject to phase-in periods of ninety days post-listing for a majority of independent committee members, and one year post-listing for full independence). For U.S. issuers, the audit committee must also have a member that is an audit committee financial expert or explain why it does not have one. Each of the committees must have a written charter, which must be in place when the IPO completes.

§ 1:10.2 Anti-Takeover Protections

A company contemplating an IPO frequently implements a suite of anti-takeover protections in advance of going public, when governance arrangements may be easily modified without the need for public shareholder approval. Selecting the right level of protection requires balancing between the defensive needs of the company and the potential opposition of proxy advisory services and investors. Peer practice, together with the guidelines issued by the proxy advisory services, generally provides a useful starting point in selecting appropriate measures.

Defensive measures that may be adopted include:

- a board with staggered terms;
- permitting only the board to fill director vacancies;
- allowing the board to increase its own size;
- giving the board, in addition to shareholders, the power to amend bylaws;
- allowing removal of directors only for cause;
- removing the ability of shareholders to call special meetings;
- imposing lengthy advance notice periods for shareholder proposals or board nominations;
- eliminating shareholder action by written consent;
- allowing for the issuance of blank check preferred stock;
- prohibiting business combinations with significant shareholders absent prior board approval;
- requiring supermajority voting for business combinations not approved by the board of directors; and
- using high/low voting structures (particularly where a group of founders wishes to retain control for a long period following the IPO), which has become more common in recent years.

[A] Other Clean-Up Matters—Management, Related-Party Matters, Consents, Corporate Policies, and More

There are many other items for a company to consider in terms of preparing to be a public company. These include:

- *Right Management Team.* Ensuring the right management team is in place and determining whether any further hiring is necessary (for example, a CFO or general counsel with public company experience).
- *Related Party and Compensation Arrangements.* Amending or eliminating certain related-party or compensatory transactions. For example, a public company may not extend credit to directors or executive officers. Accordingly, loans or similar arrangements should be unwound. In addition, there may be transactions that could be received poorly by investors—for example, excessive perks for management.

- *Required Consents.* Obtaining any required consents for the IPO (for example, from lenders or regulators).
- *Organizational Documents.* Making certain that the company's certificate of incorporation and by-laws are in good order, and that there is sufficient authorized stock for the IPO and future offerings. In addition, a stock split or reverse stock split may be needed in order to price the shares at a dollar figure that is compared to the stock price of similar listed companies similar to the issuer and that will help maximize liquidity. A company also might consider implementing anti-takeover protections, as discussed above, as well as adopting provisions that are easier to add pre-IPO—for example, a forum selection clause, which is a provision that requires shareholder class actions and derivative lawsuits to be filed in a single court (frequently, the Delaware Court of Chancery because of its well-developed body of corporate law and Delaware's common use as a state of incorporation).[15]
- *Corporate Policies.* Creating appropriate policies—for example, a code of ethics; a related-party transaction policy; a Foreign Corrupt Practices Act (FCPA), sanctions, and anti-money laundering policy; a whistleblower policy; and an insider trading policy.
- *Employment Agreements.* Entering into employment agreements with key employees, and adopting an equity compensation plan appropriate for a public company.
- *Director and Officer Insurance.* Putting in place sufficient D&O insurance.
- *Corporate Form.* Altering the company's corporate form, if necessary. An S corporation or limited liability company often will reorganize into a C corporation contemporaneously with an IPO.

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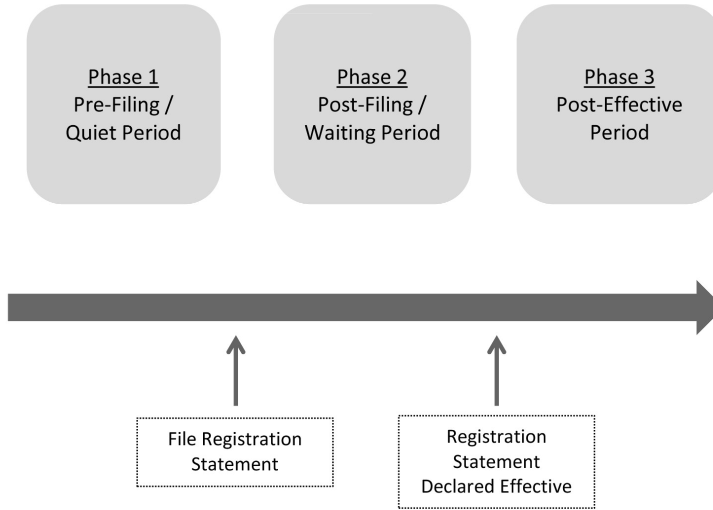
15. A 2015 amendment to the Delaware General Corporation Law allowed forum selection clauses in charters and bylaws of companies incorporated in Delaware (previously, judicial decisions in Delaware were relied upon for their inclusion).

§ 1:11 Communications During an IPO

§ 1:11.1 Generally

Figure 1-1

IPO Phases and Publicity



Publicity throughout the IPO process is highly regulated and scrutinized by the SEC. The regulatory aim is for the registration statement (and the prospectus within it) to serve as the primary source of information about the offering. The disclosure contained within the registration statement must be materially accurate and complete, a requirement underscored by the liability regime imposed on offering participants for material misstatements or omissions.

Engaging in impermissible publicity, or "gun jumping," can substantially delay the IPO because the SEC may require the company to wait while the publicity's effects "cool off." Even more significantly, gun jumping can expose the company to rescission rights for investors—that is, give investors the right to put their securities back to the company for a year following the IPO for the purchase price plus interest. In a number of high-profile IPOs, the SEC has required press articles profiling the CEO or conveying communications by the CEO to be added to the prospectus, along with disclosure indicating that investors might be able to bring rescission claims. Because of the importance of adhering to the publicity rules, company counsel usually discusses

16. [Reserved.]

publicity with the company at the start of the IPO process, and reviews any non-ordinary course communications throughout.

An IPO is characterized by three distinct phases relating to publicity:

- *Pre-filing, or Quiet, Period.* The most restrictive communication period, which begins when the decision to proceed with an offering has been made, but the registration statement has not yet been filed. (A confidential filing by an EGC or a foreign private issuer eligible to file confidentially does not end the quiet period.)
- *Post-filing, or Waiting, Period.* This period begins once the registration statement is filed and ends when it is declared effective by the SEC.
- *Post-effective Period.* This period beings once the registration statement has been declared effective.

§ 1:11.2 Pre-Filing (or Quiet) Period

During this period, no offers or sales are permitted. "Offer" is very broadly defined as "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value." In addition to information expressly about the IPO, any information that reasonably can be expected, directly or indirectly, to have the effect of encouraging interest in the IPO, or that is released primarily for the purpose of directly or indirectly encouraging interest in the IPO, can be an offer. Problematic communications can include projections and forecasts, as well as advertising and press appearances inconsistent with past practice, even if the offer of securities is not discussed. An offer can be made orally or in writing and over any medium. For example, communications to employees over a company intranet can be an offer.

Because of the broad scope of the pre-filing restrictions, the SEC has created safe harbors upon which a company can rely to ensure that certain types of ordinary course communications do not violate the gun jumping rules. Under Rule 163A, communications made by an eligible company more than thirty days before the filing of a registration statement that do not refer to a securities offering are not considered a prohibited offer. Similarly, Rule 169 excludes factual business information regularly released to persons not in their capacity as investors or potential investors from the definition of "offer." Rule 135 also contains a safe harbor for pre-filing notices of an upcoming offering, but allows only a limited set of basic information about the offering and prohibits naming the underwriters.

As discussed above, an EGC may "test the waters" with certain institutional investors before filing a registration statement.

§ 1:11.3 *Post-Filing (or Waiting) Period*

During the waiting period, oral offers are permissible, but written offers may be made only by means of a prospectus that satisfies the requirements of the Securities Act. In keeping with an SEC rule generally requiring the first prospectus circulated to the market in an IPO to contain a price range, it also is typical to refrain from talking with investors (or doing so only on a narrowly circumscribed basis) until a prospectus with a range is filed.

Similarly to the pre-filing period, Rule 134 contains a safe harbor for a notice of an offering that includes limited information (including the names of underwriters). Factual business information released in reliance on the safe harbor under Rule 169 is still permitted during the waiting period.

A company also generally may make an offer by means of a "free writing prospectus" post-filing—that is, a written communication that does not comply with the statutory prospectus requirements. In the case of an IPO, however, a free writing prospectus only can be used at the same time as, or after, a statutory prospectus with a price range has been circulated. Nonetheless, given the lack of content restrictions, a free writing prospectus can be a critical tool in conveying late-breaking information to the market during the offering process.

§ 1:11.4 *Post-Effectiveness Period*

After the registration statement has been declared effective, which generally occurs at the time the IPO is priced, sales of securities can be made. For a twenty-five-day period after effectiveness, even if they did not act as underwriters in the IPO, dealers must deliver the final prospectus when making a sale. However, if the prospectus is available on the SEC's EDGAR filing system, a dealer can provide a simple notice to purchasers to satisfy this requirement. The company should be careful during the prospectus delivery period not to make statements that materially change the information in the prospectus. As a practical matter, the prospectus delivery requirement often leads counsel to recommend that executives of the company not give press interviews until the prospectus delivery period is complete. Nonetheless, it has become increasingly common for the CEO to appear on financial television programs after the IPO prices. Before making this kind of appearance, the CEO should review carefully with issuer's and underwriters' counsel appropriate communications parameters.

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17. [Reserved.]

§ 1:12 Securities Liabilty and Due Diligence

One of the core work streams of the IPO process is the due diligence investigation. Under section 11 of the Securities Act, an issuer is strictly liable for any material misstatements or omissions in the registration statement. The underlying policy of section 11 reflects that the company is best positioned to have information about itself, and therefore should be subject to the most stringent exposure.

The directors, CEO, CFO, and other persons who sign the registration statement, the underwriters and the auditor, among others, also are subject to liability under section 11. This reflects their status as critical gatekeepers between the issuer and the public in the securities offering process. However, they generally are afforded a "due diligence" defense to the extent that, after reasonable investigation, they had reasonable grounds to believe, and did believe, in the accuracy and completeness of the relevant disclosure. For disclosure based on the authority of an expert (for example, the auditor), the other types of defendants can rely on those statements so long as they had no reason to believe the statements were inaccurate or incomplete. As a practical matter, however, this does not preclude the working group from carrying out extensive due diligence on the financial statements or any other "expertized" portions of the disclosure.

Section 12(a)(2) of the Securities Act imposes liability in the context of an SEC-registered offering on any person who offers or sells a security by means of offering material or oral communication that contains a material misstatement or omission. Similarly to section 11, a defendant has a defense if it can show that it did not know, and with the exercise of reasonable care could not have known, of the misstatement or omission.

Deal participants also may face liability for any inaccurate or misleading statements they make, whether oral or written, under Exchange Act section 10(b) and Rule 10b-5 thereunder, the catch-all anti-fraud provisions in the federal securities laws. Recovery under this type of claim is more challenging because it requires showing that the defendant acted recklessly or willfully, as well as reliance by the plaintiff on the inaccurate or misleading statement.

In addition, section 15 of the Securities Act and section 20 of the Exchange Act can impose secondary liability on anyone who controls a primarily liable party, unless the control person can show that it did not know or have reasonable grounds to know of the facts giving rise to the underlying liability of the primarily liable party. "Control" includes any party that has the power to direct or cause the direction of the company's management and its policies, whether through the ownership of voting securities, by contract or otherwise. A private equity or venture capital sponsor, founder, or other significant stockholder therefore can have control person liability.

In addition to claims brought by private litigants, the SEC can bring enforcement actions for material misstatements or omissions.

Due diligence accordingly plays a critical role in ensuring smooth execution of a transaction, while also protecting against reputational and legal risk. Core components of due diligence include the following:

- *Management Due Diligence.* A series of discussions is organized with senior management of the company. Typically, there are discussions focusing on the business with the CEO and CFO and their chief lieutenants, as well as separate specialist discussions with the members of management responsible for topics such as tax, executive compensation, employee benefits, litigation, regulatory matters, intellectual property, environmental matters, cybersecurity, and any other significant areas. As discussed further below, the underwriters also obtain legal opinions and disclosure letters from the company's and underwriters' counsel.

- *Documentary Due Diligence.* Counsel for the underwriters and the company review significant legal documents, including the organizational documents of the company; the minutes of meetings of the board of directors and its committees, as well as materials prepared for those meetings; material contracts; and materials relating to the topics covered in management due diligence.

- *Accounting Due Diligence.* Accounting due diligence centers on discussions with the auditor of the company's financial statements, the audit process, internal control over financial reporting and related matters. As discussed further below, the underwriters also obtain comfort letters from the auditor to further support their diligence effort.

- *Business/Financial Model Due Diligence.* The underwriters and research analysts conduct separate sessions with management regarding the company's financial model and projections.

- *Vendor, Customer, and Supplier Due Diligence.* In the IPO context, in particular, the underwriters may request to have calls with key vendors, customers, or suppliers of the company.

- *Statistical Due Diligence.* Underwriters' counsel requests support for each number or quantitative statement in the prospectus not comforted by the auditor (see the discussion of comfort letters below).

§ 1:13 Key Documentation

The IPO process requires the completion of a number of disclosure documents and agreements, the most important of which are the prospectus and the registration statement; the underwriting agreement; lock-up agreements; the auditor's comfort letters; the road show presentation; and legal opinions and disclosure letters from issuer's and underwriters' counsel.

§ 1:13.1 Prospectus and Registration Statement

The primary disclosure and offering document is the prospectus, which is part of the registration statement filed with the SEC. Three key sources inform the composition of the disclosure in the registration statement. First, SEC rules and registration forms (in an IPO, Form S-1 for a U.S. issuer and Form F-1 for a foreign private issuer) impose detailed disclosure requirements. The forms look to provisions of Regulations S-K and S-X (or Form 20-F for a foreign private issuer) that set forth the information and financial statements that must be included in a registration statement. Among other items, required information ranges from detailed disclosure about the company's business to risk factors about the company and investing in its stock; the company's intended use of the proceeds from the offering; MD&A; disclosure about related party and governance matters; disclosures about executives and their compensation; and disclosure of 5% and greater shareholders.

Although they do not form part of the prospectus and therefore are not distributed to investors in connection with marketing an offering, specified exhibits must be filed with the registration statement. Interested investors can access these materials easily on EDGAR. Exhibit requirements cover organizational documents; the underwriting agreement; material agreements, such as indentures for bond offerings, credit facilities, and significant commercial contracts; compensation documents, including employment agreements with executive officers and equity compensation plans; and certain related-party contracts. In some cases, a material agreement contains commercially sensitive information—for example, information that could result in competitive harm to the company. The company can file a confidential treatment request to obtain the SEC's approval to exclude this information from the filing, but the scope of the request must be narrow and not seek to omit information that is required to be disclosed by SEC rules or that is material to an investor.

The second key source of disclosure stems from liability considerations. Even if the SEC's form disclosure requirements are satisfied, the disclosure still must not be materially inaccurate or misleading. Drafting is not a mere "check-the-box" exercise, but rather must accurately portray the matters it describes. Materiality determinations

involve both quantitative and qualitative considerations. Even misstatements that quantitatively are erroneous by only a small amount (for example, less than 5%) still may be material from a qualitative perspective—for example, if the error gives a misleading impression of a key business or financial trend, changes a loss into a gain, gives an inaccurate impression of compliance with covenants or regulatory requirements, or has the effect of increasing executive compensation.[18]

The third key source of disclosure is marketing requirements and ongoing investor relations considerations. An IPO is a company's debut to the public and often the time when its disclosure will receive the most concentrated attention from the company, as well as the many experts in its working group. The prospectus communicates the company's "story" to the market and helps position it among its peers. The working group therefore studies peer disclosure carefully and considers how best to differentiate and describe the company. Industry practice in the company's sector also may include disclosing metrics or other information that analysts and investors like to see. The disclosure created for the IPO establishes a template for the company's ongoing disclosure to the market, too, as it conditions expectations as to how the company will be communicating once public. It therefore, is important to look ahead and ensure that the approach selected makes sense not just for the IPO but also for future years (for example, is not overly burdensome to prepare or unnecessarily revealing and therefore potentially competitively harmful).

§ 1:13.2 Underwriting Agreement

The underwriting agreement is the contract under which the underwriters agree to purchase the offered securities. Most major investment banks have form underwriting agreements that underwriters' counsel uses as a starting point. Although the forms vary from firm to firm, the general scope of content is largely similar.

The centerpiece of the agreement is the number or amount of securities being sold and the price at which the underwriters will buy the securities, along with the associated timing and mechanics for doing so. Particularly in an IPO, the underwriters typically require extensive representations and warranties from the company (and to a lesser degree from any selling stockholder) to support their diligence efforts and help ensure the adequacy of the disclosure in the registration statement and the absence of any impediments to completing the offering. The representations and warranties also allocate risk between the company and the underwriters in the event that the underwriters

18. *See, e.g.*, SEC Staff Accounting Bulletin No. 99 (Aug. 13, 1999).

are sued as a result of a material misstatement or omission in the disclosure (and related representation and warranties are breached). In addition, both the company and underwriters agree to take certain actions to facilitate the execution of the transaction, and the company and its insiders and significant shareholders usually commit to a "lock-up."

The agreement sets out closing conditions, including receipt of legal opinions from issuers', underwriters,' and, if applicable, selling stockholders' counsel; comfort letters from the auditor; and other certificates and closing documents. In addition, the agreement specifies the circumstances in which the underwriters can terminate the offering—for example, if there have been material adverse changes to the company or market conditions that make proceeding with the transaction impracticable. The exercise of termination rights by underwriters is exceedingly rare. In an IPO (and offerings other than bought deals), the underwriters will not sign the underwriting agreement and commit to buy the securities until after they have built a book of demand and are confident that they can sell the full amount of offered securities. From a commercial perspective, underwriters also wish to avoid gaining a reputation for walking away from transactions. In addition, even during highly disruptive market events (for example, September 11), market institutions kept functioning and transactions were able to be completed after minimal delay.

The underwriting agreement also contains detailed indemnification provisions to ensure that if the underwriters suffer losses as a result of being sued, they will be able to be made whole by the company. This is particularly important in the context of funding the ongoing defense to any claim because the legal expenses of the underwriters may well be significant before any final settlement or judgment is reached.

Underwriters are usually full-service investment banks and therefore may have other commercial relationships with the company—for example, acting as a commercial lender. When the proceeds from an offering will be directed to an underwriter, that can pose a conflict. Underwriters are regulated by the Financial Industry Regulatory Authority (FINRA), which is overseen by the SEC. FINRA has detailed rules aimed at requiring disclosure of conflicts and that, in the case of certain conflicts, require the involvement of an unconflicted underwriter (a "qualified independent underwriter," or QIU) in certain aspects of the IPO process. FINRA rules also restrict excessive underwriting compensation. As a practical matter, these rules are enforced through filings that the underwriters are required to make with FINRA in parallel to SEC filings. FINRA must issue a notice of no objections before the SEC will declare an IPO registration statement effective.

§ 1:13.3 Lock-Up Agreements

In an IPO, the underwriters almost always insist on lock-up agreements from the company (whose lock-up is contained in the underwriting agreement), as well as directors, executive officers, and most, if not all, stockholders. Subject to certain limited exceptions, these agreements restrict, absent the lead underwriters' permission, offers and sales of (as well as any announcement of an intent to offer or sell) the common stock (or similar transactions with the economic effect of an offer or sale) during a specified period following the offering, generally 180 days following pricing. A lock-up helps mitigate the overhang risk described above by ensuring an orderly market following the IPO. The lock-up indicates to the market that no significant dispositions of the shares should be expected during the lock-up period. The lock-up also prevents insiders from monetizing their holdings right away, which shows that they stand behind the offering, at least for the duration of the lock-up period, and will not take advantage of a potentially temporary price upswing to exit the position.

§ 1:13.4 Road Show Presentation

Once most or all SEC comments have been cleared and the working group believes market conditions are right, the IPO is "launched," and marketing commences. The company's top executives travel extensively for one to two weeks to meet prospective investors. They use a slide presentation that captures the essential elements of the offering and the investment case for the company. A recorded version of the road show also is placed on the Internet through a service provider to allow greater market penetration. Counsel focuses on ensuring the contents are consistent with the prospectus disclosure, and that the presentation is materially accurate and complete, as the road show carries liability risk under Rule 10b-5 (though not at the stricter level of exposure to which the registration statement is subject).

§ 1:13.5 Auditor Comfort Letters

The underwriters require "comfort" letters from the auditor, in which the auditor confirms its independence, that it has audited the audited financial statements in the prospectus and that it has performed certain review procedures, which are similar to an audit but not as extensive, in respect of unaudited interim financial data in the prospectus. The auditor also provides comfort of varying degrees on financial data included in the "front half" (that is, non-financial statement section of the prospectus), confirming that the data matches or is derived from the company's financial statements or financial records. (Financial data is different from statistical data—the former refers to numbers taken or derived from the company's financial statements or underlying financial information, while the latter relates

to matters such as the number of stores a company has or similar business-related information that is not usually included in GAAP financial statements or underlying records.) The comfort letter plays a critical role in helping the underwriters confirm that the disclosure is correct and establish their due diligence defense. Although the contents of comfort letters and the associated procedures for providing them are spelled out in detail in accounting literature, negotiating the comfort letter often is a time-consuming task. If no comfort is available in respect of a particular piece of data, underwriters' counsel may need to engage in special efforts focused on verifying that data's accuracy.

§ 1:13.6 Legal Opinions and Disclosure Letters

The underwriters require both a legal opinion and negative assurance, or "10b-5," letter from company counsel and underwriters' counsel as a condition to closing. Like the comfort letters, these documents help identify impediments to seamless execution, and form a key part of establishing a due diligence defense.

The legal opinions given by the company and underwriters' counsel differ in scope to some degree, but as a general matter provide the underwriters with comfort as to the legal underpinnings of the offering, including that the agreements relating to the offer are entered into properly and that the securities are validly issued. They may also address specific legal issues presented by the company or the transaction—for example, that the company is not an investment company that must be registered under the Investment Company Act of 1940 or that the company is in compliance with specified regulatory requirements. External deal counsel may be unable to render opinions in certain cases, in which case those opinions may be provided by the company's in-house counsel, local counsel in specified jurisdictions, or specialized regulatory counsel.

The negative assurance letters confirm that nothing has come to the attention of the lawyers during the course of their work that leads them to believe that the disclosure is materially inaccurate or misleading. The formulation of the assurance given in the letters tracks the various liability standards set out in the securities laws, including Rule 10b-5 (which is what gives rise to the common moniker, "10b-5 letters," for these documents).

Given the complex nature of legal opinions and negative assurance letters, underwriters' counsel often aims to begin negotiating drafts early in the offering process.

§ 1:14 Timeline

The IPO process generally takes between five and six months once the working group is assembled and the process commences.

Figure 1-2

Timeline

Week	Event	Responsible Parties
Week 1	Organizational meeting.	All parties: company, lead manager(s), counsel to the company and underwriters, auditor.
Week 2	First draft of registration statement.	Company and its counsel draft the registration statement; all parties review and comment on draft.
	Commence legal due diligence.	Counsel to the underwriters and company conduct legal due diligence.
Weeks 3-7	Registration statement drafting.	Company and its counsel draft the registration statement; all parties review and comment on draft.
	Management and auditor due diligence.	Lead manager(s) along with counsel and counsel to company participate in due diligence sessions.
Week 8	Complete due diligence, finalize registration statement at printer, and submit registration statement to SEC (confidentially if EGC or foreign private issuer qualified to file confidentially, if desired).	All parties.
	Negotiate underwriting agreement.	Counsel to underwriters and company.
Weeks 8-11	Prepare road show.	Lead manager(s) with assistance from company.
Week 12	Receive SEC comments (usually takes 4 weeks for the first round).	

Week	Event	Responsible Parties
Week 13	Respond to SEC comments and submit amendment to registration statement.	Company and its counsel draft responses to SEC comments and amendment to registration statement; all parties review and comment on responses and draft.
Weeks 13-17	Clear additional SEC comments (will likely take several rounds of comments, which can lengthen process).	
Week 17	Print and circulate preliminary prospectus; commence road show.	Lead manager(s) prepare the company for the road show—rehearsals, travel logistics, etc. Underwriters will accompany company for entire road show An EGC that submitted a registration statement confidentially must make the offering document public at least 21 days before the road show commences.
Weeks 18-19	Continue road show.	
Week 20	Registration statement declared effective by SEC. Pricing.	All parties.
	Execute underwriting agreement.	Underwriting agreement signed by company, underwriters and selling shareholders, if any.
	Print and circulate final prospectus to those investors who request a copy.	
Weeks 20-21	Closing (T + 3 business days; 4 if price after 4:30 p.m (EST)).	All parties.

§ 1:14.1 Pre-Filing: Drafting the Registration Statement and Due Diligence

During the first eight weeks, the primary task of the working group is to draft the registration statement, often meeting several times in person for drafting sessions. The due diligence workstreams outlined above also gets underway, working in parallel to help refine the disclosure and identify key execution issues that could impede timely and smooth execution of the offering. Underwriters' counsel also may seek to negotiate the underwriting agreement during this time, so that it is in near-final form before the initial filing of the registration statement with the SEC.

§ 1:14.2 Filing and the SEC Comment Process

Once the working group is satisfied with the registration statement and it satisfies the SEC's content requirements, it is filed with the SEC, either publicly or, if desired, on a confidential basis for an EGC or a foreign private issuer eligible to do so. (Underwriters' counsel also files the registration statement with FINRA at the same time, as described above.) The SEC usually takes thirty days to provide its initial written comments. During that thirty days, the working group continues work on other documents, carries on with due diligence if not completed, and begins the stock exchange listing process. The lead underwriters and management also work on the road show presentation.

Once the company receives the first set of comments from the SEC, issuer's counsel organizes the preparation of responses with input from the rest of the working group. Depending on the length and complexity of comments, approximately one to two weeks may be needed to respond. The comment and response process often continues for several more rounds, though generally with fewer comments and faster turnaround times. Clearing SEC comments generally requires about two months.

While finishing the SEC comment process, the working group aims to finalize other key transaction documents and ensure the transaction is on track to clear FINRA, be listed on the desired securities exchange, and that all other hurdles are cleared. Management also practices and refines the road show presentation.

§ 1:14.3 Road Show: Rules of the Road

Once the SEC comment process is almost or fully complete, giving the company confidence that the preliminary prospectus, or "red-herring," is unlikely to need further revision (barring any subsequent

material developments), the company and the lead underwriters then determine a price range for the offering, print the preliminary prospectus and commence the road show. As described above, during this intensive one- to two-week period of travel and marketing, the lead underwriters build the book of demand from prospective investors so that they are positioned to help the company set the price for the offering. Depending on demand levels, as well as market conditions in the sector and more broadly, it may be necessary to adjust the price range or contemplated offering size up or down.

§ 1:14.4 Effectiveness, Pricing and Closing

Once the road show is complete and the company is ready to price its IPO, and assuming FINRA clearance and securities exchange approval for the listing are lined up, the company and the underwriters will request that the SEC declare the registration statement effective. Typically, after the market closes on the day the registration statement is declared effective, the final price for the shares is determined, the underwriting agreement is signed, and the underwriters begin to confirm sales orally. In certain circumstances, demand for the offering may have shifted substantially, resulting in the terms of the offering shifting significantly. Complex SEC rules limit the potential scope of last-minute changes in the price per share or number of shares being sold. If demand for an offering remains uncertain or market conditions are especially volatile, the working group should consider how much flexibility it has under these rules well in advance of pricing. In addition, a significant upsizing or downsizing can be material, requiring disclosure of the impact to investors in very short order, generally by way of a free writing prospectus.

The pricing information is added to the preliminary prospectus to create a final prospectus, which is filed within forty-eight hours of pricing and made available to those who received allocations of shares in the offering.

The shares will begin trading on the securities exchange following pricing. This occurs on a "when-issued" basis prior to the actual issuance of the securities at the closing for the offering, which normally takes place three business days after pricing, or four if the offering prices after 4:30 p.m. (EST). A company making its debut on an exchange usually gets to "ring the bell" to open trading on the exchange the day after pricing or in the ensuing days. At closing, legal opinions, disclosure letters, the bring-down comfort letter and other documents are delivered and the securities are issued against payment of the purchase price.

§ 1:15 Life As a Public Company

Once public, the company will be subject to the ongoing reporting requirements of the Exchange Act and a number of other obligations.[19]

§ 1:15.1 Form 10-K/Form 20-F

A U.S. issuer must file an annual report on Form 10-K. The report contains largely the same information as the IPO registration in respect of the company, and provides a comprehensive overview of the company's business, including audited consolidated financial statements, risk factors, and MD&A. For its first year after the IPO, a company must file this report within ninety days after the fiscal year-end.[20] A foreign private issuer must file a similar annual report on Form 20-F within four months of the end of its fiscal year.

§ 1:15.2 Form 10-Q

A U.S. issuer must file quarterly reports on Form 10-Q for its first three fiscal quarters, which include unaudited financial statements for the relevant period, MD&A, and other material updates on items such as risk factors and legal proceedings. In its first year after an IPO, a company must file this report each quarter within forty-five days of each quarter-end. A foreign private issuer is not subject to quarterly reporting under the Exchange Act. Nonetheless, for investor relations purposes, or because quarterly reports are produced under home country requirements, many foreign private issuers release quarterly reports and furnish them to the SEC on Form 6-K.

§ 1:15.3 Form 8-K/Form 6-K

A U.S. issuer must file current reports on Form 8-K to disclose the occurrence of specified material events or corporate changes. The reports generally are due within four business days of the occurrence of the relevant event or change. These include, among other things, entry

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19. A company can become subject to Exchange Act reporting through several avenues: (i) by doing an SEC-registered offering of securities; (ii) by listing securities on a U.S. national securities exchange; (iii) having more than 2,000 record holders or more than 500 record holders that are not "accredited investors," excluding, among others, persons who received securities pursuant to employee compensation plans in transactions exempt from Securities Act registration; or (iv) voluntarily.
20. After a company has been an SEC registrant for a year, if its market capitalization is $75 million or more, it becomes an accelerated filer, and if it is $700 million or more, a large accelerated filer, which will result in shorter deadlines for its Form 10-K and Form 10-Q in the case of a U.S. issuer (but not Form 20-F for a foreign private issuer).

into a material definitive agreement, significant acquisitions or dispositions of assets, changes in directors or executive officers, and amendments to organizational documents. A Form 8-K also is filed each quarter in connection with announcing earnings. Form 6-K is the analogue for a foreign private issuer, and generally must be furnished to the SEC promptly after the issuer makes a material disclosure to its shareholders.

§ 1:15.4 Proxy Regime

Once a company (other than a foreign private issuer) is public, whenever it seeks stockholder proxies for a vote, it must file a proxy statement with the SEC, as well as the relevant stock exchange, in certain cases, in order to give the SEC the opportunity to comment before distributing to investors. The preparation and dissemination of proxies can be achieved through electronic means, but still requires substantial advance planning to fulfill the notice requirements imposed by the company's organizational documents and SEC rules, as well as to allow for coordination among the various constituencies, such as the company's transfer agent, proxy solicitor, financial printer, and the SEC.

In recent years, there has been an intense debate over "proxy access"—the idea that shareholders satisfying specified ownership thresholds should have the ability to place director nominees directly on a company's proxy statement. The SEC has considered the issue of proxy access several times in recent years, including in 2010 in adopting Rule 14a-11 under the Exchange Act. In 2011, however, that rule was vacated by the U.S. Court of Appeals for the D.C. Circuit. In the face of shareholder pressure, some companies nevertheless have adopted proxy access rules in their governance documents that allow nomination of 20–25% of the board and generally follow what the rule would have required in terms of shareholder qualification to propose a board nominee—most significantly, ownership of 3% of the company for at least a three-year period, with no current intent to influence control of the company.

§ 1:15.5 Schedule 13D/G

The Schedule 13D/G regime aims to let the public know who controls significant voting power in a public company with a view to preventing a clandestine takeover, among other things. Beneficial owners of more than 5% of a class of Exchange Act-registered voting equity (for example, most companies' publicly traded common stock) must publicly report their ownership and related information on Schedule 13D or, for certain passive and pre-IPO holders, on Schedule

13G, which is a shorter form requiring less information. Beneficial ownership is broadly determined, and includes convertible securities or other rights a holder has to acquire the underlying equity within sixty days (without taking into account the conversion or exercise of similar rights by any other holder).

When two or more beneficial holders agree to act together for the purpose of acquiring, holding, voting, or disposing of the equity securities of a company, they are considered to have formed a section 13(d) group, and must file reports indicating as much (either jointly or individually but acknowledging their group status). Private equity and venture capital sponsors who team up with other sponsors to acquire a company frequently report as groups following the IPO of the company because they continue to own a large position in the company and control it though a shareholders' or similar agreement.

§ 1:15.6 Tender Offer Regime

Tender offers for Exchange Act-registered equity securities require compliance with the SEC's tender offer rules, which are designed to promote fair treatment of all security holders.[21] A tender offer is not defined, but rather identified by factors such as the active and widespread solicitation of holders; solicitation of a substantial portion of the outstanding class; offering at a premium over the prevailing market price; firm rather than negotiable terms; offering only for a limited time; conditioning the solicitation on a minimum number of shares or subjecting it to a fixed maximum; pressuring holders to sell; and making public announcements. A tender offer for registered equity requires the filing of a tender offer document with the SEC and, if the tender is taking the form of an exchange offer, can require the filing of a registration statement (on Form S-4 for a U.S. issuer and Form F-4 for a foreign private issuer) in respect of the offered securities. Among other things, SEC rules generally require the offer to be kept open for at least twenty business days; tendering holders to have withdrawal rights during the offering period; all holders to receive the same offer; and payment of the consideration to be made promptly to tendering holders. Both third parties and issuers tendering for their own securities must comply with the applicable tender offer rules.

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21. A less onerous regime applies to tender offers for equity that is not registered under the Exchange Act and straight debt securities. In addition, a more onerous set of requirements applies with respect to a "going private transaction," which includes certain tender offer and business combination transactions with controlling stockholders or other affiliates that have the result of causing the company's stock to be delisted or its Exchange Act registration to be suspended or terminated.

§ 1:15.7 Section 16

For U.S. issuers (but not foreign private issuers), section 16 of the Exchange Act requires "insiders"—that is, directors, officers, and beneficial owners of more than 10% of a class of registered voting equity—to report their transactions in the issuer's equity securities and, subject to a number of exceptions, to disgorge to the issuer profits (or deemed profits) resulting from "short-swing" trading in the issuer's equity securities—that is, purchases and sales of those securities within six months of each other. Although section 16 imposes reporting requirements on insiders, as the short-swing disgorgement rules indicate, its purpose is to prevent them from taking advantage of inside information in trading the issuer's securities. Section 16 imposes bright-line liability without regard to intent and is in addition to more general insider trading restrictions under the federal securities laws. Section 16 filings are monitored by a very active plaintiffs' bar, which seeks redress on behalf of companies entitled to disgorgement from insiders in order to earn the associated legal fees.

Membership in a group that owns in excess of 10% can result in a person that individually owns less than 10% being treated as an insider and therefore being subject to section 16 reporting and disgorgement. Accordingly, it is critical for shareholders to monitor potentially joint activity with other shareholders (for example, in the context of shareholder activism).

§ 1:15.8 Other Large Holder Considerations

Holders of securities issued by public companies also should be mindful of other potential compliance obligations. For example, institutional investment managers exercising investment discretion over $100 million or more in exchange-traded stocks and other securities must file Form 13F disclosing their positions each quarter. Similarly, "large traders"—generally persons trading exchange-listed equity and certain other securities of at least (i) two million shares or $20 million during any calendar day, or (ii) 20 million shares or $200 million during any calendar month—must file quarterly confidential reports with the SEC providing certain information about their brokerage arrangements and also tag their trades with a special identifier. Among other things, the acquisition of a significant stake in a public company can trip anti-takeover provisions adopted by the acquired company; antitrust filing and clearance obligations; and notice, consent, or other compliance obligations in regulated industries or similar contexts (for example, banking, energy, insurance, and gaming).

§ 1:15.9 *Earnings Reports*

As noted above, one marked feature of life as a public company is the scrutiny associated with quarterly reporting. Public companies publish their earnings releases each quarter in advance of (or sometimes at the same time as) filing the corresponding quarterly or annual report. The earnings release is accompanied by an earnings call where top executives give an overview of the business and financial results and condition of the company. The call then features a question and answer session in which research analysts ask executives questions to help the analysts as they prepare their research reports. These reports, including, in particular, the analysts' recommendations to buy, hold, or sell a security and the associated price targets, are significant drivers of stock price performance. A company's failure to meet the street's "consensus" estimate for a period, for example, can be significantly price-depressive. The analysts play a key role in helping digest complex financial information for the benefit of their clients (and indirectly the wider market, which benefits from the resulting price discovery).

A public company also needs to determine whether it will give earnings guidance and, if so, how frequently (quarterly or only annually) and to what level of detail (revenue only or revenue, earnings and possibly other metrics). Guidance arguably assists research analysts and helps control the dialogue around consensus, making for greater transparency and therefore less volatility in the stock price. Potential drawbacks with giving guidance include a heightened and arguably destructive focus on short-term performance, as well as potential legal uncertainty around when guidance should be updated. Although some federal appellate circuit courts have rejected a duty to update or held that it does not apply to routine earnings guidance, others have not yet addressed the question in the context of earnings guidance. Many companies continue to give guidance, but there appears to be a trend in recent years away from the practice.

§ 1:15.10 *Non-GAAP Financial Measures*

In many industries, research analysts look to certain financial metrics that are not line items in GAAP financial statements to analyze the performance of companies. Common examples of non-GAAP financial measures include EBITDA, EBIT, adjusted EBITDA, free cash flow, economic net income, and adjusted net income. The SEC generally allows presentation of these metrics, but regulates their presentation through Regulation G and Regulation S-K Item 10(e). The key requirement generally is to reconcile a non-GAAP financial measure to the most directly comparable GAAP measure. In addition to other requirements, the non-GAAP measure cannot be adjusted to

eliminate or smooth items identified as nonrecurring, infrequent, or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or where there was a similar charge or gain within the prior two years. As it prepares for its IPO, a company in a sector that uses non-GAAP measures should assess the practices of its peers and develop its approach to non-GAAP measures in light of common practice and SEC requirements.

§ 1:15.11 Regulation FD

Regulation FD, for "fair disclosure," prohibits a U.S. issuer from selectively disclosing material non-public information only to certain market professionals or security holders. (Foreign private issuers often follow Regulation FD because their home country has a similar regulation, or as a matter of best practice and to avoid potential insider trading liability in connection with selectively sharing information.) The regulation's restrictions do not apply to selective disclosure to someone who owes a duty of trust or confidence to the issuer (for example, attorneys, investment bankers and accountants) or who expressly agrees to maintain the information in confidence.

An intentional selective disclosure of material non-public information must be disclosed publicly simultaneously, while an inadvertent selective disclosure must be disclosed promptly (and generally within twenty-four hours). Most issuers satisfy the "public" disclosure requirement through filing the information on a Form 8-K and also disseminating a press release. Corporate websites and social media channels can be sufficiently public for this purpose, but the company must have previously indicated its plan to use them as the intended platform for communicating material information, among other requirements.

§ 1:15.12 Sarbanes-Oxley Act

As noted above, there is a host of additional compliance considerations that apply to a public company (in some cases after a phase-in period), many as a result of the Sarbanes-Oxley Act of 2002. These include: a prohibition on the extension of credit to the company's directors and executive officers; personal certifications by the company's CEO and CFO of annual and quarterly reports in respect of the absence of material misstatements or omissions, compliance of the financial statements with Exchange Act requirements, and other matters; implementation and maintenance of disclosure controls and procedures; implementation and maintenance of internal control over financial reporting; and preparation of a management report on internal control over financial reporting and a related attestation report by the company's auditor.

§ 1:15.13 Conflict Minerals

Both U.S. and foreign private issuers are subject to the SEC's conflict mineral rules adopted pursuant to the Dodd-Frank Act. These rules require an annual report on Form SD to be filed with the SEC detailing the use of specified minerals from the Democratic Republic of the Congo and neighboring countries to the extent the company manufactures or contracts to manufacture products for which the minerals are necessary to the products' functionality or production. The rules apply to a large number of companies given the widespread use of these minerals in products, including jewelry, electronics, lighting, and electrical and heating applications. The compliance burden on a company and its suppliers, from which the company needs to collect information for purposes of preparing the report, can be significant. In addition, after a phase-in period (which is currently suspended by the SEC), an affected company is required to obtain an independent private sector audit in respect of its report, further adding to the associated costs. Although the D.C. Circuit Court of Appeals recently held that certain statements required by the conflict mineral rules are unconstitutional, much of the work required for the conflict minerals disclosures is still required.

§ 1:15.14 Iran Notice

If a public company or any of its affiliates knowingly engages in specified transactions with the government of Iran or other designated Iranian entities, it must report those activities in its annual and quarterly reports, and concurrently file an IRANNOTICE with the SEC. This requirement applies to both U.S. and foreign private issuers. To date, much of the disclosure has related to activities of foreign subsidiaries, with the disclosure often noting past activities that the company is winding down. (It remains to be seen how the recent nuclear deal with Iran will affect these requirements.)

§ 1:15.15 XBRL

A U.S. company and any foreign private issuer that prepares its financial statements in accordance with U.S. GAAP also must provide financial statements to the SEC in interactive data (XBRL) format, which makes the financial statements machine-readable so they can be downloaded, analyzed, and compared using certain software applications.[22]

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22. A foreign private issuer that prepares its financial statements in accordance with IFRS technically must comply with XBRL requirements, but to date

§ 1:16 Company and Selling Security Holder Financing Options Post-IPO

Once a company is public, one of the primary benefits is the ability to access public markets readily, allowing an offer to be executed quickly when market conditions are advantageous. The primary way to do so is through shelf registration. Shelf registration allows a company to register equity and debt securities on behalf of itself or selling security holders that may be sold (or "taken off the shelf") in the future without having to go over the "speed bump" of having each take-down offering document declared effective. The shelf establishes the base terms for an offering and further incorporates the company's Exchange Act disclosure, both on a retrospective and forward-looking basis. This set of disclosures is coupled with a prospectus supplement that describes the terms of a particular offering off the shelf, to form a complete "prospectus" for the offering.

Among other eligibility requirements, a company generally does not become eligible to use a shelf until it has been a reporting company for twelve months and timely filed its periodic Exchange Act reports. The company files the shelf with the SEC, has it reviewed and declared effective, and then generally can use the shelf for a period of three years. Moreover, if the issuer qualifies as a "well-known seasoned issuer" (or WKSI)—that is, has a market capitalization exceeding $700 million or, for a debt shelf, has issued at least $1 billion in debt in the prior three years, among other requirements—a shelf filed by it becomes automatically effective on filing, making for extremely fast access to the market.

Even after the IPO lock-up has terminated, a founder or sponsor that retains a significant ownership stake or a board position may well be unable to resell its securities freely because it will be an affiliate of the issuer, and securities in its hands are treated as "control securities," which are subject to restrictions on free public resale. An affiliate of the issuer is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with the company. "Control" is the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. The existence of a control relationship depends on the facts and circumstances of each case, but indicators of control include ownership of more than 10% of a company's outstanding voting securities, having a board seat, being

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the SEC has not issued a applicable XBRL taxonomy, giving these foreign issuers a de facto exemption.

an executive officer or having special voting rights, such as a veto over significant corporate actions, among other things.

Securities acquired directly or indirectly from a company or an affiliate of a company in a transaction or chain of transactions not involving a public offering also cannot be resold freely under the securities laws. Instead, for these "restricted securities," a holding period of six months (in the case of Exchange Act-reporting companies that are not delinquent in filing certain reports) or one year (in other cases) must be observed by the holder of the "restricted securities" before free public resale is permitted. In the case of an IPO, however, pre-IPO investors often have held their securities for far longer periods and, even if they have not, generally cannot sell prior to the termination of a 180-day lock-up period.

Rule 144 under the Securities Act allows control securities (that are not restricted or, if restricted, in respect of which the holding period has elapsed) to be freely resold publicly, but only if they are "dribbled out" to the market in unsolicited, volume-constrained sales that mimic secondary market trading. Private resales of control securities to sophisticated purchasers also are possible, but result in the purchaser taking restricted securities and likely imposing a discount as a result of the illiquidity of the acquired shares.

As a result of these constraints, sponsors and founders may negotiate for registration rights, which allow them to cause the company to register their securities to facilitate their free public resale. The company generally will commit to support a specified number of offerings by the selling security holder, including in the context of underwritten transactions. The ability to access a shelf registration statement if the company is eligible, or to cause the company to put up a registration statement if it is not, helps ensure a path to liquidity for the selling security holder.

In addition to ensuring compliance with the registration requirements of the Securities Act (by either selling on a registered basis or pursuant to an available exemption from registration), selling security holders generally must ensure that they do not sell (or purchase) securities while in possession of material non-public information. Doing so may result in insider trading liability and enforcement. To help prevent insider trading violations (and the appearance of any impropriety), most public companies have window or blackout policies, which allow trading only during specified periods (or black it out at all other times). Trading is permitted only following a "cleansing" disclosure event, such as publishing an earnings release, with the window opening two or three days after the information has been disclosed (to give it time to disseminate into the market) and then closing again once the company has insight into its financial results

for the current period. This cut-off varies among industries and issuers, depending on the nature of their business and financial information.

An insider who wishes to preserve the ability to sell when it may come to possess material non-public information may enter into a "10b5-1" plan. This type of plan allows an insider, at a time when it does not possess material non-public information, to delegate trading authority to another person or to adopt a written plan for executing trades, with the insider surrendering the ability to influence the resulting trading decisions. When arranging these plans, insiders always must be mindful of sction 16 and avoid short-swing trading, absent an available exemption.

§ 1:17 Conclusion

An IPO is a unique moment in the life cycle of a company. The foregoing chapter is just a high-level overview of some of the chief considerations. As with any high-profile, complicated financial and legal undertaking, the devil is in the details. Proper structuring and execution are essential to securing the tremendous benefits that going public can bring, while efficiently managing the attendant costs and compliance burdens. Familiarity with the process on the part of the business team, and the support of experienced and savvy advisors, are critical.