Chapter 10

An Overview of the IPO Process

§ 10:1 Introduction

Part I of this book focuses on preparing to go public; Part II turns to the process of going public. This chapter begins with a thumbnail sketch of the federal securities law concepts that shape the entire IPO process; reviews the roles played by the principal IPO participants; discusses public company education; describes the impact of the JOBS Act on emerging growth companies and the IPO process; provides a high-level review of the timing and major steps in the IPO journey,

from the planning stage to the organizational meeting and on through the closing; and offers a few observations about the ways in which an IPO can change the lives of company management.

The balance of Part II addresses, in the sequence in which these topics typically arise, the following aspects of the IPO process: the quiet period; liability and due diligence; preparation of the Form S-1; selling stockholders; stock exchange listing; initial Form S-1 filing (or submission of a draft Form S-1 for confidential SEC review, as permitted for emerging growth companies under the JOBS Act); the SEC review process; marketing the IPO; underwriting arrangements; and going effective, pricing, trading, and closing. Part II concludes with a discussion of special issues faced by companies involved with certain types of IPOs.

§ 10:2 Securities Law in a (Tiny) Nutshell

Readers need not be securities lawyers to learn from this book, but a brief review of the principal tenets of the IPO registration process will help set the context for all that follows. In a nutshell, the federal securities laws provide for:

- required *registration* of the sale of the shares in an IPO;
- mandatory *disclosure* of business and financial information in a *prospectus*;
- *SEC review* of such disclosure;
- prohibitions on *misrepresentations* and *fraud*; and
- *civil liability* and *SEC enforcement* for violations.

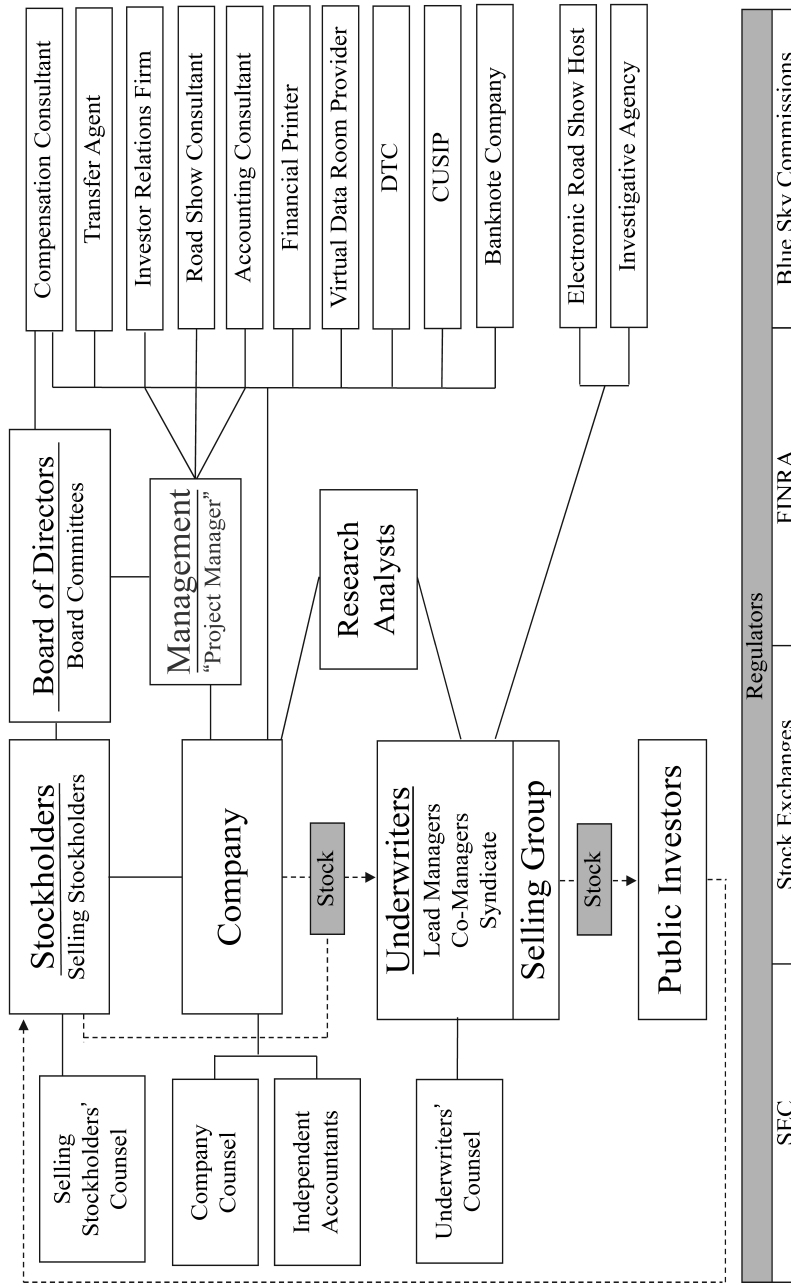
Layers of complexity and nuance accompany these concepts, but at the most basic level they set the stage for the entire IPO process. These requirements have multiple sources, including the two principal federal statutes—the Securities Act of 1933, commonly known as the "Securities Act," and the Securities Exchange Act of 1934, commonly known as the "Exchange Act"—as well as SEC rules and regulations, formal and informal SEC interpretations, and federal court cases. Many of these requirements apply to all securities offerings, while others are unique to IPOs. The going-public process also involves a healthy dose of industry custom, not to mention colorful phrases such as "green shoe" and "red herring."

§ 10:3 Roles of IPO Participants

The principal participants in the IPO process are the company's management, board of directors, counsel, independent accountants, and pre-IPO stockholders; the managing underwriters, research analysts, and underwriters' counsel; and, of course, the SEC. Supporting

Figure 10-1

Principal Relationships Among IPO Participants



roles are played by a financial printer, the stock exchange on which the common stock is to be listed, FINRA, a transfer agent, DTC, the CUSIP Service Bureau, a banknote company (or other supplier of stock certificates), an electronic road show host and, for many companies, a virtual data room provider, a compensation consultant, an investor relations firm, a road show consultant, and an accounting consultant.

The typical roles of the IPO participants are described briefly in the following sections and elaborated on throughout Part II of this book.

§ 10:3.1 Company Management

Company management is essential to the success of an IPO. The company's CEO and CFO manage the IPO process for the company and serve as the liaisons between the board of directors and working group. They make recommendations to the board concerning fundamental matters such as the decision to go public, the selection of managing underwriters, the size and composition of the offering, and the selection of counsel and other advisors. Working with company counsel, the CEO and CFO lead the company's IPO preparations in the areas of corporate governance, executive compensation, and public company education; the CFO supervises the development of the company's internal controls and coordinates accounting preparation with the independent accountants.

The CEO and CFO are also the company's primary contacts with the underwriters—these officers usually have developed relationships with the managing underwriters and their research analysts in the months leading up to the organizational meeting. In the IPO process, the CEO generally serves as the company's chief evangelist and strategic visionary, while the CFO naturally gravitates toward financial and accounting matters. Both attend drafting sessions and help prepare the Form S-1. Once SEC comments arrive, management coordinates the company's responses with counsel. The CEO and the CFO conduct road show presentations and, following the IPO, are the company's principal points of contact with the capital markets through earnings conference calls, investor presentations, and other public communications.

Other members of management serve important, but less visible, roles. The controller helps develop the company's internal controls, supports the CFO in creating the company's financial model and forecasts, serves as a key contact with the independent accountants and, depending on the CFO's background, may serve as the company's principal accounting officer. The general counsel participates in drafting sessions and works with outside counsel on due diligence, IPO preparations, and various other tasks. The senior human relations officer assists in the development of public company compensation arrangements. Public relations or investor relations personnel help manage the

public communications associated with the IPO. The leaders of other business functions—such as research and development, marketing, sales, support, and manufacturing—help educate company counsel, the managing underwriters, and underwriters' counsel about the company's business, respond to due diligence requests within their areas of expertise, and review the relevant portions of the Form S-1.

Planning Tip

IPO Project Manager

An IPO involves an enormous number of details and innumerable tasks among multiple parties and organizations. Many companies find it helpful to designate a "project manager"—usually drawn from the company's finance, legal, or business development groups—to coordinate the overall IPO process. The project manager should be very familiar with the company, have ready access to the company's management and legal and accounting advisors, possess the internal authority and stature to make administrative decisions and prod others to act as needed, and be able to devote a substantial majority of his or her business time to the job. In the absence of a designated project manager, the company's CFO or general counsel often end up adding this role to their many other job responsibilities.

§ 10:3.2 Board of Directors and Board Committees

The board's fiduciary duties and oversight responsibilities[1] naturally extend to the IPO process. Among other things, the board—directly or, for some matters, through committees—must make the threshold decision to pursue an IPO; select the managing underwriters; ensure that appropriate policies, controls, and procedures are in place; establish an appropriate governance structure; approve various matters related to the IPO; reassess compensation programs in the context of becoming a public company; oversee the preparation of the Form S-1; authorize the filing of the Form S-1 (and the initial submission of a draft Form S-1 for confidential SEC review, if applicable); and sign the Form S-1. Although it would be atypical for directors (other than the CEO) to attend drafting sessions, the board should be afforded ample opportunity to review and comment on the Form S-1.

1. These topics are discussed in chapter 6. *See* section 6:2.

Board committees also play integral roles in the IPO process. The audit committee should review the financial statements included in the Form S-1. The compensation committee should review the CD&A, if one is included in the prospectus. (As a practical matter, the compensation committee should participate in the preparation of the CD&A itself, since the CD&A describes the principles underlying the company's executive compensation policies and decisions.) The nominating and corporate governance committee, once established, should assist in the development of governance-related matters.[2]

§ 10:3.3 Company Counsel

Company counsel coordinates the overall IPO process and the efforts of the working group. Sometimes having the most IPO experience among all offering participants, company counsel guides the company through the entire IPO process, the often labyrinthine maze of securities law statutes, rules, and regulations, and an equally important patchwork of SEC interpretations, practices, preferences, and tendencies. Skilled company counsel can often make up for gaps in the knowledge and experience of other participants, while inexperienced company counsel will magnify the limitations of others involved.

Among other tasks, company counsel assists the company with "corporate housekeeping" and other IPO preparations; advises the company regarding required notices and consents; coordinates the company's responses to the due diligence requests of the managing underwriters; responds to legal due diligence requests of underwriters' counsel; educates the company about publicity restrictions while in registration; has the principal responsibility for preparation and revision of the Form S-1 and responses to SEC comments; leads drafting sessions; helps the company identify required exhibits and prepares any needed request for confidential treatment; coordinates arrangements with any selling stockholders; makes board presentations regarding the Form S-1 and other IPO topics, including potential liabilities; advises management and the board regarding corporate governance requirements and best practices; prepares public company charters, policies, guidelines, and other corporate governance materials for review and approval by the board; and helps the company and board develop public company equity plans and other compensation programs.

Company counsel leads the filing process for the Form S-1 and amendments; advises the company regarding IPO marketing restrictions; reviews and negotiates lockup agreements and the underwriting

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2. Board and committee involvement with the preparation of the Form S-1 and with the SEC review process are discussed in more detail in chapters 13 and 16. *See* sections 13:5.5 and 16:10.

agreement; educates the company concerning the public company responsibilities and restrictions that will apply following the IPO; helps directors and officers make their initial section 16 filings; prepares and files the listing application with the stock exchange selected by the company for its common stock; serves as the principal contact with the SEC and stock exchange for the offering; and manages the closing. In most cases, company counsel also coordinates arrangements with the transfer agent, DTC, the CUSIP Service Bureau, and the banknote company.

§ 10:3.4 Independent Accountants

In addition to its principal role of auditing the company's financial statements and reviewing any interim financial statements that are not audited, the company's audit firm contributes to other parts of the IPO process. As part of the company's IPO planning process, the audit firm confirms its eligibility to serve as independent registered public accountants, provides advice on appropriate accounting principles, identifies and addresses potential accounting issues, and often offers guidance regarding internal controls. During the registration process, the audit firm assists in the preparation of the financial portions of the Form S-1, advises the company on compliance with Regulation S-X and other SEC accounting requirements, and helps the company respond to accounting comments received from the SEC. The audit firm also renders to the underwriters a "comfort letter" on the preliminary prospectus at the time the underwriting agreement is signed, a comfort letter covering the final prospectus (sometimes combined with the comfort letter on the preliminary prospectus), and an updated, or "bring-down," comfort letter at closing.

§ 10:3.5 Pre-IPO Stockholders

The company's pre-IPO stockholders must approve various matters in connection with the IPO. In many cases, the founders of the company and outside investors affiliated with board members control sufficient shares to dictate all necessary stockholders decisions by written consent in lieu of a formal stockholder meeting (with notice to non-consenting stockholders, if required by applicable state corporate law). Waivers or amendments of investor agreements—such as a waiver of registration rights or an amendment to reduce the minimum offering price to trigger the automatic conversion of preferred stock into common stock—may also be needed. Large stockholders need to complete questionnaires and supply information for Form S-1 and FINRA purposes, and all stockholders are typically asked to sign lockup agreements. Major investors often review the Form S-1 and get involved with the underwriting arrangements, especially if they are

selling shares in the IPO; but other non-management stockholders usually do not play any role in the preparation of the Form S-1 or other aspects of the offering process.

§ 10:3.6 Managing Underwriters

The managing underwriters play a central role in the IPO process. They are the intermediaries between the company and IPO investors, are primarily responsible for the support and development of an active trading market in the company's common stock following the IPO, and advise the company on capital market conditions. The managing underwriters usually include one or more lead managers and several co-managers. The lead managers are responsible for advising the board, selecting underwriters' counsel, establishing the underwriting syndicate, conducting due diligence on behalf of the underwriting syndicate, organizing the road show, building the "book" of orders, allocating shares, recommending the final price and size of the IPO, and stabilizing the market after the offering. The co-managers generally participate in the offering process, other than in bookbuilding and stabilization activities,[3] although in recent years the participation of co-managers—particularly if there are two or more lead managers—has been increasingly circumscribed.

Drawing on their familiarity with the company's industry sector and its competitors, the managing underwriters help the company crystallize its business positioning for presentation in the Form S-1. Through extensive business due diligence (conducted by representatives of the managing underwriters and sometimes supplemented by outside investigative agencies), legal due diligence (conducted by underwriters' counsel), and active participation in drafting sessions, the managing underwriters enhance the accuracy and completeness of the disclosure in the Form S-1 and help ensure that the prospectus will address investor questions and will serve as an appropriate marketing document for targeted investors. Based on internally developed valuation models and an assessment of market conditions, the lead managers help the company set the estimated size and price range for the offering and can advise the company as to the market's tolerance for the inclusion of "secondary shares" to be sold by existing stockholders.

After assisting management in preparing for the road show, the lead managers schedule one-on-one and group meetings and coordinate the road show process, including any electronic road show presentation. The lead managers arrange the underwriting syndicate and make a recommendation, based on investor interest and market conditions, as

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3. The bookbuilding process and stabilization are discussed in chapter 19. *See* section 19:3.

to the final number of shares and price of the offering. Following the closing, the lead managers seek to maintain an orderly market through the use of techniques such as stabilizing transactions, passive market-making activities, penalty bids, and syndicate covering transactions, and help stabilize the market when the lockup agreements expire and additional shares become eligible for public sale. The lead managers can also help the company anticipate market expectations regarding financial reporting and other public company matters.

§ 10:3.7 Research Analysts

Research analysts write reports about the company and its stock, develop earnings estimates, and make investment recommendations. Typically focusing on a single industry, research analysts become very familiar with the companies they cover, enabling them to draw inferences and derive insights from publicly available information that are not apparent to ordinary investors. During the IPO process, the company meets with the research analysts employed by the managing underwriters to help them understand the company's financial model and internal projections so the analysts can develop their own forecasts of the company's future results. In lieu of separate meetings with each analyst, companies often invite all research analysts to an "analyst day," during which company management makes in-depth presentations and entertains questions. (Investment banking personnel may attend these meetings, if properly chaperoned.)[4] Just prior to the road show, research analysts hold "teach-ins" with the institutional sales forces (without the company's involvement) to educate them about the company and the offering. Research analysts are prohibited from soliciting underwriting business or participating in IPO road shows, but they may communicate with prospective investors if investment banking personnel and company management are not present, and they are allowed to express their views to investment banking commitment committees.

§ 10:3.8 Underwriters' Counsel

The managing underwriters will retain an outside law firm to serve as counsel to the underwriters in the offering. Although selected by the lead managers, underwriters' counsel represents the entire syndicate. Underwriters' counsel conducts a legal due diligence investigation of the company and advises the underwriters on legal issues affecting the offering. Participation in drafting sessions by underwriters' counsel serves both of these roles, and additional document review and other

4. Chaperoning requirements are discussed in chapter 19. *See* section 19:7.2[B].

due diligence steps are taken in parallel. Company counsel coordinates disclosure issues and publicity questions with underwriters' counsel, since the managing underwriters have a strong interest in avoiding miscues. Underwriters' counsel prepares the underwriting agreement and other underwriting documents, coordinates syndicate arrangements with the lead managers, handles FINRA filings and any necessary follow-up leading to FINRA clearance of the underwriting compensation, and collaborates with company counsel on the closing. If the IPO is not exempt from state securities regulation—because the common stock is not listed on a qualifying stock exchange—underwriters' counsel arranges for any necessary state securities "blue sky" filings. Underwriters' counsel is also responsible for any required foreign securities law disclosure documents and filings.

Underwriters' counsel will consult with in-house counsel for the lead managers on non-routine offering issues, such as important due diligence and publicity matters and other unusual or significant offering issues. Most investment banking firms also require underwriters' counsel to clear significant changes to the firm's form of underwriting agreement with in-house counsel. Moreover, in-house counsel will be deeply involved on regulatory and compliance matters affecting the underwriters, including issues relating to FINRA review of the underwriting arrangements and questions relating to the separation of investment banking and research functions.

§ 10:3.9 Securities and Exchange Commission

The SEC reviews and comments on the Form S-1 for nearly every IPO. Rooted in its mandate to protect investors, the SEC's objective is to improve the quality of the disclosure in the Form S-1. Upon request, the SEC provides interpretive guidance regarding accounting and legal disclosure requirements. The SEC also reviews and grants requests for confidential treatment of eligible portions of required exhibits. Following the road show—and assuming the SEC's comments on the Form S-1 have been satisfactorily addressed and any application for confidential treatment has been granted or withdrawn—the SEC declares the Form S-1 effective so the offering can be completed. If necessary, the SEC issues stop orders or brings enforcement actions for violations of the federal securities laws occurring during (or after) the IPO process.

§ 10:3.10 Other Participants

Various other parties also play roles—some minor but nonetheless necessary—in the IPO process.

[A] FINRA

The Financial Industry Regulatory Authority's Corporate Financing Department must review and approve the underwriting compensation arrangements in every IPO. FINRA evaluates both direct compensation—the underwriting discount—and other arrangements that are deemed to constitute indirect compensation under fairly complex rules.

[B] Financial Printer

The company will need to hire a financial printing firm to typeset the Form S-1, prepare electronic filings for submission on the SEC's EDGAR system, and print the preliminary prospectus and final prospectus.

[C] Stock Exchange

The company must select the stock exchange on which the common stock will trade following the IPO. The two principal exchanges for U.S. IPOs are Nasdaq and the NYSE, each of which has more than one listing classification.

[D] Transfer Agent

The transfer agent and registrar records stock ownership and transfers among record holders, cancels and issues stock certificates, and distributes any dividends paid by the company. Since most freely tradable shares are held in "street name," the transfer agent generally processes relatively few transfers except of restricted securities. Following the IPO, the company may also wish to retain the transfer agent (or another provider) to administer the company's stock incentive plans, including the creation of electronic grant documents pursuant to company instructions and the processing of option exercises.

[E] Banknote Company

An inventory of physical stock certificates needs to be printed by a banknote company or other supplier and then made available to the transfer agent for issuance as needed. In bygone days, stock certificates were elaborately designed and engraved and, in the case of NYSE companies, required to include individualized border designs and vignettes—spawning the collection and study of historic stock certificates known as "scripophily." Today, some transfer agents have the ability to generate color laser-printed stock certificates. Stock certificates must comply with applicable state corporate law and contain any information prescribed by the exchange on which the common stock is listed.

[F] DTC

Depository Trust Company serves as a clearing agency for the settlement of securities trades and acts as a depository to enable shares to be held in street name and to qualify for DTC's direct registration system. In order to list on Nasdaq or the NYSE, the common stock must be eligible for deposit at DTC and the company must be eligible to (but need not) participate in the direct registration system.[5]

[G] CUSIP

The CUSIP Service Bureau of Standard & Poor's Corporation must assign a unique nine-character alphanumeric identifier, known as a CUSIP number, to the company's common stock before trading can commence.

[H] Virtual Data Room Provider

Many IPO companies retain a financial printer or other vendor to establish and host a virtual data room to facilitate due diligence.

[I] Electronic Road Show Host

Most IPOs include an electronic road show, which is usually hosted by one of several vendors who provide this service and arranged by the managing underwriters.

[J] Compensation Consultant

With the advent of the CD&A and an increasing focus on executive compensation matters by regulators and investors, many IPO companies now retain a compensation consultant. Among other tasks, a compensation consultant can advise the company on prevailing practices in areas such as executive severance and change-in-control agreements, board compensation, and stock plans, and help design public company compensation programs.

[K] Investor Relations Firm

In light of the publicity restrictions that apply to an IPO, an investor relations firm's role in the IPO process is ordinarily confined to road show assistance and helping set up the investor relations portion of the company's website that will go live after the IPO is priced. After the IPO, an investor relations firm can provide professional assistance in developing the company's ongoing investor

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5. Listing eligibility is discussed in chapter 15. *See* sections 15:5 and 15:6. For discussion of direct registration system eligibility, see section 15:6.4.

communications programs and specific messaging in the context of important corporate events, such as acquisitions.

[L] Road Show Consultant

Although the managing underwriters will assist the company in preparing for the road show, many IPO companies—especially those whose management has never led an IPO—can benefit from a road show consultant. Services offered by road show consultants range from professional writing and graphics capabilities to enhance the slide deck to presentation skills coaching for company management.

[M] Accounting Consultant

When novel accounting issues arise during the company's IPO preparations or SEC review, some companies find it helpful to retain an accounting consultant to supplement the company's internal accounting expertise.

§ 10:4 Public Company Education

A critical component of the IPO process is preparation for life as a public company. This includes myriad business matters, such as a sound operating model, the hiring of experienced personnel, the development of necessary financial and accounting systems and controls, the establishment of effective disclosure controls and procedures, the creation of appropriate corporate governance arrangements, the retention of skilled professional advisors, and investor relations preparation. At the same time, IPO preparedness must include an understanding of the legal implications of becoming a public company, including:

- potential exposure for material misstatements or omissions in the Form S-1;
- the responsibilities and potential liabilities of individual directors and officers;
- the corporate governance and other obligations arising under the rules of the stock exchange on which the company's common stock is listed;
- the company's periodic reporting obligations under the Exchange Act, including the associated officer certifications;
- the company's other public disclosure obligations, including restrictions on the nature and manner of communications;
- other requirements imposed by the federal securities laws and SEC rules;
- the restrictions on trading in the company's common stock by insiders and their related reporting obligations;

- the means by which pre-IPO stockholders may resell their shares into the public market without registration following the IPO; and
- the ability of employees to achieve liquidity for their equity incentives once the company is public.

§ 10:4.1 Informal and Formal "Schooling"

The public company education process has various informal and formal elements. Informal instruction usually begins with the earliest meetings between management and company counsel to discuss the possibility of an IPO, since an informed decision to go public requires an understanding of the principal obligations and consequences of becoming a public company. Management's discussions with potential managing underwriters of the offering also may have an education component, particularly relating to minimum operating metrics for going public, market positioning, corporate governance, and investor relations matters. Additional knowledge arrives when the company hires seasoned public company personnel in preparation for the IPO. Perhaps most importantly—and certainly most pervasively—the IPO process itself inevitably gives management a healthy dose of public company education.

As the IPO process unfolds, more formal education efforts will be directed to the company's board of directors, management, and employees. This burden falls mainly on company counsel, underscoring the importance of public company experience when selecting counsel.

The exact nature of the public company education activities needs to be tailored to the company's individual circumstances, including the experience of management, the size and geographic concentration of the employee base, the dispersion of stock and options among employees, and other relevant considerations. Smaller companies may be able to supplement written information with Q&A sessions for all employees; larger companies may need to rely primarily on written communications. Regardless of the method selected, the education process must be incorporated into the company's IPO preparations. An IPO company cannot delay all public company education until after the closing without serious risk of missteps.

§ 10:4.2 Common Approaches to the "Curriculum"

Although IPO companies have varying appetites for public company education, summarized below are examples of ways in which the topic is often approached.

[A] Potential Liability

Before the Form S-1 is filed (or submitted by an emerging growth company for confidential SEC review, if applicable), company counsel

should advise the company's directors and officers about the sources of potential liability resulting from the IPO and then from operating as a public company. These presentations should be supplemented with less formal, but more contextual, guidance throughout the course of preparing the Form S-1 with management and reviewing the Form S-1 with the board.

[B] Corporate Governance

Understanding of the corporate governance requirements imposed by stock exchanges will occur when company counsel reviews eligibility criteria with management. Stock exchange rules (along with applicable SEC rules) will also shape various governance decisions made at the board level as part of IPO preparations.

[C] Sarbanes-Oxley Act; Dodd-Frank Act; JOBS Act

Public company education must include consideration of the applicable portions of a trifecta of federal legislation: the Sarbanes-Oxley Act (enacted in 2002); the Dodd-Frank Act (enacted in 2010); and the JOBS Act (enacted in 2012).

[C][1] Sarbanes-Oxley Act

The requirements of the Sarbanes-Oxley Act have both legal and accounting components. Company counsel should advise the directors and officers about the corporate governance aspects; the ban on loans to directors and executive officers (which becomes applicable upon the initial filing of the Form S-1); the post-IPO officer certification requirements; the profit disgorgement provisions applicable to the CEO and the CFO following a restatement of financial statements due to misconduct; the "whistleblower" protection provisions; the rule requiring an attorney to report evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the company "up the ladder" within the company; and other legal implications of the act. The company's independent accountants should brief the directors and officers regarding Sarbanes-Oxley's requirements in the areas of auditor independence; prohibited non-audit services; pre-approval requirements for all services; section 404 preparation; and other audit and accounting matters. Every detail of the Sarbanes-Oxley Act need not be tackled up front, but the basic requirements should be factored into the company's decision to pursue an IPO.

[C][2] Dodd-Frank Act

Although the vast majority of the Dodd-Frank Act does not directly affect public companies outside of the financial services industry, the

act imposed several significant corporate governance, executive compensation, and disclosure requirements on public companies generally. These requirements include say-on-pay (a requirement to hold periodic, non-binding stockholder votes on executive compensation that became effective in January 2011; smaller reporting companies became subject to this requirement in January 2013, but emerging growth companies are exempted by the JOBS Act for so long as they qualify as emerging growth companies); enhanced whistleblower protections and a bounty program designed to reward whistleblowers for tips provided to the SEC; and disclosure requirements regarding the company's use of "conflict minerals" (defined as cassiterite, columbite-tantalite, wolframite, their derivatives (tin, tantalum, and tungsten), and gold). In addition, following SEC rulemaking, public companies (other than emerging growth companies) will have additional disclosure obligations related to executive compensation matters, and all public companies listed on a national securities exchange will be required to adopt "clawback" policies to recover incentive-based compensation erroneously paid to executive officers following an accounting restatement due to material noncompliance with financial reporting requirements.[6] Education concerning these requirements should be part of an IPO company's overall corporate governance preparations.

[C][3] JOBS Act

The JOBS Act has significant consequences for both pre-IPO and post-IPO companies. A principal thrust of the JOBS Act is to ease the IPO process for companies that qualify as emerging growth companies, but other provisions of the act are available to private companies that are years away from an IPO, or never plan to go public. For companies that choose to go public, emerging growth company status can last until the last day of a company's fiscal year following the fifth anniversary of its IPO. As a result, publicly held emerging growth companies can continue to benefit from the act's reduced disclosure requirements and accounting relief, as described in more detail below, for an extended period of time following an IPO. Company counsel should advise on the disclosure and corporate governance aspects of the JOBS Act, while the company's independent accountants should address the audit and accounting portions of the act.

[D] Periodic Reporting

The company needs to be prepared to comply with its periodic reporting requirements under the Exchange Act, including its initial Form 10-Q

6. The corporate governance implications of the Dodd-Frank Act are discussed in more detail in chapter 5.

or Form 10-K, which could be due not long after the IPO closing. The company's financial management will be generally familiar with these filings in most cases, although the specific timing and content requirements may well have changed since management's last tour of duty with a public company. Prior to the closing of the IPO, company counsel should outline the company's reporting obligations for management.

[E] Public Communications

SEC and exchange rules governing other public company communications, including Regulation FD, need to be understood by company management and, to some extent, by all employees. This topic is usually best addressed through a combination of written information from company counsel and Q&A sessions with management and investor relations personnel, with less extensive information provided to other employees as needed. Written communications on this topic are often coupled with quiet-period instructions early in the IPO process,[7] with more elaborate presentations deferred until the closing is approaching.

[F] Insider Trading and Reporting

Instruction on insider trading and reporting needs to commence at the management level early in the IPO process, since it will be the underpinning of board discussions leading to the adoption of an insider trading policy before the closing, and some directors and officers may elect to implement Rule 10b5-1 trading plans before the closing. Broad dissemination of the company's insider trading policy to all employees and related education efforts usually begin shortly before the closing.

[G] Section 16 Reporting

The company needs to be prepared to assist its directors and officers in satisfying their section 16 reporting obligations. This requires a combination of a notification process, so the company is aware of trades by insiders, and the preparation and filing of Forms 3, 4, and 5 with the SEC (followed by posting on the company's website by the end of the next business day). Advance planning is required, as the initial Form 3 filings will be due on the day the Form S-1 becomes effective.

[H] Financial Planning for Executives

Company counsel should alert the company's executives to estate planning and tax strategy opportunities that may be available to them. If requested by the company, counsel should hold a group meeting on the subject for executives, and provide referrals to estate planning

7. See chapter 11 for further discussion of the quiet period.

lawyers that individual executives may retain if desired. Alternatively (or supplementally), the company might invite a financial planning firm to make a group presentation to company executives.

[I] Post-IPO Resales

All employees will have great interest in learning about the manner and timing in which unregistered shares acquired prior to the IPO may be sold into the public market following the IPO, as well as their ability to exercise and sell option shares once the company is public. Company-wide discussion of these matters is usually prompted by the circulation of the underwriters' lockup request, and is often preceded by individual discussions with the holders of contractual registration rights, who sometimes include selected employees.

§ 10:5 Impact of the JOBS Act

§ 10:5.1 Overview

On April 5, 2012, the Jumpstart Our Business Startups Act (JOBS Act) was enacted. Intended to spur job creation and economic growth by improving access to the capital markets for startup and emerging companies, the JOBS Act effected profound changes to the U.S. securities laws, with broad implications for pre-IPO companies and the conduct of IPOs and other securities offerings. Although some aspects of the JOBS Act remain subject to future SEC rulemaking, the provisions applicable to IPOs were immediately effective. All JOBS Act provisions except crowdfunding are available to foreign companies.[8]

Companies that went public after December 8, 2011, but before enactment of the JOBS Act on April 5, 2012, can qualify as emerging growth companies but are unlikely to realize the EGC benefits as fully as a company completing an IPO after the act's enactment.[9] For example, the reduced financial statement disclosure requirements may

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8. Crowdfunding is discussed in chapter 2. *See* section 2:8.2[E].
9. Approximately forty U.S. companies completed IPOs during this time period, of which 78% qualified as emerging growth companies based on information contained in their subsequent SEC filings. Not surprisingly, the extent to which these companies have taken advantage of the relief available to them as emerging growth companies has differed from the practices of emerging growth companies completing IPOs following the act's enactment. For example, only 42% of these companies omitted CD&A from their first proxy statement (compared to 96% of emerging growth companies that omitted CD&A from their Form S-1). *See* Table 10-2 for additional information regarding emerging growth company elections by IPO companies. In addition, among U.S. companies that went public between December 8, 2011, and April 5, 2012, 65% elected

be of minimal value because the company has already publicly disclosed financial information for all periods prescribed by prior requirements. Companies that went public on or before December 8, 2011, are not eligible to be emerging growth companies.

§ 10:5.2 *"IPO On-Ramp"*

The cornerstone of the JOBS Act is the creation of an "IPO on-ramp," which provides emerging growth companies with a phase-in period to fully comply with various disclosure and accounting requirements. An emerging growth company will have up to the last day of the fiscal year following the fifth anniversary of its IPO to come into full compliance with various disclosure regulations and accounting and auditing standards that are otherwise applicable to all U.S. public companies. Many of the act's benefits begin to apply during the IPO process, while others become applicable only following an IPO.

[A] Definition of "Emerging Growth Company"

The JOBS Act defines an emerging growth company (EGC) as any issuer that had total annual gross revenues of less than $1 billion (adjusted for inflation every five years) during its most recently completed fiscal year, other than an issuer that completed an IPO on or before December 8, 2011.[10] A company that is an emerging growth company on the first day of its fiscal year will no longer qualify as an emerging growth company upon the earliest of:[11]

- the last day of its fiscal year following the fifth anniversary of the first sale of its common equity securities in a public offering;

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not to hold say-on-pay and say-on-frequency votes at their first annual meeting, and 68% did not include a section 404(b) ICFR audit opinion in their first applicable Form 10-K. (Comparable data for emerging growth companies completing IPOs since April 5, 2012, is not available.)

10. For purposes of determining emerging growth company status, the revenue test is applied to the issuer's most recently completed fiscal year, regardless of whether financial statements for that fiscal year are presented in the registration statement. For example, a company that files a Form S-1 early in its fiscal year and is permitted to include in the Form S-1 financial statements for the first nine months of the preceding fiscal year as the most recent financial statements presented would nevertheless use its gross revenues for the full preceding fiscal year to determine whether it qualifies as an emerging growth company. See section 4:4.1[A] for discussion of the periods for which company financial statements are required to be presented in a Form S-1.

11. The SEC staff has published detailed guidance regarding the determination of EGC eligibility and other JOBS Act interpretations. *See* Jumpstart Our Business Startups Act Frequently Asked Questions: Generally Applicable Questions on Title I of the JOBS Act (Apr. 16, 2012, May 3, 2012, and Sept. 28, 2012).

- the last day of a fiscal year during which it had total annual gross revenues of $1 billion (adjusted for inflation every five years);
- the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt;[12] or
- the date on which it is deemed to be a "large accelerated filer" (a company that, as of the end of any fiscal year, has a public float of at least $700 million (measured as of the last business day of its second fiscal quarter of that year), has been subject to the Exchange Act for at least twelve calendar months, and has filed at least one Form 10-K).

The overwhelming majority of all IPO candidates are likely to qualify as emerging growth companies—approximately 90% of all IPO companies in the five years preceding the adoption of the JOBS Act would have qualified. In the first half of 2014, for example, emerging growth companies accounted for 91% of all U.S. IPOs.

[B] IPO Relief

An emerging growth company is entitled to the following exemptions from, and modifications of, the disclosure, accounting, auditing, and other requirements that would otherwise apply, beginning with the IPO process:

- *Confidential Submission of Registration Statements*: An emerging growth company is permitted to submit a draft Form S-1 (and amendments to the Form S-1) to the SEC for confidential review instead of filing it publicly. A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements, signed audit reports covering the audited financial statements presented in the Form S-1, and exhibits, but need not be signed by the company or its directors or principal officers, include consents from auditors or other experts, or be accompanied by the registration fee. Required signatures, consents, and the registration fee are provided upon the first public filing. The SEC review process for a confidential

12. The SEC staff has interpreted non-convertible debt to mean a non-convertible debt *security*, suggesting that the incurrence of more than $1 billion in indebtedness under credit facilities, term loans, and other instruments that are not considered to be securities will not preclude a company from qualifying as an emerging growth company. *See* Jumpstart Our Business Startups Act Frequently Asked Questions: Generally Applicable Questions on Title I of the JOBS Act, Question 17 (Apr. 16, 2012).

submission is generally the same as for a public filing. Confidential submissions are exempt from Freedom of Information Act requests, but the initial submission and all amendments must be filed publicly no later than twenty-one days before the road show commences (or twenty-one days before effectiveness of the Form S-1, if there is no road show). This twenty-one-day period is intended to give the market sufficient time to digest the Form S-1 before marketing of the offering commences.[13]

- *Reduced Financial Statement and MD&A Disclosure*: In IPO registration statements, emerging growth companies are required to provide only two years of audited financial statements (instead of three) plus unaudited interim financial statements. If an emerging growth company is required to include separate financial statements for a significant business whose acquisition is completed or probable, the maximum time period for which such separate financial statements must be provided is also two years if the company is presenting only two years of audited financial statements in its Form S-1, regardless of the significance of the acquisition under Regulation S-X. In addition, an emerging growth company need not present selected financial data in the Form S-1 for any period prior to the earliest audited period presented in its IPO registration statement. Similarly, MD&A must cover only the fiscal periods presented in the required financial statements.[14]
- *Reduced Executive Compensation Disclosures*: An emerging growth company is allowed to provide the "scaled" executive compensation disclosures previously available only to smaller reporting companies.[15] As a result, an emerging growth company need not provide CD&A; compensation information is required only for three named executive officers (including the CEO); only three of the seven compensation tables otherwise required must be provided; and narrative disclosure of

13. See section 16:5.4 for further discussion of the confidential submission process and chapter 17 for further discussion of the SEC review process.
14. See sections 4:4, 7:5.1, and 13:2.1[J] for further discussion of financial statement and MD&A requirements.
15. "Smaller reporting companies" are companies with a public float of less than $75 million, regardless of revenue or assets. If a company is unable to calculate its public float—for example, if it has no common stock outstanding or no market price exists for its outstanding common stock—it must have had less than $50 million in revenue in its most recent fiscal year to qualify as a smaller reporting company.

compensation policies and practices as they relate to risk management is not required.[16]

- *Delayed Application of New Accounting Standards*: Emerging growth companies are not subject to any accounting standards that are adopted or revised on or after April 5, 2012, unless and until these standards are required to be applied to non-public companies (companies that are not subject to the reporting requirements of the Exchange Act and have not filed a pending registration statement under the Securities Act), although emerging growth companies may elect to be subject to such accounting standards at the time they become applicable to public companies. This election must be made on an "all or nothing" basis and is irrevocable.[17]
- *Exemption from New PCAOB Audit Requirements*: Emerging growth companies are exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors supplement their audit reports with additional information about the audit or financial statements of the company (a so-called auditor discussion and analysis) that the PCAOB might adopt. Any other new auditing standards adopted by the PCAOB will not apply to audits of emerging growth companies unless the SEC determines that application of the new rules to audits of emerging growth companies is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.[18]
- *Expansion of Permitted Investor Communications*: Emerging growth companies and their agents have more freedom to communicate with potential investors that are "qualified institutional buyers" (as defined in Rule 144A) or institutions that are "accredited investors" (as defined in Regulation D), both before and after the filing of a registration statement for an IPO or other securities offering (including during the quiet period).

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16. See Table 21-1 for further information regarding the scaled executive compensation disclosures available to smaller reporting companies (and now emerging growth companies) under Item 402 of Regulation S-K. Emerging growth companies are not entitled to the other scaled disclosures available to smaller reporting companies summarized in Table 21-1.
17. See section 4:4.1[B][2] for further discussion of this election.
18. See section 4:4.1[C][2] for further discussion of PCAOB audit requirements for emerging growth companies.

- *Relaxation of Research Analyst Restrictions*: Research analysts have greater ability to communicate with investors and with the management of an emerging growth company in connection with the company's IPO. Research analysts are permitted to attend meetings with the company's management at which other broker-dealer personnel, including investment bankers participating in the IPO, are present, and are also able to attend investor meetings arranged by investment bankers. In addition, broker-dealers, including underwriters participating in the IPO, may publish research reports and make public appearances regarding the company both prior to and after the filing of a registration statement for an offering of common equity securities, during any prescribed post-offering blackout period, and during any blackout period prior to or after the expiration, termination, or waiver of a lockup period. However, most major investment banks remain constrained by the global settlement (the terms of which were not modified by the JOBS Act).[19]

[C] Post-IPO Relief

Following its IPO, an emerging growth company can also benefit from the following provisions of the JOBS Act:

- *Reduced Financial and MD&A Disclosure*: Once public, emerging growth companies (that are not smaller reporting companies) are required to include three years of audited financial statements in other registration statements and Form 10-K filings, but need not present audited financial statements or selected financial data for any period prior to the earliest audited period presented in the Form S-1, and MD&A must cover only the fiscal periods presented in the required financial statements. Over time, a third year of audited financial statements (and corresponding MD&A) and up to five years of selected financial data will be required in other registration statements and Exchange Act reports filed by the emerging growth company.[20]

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19. See section 19:7 for further discussion of the global settlement, research analyst issues, and related FINRA and SEC rules.

20. The SEC staff has also indicated that a company that loses its emerging growth company status is not required to present, in subsequently filed registration statements and Exchange Act reports, selected financial data for periods prior to the earliest audited period presented in its IPO registration statement. See section 22:2.2 for further discussion of an emerging growth company's Exchange Act reporting obligations.

Table 10-2

Emerging Growth Company Elections

Based on IPOs initiated and completed by U.S. emerging growth companies after enactment of the JOBS Act and prior to June 30, 2014, below are the rates of adoption with respect to several key items of relief available to emerging growth companies. The prevalence of elections is fairly consistent across different types of emerging growth companies, except that life sciences companies are much more likely than technology companies to provide only two years of audited financial statement and two years of selected financial data. In other industries, a majority of companies are continuing to provide three years of audited financial statements and three to five years of selected financial data.

Item of Relief	Prevalence of Election			
	Life Sciences Companies	Technology Companies	Other EGCs	All EGCs
Confidential submission of Form S-1	93%	92%	85%	91%
Two years of audited financial statements (instead of three years)	85%	20%	41%	52%
Two years of selected financial data (instead of five years)	83%	7%	37%	46%
Omission of CD&A	100%	97%	93%	96%
Delayed application of new or revised accounting standards	16%	14%	9%	14%

- *Exemption from Internal Controls Audit Attestation*: Emerging growth companies are exempt from the requirement under section 404(b) of the Sarbanes-Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company's internal control over financial reporting (ICFR). However, emerging growth companies are not exempt from the requirement to maintain an effective system of ICFR and to provide an annual management report on ICFR and a quarterly ICFR certification from the CEO and CFO.[21]
- *Additional Reduction in Executive Compensation Disclosures*: In addition to the continued availability of the reduced executive compensation disclosures applicable to an IPO, the Summary Compensation Table for an emerging growth company is only required to cover two years, as opposed to three years.
- *Exemption from Say-on-Pay, Say-on-Frequency, and Say-on-Parachute Requirements*: Emerging growth companies are exempt from the requirements mandated by the Dodd-Frank Act that companies seek stockholder approval of an advisory vote on their executive compensation arrangements, including golden parachute compensation.[22] The say-on-pay exemption lasts for a period of at least three years after an emerging growth company's IPO even if the company ceases to be an emerging growth company sooner than that.
- *Exemption from Additional Executive Compensation Disclosures*: Emerging growth companies are exempt from the Dodd-Frank Act requirements, which remain subject to SEC rulemaking, to include disclosures about the relationship between executive compensation and financial performance and the ratio between CEO compensation and median employee compensation.

§ 10:5.3 Adoption of Emerging Growth Company Standards

An emerging growth company may elect to forgo any of the exemptions available to it under the JOBS Act and instead comply with the requirements that apply to a company that is not an emerging growth company, but is not permitted to choose to comply with some but not all of the non-EGC accounting standards. An emerging growth company must decide whether to avail itself of the extension of time

21. See section 6:3.1 for further discussion of ICFR requirements and section 22:4.1 for discussion of CEO and CFO ICFR certification requirements.
22. See sections 5:4.2[C], 22:2.3[A][3], and 24:12.5 for further discussion of these requirements.

to comply with accounting standards that are adopted or revised on or after April 5, 2012, at the time the company is first required to file a registration statement, periodic report, or other report with the SEC. A decision to forgo the extended transition period to comply with new or revised accounting standards is irrevocable, but an election to take advantage of the extended transition period can be reversed. The decision to change is irrevocable and should be prominently disclosed in the company's next registration statement or periodic report filed with the SEC.

Eligible companies that adopt emerging growth company standards should explain that they are providing EGC disclosures in their public filings. The SEC staff no longer insists that an emerging growth company state its EGC status on the cover of its IPO prospectus, but this remains common practice. Emerging growth companies should also include risk factor disclosure concerning EGC standards that create additional risk for investors, such as the absence of an ICFR audit or the delayed application of new accounting standards to the company.[23]

Evidence to date suggests that institutional investors in IPOs are not balking at the reduced financial and compensation disclosure being provided by emerging growth companies. Nonetheless, a pre-IPO emerging growth company should discuss with its IPO underwriters the impact of adopting EGC standards on marketability of the offering. All emerging growth companies should also consider the likely market and investor expectations after the offering.

§ 10:5.4 General Solicitation in Rule 506 and Rule 144A Placements

The JOBS Act directed the SEC to modify its rules to:

- eliminate the prohibition on general solicitation and general advertising in private placements conducted pursuant to Rule 506 under Regulation D, provided that all purchasers are "accredited investors" (as defined in Regulation D);[24] and
- permit securities to be offered to investors who are not "qualified institutional buyers" (as defined in Rule 144A) in private placements conducted pursuant to Rule 144A, including by means of general solicitation and general advertising, provided that securities are sold only to persons that the company (and any person acting on its behalf) reasonably believes are qualified institutional buyers.[25]

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23. See chapter 13 for further discussion of EGC disclosures in the Form S-1.
24. See section 2:8.2[B] for further discussion of Rule 506.
25. Rule 144A is discussed further in chapter 24. *See* section 24:9.

In July 2013, the SEC adopted rule amendments to implement the above requirements. The amended rules, which became effective September 23, 2013, are not limited to placements by emerging growth companies and are available to all companies.

§ 10:5.5 Required SEC Studies

The JOBS Act requires the SEC to conduct two studies that may result in further changes to the registration process for emerging growth companies or changes that affect trading in the securities of emerging growth companies:

[A] Streamlining of Registration Process

The SEC is required to comprehensively analyze the current requirements of Regulation S-K and determine how these requirements can be updated to modernize and simplify the registration process and reduce the costs and other burdens associated with these requirements for emerging growth companies. The JOBS Act called for the SEC to report to Congress with specific recommendations on how to streamline the registration process in order to make it more efficient and less burdensome for the SEC and for emerging growth companies.

In December 2013, the staff of the SEC issued its report on Regulation S-K's disclosure requirements. After reviewing the regulatory history of Regulation S-K and prior initiatives to modernize disclosure requirements, the report presents a detailed analysis of the disclosure items in Regulation S-K and related rules and forms. The report then recommends the development of a comprehensive plan to systematically review all SEC disclosure requirements, including Regulation S-K and Regulation S-X, and related rules concerning the presentation and delivery of information to investors and the marketplace. The review would encompass disclosure requirements for both emerging growth companies and public companies generally.

The report is essentially a framework for disclosure effectiveness (also referred to as disclosure reform). Following the report's release, the SEC's Division of Corporation Finance announced that it is reviewing the disclosure requirements in Regulation S-K and Regulation S-X and considering ways to improve the disclosure regime for the benefit of both companies and investors. The stated goal is to comprehensively review the requirements and make recommendations on how to update them to facilitate timely, material disclosure by companies and stockholders' access to that information. The review will initially focus on the business and financial disclosures required by Forms 10-K, 10-Q, and 8-K; subsequent phases of the project will consider compensation and governance information included in proxy

statements. Disclosure effectiveness is likely to be a large undertaking and a long-term project. In the meantime, the Director of the Division of Corporation Finance has publicly exhorted public companies to improve their disclosure documents in the absence of rule changes by reducing repetition, focusing disclosure, and eliminating outdated information.[26]

[B] Decimalization

The SEC is required to examine the transition to trading and quoting securities in one penny increments, the impact that this "decimalization" has had on the number of IPOs and liquidity for small-cap and mid-cap company securities, and whether there is sufficient economic incentive to support trading in these securities in penny increments. If the SEC determines that the securities of emerging growth companies should be quoted and traded using a minimum increment of greater than $0.01, the JOBS Act authorized the SEC to designate a "tick size" greater than $0.01 but less than $0.10.

In July 2012, the staff of the SEC issued its report on decimalization, concluding that further study is warranted to assess the impact of tick size on IPOs, trading, and liquidity for smaller companies as distinct from other potential factors, and recommending that the SEC not proceed with specific rulemaking to increase tick sizes as provided for in the JOBS Act and instead should consider the additional steps that may be needed to determine whether rulemaking should be undertaken in the future.

In June 2014, the SEC ordered the national securities exchanges and FINRA to jointly develop a pilot program to assess whether a wider tick size for the securities of smaller issuers would enhance market quality to the benefit of U.S. investors, issuers, and other market participants. The national securities exchanges and FINRA submitted a plan for the program to the SEC in August 2014. As proposed, the program will last for one year and include common stocks with a market capitalization of $5 billion or less, an average daily trading volume of one million shares or less, and a price of $2.00 per share or more. The program will consist of one control group and three test groups with 400 securities in each test group selected by stratified sampling based on share price, market capitalization, and trading volume. Securities in the control group will be quoted at the current tick size increment of $0.01 per share and traded as currently permitted, and securities in the test groups will be quoted in $0.05

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26. Keith F. Higgins, Dir., Div. of Corp. Fin., Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting (Apr. 11, 2014).

minimum increments but traded in different increments and subject to different requirements. During the program, the exchanges and FINRA will collect data and make it available to both the SEC and the public. Within six months after the end of the pilot period, the exchanges and FINRA will submit their assessment of the program to the SEC. The proposed program has not been approved by the SEC as of October 1, 2014.

§ 10:5.6 SEC Rulemaking and Market Practices

The JOBS Act was created by combining various legislative proposals that had been under consideration by Congress over the preceding year or so, and was enacted quickly. The act requires a substantial amount of SEC rulemaking and prescribes deadlines that have proven to be unachievable in light of the volume of rulemaking and the time required to draft new rules, prepare the accompanying economic analyses, permit proper review by the SEC, and afford opportunity for public input, as well as the backlog of uncompleted rulemaking mandated by the Dodd-Frank Act. Legal challenges to the upcoming rules are also possible, particularly in light of successful efforts to overturn other recent SEC rules and the high judicial standards that must be satisfied for rules to be upheld. As a result, the timing of the remaining SEC rulemaking under the JOBS Act is uncertain.

In addition to the rulemaking required by the JOBS Act, the SEC staff has been issuing Frequently Asked Questions and providing other guidance on the JOBS Act. In doing so, the staff has indicated it is striving to implement Congress's intent in a pragmatic manner to make the act a success—for example, by finding solutions to technical glitches and filling in gaps in the act. Moreover, market practices with respect to the JOBS Act are still developing. The ultimate implications of the JOBS Act will become known over time as SEC rulemaking and interpretations continue and market practices develop further.

§ 10:5.7 "JOBS Act 2.0"?

In the spirit of the JOBS Act, additional legislation has been introduced to promote and streamline capital formation. For example, in May and June of 2014, the Committee on Financial Services of the U.S. House of Representatives passed bills that would reduce the minimum public float for WKSI status from $700 million to $250 million and prohibit an emerging growth company from qualifying as a WKSI (H.R. 4697);[27] for accelerated filer status, increase the

27. A WKSI, or well-known seasoned issuer, is a special category of public company that is afforded additional flexibility in the timing of follow-on public offerings. *See* section 24:8.1[D].

minimum public float from $75 million to $250 million and require annual revenue of at least $100 million (H.R. 2629);[28] permit any company with a public float of at least $75 million or with a class of common stock listed on a national securities exchange to use Form S-3 (H.R. 4568);[29] and shorten the minimum holding period under Rule 144 from six months to three months (H.R. 4554).[30] Neither the full U.S. House of Representatives nor the U.S. Senate has acted on any of these bills as of October 1, 2014.

In September 2014, the U.S. House of Representatives passed a bill (H.R. 5405) that would, among other things:

- reduce from twenty-one days to fifteen days the minimum period of time before commencing a road show for an emerging growth company to publicly file its Form S-1;
- provide that an issuer that is an emerging growth company at the time of its initial confidential submission or public filing will continue to be treated as an emerging growth company at least until the earlier of consummation of its IPO or one year after ceasing to be an emerging growth company;
- permit an emerging growth company to omit from a Form S-1 for an IPO financial information for historical periods otherwise required as of the time of confidential submission or public filing of the Form S-1 if the omitted financial information relates to a historical period that the issuer reasonably believes will not be required to be included in the Form S-1 at the time of the contemplated offering and the preliminary prospectus used in the road show includes all financial information required by Regulation S-X; and
- exempt emerging growth companies and other companies with total annual gross revenues of less than $250 million from the requirement to provide financial statements in XBRL format in registration statements filed under the Securities Act (IPO registration statements are already exempt from XBRL requirements) and in reports filed under the Exchange Act.

The U.S. Senate has not acted on this bill as of October 1, 2014.

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28. An accelerated filer is subject to shorter deadlines for filing Forms 10-Q and 10-K, all aspects of section 404 of the Sarbanes-Oxley Act (unless it is also an emerging growth company, in which case it is exempt from the ICFR audit requirement), and certain additional disclosure requirements in its Form 10-K. *See* sections 6:3.1[B], 22:2, and 23:7.2[B].
29. Form S-3 is a "short-form" registration statement filed with the SEC for a? follow-on public offering by an eligible company. *See* section 24:6.
30. Rule 144 permits public resales of unregistered securities. *See* section 24:3.

§ 10:6 Sequence and Timing of Events in the IPO Process

The IPO process is not quick. In a typical IPO, the company spends six to twelve months in some level of preparations before holding the organizational meeting that launches the formal process. The Form S-1 usually is filed (or submitted by an emerging growth company for confidential SEC review, if applicable) one to two months later, and the offering typically is completed after another three to four months. Total elapsed time: twelve to eighteen months. Overall timing can vary widely, however, depending on numerous factors within and outside the company's control. It is, for example, often possible to compress the phase prior to the organizational meeting. It is unusual, however, to close an IPO in less than four or five months after the organizational meeting, or for a company not to devote at least two to three months to IPO preparations in advance of the organizational meeting.

Nor is the outcome of the IPO process certain. The reality is that the company must be ready for the market, and the market must be ready for the company. Without both, there can be no IPO, and the company controls only half the equation.

The length and uncertainty of the IPO process have several implications:

- It is difficult to achieve the optimal timing for the offering, as market conditions can change several times (negatively or positively) during the course of the IPO process.
- A substantial amount of management time and attention is diverted from normal business operations for an extended period of time.
- The company incurs significant legal and accounting expenses in advance of—and even in the absence of—receiving any IPO proceeds.

The first consequence listed above is unavoidable and simply means the company may need to delay an offering if market conditions become inhospitable or may have to push very hard to complete the IPO during a market window. The company should plan for the other two consequences by building a deep management team before embarking on the IPO process and by budgeting sufficient resources to pay offering expenses as incurred.

Figure 10-3 depicts the sequence of key events in an illustrative IPO timetable. As shown in the diagram, the overall IPO timetable is the same for emerging growth companies electing confidential SEC review and for companies undergoing a traditional filing and review process, and the steps in the IPO process are the same except that with a confidential submission part of the SEC review process occurs before any public filing has been made.

A high-level outline of what transpires during the IPO process follows. These topics are discussed in depth elsewhere in this book.

§ 10:6.1 Six to Twelve Months Before the Organizational Meeting

After selecting new (or confirming incumbent) company counsel and independent accountants, the company attends to longer-range items during this phase of the IPO process, including the need to:

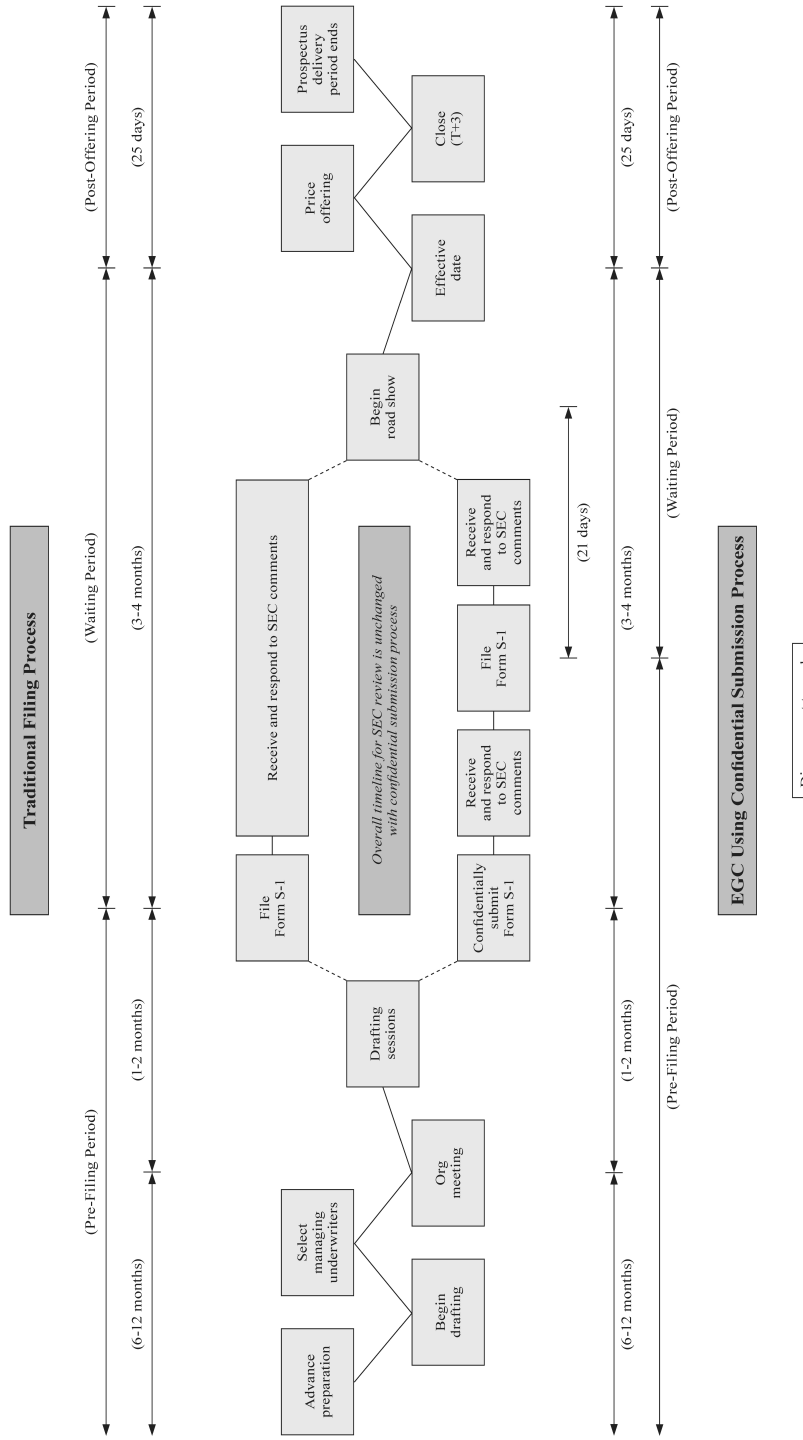
- ensure the availability of all required financial statements;
- consider cheap stock issues;
- address any other accounting issues, including changes in accounting policies and practices that will need to be implemented in order to report as a public company;
- develop disclosure controls and procedures;
- begin to develop the internal control over financial reporting required by section 404 of the Sarbanes-Oxley Act;
- establish relationships with investment bankers and research analysts at targeted firms;
- consider the composition of the board of directors and board committees, and recruit new directors if any are to be added prior to the IPO;
- assemble the IPO team, including internal staff and outside advisors;
- commence the corporate housekeeping process; and
- consider estate and tax planning needs of founders and executives.

§ 10:6.2 Three to Six Months Before the Organizational Meeting

This phase involves a mix of planning and implementation, as the level of IPO preparations picks up. During this time period, IPO activities do not yet dominate management's time, but the company—guided by counsel—should:

- begin to develop corporate governance policies and practices;
- educate management about public company responsibilities and restrictions;
- identify and address outstanding loans to executive officers or directors;
- consider the treatment of other related person transactions;

Figure 10-3
Illustrative IPO Timetable



- review arrangements with officers (employment, change-in-control and severance agreements, and confirmation of offices and titles);
- evaluate the need for additional financing prior to the IPO closing and assess the availability of exemptions from registration; and
- if necessary, hold a pre-filing conference with the SEC to resolve any novel accounting or legal issues that might impede the IPO.

§ 10:6.3 One to Three Months Before the Organizational Meeting

In this phase, efforts intensify as IPO preparations begin to demand a substantial portion of management's time and attention. Company counsel will now be deeply involved, as the company needs to:

- begin drafting the Form S-1, particularly the business section;
- determine the aspects of the JOBS Act on which the company plans to rely (if qualifying as an emerging growth company under the JOBS Act);
- prepare for due diligence by the underwriters and underwriters' counsel;
- review prior stock issuances and option grants and remedy any deficiencies;
- identify required amendments or waivers under financing documents or other contracts;
- evaluate the company's registration rights and IPO participation obligations;
- determine material contracts that must be filed, ensure availability of electronic versions of those contracts, and identify the portions for which confidential treatment will be sought;
- establish an external communications policy and avoid gun-jumping issues;
- review and revise the company's website;
- consider takeover defenses;
- consider board and executive compensation matters, including stock plans;
- arrange for D&O insurance prior to closing and consider indemnification agreements;

- choose an exchange for common stock listing and reserve a trading symbol; and
- select the lead managers and co-managers.

§ 10:6.4 *The Organizational Meeting*

At an all-day organizational meeting, the IPO working group—management, company counsel, managing underwriters, underwriters' counsel, and the independent accountants—will:

- review the basic IPO terms, including the anticipated size and composition of the offering and over-allotment option, and the desired mix of institutional/retail and domestic/international investors;
- discuss the proposed timeline and timing considerations;
- review quiet period restrictions and the company's publicity plans;
- discuss due diligence arrangements;
- hear in-depth presentations from management regarding the company and its business; and
- discuss the business section of the draft Form S-1, if available.

§ 10:6.5 *One to Two Months After the Organizational Meeting*

This is the busiest phase of the IPO process for the entire working group and a period of intense activity for management and company counsel as they:

- participate in drafting sessions;
- with the working group's input, continue drafting the Form S-1 and prepare the prospectus cover artwork;
- circulate questionnaires to directors, officers, 5% stockholders, and selling stockholders to elicit required information;
- obtain signed lockup agreements;
- respond to due diligence requests from the underwriters and underwriters' counsel;
- continue public company preparations;
- negotiate the underwriting agreement;
- review the Form S-1 with the board and obtain board approval;

- file the Form S-1 with the SEC (or, in the case of an emerging growth company electing confidential SEC review, submit the draft Form S-1 to the SEC);
- file any confidential treatment request with the SEC (this process is unrelated to status as an emerging growth company); and
- submit a listing application to the selected stock exchange.

§ 10:6.6 One to Three Months After the Initial Form S-1 Filing/Confidential Submission

After a lull of roughly thirty days, during which the company awaits the SEC's initial comments, management, and company counsel:

- with the working group's input, revise the Form S-1 in response to SEC comments (typically three to five cycles over approximately two months);
- respond to additional due diligence requests and update responses to the original requests;
- finalize the underwriting agreement;
- finalize arrangements with any selling stockholders; and
- continue public company preparations.

An emerging growth company that submits a draft Form S-1 for confidential SEC review must publicly file the Form S-1 (including the initial submission and all amendments) on the SEC's EDGAR system no later than twenty-one days before the road show commences. Based on historical timelines, conversion of the confidential submission into a public filing is likely to occur approximately two months after the initial Form S-1 submission.

Also during this period, management prepares for the road show (with assistance from the lead managers); the co-managers are selected (if not chosen before the initial Form S-1 filing or confidential submission); and the lead managers organize the underwriting syndicate and selling group, prepare internal sales memoranda describing the company and its investment highlights, and educate the sales forces of the managing underwriters concerning the offering.

§ 10:6.7 Three to Four Months After the Initial Form S-1 Filing/Confidential Submission

In this final phase of the IPO process, the following occur:

- SEC comments are cleared;
- preliminary prospectuses are printed;

- the road show is conducted, with a typical process consisting of fifty to 100 presentations in ten to fifteen cities in the United States and Europe over a period of about two weeks;
- any remaining due diligence requests from the underwriters and underwriters' counsel are addressed;
- public company preparations are concluded;
- FINRA clearance of the underwriting arrangements is obtained;
- a registration statement on Form 8-A is filed with the SEC to register the common stock under the Exchange Act;
- acceleration requests are filed with the SEC, the SEC declares the Form S-1 effective, and the Form 8-A concurrently becomes effective;
- the offering is priced, the underwriting agreement is signed, the comfort letter is delivered and the common stock begins trading; and
- the closing is held three business days after trading begins.

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The process and consequences of an IPO can be daunting, particularly when seriously considered for the first time. Table 10-3 shares a lighthearted, yet not inaccurate, list of the top ten ways in which an IPO will change the lives of company management.

Table 10-4

Top Ten List

Top Ten Ways an IPO Will Change Your Life

10. An IPO will consume you totally and transform your company.
9. People in suits will be hanging around more than usual (or maybe for the first time).
8. You will spend countless hours with lawyers, bankers, and accountants.
7. You will have new responsibilities under *FEDERAL LAW* and must act like adults.
6. You will lose a lot of privacy and flexibility.
5. Investors will make you fixate on quarterly results.
4. People you do not even know will act like your best friends. (The calls will start as soon as the Form S-1 hits the EDGAR system.)
3. An IPO is "woodwork" time: Former employees and others you have long since forgotten, or never knew, will show up looking for a piece of the action.
2. Some of you will get rich (at least on paper).
1. You will have lots of fun—but probably appreciate it only in hindsight.