Chapter 10

An Overview of the IPO Process

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§ 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; 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; 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 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
Figure 10-1
Principal Relationships Among IPO Participants
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

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.
Table 10-2

Am I an Officer?

This simple question often requires a complex answer because SEC rules, state corporate law, federal tax law and common parlance provide multiple definitions of “officer.”

- **Corporate Officers**: A company’s “corporate officers” are defined by state corporate law and the company’s bylaws. Typical bylaws provide that a company will have a president, one or more vice presidents, a treasurer, a secretary, and such other officers as the board determines. Corporate officers have the authority and duties specified in the bylaws or established by the board, and generally have authority to execute contracts, or otherwise create legally binding obligations, on behalf of the company. In dealing with third parties, employees who are not corporate officers can have “apparent authority” or “implied authority” to bind the company. Apparent or implied authority can arise from the actions of employees or even from their titles alone. In many circumstances, it would be reasonable for a third party dealing with a company to assume that someone with the title of vice president has the authority to act for the company. Where does this leave a company with employees who have titles ordinarily conferred on officers (such as vice president) but have not been appointed corporate officers? With the need to define the authority of these employees and monitor their actions—and the unavoidable risk that they will incur unauthorized company obligations.

- **Officers**: Rule 3b-2 under the Exchange Act defines a company’s “officers” as its president, vice president, secretary, treasury or principal financial officer, controller or principal accounting officer, and any person routinely performing corresponding functions for the company. This definition, although expansive, has limited practical significance since most prospectus disclosures relating to company management apply to “executive officers” and not “officers” generally.

- **Executive Officers**: Rule 3b-7 under the Exchange Act defines a company’s “executive officers” as its president, any vice president in charge of a principal business unit, division, or function, any other officer who performs a policy making function, and
any other person who performs similar policy making functions. The IPO prospectus must identify all executive officers and provide biographical information for each.

- **Named Executive Officers**: Item 402(a)(3) of Regulation S-K defines a company’s “named executive officers” as anyone who served as the principal executive officer or principal financial officer during the company’s last fiscal year, regardless of compensation, and the other three highest-paid executive officers who were serving as executive officers at the end of the company’s last fiscal year (plus up to two additional individuals for whom disclosure would have been required but for the fact that they were not serving as executive officers of the company at the end of the last fiscal year). Extensive disclosure is required in the IPO prospectus concerning the compensation, equity ownership, and other matters for each named executive officer.

- **Principal Officers**: Various SEC rules reference—but do not define—a company’s “principal executive officer” (almost always the CEO), “principal financial officer” (almost always the CFO), and “principal accounting officer” (usually the CFO or controller). These officers must sign (and potentially have personal liability for) the Form S-1 and certain other SEC filings.

- **Section 16 Officers**: Specified “officers” of every public company are subject to the public reporting and short-swing liability provisions of section 16 of the Exchange Act. Pursuant to Rule 16a-1(f) under the Exchange Act, the officers subject to section 16 (often referred to as “section 16 officers”) generally are the same as the company’s executive officers, except that the controller automatically is a section 16 officer if there is no principal accounting officer even if the company does not otherwise consider the controller to be an executive officer.

- **Section 162(m) Officers**: Section 162(m) of the Internal Revenue Code disallows a federal income tax deduction by a public company for “annual compensation” in excess of $1 million paid to its CEO and the other three highest-paid officers (because of a quirk in the federal tax code, “officer” does not include the CFO for this purpose).

- **C-Level Officers**: The colloquial phrase “C-level officers” refers to a company’s chief executive officer, chief financial officer, chief operating officer, chief accounting officer, and chief legal officer (and perhaps other chiefs). These terms are sometimes used—but not defined—in SEC rules.
§ 10:3.2 Board of Directors and Board Committees

The board’s fiduciary duties and oversight responsibilities 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; and authorize the filing of, 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.

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 for inclusion 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.

§ 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

1. These topics are discussed in chapter 6. See section 6:2.
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.
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 also coordinates arrangements with the transfer agent, DTC, the CUSIP Service Bureau, and the banknote company; 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 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.

§ 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 a “comfort letter” to the underwriters at the time the underwriting agreement is signed 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, 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

3. The bookbuilding process and stabilization are discussed in chapter 19. See section 19:3.
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 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 separately (without investment banking personnel present) with the research analysts employed by the managing underwriters to help them understand the company’s business model and develop their own forecasts of the company’s future results. Just prior to the road show, each of these research analysts will 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 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, before or after the initial filing. 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 option 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.4

[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 requirement to include a CD&A in the prospectus 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 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, 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**

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.

Although the vast majority of the Dodd-Frank Act will not directly affect public companies outside of the financial services industry, the act imposes (or authorizes the SEC to adopt rules imposing) several significant corporate governance, executive compensation, and disclosure requirements on all public companies, including say-on-pay (a requirement to hold periodic non-binding stockholder votes on executive compensation) and proxy access (the ability of stockholders to include director nominees in the company’s proxy statement). In addition, 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. Education concerning these new requirements should be part of an IPO company’s overall corporate governance preparations.

[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 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, 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. Also, the initial Form 3 filings will be due on the day the Form S-1 becomes effective, 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

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

[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 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.

[J] Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act (FCPA) is a criminal and securities statute that is jointly enforced by the Department of Justice and the SEC. The FCPA has two components, one of which applies before the company’s IPO and one of which will become applicable once the company completes its IPO:

- The statute prohibits any company, whether private or public, as well as its officers, directors, employees, stockholders, and agents, from making or offering corrupt payments to foreign government officials.
- The statute requires every public company to maintain accurate books and records and to implement adequate internal accounting controls. This requirement is in addition to the internal control requirements imposed by section 404 of the Sarbanes-Oxley Act.

6. These requirements, which are embodied in section 13(b)(2) of the Exchange Act, are discussed further in chapter 6. See section 6:3.1[A].
FCPA compliance is particularly important because the company’s directors and officers can be personally liable for FCPA violations. Enforcement of the FCPA is a priority for both the Department of Justice and the SEC; in 2010, the SEC further bolstered its focus on the statute by forming a specialized FCPA unit.

Preparation for compliance with the “books and records” component of the FCPA is ordinarily an element of the company’s overall accounting and internal control preparations, although the FCPA accounting requirements, unlike section 404 of the Sarbanes-Oxley Act, become immediately applicable upon completion of the IPO. As part of its IPO preparations, the company should consider adopting an FCPA compliance program, typically including training and certifications by relevant officers and employees and a process to evaluate, monitor, and investigate potential corruption risks. In addition, companies conducting international business may wish to conduct FCPA due diligence in advance of an IPO because uncorrected foreign bribery issues that persist after the IPO may expose the company to stockholder litigation, SEC enforcement action, and criminal prosecution.

§ 10:5 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 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.

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7. See generally section 6:3.1 for a discussion of internal control preparation.
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.

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

§ 10:5.1 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.
§ 10:5.2 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;
- 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.

§ 10:5.3 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;
- 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 gunjumping 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.

§ 10:5.4 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.

§ 10:5.5 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 and any confidential treatment request with the SEC; and
• submit a listing application to the selected stock exchange.

§ 10:5.6 One to Three Months After the Initial Form S-1 Filing

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.

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); 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.

§ 10:5.7 Three to Four Months After the Initial Form S-1 Filing

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 50 to 100 presentations in ten to fifteen cities in the United States and Europe over a period of two to three 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.

The process and consequences of an IPO can be daunting, particularly when seriously considered for the first time. Table 10-4 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

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<table>
<thead>
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<tbody>
<tr>
<td>10.</td>
<td>An IPO will consume you totally and transform your company.</td>
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<tr>
<td>9.</td>
<td>People in suits will be hanging around more than usual (or maybe for the first time).</td>
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<tr>
<td>8.</td>
<td>You will spend countless hours with lawyers, bankers, and accountants.</td>
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<tr>
<td>7.</td>
<td>You will have new responsibilities under <em>FEDERAL LAW</em> and must act like adults.</td>
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<tr>
<td>6.</td>
<td>You will lose a lot of privacy and flexibility.</td>
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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.